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# BANKING ON SOLVENCY: THE TAKINGS POWER OF FIRREA'S CROSS-GUARANTEE PROVISION

## I. INTRODUCTION

[A] permanent physical occupation is a government action of such a unique character that it is a taking without regard to other factors that a court might ordinarily examine.<sup>1</sup>

In response to the savings and loan (S&L) crisis<sup>2</sup> and in the hope of salvaging the thrift industry,<sup>3</sup> Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).<sup>4</sup> As the number

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1. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 432 (1982). See *infra* notes 240-51 and accompanying text.

2. Between 1980 and 1988, over 500 savings associations failed, three-and-a-half times more than the combined number that had failed during the previous 45 years. Paul T. Clark et al., *Regulation of Savings Associations Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 BUS. LAW. 1013, 1013 (1990) (citing S. REP. NO. 19, 101st Cong., 1st Sess. 2 (1989)). For background on the causes of the S&L crisis, see generally EDWARD J. KANE, *THE S&L INSURANCE MESS: HOW DID IT HAPPEN?* (1989); LAWRENCE J. WHITE, *THE S&L DEBACLE: PUBLIC POLICY LESSONS FOR BANK AND THRIFT REGULATION* 109-11 (1991) (describing the effect of the economic downturn on thrifts in the Southwest region); R. DAN BRUMBAUGH, JR., *THE COLLAPSE OF FEDERALLY INSURED DEPOSITORIES: THE SAVINGS AND LOANS AS PRECURSOR* 3-17 (1993) (providing a perspective on the collapse of Federally Insured Depositories); Symposium, *Financial Institutions and Regulations, The S&L Crisis: Death and Transfiguration*, 59 FORDHAM L. REV. S1 (1991) (outlining the downfall of the savings and loan system).

3. The thrift industry is more commonly known as the savings and loan industry. H.R. REP. NO. 54(I), 101st Cong., 1st Sess., 292 (1989), reprinted in 1989 U.S.C.C.A.N. 86, 88. The thrift consists of three types of financial intermediaries: savings and loan associations; savings banks; and credit unions. ANDREW S. CARRON, *THE PLIGHT OF THE THRIFT INSTITUTIONS* 1-3 (1982). Thrift institutions accept consumer deposits and generally concentrate on mortgage lending. ALAN GART, *REGULATION, DEREGULATION, REREGULATION: THE FUTURE OF THE BANKING, INSURANCE, AND SECURITIES INDUSTRIES* 401 (1994).

4. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 12 U.S.C.) [hereinafter FIRREA]. Although there had been other significant savings and loan and commercial banking laws passed by Congress, FIRREA was the first to provide substantial changes in regulatory structure. For an in depth analysis of FIRREA and its impact on the banking industry, see generally Daniel B. Gail & Joseph J. Norton, *A Decade's Journey From "Deregulation" to "Supervisory Reregulation": The Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 BUS. LAW. 1103 (1990); Michael P. Malloy, *Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation*, 50 OHIO ST. L.J. 1117 (1989). See *infra* notes 63-94 and accompanying text (interpreting the history and purpose behind FIRREA's enactment).

of insolvent thrift institutions increases and the Federal Deposit Insurance Corporation's (FDIC) insurance fund decreases,<sup>5</sup> the arsenal of legislative authority granted to federal banking regulators<sup>6</sup> expands.<sup>7</sup> Failures and

5. The FDIC's insurance fund is decreasing due to the costs currently incurred from assisting failing and failed banks. Helen A. Garten, *What Price Bank Failure?*, 50 OHIO ST. L.J. 1159, 1160 (1989). The costs incurred from assisting failed banks are the expenses from appraising failed assets, the direct financial aid used to keep a failing bank afloat or needed to acquire a bank to assume its liabilities, in addition to payments to insured depositors from the fund, the costs related to liquidation of assets, the collection of claims and other losses associated with assets or equity acquired by the FDIC from a failed institution. *Id.* at 1160 n.8. See also *infra* note 10.

6. The federal regulators of the banking industry are technically threefold. EDWARD L. SYMONS, JR., & JAMES J. WHITE, *BANKING LAW* 45 (3d ed. 1991). The oldest of the agencies is the Office of the Comptroller of the Currency which is the primary regulator of national banks. *Id.* National banks are those that obtain their charter from the federal government. *Id.* All national banks located in a state, rather than a territory, of the United States must belong to the second agency, the Federal Reserve System, and must be insured by the third agency, the Federal Deposit Insurance Corporation (FDIC). *Id.* State banks that obtain a charter from the state in which they are located are primarily regulated by each state's department of banking. *Id.* Although membership is not mandatory, almost all state banks are insured by the FDIC. *Id.* FIRREA reorganized and supplemented this regulatory structure by creating the Office of Thrift Supervision to examine and regulate savings associations and the Resolution Trust Corporation to manage and resolve failed savings institutions. *Id.* For more information on the dual nature of the banking regulatory scheme in the United States, see Carter H. Golembe, *Our Remarkable Banking System*, 53 VA. L. REV. 1091, 1092-93 (1967); Howard H. Hackley, *Our Baffling Banking System*, 52 VA. L. REV. 565, 566-67 (1966).

7. The past four pieces of banking legislation enacted by Congress have been devoted to the resolution of the crisis in the thrift industry. Michael P. Malloy, *Foreword: . . . And Backward: Death And Transfiguration Among The Savings Associations*, 59 FORDHAM L. REV. S1, S1 n.5 (1991). These four legislative acts include: Depository Institutions Deregulation and Monetary Control Act (DIDAMCA), Pub. L. No. 96-221, 94 Stat. 132 (1980) (codified in scattered sections of 12 U.S.C.) (providing for expanded powers for thrift institutions and higher maximum deposit insurance limits); Garn-St Germain Depository Institutions Act of 1982 (DIA), Pub. L. No. 97-320, 96 Stat. 14 (1982) (codified as amended at 12 U.S.C. § 226 (1994)) (allowing a further expansion of powers within thrift institutions); Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 (1987) (codified in scattered sections of 2, 12, 15, and 31 U.S.C.) (providing for the limiting and conditioning of powers of thrift institutions and their holding companies); Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 12 U.S.C.) (providing for restructuring of federal regulation of thrift institutions and greater enforcement powers).

A fifth piece of banking legislation which was devoted to the S&L crisis was the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Pub. L. No. 102-242, 105 Stat. 2236 (codified in scattered sections of 5, 12, and 15 U.S.C.) (providing for reformation of federal deposit insurance). For a discussion on the DIA, see generally Roger M. Zaitzeff & Daniel J. Mette, *Investment Powers of Federal Savings and Loan Associations After Garn-St Germain*, 36 U. FLA. L. REV. 591 (1984); Dennis S. Aronowitz & Robert Volk, *Developments in Banking Law: 1982*, 2 ANN. REV. BANKING L. 1 (1983); Joseph J. Norton, *The 1982 Banking Act and The Deregulation Scheme*, 38 BUS. LAW. 1627 (1983). For an analysis of FIRREA, see generally Gail & Norton, *supra* note 4, at 1103-1228. For an examination of the FDICIA, see generally Richard Scott Carnell, *A Partial Antidote to Perverse Incentives: The FDIC Improvement Act of 1991*, 12 ANN. REV. BANKING L. 317 (1993).

threatened failures of federally insured and regulated thrift institutions arise on a scale and magnitude that prompts regulators to create and exercise powers not previously asserted.<sup>8</sup> The problem is that now the regulators wield powers that provide too much discretion, giving rise to regulatory abuse.<sup>9</sup>

Due to the S&L crisis, the FDIC's deposit insurance funds lost extensive capital.<sup>10</sup> Congress enacted FIRREA in an attempt to recapitalize the deposit insurance funds and tackle the threat of proliferating S&L failures.<sup>11</sup> Through a number of its provisions, FIRREA restructured the system that regulates the nation's banks.<sup>12</sup> FIRREA created and placed the Office of Thrift Supervision

8. For example, the January 1991 failure of the Bank of New England Corporation and its subsidiaries, the Bank of New England, the Connecticut Bank and Trust Co., and the Maine National Bank, has been called "the third largest failure in recent times, and I guess one of the largest in history." *The Failure of the Bank of New England: Hearings before the Senate Comm. on Banking, Housing, and Urban Affairs*, 102d Cong., 1st Sess. 24 (1991) (statement of Sen. Kerry). The Bank of New England is a watershed case in the history of the cross-guarantee power because it is the first circumstance in which the FDIC has asserted that power. See *infra* notes 124-52 and accompanying text (discussing the use of the cross-guarantee assessment against the Maine National Bank).

9. The most recent example of regulatory abuse stems from the FDIC's exercise of its cross-guarantee assessment power on Maine National Bank. See *infra* notes 124-52 and accompanying text. Under FIRREA, the legislature grants the FDIC the discretion to make assessments against solvent banks for losses the FDIC incurs when bailing out one of the bank's insolvent affiliates. 12 U.S.C. § 1815(e) (1994). The abuse of power stems from the latitude given by Congress to the FDIC in making cross-guarantee assessments. See *infra* note 24. Since the statute provides little or no guidelines for the FDIC in making these assessments, the FDIC may assert its powers any time it deems appropriate. See *infra* notes 336-67 and accompanying text (proposing an amendment to FIRREA that supplies additional assessment guidelines).

10. Clark, *supra* note 2, at 1013-14. The deteriorating condition of the thrift industry eventually took its toll on the Federal Savings and Loan Insurance Corporation (FSLIC). *Id.* By meeting its obligations to depositors of failed S&Ls, the FSLIC became insolvent. *Id.* As of December 31, 1988, the FSLIC reportedly had a negative net worth of approximately \$50 billion. H.R. Rep. No. 54(I), *supra* note 3, at 304, reprinted in 1989 U.S.C.C.A.N. at 100. This amount was almost four times the \$14 billion dollar amount of insolvency at the end of 1987. *Id.* Under FIRREA, this responsibility was transferred to the FDIC. *Id.* at 106.

Originally, the FDIC was created in 1933 as the insurer of commercial banks, and the FSLIC was created in 1934 as the insurer of thrift institutions. BRUMBAUGH, *supra* note 2, at 22. FIRREA consolidated management of both insurance funds under the control of the FDIC. 12 U.S.C. § 1821(a)(4)-(6) (1994). Under the FDIC, the insurance funds were renamed the Bank Insurance Fund, which insures commercial banks, and the Savings Association Insurance Fund, which insures thrift institutions. *Id.* § 1821(a)(5)-(6). While the administration of the Bank Insurance Fund and Savings Insurance Fund were merged, the two were not commingled. GART, *supra* note 3, at 92. For purposes of this note, the two FDIC funds will be referred to collectively as the deposit insurance funds. See also *supra* note 5.

11. H.R. Rep. No. 54(I), *supra* note 3, at 1, reprinted in 1989 U.S.C.C.A.N. at 86.

12. See *supra* note 6. See also Malloy, *supra* note 4, at 1127-46 (summarizing FIRREA's principal provisions and discussing their impact on the functions and powers of all federal banking regulators).

within the Department of the Treasury<sup>13</sup> to replace the Federal Home Loan Bank Board.<sup>14</sup> The Office of Thrift Supervision obtained carefully enumerated powers that were somewhat broader than its predecessor, the Federal Home Loan Bank Board.<sup>15</sup> Through FIRREA, Congress also created the Resolution Trust Corporation to take responsibility for managing and liquidating failed S&Ls.<sup>16</sup> More importantly, FIRREA dissolved the Federal Savings and Loan Insurance Corporation (FSLIC)<sup>17</sup> and placed the responsibility of the deposit insurance funds with the FDIC.<sup>18</sup> However, FIRREA's most prominent

13. 12 U.S.C. § 1462a(a) (1994). For an explanation of the Office of Thrift Supervision and its duties, see Robert Cooper, Note, *The Office of Thrift Supervision*, 59 FORDHAM L. REV. S363 (1991).

14. "Effective at the end of the 60-day period beginning on the date of the enactment of this Act, the Federal Home Loan Bank Board and the position of Chairman of the Federal Home Loan Bank Board are abolished." 12 U.S.C. §1437(a)(2) (1994). In addition,

[t]he Director of the Office of Thrift Supervision, the Chairperson of the Oversight Board of the Resolution Trust Corporation, the Chairperson of the Federal Deposit Insurance Corporation, and the Chairperson of the Federal Housing Finance Board may use the services of employees and other personnel and the property of the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation, on a reimbursable basis, to perform functions which have been transferred to such agencies for such time as is reasonable to facilitate the orderly transfer of functions transferred pursuant to any other provision of this Act or any amendment made by this Act to any other provision of law.

*Id.* § 1437(e)(1).

15. The powers of the Director of the Office of Thrift Supervision are based on those of the Chairman of the Federal Home Loan and Bank Board:

(e) Powers of the Director. The Director shall have all powers which -

(1) were vested in the Federal Home Loan Bank Board (in the Board's capacity as such) or the Chairman of such Board on the day before the date of the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989; and

(2) were not -

(A) transferred to the Federal Deposit Insurance Corporation, the Federal Housing Finance Board, the Resolution Trust Corporation, or the Federal Home Loan Mortgage Corporation pursuant to any amendment made by such Act; or

(B) established under any provision of law repealed by such Act.

12 U.S.C. § 1462a(e) (1994). The Director's powers are broader, though, because the Director has additional authority to prescribe regulations, *id.* § 1462a(b)(2), additional autonomy, *id.* § 1462a(b)(3), and additional hiring powers, *id.* § 1462a(h)(1).

16. *Id.* § 1441a(b)(1). For additional background on the responsibilities of the Resolution Trust Corporation see Wayne M. Josel, Note, *The Resolution Trust Corporation: Waste Management and the S&L Crisis*, 59 FORDHAM L. REV. S339 (1991).

17. "The insurance function of the FSLIC will be transferred to the FDIC which will now administer both the commercial bank and thrift deposit insurance funds." H.R. REP. No 54(I), *supra* note 3, at 310, *reprinted* in 1989 U.S.C.C.A.N. at 106. See also 12 U.S.C. § 1441(i)(1) (1994).

18. H.R. REP. NO. 54(I), *supra* note 3, at 310, *reprinted* in 1989 U.S.C.C.A.N. at 106. 12 U.S.C. § 1821 (a)(4)-(6) (1994). See *supra* note 10.

provision is the cross-guarantee assessment power it granted to the FDIC.<sup>19</sup>

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19. 12 U.S.C. § 1815(e)(1)-(2) (1994). The cross-guarantee assessment provision provides:

(e) Liability of commonly controlled depository institutions

(1) In general

(A) Liability established

Any insured depository institution shall be liable for any loss incurred by the [Federal Deposit Insurance] Corporation, or any loss which the [Federal Deposit Insurance] Corporation reasonably anticipates incurring, after August 9, 1989 in connection with—

- (i) the default of a commonly controlled insured depository institution; or
- (ii) any assistance provided by the [Federal Deposit Insurance] Corporation to any commonly controlled insured depository institution in danger of default.

(B) Payment upon notice

An insured depository institution shall pay the amount of any liability to the [Federal Deposit Insurance] Corporation under subparagraph (A) upon receipt of written notice by the [Federal Deposit Insurance] Corporation in accordance with this subsection.

(C) Notice required to be provided within 2 years of loss

No insured depository institution shall be liable to the [Federal Deposit Insurance] Corporation under subparagraph (A) if written notice with respect to such liability is not received by such institution before the end of the 2-year period beginning on the date the [Federal Deposit Insurance] Corporation incurred the loss.

(2) Amount of compensation; procedures

(A) Use of estimates

When an insured depository institution is in default or requires assistance to prevent default, the [Federal Deposit Insurance] Corporation shall—

- (i) in good faith, estimate the amount of the loss the [Federal Deposit Insurance] Corporation will incur from such default or assistance;
- (ii) if, with respect to such insured depository institution, there is more than 1 commonly controlled insured depository institution, estimate the amount of each such commonly controlled depository institution's share of such liability; and
- (iii) advise each commonly controlled depository institution of the [Federal Deposit Insurance] Corporation's estimate of the amount of such institution's liability for such losses.

(B) Procedures; immediate payment

The [Federal Deposit Insurance] Corporation, after consultation with the appropriate Federal banking agency and the appropriate State chartering agency, shall—

- (i) on a case-by-case basis, establish the procedures and schedule under which any insured depository institution shall reimburse the [Federal Deposit Insurance] Corporation for such institution's liability under paragraph (1) in connection with any commonly controlled insured depository institution; or
- (ii) require any insured depository institution to make immediate payment of the amount of such institution's liability under paragraph (1) in connection with any commonly controlled insured depository institution.

*Id.*

Specifically, FIRREA's cross-guarantee assessment power enables the FDIC to automatically assess the cost for bailing out a failed "insured depository institution"<sup>20</sup> against other "commonly controlled"<sup>21</sup> depository institutions,

20. The terms used in FIRREA are defined as:

(1) **Depository Institution.** —The term "depository institution" means any bank or savings association.

(2) **Insured Depository Institution.** —The term "insured depository institution" means any bank or savings association the deposits of which are insured by the [Federal Deposit Insurance] Corporation pursuant to this Chapter [Act].

(3) **Institutions Included for Certain Purposes.** —The term "insured depository institution" includes any uninsured branch or agency of a foreign bank or a commercial lending company owned or controlled by a foreign bank for purposes of section 1818 of this title.

(4) **Federal Depository Institution.** —The term "Federal depository institution" means any national bank, any Federal savings association, and any Federal branch.

(5) **State Depository Institution.** —The term "State depository institution" means any State bank, any State savings associations, and any insured branch which is not a Federal branch.

12 U.S.C. § 1813(c)(1)-(5) (1994). For the purposes of this note, the thrift industry refers to depository institutions as defined by FIRREA.

21. Both the definition of "control" in the Bank Holding Company Act of 1956 and the definition of "commonly controlled" in Title 12 section 1815 of the United States Code apply to the cross-guarantee provision. The Bank Holding Company Act of 1956 delineates that a company is deemed to "control" a bank if:

(A) the company directly or indirectly . . . owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company;

(B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or

(C) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.

12 U.S.C. § 1841(a)(2) (1994) (Bank Holding Company Act of 1956). Section 1815 states:

For purposes of this subsection, depository institutions are commonly controlled if-

(A) such institutions are controlled by the same depository institution holding company (including any company required to file reports pursuant to section 1843(f)(6) of this title); or

(B) 1 depository institution is controlled by another depository institution.

12 U.S.C. § 1815(e)(9) (1994) (Financial Institutions Reform, Recovery, and Enforcement Act of 1989).

which are solvent subsidiaries of the same bank holding company.<sup>22</sup> As designed, this power makes the bank holding company's subsidiary banks reimburse the FDIC for the entire cost incurred or expected to be incurred for resolving the failure of a commonly controlled subsidiary.<sup>23</sup> This is a vigorous and commanding power extended to one agency. Since FIRREA does not provide concrete guidelines for monitoring the FDIC's use of this power,<sup>24</sup> the power may be abused. An example of this abuse stems from exercising this power and demanding reimbursement from a subsidiary which cannot afford to pay the bill without becoming insolvent itself. Thus, the FDIC's use of the cross-guarantee power results in taking property without just compensation in

22. *Id.* § 1815(e)(1)(A). Bank holding companies are companies that acquire a controlling interest in a bank or nonbank and supervise the entity's activities. SYMONS & WHITE, *supra* note 6, at 353. Nonbanks are "financial institutions that look like and act like banks, but do not offer either demand deposits or commercial loans." GART, *supra* note 3, at 399. "They were established by bank holding companies and nonbanks to avoid regulations pertaining to interstate banking." *Id.* However, these nonbank activities must be in accord with those specified in 12 U.S.C. § 1843(c)(8) (1988). They must be activities "so closely related to banking . . . as to be a proper incident thereto . . ." SYMONS & WHITE, *supra* note 6, at 353. A bank holding company is defined as any company that controls either a bank or another company that itself controls a bank. 12 U.S.C. § 1841(a) (1994). A bank holding corporation consists of a parent corporation, which is the parent banking company that owns subsidiary banking or non-banking corporations. Even though the parent bank owns its subsidiaries, all the corporations operate as separate corporations. *Id.*

Today, bank holding companies, through their banking subsidiaries, control the vast majority of all federally insured deposits. PAULINE B. HELLER, FEDERAL BANK HOLDING COMPANY LAW, xix & n.19 (1993). In 1974, there were only 1752 registered bank holding companies controlling approximately 68% of all deposits of commercial banks. *Id.* As of December 1988, the 6474 bank holding companies in the United States controlled 91% of the assets of all commercial banks. *Id.* at xx.

23. 12 U.S.C. § 1815(e)(1)(A) (1994). See *infra* notes 95-124 and accompanying text (addressing FIRREA's cross-guarantee provision).

24. The only factors provided by FIRREA for the FDIC to consider when deciding whether to assist a failing or failed bank are somewhat vague.

The factors . . . that are required, under section 1815 of [title 12], to be considered by the [FDIC's] Board of Directors in connection with any determination by such Board pursuant to section 1815 of this title are the following:

- (1) The financial history and condition of the depository institution.
- (2) The adequacy of the depository institution's capital structure.
- (3) The future earnings prospects of the depository institution.
- (4) The general character and fitness of the management of the depository institution.
- (5) The risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund.
- (6) The convenience and needs of the community to be served by such depository institution.
- (7) Whether the depository institution's corporate powers are consistent with the purposes of this chapter.

12 U.S.C. § 1816(1)-(7) (1994).



violation of the Fifth Amendment.<sup>25</sup>

The FDIC violates the Fifth Amendment's Taking Clause when it exercises the cross-guarantee power by taking assets from a solvent banking corporation for the debts owed to the FDIC by its insolvent subsidiary.<sup>26</sup> Part of what makes corporations attractive business structures is that they enjoy limited liability.<sup>27</sup> Limited liability means that shareholders of a corporation cannot be held personally liable for the debts of that corporation or those of another corporation owned by the same company.<sup>28</sup> Courts rarely deny corporations limited liability status, and the only time a court will disregard limited liability status is when the corporation has been used as a veil or sham for other fraudulent business.<sup>29</sup> This is referred to as "piercing the corporate veil."<sup>30</sup> The problem with the cross-guarantee provision is that the FDIC has the power to override this proof of fraud and disregard limited liability, making an affiliate automatically liable for debts of another corporation.<sup>31</sup> The FDIC makes a cross-guarantee assessment that exceeds the capital of the solvent banking institution; in order to satisfy the assessment, the FDIC seizes the once solvent bank's assets and takes title to the bank's property.<sup>32</sup> Under corporate law, the FDIC must prove that the bank holding company acted fraudulently before making a bank liable through a cross-guarantee assessment.<sup>33</sup> Principles of corporate law require the FDIC to first make some showing of fraud. This

25. The Fifth Amendment states, "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." U.S. CONST. amend. V.

Although the Fifth Amendment was made applicable to the states in 1868 by ratification of the Fourteenth Amendment, the regulators referred to in this note are agencies created by the federal government. This note will discuss the issue of whether the cross-guarantee provision constitutes an unconstitutional taking by the federal government under the Fifth Amendment. See *infra* notes 288-335 and accompanying text.

26. *Branch ex rel. Maine Nat'l. Bank v. United States*, 31 Fed. Cl. 626, 628 (1994). See *infra* notes 37-48, 124-52 and accompanying text (discussing the *Branch* case).

27. See *infra* notes 153-210 and accompanying text (explaining the doctrine of corporate separateness and limited liability).

28. See, e.g., Model Business Corp. Act § 6.22 (1984) (proving shareholders of corporations limited liability). The notion of limited liability is a concept viewed with reverence in corporate law. David W. Leebron, *Limited Liability, Tort Victims and Creditors*, 91 COLUM. L. REV. 1565, 1569 (1991) (considering limited liability as a birthright).

29. E.g., *Castleberry v. Branscum*, 721 S.W.2d 270, 273 (Tex. 1986) (holding that the corporate veil may be pierced if the corporate fiction is used as a means of perpetuating fraud or as a sham to perpetuate fraud).

30. See *infra* notes 169-210 and accompanying text (describing how the courts pierce the corporate veil).

31. 12 U.S.C. § 1815(e)(1)(A) (1994).

32. *Id.*

33. See *infra* notes 336-67 and accompany text (proposing that the FDIC prove acts of fraud or wrongdoing within the bank holding company prior to making a cross-guarantee assessment).

curtails the potential abuse that occurs from arbitrary cross-guarantee assessments.

Historically, an FDIC insured solvent bank subsidiary of a bank holding company could exclude the government from taking possession of all of its assets for the purpose of paying the debts of another corporation.<sup>34</sup> In addition, under corporate law, corporations are treated as separate legal entities and are not responsible for the debts of other corporations; absent some showing of fraud or disregard of the corporate form, the corporate veil may not be pierced.<sup>35</sup> Essentially, the cross-guarantee provision has eroded a bank's right to prevent the government by illegally piercing the corporate veil of the bank holding company without having to first prove fraud. As a result, FIRREA grants the FDIC the power to effectuate a taking without just compensation.<sup>36</sup>

The case of *Branch ex rel. Maine National Bank v. United States*<sup>37</sup> illustrates the problem of the potential abuse by the FDIC when exercising the cross-guarantee provision.<sup>38</sup> The failure of the Bank of New England in January of 1991 created the opportunity for the FDIC's first exercise of the cross-guarantee power since the passage of FIRREA.<sup>39</sup> The Bank of New England was a subsidiary of the Bank of New England Corporation, which also held the Connecticut Bank and Trust Company and Maine National Bank.<sup>40</sup>

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34. *Branch*, 31 Fed. Cl. at 633. Prior to FIRREA, a bank had a reasonable expectation that if it complied with the applicable banking regulations, the bank would remain in possession of its assets, would not be held accountable for debts that were not its own, and would not be seized by the FDIC. *Id.* The enactment of the cross-guarantee power under FIRREA was a radical departure from the historic banking policy of insulating banks from the failure of other banks that were not reasonably foreseeable. *Id.* at 631. See also *California Housing Securities, Inc. v. United States*, 959 F.2d 955 (Fed. Cir.), cert. denied, 113 S. Ct. 324 (1992); *Golden Pacific Bancorp v. United States*, 15 F.3d 1066 (Fed. Cir. 1994).

35. *Branch*, 31 Fed. Cl. at 633. *Tennessee Valley Auth. v. Exxon Nuclear Co.*, 753 F.2d 493, 497 (6th Cir. 1985); *American Bell Inc. v. Federation of Tel. Workers*, 736 F.2d 879, 887 (3d Cir. 1984).

36. See *infra* notes 288-335 and accompanying text (describing the taking power of the cross-guarantee assessment).

37. 31 Fed. Cl. 626 (1994). See *infra* notes 124-52 and accompanying text.

38. *Branch*, 31 Fed. Cl. 626 (1994).

39. *Failure of the Bank of New England: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. 63 (1991) [hereinafter *Failure*] (statement of Robert L. Clarke).

40. *Id.* at 66. The Bank of New England Corporation was a holding corporation with three subsidiaries: The Bank of New England, based in Massachusetts; The Connecticut Bank and Trust Co.; and the Maine National Bank. *Id.* Due to the declining New England real estate market, the equity capital of the Bank of New England depleted, causing the Office of the Comptroller of the Currency to declare the bank insolvent on January 6, 1991. *Id.* Its failure subsequently illustrated the practical effect of the exercise of the cross-guarantee. *Id.* at 63. See also *Bank of New England Declared Insolvent: FDIC to Insure Deposits Above \$100,000*, 56 BNA'S BANKING REP., 44 (Jan.

At the time of the Bank of New England's failure, its two affiliates, Connecticut Bank and Trust Company and Maine National Bank, were solvent.<sup>41</sup> The FDIC used the cross-guarantee assessment power to assess the Maine National Bank with the losses the FDIC incurred from bailing out the Bank of New England.<sup>42</sup> This assessment exceeded Maine National Bank's capital, causing it to become insolvent as well.<sup>43</sup> The FDIC was appointed receiver,<sup>44</sup> took possession of all Maine National Bank's assets, established bridge banks, and has since sold them to other solvent banks.<sup>45</sup> The Bank of New England Corporation was forced to file for bankruptcy the next day.<sup>46</sup> This case exemplifies the shortcomings of the cross-guarantee provision and the need for legislative supervision to protect banks from abuse of regulatory power.<sup>47</sup> Thus, *Branch* will be the authoritative test case in the analysis of the effectiveness and validity of FIRREA's cross-guarantee provision and in the challenge to its regulatory authority.<sup>48</sup>

This Note examines whether the FDIC, through the exercise of the cross-guarantee assessment provision, should be able to force a solvent affiliate of an insolvent bank to shoulder the cost of its affiliate's failure, in direct opposition to the doctrine of corporate separateness.<sup>49</sup> More specifically, this Note will discuss whether the FDIC's exercise of its cross-guarantee power, in taking possession of property from a private corporation, results in a taking for a

14, 1991) (discussing the appointment of the FDIC as receiver of Maine National Bank's assets).

41. *Branch*, 31 Fed. Cl. at 629.

42. *Id.*

43. *Id.* See also *U.S. May Have to Pay Up For Failure Attributed to Use of Cross-Guaranty*, 63 BNA's BANKING REP., 164-65 (Aug. 1, 1994) [hereinafter *Pay Up*] (explaining the disposition of the *Branch* case).

44. When a bank becomes insolvent, it may be closed by its principal regulator, either the Office of the Comptroller of the Currency in the case of national banks or the relevant state-chartering authority in the case of state-chartered banks. Garten, *supra* note 5, at 1159 n.2. If the bank is federally insured, the FDIC is appointed receiver and takes charge of paying insured depositors out of the deposit insurance funds and liquidating the bank's assets. See 12 U.S.C. § 1821(c) (1994).

45. *Bank of New England Corporation Change in Financial Condition: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 102nd Cong., 1st Sess 141 (1991).

46. *Branch*, 31 Fed. Cl. at 629.

47. Jennifer B. Arlin, Note, *Of Property Rights and the Fifth Amendment: FIRREA's Cross-Guarantee Reexamined*, 33 WM. & MARY L. REV. 293, 308 (1991) (analyzing the cross-guarantee provision in light of the economic substantive due process doctrine). Arlin argues that although the doctrine of economic substantive due process is in disfavor and is unlikely to influence the rulings of any federal court, the application of its general principles could help prevent unjust exercises of the cross-guarantee provision by protecting against unwarranted intrusions upon property rights. *Id.* at 298.

48. *Pay Up*, *supra* note 43, at 165.

49. See *infra* notes 153-210 and accompanying text (describing the doctrine of corporate separateness).

public purpose without just compensation.<sup>50</sup> If the individual banks in a bank holding corporation adhere to the corporate form, operating as separate entities, each has an historically based expectation that it will not become liable for their parent and subsidiary banks' debts.<sup>51</sup> If the banks do adhere to the corporate form and the FDIC makes a cross-guarantee assessment, without first piercing the corporate veil, a taking has occurred which requires compensation.<sup>52</sup> Legally, the only way the FDIC can make such an assessment is by piercing the corporate veil with a showing of fraud or wrongdoing on the part of the bank holding corporation, thus making each bank liable for its sister banks' debts without effectuating a taking.<sup>53</sup> The constitutionality of the cross-guarantee assessment power is an important question for the banking industry, as well as its regulators.

Section II of this Note will outline the history and purpose behind the enactment of FIRREA<sup>54</sup> and will explain FIRREA's cross-guarantee provision.<sup>55</sup> In addition, Section II will discuss the FDIC's first exercise of its cross-guarantee power.<sup>56</sup> Section III will address the doctrine of corporate separateness as it relates to the liability of bank holding corporations.<sup>57</sup> Section III will also review the takings jurisprudence<sup>58</sup> and will analyze the cross-guarantee assessment provision in light of the Takings Clause.<sup>59</sup> Section III will conclude that the FDIC, by making assessments on solvent subsidiaries without a proper showing of fraud or wrongdoing, is taking property without just compensation under the Takings Clause of the Fifth Amendment.<sup>60</sup> Finally, Section IV will propose an amendment to FIRREA's cross-guarantee provision that will provide better guidelines for the FDIC to determine when the assessment provision can be exercised.<sup>61</sup> Making the cross-guarantee provision

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50. See *infra* notes 288-335 and accompanying text (describing the FDIC's use of the cross-guarantee provision effectuating a taking).

51. *Branch*, 31 Fed.Cl. 626, 637 (1994).

52. *Id.*

53. *Id.* A taking occurs when the FDIC, without proving fraud, makes an assessment that exceeds the capital of the assessed bank and subsequently takes the bank's assets in fulfillment of the assessment. *Id.* at 631.

54. See *infra* notes 63-94 and accompanying text (portraying the demise of the S&L industry which lead to FIRREAs enactment).

55. See *infra* notes 95-125 and accompanying text.

56. See *infra* notes 126-52 and accompanying text (characterizing the failure of the Bank of New England).

57. See *infra* notes 153-210 and accompanying text.

58. See *infra* notes 211-87 and accompanying text.

59. See *infra* notes 288-335 and accompanying text.

60. See *infra* notes 330-35 and accompanying text.

61. See *infra* notes 336-67 and accompanying text. This proposal is meant to prevent the FDIC from imposing an arbitrary assessment on a legitimate, commonly controlled, depository institution. Under the proposal, the FDIC would have to establish some wrongdoing within a bank holding

more closely tailored to the policy and purpose behind its enactment will ensure that banks are better protected from regulatory abuse of power.<sup>62</sup>

## II. THE S&L DEBACLE AND THE ENACTMENT OF FIRREA

### A. FIRREA: History and Purpose

Congress passed FIRREA in 1989 as a remedial measure necessitated by the failure of the S&L industry.<sup>63</sup> The S&L industry's troubles occurred throughout the 1980s.<sup>64</sup> Since FIRREA was passed wholly in response to the continuing S&L crisis, FIRREA serves to restructure the banking industry and recapitalize the depleted FDIC's insurance funds.<sup>65</sup> The purposes behind the regulatory changes include improving supervision of S&Ls and curtailing S&L activities that pose unacceptable risks to FDIC insurance funds.<sup>66</sup> FIRREA was purported to be the most important restructuring of America's financial institutions and deposit insurance apparatus in over fifty years.<sup>67</sup> By directly confronting the S&L crisis, FIRREA's provisions greatly affect the S&L industry.<sup>68</sup>

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company before it could make an assessment, thus preventing the cross-guarantee provision from effectuating a taking.

62. H.R. CONF. REP. NO. 222, 101st Cong., 1st Sess. 393 (1989), *reprinted in* 1989 U.S.C.C.A.N. 432.

63. H.R. REP. NO. 54(I), *supra* note 3, at 291-92, *reprinted in* 1989 U.S.C.C.A.N. at 87-88. *See infra* notes 64-94 and accompanying text (discussing the savings and loan crisis in general and the fact that it necessitated the passage of reform legislation).

64. H.R. REP. NO. 54(I), *supra* note 3, at 291, *reprinted in* 1989 U.S.C.C.A.N. at 87. *See also supra* note 2.

65. The regulatory changes and purposes of FIRREA are expressed in part as follows:

- (2) To improve the supervision of savings associations by strengthening capital, accounting, and other supervisory standards.
- (3) To curtail investments and other activities of savings associations that pose unacceptable risks to the Federal deposit insurance funds.
- (4) To promote the independence of the Federal Deposit Insurance Corporation from the institutions the deposits of which it insures, by providing an independent board of directors, adequate funding, and appropriate powers.
- (6) To establish an Office of Thrift Supervision in the Department of the Treasury under the general oversight of the Secretary of the Treasury.
- (7) To establish a new corporation, to be known as the Resolution Trust Corporation, to contain, manage, and resolve failed savings associations.
- (9) To strengthen the enforcement powers of Federal regulators of depository institutions.

12 U.S.C. § 1811 (1994) *citing* Sec. 101 of Pub. L. No. 101-73 (2),(3),(4),(6),(7),(9) (1994).

66. *Id.*

67. *See, e.g.*, 135 CONG. REC. S10191 (daily ed. Aug. 4, 1989) (remarks of Sen. Riegle).

68. Anthony C. Providenti Jr., Note, *Playing With FIRREA, Not Getting Burned: Statutory Overview of the Financial Institutions Reform, Recovery and Enforcement Act of 1989*, 59 FORDHAM L. REV. S323, S325 (1991).

Originally, the thrift industry profited from the difference between the interest rate the institutions paid to depositors and the interest rate they charged on mortgage loans.<sup>69</sup> However, the inability of thrifts to diversify their asset portfolios to accommodate the risk of funding long-term mortgage loans with short-term customer deposits caused their steady deterioration.<sup>70</sup> By the late 1980s, the industry's financial condition had plummeted.<sup>71</sup> At that time, the government agencies responsible for supervising these institutions and even the thrifts themselves underestimated the extent of the underlying problems.<sup>72</sup>

The problems of the S&L industry can be divided into three distinct periods.<sup>73</sup> The first period is the time prior to 1980, which saw rising interest rates that created difficulty for S&Ls to raise capital.<sup>74</sup> During this period, the banking regulators misjudged the signs indicating a failure of an industry which extended long-term loans on short-term deposits.<sup>75</sup> The second period of the S&L crisis fell between 1980 and 1982, when virtually every S&L in the industry became insolvent due to the unexpected and significant increase in interest rates.<sup>76</sup> Finally, after a surprising decrease in interest rates from late 1982 through 1987, the final period saw hundreds of S&Ls that, even though they remained open, were insolvent.<sup>77</sup> Due to the lack of supervision by banking regulators, the many insolvent S&Ls that remained open had additional incentive to take greater risks for their own resurrection.<sup>78</sup>

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69. Robert J. Laughlin, Note, *Causes of Savings and Loan Debacle*, 59 *FORDHAM L. REV.* S301, S301 (1991). Originally, thrifts were only authorized to extend mortgages on property located within a fifty-mile radius of the home office. See H.R. Rep. No. 54(I), *supra* note 3, at 293, reprinted in 1989 U.S.C.C.A.N. at 89. By 1983, thrifts were allowed to lend throughout the country. Laughlin, at S301 n.3.

70. Laughlin, *supra* note 69, at S301 n.2.

71. *Id.* at S302. At the end of 1988, 754 of the 2,949 federally insured banking institutions were either insolvent or on the brink of insolvency. H.R. REP. NO. 54(I), *supra* note 3, at 303, reprinted in 1989 U.S.C.C.A.N. at 99.

72. See Kenneth E. Scott, *Never Again: The S&L Bailout Bill*, 45 *BUS. LAW.* 1883, 1883 (1990).

73. Clark, *supra* note 2, at 1019-22.

74. *Id.* at 1019. After the Great Depression and throughout the 1960's, thrifts continued to be profitable because they could attract low-cost deposits while the interest rates remained stable. *Id.* However, between the 1970s and 1980s, interest rates soared above the rates banking regulators allowed depository institutions to pay on deposits, thus creating problems. *Id.*

75. Clark, *supra* note 2, at 1020.

76. Laughlin, *supra* note 69, S308-14. See generally CARRON, *supra* note 3, at 56 (presenting the first comprehensive analysis of the extent of the interest rate risk problem and its implications).

77. Laughlin, *supra* note 69, at S315-21. Due to the structure of the banking regulators, at the time, there was a lack of proper regulatory supervision. *Id.* at S319.

78. H.R. REP. NO. 54(I), *supra* note 3, at 297, reprinted in 1989 U.S.C.C.A.N. at 93. "As long as the federal government was responsible for picking up the tab for a failed state-chartered thrift, there was no great incentive for many state legislatures to deny the sweeping demands for additional investment powers made by the thrift industry." *Id.* As a result, seventy percent of all

Congress speculated that the risks taken by the S&Ls were linked to several factors, including: (i) poorly timed deregulation; (ii) poor internal management in the thrift industry; (iii) lack of proper government supervision and regulation; (iv) regional economic collapse, specifically in the Southwest; and (v) insider corruption and fraud.<sup>79</sup> Congress revealed that, although the majority of S&Ls were run by honest and dedicated management personnel, fraud and insider abuse contributed to a significant portion of the S&L failures in the 1980s.<sup>80</sup> Increasing political pressure and concern over white collar crime forced Congress to adopt measures, like FIRREA, to control bank fraud.<sup>81</sup> When Congress decided to bail out the S&L industry, most members of Congress primarily attributed the crisis to bank fraud.<sup>82</sup>

The problems of bank fraud stemmed from the bank holding company structure.<sup>83</sup> The structure allowed bank holding companies to strategically coordinate the activities of a number of their subsidiary banks.<sup>84</sup> Fraud occurred when the largest, or lead, subsidiary bank in the system would generate the majority of the loan business and depend on capital from some of its smaller affiliate banks to fund the lead bank's high-risk lending activities.<sup>85</sup> During the Congressional hearings prior to FIRREA's enactment, former FDIC Chairman L. William Seidman testified that when the lead bank's lending practices are inferior, the bank holding company effectively isolates its poorer-quality assets

FSLIC expenditures during 1988 went to pay for problems created by high-risk, ill-supervised, state-chartered thrifts in California and Texas. *Id.* Both California and Texas absorbed fifty-four percent of FSLIC expenditures in 1987. *Id.*

79. H.R. REP. NO. 54(D), *supra* note 3, at 294, *reprinted in* 1989 U.S.C.C.A.N. at 90.

80. *Id.* at 300. The problem lies in determining when a bank's activities cross the fine line between poor business judgment and fraud. *Fraud in America's Insured Depository Institutions: Senate Comm. on Banking, Housing and Urban Affairs*, 101st Cong., 2nd Sess. 15, 16 (1990) (statement by Richard L. Fogel). Fraud cases are quite complex, and it often takes several months, and sometimes years, to sort through the thousands of documents just to determine if a criminal offense has occurred. *Id.* In addition, the prosecutor is left to prove that the paper trail establishes beyond a reasonable doubt that a criminal violation was committed. *Id.*

81. "Society . . . pays a heavy price for the activities of 'white collar' criminals. No more vivid or current example of this price can be found than in the unfolding savings and loan scandal . . . . It is estimated that the ultimate cost of this scandal may be as much as \$500 billion as amount that might otherwise be put to useful purposes in our society." H.R. REP. NO. 681, 101st Cong., 2nd Sess., 1, at 69 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6472, 6473.

82. H.R. REP. NO. 54(I), *supra* note 3, at 300, *reprinted in* 1989 U.S.C.C.A.N. at 96. Banking regulators estimate that up to forty percent of thrift failures are attributable to some type of fraud or insider abuse. *Id.* See Renae V. Stevens, *Insider Abuse and Criminal Misconduct in Financial Institutions: A Crisis?*, 64 NOTRE DAME L. REV. 222, 224-29 (1989) (assessing the scope of insider abuse).

83. Defendant's Mem. Supp. Summ. J. at 2, *Branch ex rel. Maine Nat'l. Bank v. United States*, 31 Fed. Cl. 626 (1994).

84. *Id.*

85. *Id.* at 2-3.

in that bank.<sup>86</sup> When the bank holding company concentrates the poorer-quality assets in a single bank, letting that bank fail, the bank holding company shifts the cost of those assets—the loss it would otherwise be forced to realize—to the FDIC.<sup>87</sup> Consequently, the extreme financial losses caused by the failure of a lead bank in a bank holding company system were originally borne by the deposit insurance funds.<sup>88</sup> To rectify this depletion of deposit insurance funds, the government sought legislation to guard the public interest by assuring that the banking assets of a holding company system are appropriately applied towards solving problems in a subsidiary bank instead of by the expenditure of the FDIC insurance funds.<sup>89</sup> FIRREA's answer was to force the costs originally borne by the FDIC onto the subsidiaries within a bank holding company system.<sup>90</sup>

FIRREA was a legislative attempt to resolve the financial crisis facing the S&L industry by reorganizing the banking industry and recapitalizing the depleted insurance funds.<sup>91</sup> FIRREA reorganized the deposit insurance system by abolishing the insolvent FSLIC and by creating two separate deposit

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86. *Id.* at 3 (citing *Condition of the Federal Deposit Insurance Funds: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 100th Cong., 2d Sess. 354 (1988)). Then FDIC Chairman L. William Seidman testified before Congress in 1988:

This arrangement concentrates the bank holding company's assets in a single bank (usually the lead bank). If the lead bank's lending practices are inferior, the bank holding company effectively isolates its poor-quality assets in that bank. Moreover, the bank has the resources to make far more poor-quality loans than would be the case if the bank did not serve as the conduit for its affiliated banks' funds.

*Oversight on the Condition of the Financial Services Industry: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 100th Cong., 2d Sess. 254, 255 (1988) [hereinafter *Condition*].

87. *Condition*, *supra* note 86, at 255. Seidman went on to state, "This technique amounts to a misuse of the FDIC's resources, which can do substantial harm to the Federal safety net for depositors." *Id.* However Seidman acknowledges that when a bank within the bank holding system fails, the FDIC must deal with that bank individually. Therefore, the FDIC must act as if there is no connection between the failed bank and the rest of the bank holding company system. *Id.*

88. *E.g.*, JAMES L. PIERCE, *THE FUTURE OF BANKING* 120 (1991).

89. Defendants Mot. Summ. J. at 4, *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed Cl. 626 (1994). Originally, the legislation proposed by the FDIC in 1988 would have allowed the federal bank regulatory agencies to require a failing bank to consolidate with other banks in its holding company system. *Id.* at n.8. This measure did fail. *Id.* However, Congress finally pinpointed the problem and passed the FIRREA cross-guarantee provision, codified at 12 U.S.C. § 1815(e) (1994).

90. *See* PIERCE, *supra* note 88, at 120 (criticizing the cross-guarantee as permitting the FDIC to shift its own losses onto banks that themselves have done nothing wrong but happen to be affiliated with an institution that fails).

91. *Providenti*, *supra* note 68, at §325. *See also* H.R. Rep. No. 54(I), *supra* note 3, at 1, *reprinted in* 1989 U.S.C.C.A.N. at 86.



insurance funds to be regulated by the FDIC.<sup>92</sup> To help recapitalize the FDIC deposit insurance funds, FIRREA injected billions of taxpayer dollars to restore the health of the deposit insurance funds.<sup>93</sup> In addition to taxpayer dollars, Congress wanted to make someone other than the government bear the burden of bailing out insolvent depository institutions.<sup>94</sup> Therefore, the S&L crisis brought FIRREA and its cross-guarantee provision which provides the FDIC great discretion in making commonly controlled subsidiary banks pay for their own failures, so that the government does not have to.

### B. The Cross-Guarantee Provision

Under the cross-guarantee provision of FIRREA,<sup>95</sup> the FDIC gained new and pervasive authority with respect to banks and thrifts affiliated with an insolvent institution.<sup>96</sup> The cross-guarantee provision makes insured depository institutions liable for losses incurred by the FDIC in connection with the "default"<sup>97</sup> of a "commonly controlled"<sup>98</sup> insured depository financial

92. See Lissa Lamkin Broome, *Private Market Solutions to the Savings and Loan Crisis: Bank Holding Company Acquisitions of Savings Associations*, 59 FORDHAM L. REV. S111, S119 (1991). See also *supra* note 10. The two separate depository institutions funds are the Bank Insurance Fund and the Savings Association Insurance Fund. Section 1817 of title 12 of the United States Code states:

(1) Bank Insurance Fund

Any institution which—

(A) becomes an insured depository institution; and

(B) does not become a Savings Association Insurance Fund member pursuant to paragraph (2), shall be a Bank Insurance Fund member.

(2) Savings Association Insurance Fund

Any savings association, other than any Federal savings bank chartered pursuant to section 1464(o) of this title, which becomes an insured depository institution shall be a Savings Association Insurance Fund member.

12 U.S.C. § 1817(j)(1)-(2) (Supp. V 1993).

93. See, e.g., 12 U.S.C. § 1821(a)(6)(D) (1994) (requiring Treasury payments to the Savings Association Insurance Fund). See also H.R. CONF. REP. NO. 222, 101st Cong., 1st Sess. 393, 398-99 (1989), reprinted in 1989 U.S.C.C.A.N. 432, 437-38; FIRREA was hailed as the "most important financial legislation . . . in the past 50 years." 135 CONG. REC. H4963 (daily ed. Aug. 3, 1989) (statement of Rep. Pashayan).

94. H.R. CONF. REP. NO. 222, *supra* note 62, at 395, reprinted in 1989 U.S.C.C.A.N. at 434.

95. 12 U.S.C. § 1815(e)(1)(A) (1994). See *supra* note 19.

96. Clark, *supra* note 2, at 1016.

97. "The term 'default' means, with respect to an insured depository institution, any adjudication or other official determination by any court of competent jurisdiction, the appropriate Federal banking agency, or other public authority pursuant to which a conservator, receiver, or other legal custodian is appointed for an insured depository institution . . ." 12 U.S.C. § 1813(x)(1) (1994).

98. See *supra* note 21 (defining "commonly controlled").

institution.<sup>99</sup> Also, it makes insured depository institutions liable for those losses the FDIC reasonably anticipates incurring to assist commonly controlled insured depository institutions that are "in danger of default."<sup>100</sup>

The cross-guarantee provision is part of the initiative to augment the FDIC's insurance funds.<sup>101</sup> Since the deposit insurance system cannot work without the funds necessary to pay the claims of the depositors of failed financial institutions, Congress designed the cross-guarantee provision to provide an alternate means of procuring the needed funds. One essential goal of FIRREA is to provide funds from public and private sources.<sup>102</sup> One public source, namely tax dollars, was the only alternative resource for the deposit insurance funds before Congress enacted FIRREA.<sup>103</sup> It became painfully apparent to legislators and bankers alike, that this source was insufficient to counteract the inadequacy of the insurance premiums paid by insured institutions.<sup>104</sup> By

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99. 12 U.S.C. § 1815(e)(1)(A)(1994). If more than one commonly controlled depository institution is to be assessed, each will be jointly and severally liable for the losses suffered by the FDIC. Statement of Policy Regarding Liability of Commonly Controlled Depository Institutions, 55 Fed. Reg. 21,934, at 21,935 (1990). The FDIC, however, shall estimate the liability of each individual institution by first assessing an amount on a pro rata capital basis that results in parity in the capital ratios of the responsible institutions and will divide any additional assessment on a pro rata basis. *Id.*

100. The term "in danger of default" means an insured depository institution with respect to which . . . the appropriate Federal banking agency . . . has advised the [Federal Deposit Insurance] Corporation . . . that —

(A) in the opinion of such agency or authority—

(i) the depository institution . . . is not likely to be able to meet the demands of the institution's . . . depositors or pay the institution's . . . obligations in the normal course of business; and

(ii) there is no reasonable prospect that the depository institution . . . will be able to meet such demands or pay such obligations without Federal assistance; or

(B) in the opinion of such agency or authority—

(i) the depository institution . . . has incurred or is likely to incur losses that will deplete all or substantially all of its capital; and

(ii) there is no reasonable prospect that the capital of the depository institution . . . will be replenished without Federal assistance.

12 U.S.C. § 1813(x)(2) (1994).

101. H.R. CONF. REP. NO. 222, *supra* note 62, at 393, *reprinted in* 1989 U.S.C.C.A.N. at 492.

102. *Id.* at 453, 432.

103. A public source such as tax dollars is distinguishable from the private source that had always been available to the FSLIC—insurance premiums paid by member institutions. 12 U.S.C. § 1727 (1988).

104. Geoffrey P. Miller, *Symposium Banking Regulation: The Future of the Dual Banking System*, 53 BROOK. L. REV. 1, 8-10 (1987). Pre-FIRREA, a banking institution's total deposits determined the amount of insurance premiums it paid to the deposit insurance fund. Since FIRREA's enactment:

[A] bank's assessment base for any date shall be equal to the bank's liability for deposits

enacting FIRREA, Congress provided the FDIC with an alternative insurance policy: the possibility of obtaining funding from private sources other than bank insurance premiums. The cross-guarantee power allows the FDIC to tap the resources available from a bank holding company's subsidiaries, in order to rescue an insolvent affiliate subsidiary.<sup>105</sup> Although this seems to be a viable solution, an unfortunate consequence is that the sibling institutions may also be forced into insolvency.<sup>106</sup>

The cross-guarantee provision is applied only after a subsidiary bank has failed or received other federal assistance.<sup>107</sup> The FDIC can only impose the assessment after an affiliated bank has been declared insolvent and placed into FDIC receivership or after the agency has used deposit insurance funds to avert an affiliated bank's failure.<sup>108</sup> In addition, the FDIC's cross-guarantee power

(including the deposits of any other bank for which it has assumed liability) as reported in its report of condition for such date, plus the assessment base additions set forth in paragraph (5), and less the assessment base deductions set forth in paragraph (6).

12 U.S.C. § 1817(b)(4)(A) (1988).

105. See *supra* note 19.

106. See *infra* notes 125-52 and accompanying text (discussing the Bank of New England failure and the exercise of the cross-guarantee assessment that caused the Maine National Bank to fail as well). Professor Broome provides an excellent illustration of the application of the cross-guarantee provision. Lissa Lamkin Broome, *Redistributing Bank Insolvency Risks: Challenges to Limited Liability in the Bank Holding Company Structure*, 26 U.C. DAVIS L. REV. 935, 962 (1993). Broome sets out an example of a bank holding company, operating under a system of limited liability, which owns insolvent Bank A and solvent Bank B. *Id.* Assume the bank holding company has invested \$100,000 of capital into both Banks A and B. *Id.* Upon Bank A's insolvency, the FDIC suffers a \$150,000 loss from a purchase and assumption transaction. *Id.* This is where the FDIC transfers some of the assets and liabilities of a failed bank to another insured bank. Due to Bank A's insolvency, the bank holding company loses its \$100,000 capital in Bank A. *Id.*

Normally, Bank B continues to operate with its \$100,000 of capital intact and unaffected by the failure of Bank A. However, if the FDIC elects to assert its cross-guarantee power, it would reduce its own loss from \$150,000 to \$50,000 by using the \$100,000 capital of Bank B to satisfy Bank B's guarantee to the FDIC for the costs in insuring Bank A. *Id.* The bank holding company loses not only its original \$100,000 investment in Bank A, but also its \$100,000 investment in Bank B. *Id.* at 963. Bank B is now also insolvent as a result of the exercise of the cross-guarantee provision. *Id.* at 963 n.104. Since both banks are now insolvent, the FDIC then sells the insolvent banks to new banks to recoup its losses. *Id.* This example illustrates the damaging effects that permeate throughout the corporate structure as a consequence of the cross-guarantee assessment liability.

107. 12 U.S.C. § 1815(e) (1994).

108. The cross-guarantee provision provides the FDIC with indemnification for "losses incurred." *Id.* This means that the agency must first have expended resources to bail out or reorganize an affiliated bank before it can use its cross-guarantee power. Compare the cross-guarantee provision with the Federal Reserve Board's source-of-strength doctrine which enforces an obligation on the bank holding company to assist a troubled subsidiary bank before it fails or imposes any burdens on the FDIC. 12 C.F.R. § 225.4(a)(1) (1990); 52 Fed. Reg. 15,707 (1987). For further information on the "source-of-strength" doctrine see James F. Groth, Comment, *Can Regulators Force Bank Holding Companies to Bail Out Their Failing Subsidiaries?—An Analysis*

applies only to assets of other affiliated banks and does not reach non-bank assets of the bank holding company.<sup>109</sup>

The provision requires that any loss incurred by the FDIC due to the failure of one institution may be automatically assessed against affiliated banks within the same holding company structure.<sup>110</sup> Shareholders and non-bank<sup>111</sup> affiliates of the failed bank are not required to pay, but their claims against the failed bank are subordinated to the FDIC's claim.<sup>112</sup> These insiders will often lose secured claims against the failed bank.<sup>113</sup> Also, if the FDIC is providing assistance to a subsidiary bank in the holding company system, FIRREA prohibits the holding company's receipt of dividends from any of the banks in the system.<sup>114</sup>

Pursuant to the cross-guarantee provision, liability attaches at the time of default.<sup>115</sup> An insured depository institution must pay the amount of its

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*of the Federal Reserve Board's Source-of-Strength Doctrine*, 86 NW. U. L. REV. 112 (1991); Kieran J. Fallon, Note, *Source of Strength or Source of Weakness?: A Critique of the "Source-of-Strength" Doctrine in Banking Reform*, 66 N.Y.U. L. REV. 1344 (1991).

109. 12 U.S.C. § 1815(e) (1994).

110. See *supra* note 19. It is important to note that this provision does not allow the FDIC to recoup its losses from the bank holding company parent itself. The FDIC may only require reimbursement from other affiliated subsidiary banks. 12 U.S.C. § 1815(e) (1994).

111. Non-bank banks are "financial institutions that look like and act like banks, but do not offer either demand deposits or commercial loans. They were established by bank holding companies and non-banks to avoid regulations pertaining to interstate banking." GART, *supra* note 3, at 399. However, these non-bank activities are specified in 12 U.S.C. § 1843(c)(8) (1994); they must be activities "so closely related to banking . . . as to be a proper incident thereto . . . ." SYMONS & WHITE, *supra* note 6, at 353.

112. 12 U.S.C. § 1815(e)(2)(C)(i); David L. Glass, *Cross-Guarantee Is Seen as Risk to Holding Companies*, AM. BANKER, July 19, 1990, at 19. Moreover, FIRREA forbids any otherwise valid right of private parties from interfering with the cross-guarantee obligations of assessed subsidiary banks. See 12 U.S.C. § 1815(e)(4). However, the FDIC's cross-guarantee claims expressly are subordinate to depositor claims and certain secured obligations of affiliates. See *id.* § 1815(e)(2)(C)(ii). The FDIC even has the power to name itself "receiver" (liquidating the failed institution) or "conservator" (conserving the failed institution as a going concern in hopes of reselling it) for failed national banks by law and for failed state-insured banks by practice. 12 U.S.C. § 1821(c) 1-5 (1994). This provision gives the FDIC broad discretion to appoint itself receiver for "[a]ny violation of any law or regulation, or an unsafe or unsound practice or condition that is likely to (i) cause insolvency or substantial dissipation of assets or earnings; (ii) weaken the institution's condition or (iii) otherwise seriously prejudice the interests of the institution's depositors or the deposit insurance fund." *Id.* § 1821(c)(5)(H).

113. *Id.* § 1815(e)(2)(C)(ii). The cross-guarantee liability has priority over any obligations to shareholders and any obligation owed to any affiliate of the bank. *Id.* § 1815(e)(2)(C)(i).

114. See Glass, *supra* note 112, at 24.

115. 12 U.S.C. § 1815(e)(1)(A) (1994).

Any insured depository institution shall be liable for any loss incurred by the [Federal Deposit Insurance] Corporation, or any loss which the [Federal Deposit Insurance] Corporation reasonably anticipates incurring, after August 9, 1989 in

liability for losses incurred in connection with the insolvency of a commonly controlled institution upon receipt of written notice from the FDIC.<sup>116</sup> The FDIC must provide written notice to a commonly controlled institution of the estimated expected loss from a bail out of its subsidiary within two years of the occurrence of that loss or the depository institution will not be liable.<sup>117</sup> Importantly, Congress does not require the FDIC to be precise or to have perfect information about the amount of loss when making cross-guarantee assessments.<sup>118</sup> All that is required is a "good-faith estimate" of the amount of loss the FDIC expects to incur.<sup>119</sup> The FDIC can either require an insured depository institution to make immediate payment of its liability or it can establish a schedule for payment.<sup>120</sup> The assessed institution may seek judicial

connection with—

- (i) the default of a commonly controlled insured depository institution; or
- (ii) any assistance provided by the [Federal Deposit Insurance] Corporation to any commonly controlled insured depository institution in danger of default.

*Id.*

116. *Id.* § 1815(e)(1)(B).

"An insured depository institution shall pay the amount of any liability to the [Federal Deposit Insurance] Corporation under subparagraph (A) upon receipt of written notice by the [Federal Deposit Insurance] Corporation in accordance with this subsection."

*Id.*

117. *Id.* § 1815(e)(1)(C).

No insured depository institution shall be liable to the [Federal Deposit Insurance] Corporation under subparagraph (A) if written notice with respect to such liability is not received by such institution before the end of the 2-year period beginning on the date the [Federal Deposit Insurance] Corporation incurred the loss.

*Id.*

118. 12 U.S.C. § 1815(e)(2)(A) (1994).

119. *Id.*

(A) Use of estimates

When an insured depository institution is in default or requires assistance to prevent default, the [Federal Deposit Insurance] Corporation shall—

- (i) in good faith, estimate the amount of the loss the [Federal Deposit Insurance] Corporation will incur from such default or assistance;

*Id.*

120. *Id.* § 1815(e)(2)(B).

(B) Procedures; immediate payment

The [Federal Deposit Insurance] Corporation, after consultation with the appropriate Federal banking agency and the appropriate State chartering agency, shall—

- (i) on a case-by-case basis, establish the procedures and schedule under which any insured depository institution shall reimburse the [Federal Deposit Insurance] Corporation for such institution's liability under paragraph (1) in connection with any commonly controlled insured depository institution; or
- (ii) require any insured depository institution to make

review of the FDIC's decision only after a hearing by an administrative law judge and full review by the FDIC's Board of Directors.<sup>121</sup>

FIRREA's cross-guarantee provision was designed to serve as an integral part of the legislative effort to place the FDIC's deposit insurance funds on a sound financial footing for the future, to produce capital from public and private sources to deal efficiently with failed financial institutions, and to heighten the enforcement powers of banking regulators.<sup>122</sup> However, while the provision's automatic assessment power may provide the much needed funding for the FDIC's deposit insurance funds, this Note will show that the FDIC's exercise of this power also constitutes a taking under the Fifth Amendment to the United States Constitution.<sup>123</sup>

Although the cross-guarantee provision allows the FDIC to recoup its losses for bailing out an insolvent depository institution, it goes too far. This abuse of power is illustrated in *Branch ex rel. Maine National Bank v. United States*.<sup>124</sup> *Branch* was the first case in which the FDIC exerted its cross-guarantee authority, by making an assessment against the Maine National Bank for reimbursement of deposit insurance funds paid for an affiliate's failure.<sup>125</sup>

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immediate payment of the amount of such institution's liability under paragraph (1) in connection with any commonly controlled insured depository institution.

*Id.*

121. 12 U.S.C. § 1815(e)(3) (1994).

(A) Judicial

Actions of the [Federal Deposit Insurance] Corporation shall be reviewable pursuant to chapter 7 of title 5.

(B) Administrative

The [Federal Deposit Insurance] Corporation shall prescribe regulations and establish administrative procedures which provide for a hearing on the record for the review of—

- (i) the amount of any loss incurred by the [Federal Deposit Insurance] Corporation in connection with any insured depository institution;
- (ii) the liability of individual commonly controlled depository institutions for the amount of such loss; and
- (iii) the schedule of payments to be made by such commonly controlled depository institutions.

*Id.*

122. H.R. REP. No. 54(I), *supra* note 3, at 307, *reprinted in* 1989 U.S.C.C.A.N. at 103.

123. *See infra* notes 288-335 and accompanying text.

124. 31 Fed. Cl. 626 (1994).

125. *Failure, supra* note 39, at 63.

### C. The FDIC's First Exercise of its Cross-Guarantee Power

A prime example of the government's broad discretionary powers under FIRREA is shown by the use of the cross-guarantee assessment power in the failure of the Bank of New England.<sup>126</sup> Due to the collapse of the New England real estate market in the late 1980s,<sup>127</sup> commercial banks, specifically the Bank of New England, found themselves struggling.<sup>128</sup> The economic downturn adversely affected virtually all New England banks, but it was particularly damaging for the Bank of New England which had aggressively pursued real estate financing prior to the collapse.<sup>129</sup> In one of the hearings held by the House Committee on Banking, Finance and Urban Affairs, Robert Clarke, Comptroller of the Currency, explained that, "concern over the continued deterioration in the Bank's condition led to a decision to involve the Office of the Comptroller of the Currency headquarters more directly in the day-to-day supervision" of the Bank of New England.<sup>130</sup> Even though the Office of the Comptroller of the Currency supervised the Bank of New England closely and attempted to remedy the problems, the bank continued to suffer losses throughout 1990.<sup>131</sup>

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126. Arlin, *supra* note 47, at 307-08. Failure of the Bank of New England is purported to be the third most costly loss to the FDIC's deposit insurance funds behind only the failures of Continental Illinois National Bank and First Republic Bank of Dallas. GART, *supra* note 3, at 161.

127. *Failure*, *supra* note 39, at 57. During the first half of the 1980s, much of the New England region experienced an economic boom fueled by growth in high-technology manufacturing industries. *Id.* One byproduct of the boom was a rapid escalation in commercial and residential real estate values. *Id.* The resulting increase in real estate construction served to augment and prolong the economic expansion of the New England economy. *Id.* In some areas, the commercial real estate was substantially over-built, resulting in large numbers of distressed properties. *Id.* The Bank of New England failed to adhere to sound credit underwriting standards or to maintain a properly diversified balance sheet; therefore, when the real estate market collapsed, the Bank of New England exposed itself to unsustainable losses. *Id.* at 58.

128. *Id.* By failing to adhere to sound credit underwriting standards or to maintain a properly diversified balance sheet, the Bank of New England (the subsidiary of the Bank of New England Corporation) exposed itself to disproportionate, and ultimately unsustainable, losses when the real estate market collapsed. *Id.*

129. Over 30% of the Bank of New England's loan portfolio was in commercial real estate. GART, *supra* note 3, at 161.

130. *Failure*, *supra* note 39, at 59. The Office of the Comptroller of the Currency's learned of the problems at the end of 1987. *Id.* at 58. Office of the Comptroller of the Currency presence at the Bank of New England was substantial, at times numbering as many as 150 examiners. *Id.*

131. *Failure*, *supra* note 39, at 62. Prior to declaring insolvency, the Bank of New England Corporation and its subsidiaries met with the Office of the Comptroller of the Currency examiners to report the results of operations for the fourth quarter of 1990, as well as the overall condition of the banks. *Id.* The representatives stated that the Bank of New England Corporation expected to post an operating loss of up to \$450 million of the fourth quarter and that a loss of that magnitude would exhaust the equity capital of both the Bank of New England and the parent corporation. *Id.* The Officer of the Comptroller of the Currency's examination team reviewed the data provided and determined that the Bank of New England's equity capital was indeed exhausted and declared it

On January 6, 1991, the Office of the Comptroller of the Currency formally declared the Bank of New England insolvent and appointed the FDIC receiver.<sup>132</sup> This event, in turn, triggered the insolvency of the two affiliated banks. While one of the Bank of New England's affiliates, Connecticut Bank and Trust Company, had failed because it was unable to recover the money it had loaned to its insolvent sibling institution,<sup>133</sup> the other affiliate, Maine National Bank, was forced to close as a direct result of the FDIC's demand for compensation under FIRREA's cross-guarantee provision.<sup>134</sup>

Section 1815(e)(1)(A) of FIRREA provides that an insured depository institution can be held liable for any loss which the FDIC anticipates it will incur in connection with the default of a commonly controlled insured depository institution.<sup>135</sup> The FDIC, after consulting with the Office of the Comptroller of the Currency, demanded immediate payment by the Maine National Bank of an amount equal to the FDIC's expected loss as receiver for the Bank of New England.<sup>136</sup> When the Maine National Bank responded that it was unable to make the payment, the Office of the Comptroller of the Currency declared the Maine National Bank insolvent and placed it in receivership as well.<sup>137</sup> This marked the first time that the cross-guarantee provision was asserted, and a once viable institution was made insolvent.<sup>138</sup>

After the Office of the Comptroller of the Currency closed the three banks, the FDIC established three bridge banks to assume the assets and liabilities of the three insolvent banks.<sup>139</sup> Bridge banks are chartered by the Office of the Comptroller of the Currency, are totally owned by the FDIC, and are originally authorized by the Competitive Equality Banking Act of 1987<sup>140</sup> as a means of continuing the operation of an insolvent bank, while a more permanent solution

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insolvent. *Id.* at 62-63.

132. *Failure, supra* note 39, at 63. By statute, the FDIC is the receiver for all national banks. See 12 U.S.C. § 1821(c) (1994). Although a state is free to name a receiver other than the FDIC for state-chartered banks, such appointments are unusual. See Jonathan R. Macey & Geoffrey P. Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1173 & n.75 (1988).

133. *Failure, supra* note 39, at 63.

134. *Id.* See also Arlin, *supra* note 47, at 308-09.

135. 12 U.S.C. § 1815(e)(1)(A) (1994). See *supra* note 19.

136. *Failure, supra* note 39, at 63.

137. *Id.*

138. *Branch*, 31 Fed. Cl. 626, 628-29 (1994).

139. *Failure, supra* note 39, at 65.

140. 12 U.S.C. § 1821(i) (1988) (amended 1989).



is developed.<sup>141</sup> The three bridge banks were capitalized by the FDIC and opened for business on January 7, 1991.<sup>142</sup>

After Maine National Bank was declared insolvent, the Bank of New England Corporation was forced to file for bankruptcy.<sup>143</sup> Dr. Branch, the Chapter 7 Trustee of the Estate of the Bank of New England Corporation, filed a derivative suit on behalf of Maine National Bank, a wholly owned subsidiary of the Bank of New England Corporation.<sup>144</sup> The suit was filed against the United States, arguing that the FDIC's use of the cross-guarantee authority amounted to a taking under the Takings Clause of the Fifth Amendment to the United States Constitution.<sup>145</sup> Dr. Branch alleged that when the FDIC forced the failure of Maine National Bank and seized the bank's assets, the FDIC took Maine National Bank's property for a public purpose without just compensation.<sup>146</sup> Judge Christine Cook Nettlesheim, in writing the opinion for the United States Court of Federal Claims, denied cross-summary judgment motions and reasoned that the result of the takings question rested heavily on whether the bank holding company adhered to the corporate form or used the corporation as a veil for fraudulent business.<sup>147</sup> The parties agreed during the summary judgment hearing, however, that the Bank of New England's collapse was not caused by fraud, misconduct, or disregard of the separate corporate

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141. Under FIRREA, the new bridge banks represent a substantive revision of prior law. Gail & Norton, *supra* note 4, at 1148-49. First, before FIRREA the FDIC could not establish a bridge bank until an insured bank was closed. 12 U.S.C. § 1821(i)(1)(1988) (amended 1989). Now, the FDIC may organize a bridge bank when an insured bank is in default or when the FDIC anticipates that an insured bank may become in default. *Id.* § 1821(n)(1)(A)(1994). Second, the FDIC may transfer the assets and liabilities of a bank in default without judicial approval. *Id.* § 1821(n)(3)(A)(iv). Third, under prior law a bridge bank's existence could be extended for one year. *Id.* § 1821(i)(10)(B) (1988) (amended 1989). Now, the FDIC may extend the life of a bridge bank for three additional one-year periods. *Id.* § 1821(n)(9) (1994).

142. *Failure*, *supra* note 39, at 65. The FDIC agreed to provide assistance to facilitate the acquisition by qualified institutions. *Id.* The Bank of Boston, Fleet, and BankAmerica made bids for the failed institution, which was eventually awarded to Fleet and its partner, Kohlberg, Kravis Roberts & Co., an investment firm specializing in buy-outs and takeovers. GART, *supra* note 3, at 162.

143. Branch *ex rel.* Maine Nat'l Bank v. United States, 31 Fed. Cl. 626, 629 (1994).

144. *Id.* at 628. Maine National Bank was a national banking association established in 1889. *Id.* In 1985, Maine National Bank was acquired by the Bank of New England Corporation, a bank holding company that owned a number of other subsidiary banks, including the Bank of New England, and the Connecticut Bank and Trust Co. *Id.*

145. *Id.* at 629. See also *Pay Up*, *supra* note 43, at 164-65. As of this printing, the U.S. Court of Appeals for the Federal Circuit granted the United States an interlocutory appeal by deciding that the case was one involving a controlling question of law for which there was substantial ground for difference of opinion and that an immediate appeal could materially advance the ultimate determination of the litigation. United States v. Branch, 1994 U.S. App. LEXIS 33273, \*1-2 (Fed. Cir. Nov. 18, 1994).

146. Branch, 31 Fed. Cl. at 629.

147. *Id.* at 637. See also *Pay Up*, *supra* note 43, at 164.

forms by the Bank of New England Corporation.<sup>148</sup> Furthermore, no allegation was raised that Bank of New England was used as a shelter for bad loans, as was the general fear prior to the passage of FIRREA.<sup>149</sup>

At the time of the cross-guarantee assessment, L. William Seidman, then Chairman of the FDIC, readily acknowledged that the FDIC deliberately used the cross-guarantee provision to fail the Maine National Bank which was otherwise financially sound.<sup>150</sup> During the hearing for summary judgment, Judge Nettlesheim stated that before January 5, 1991, the Maine National Bank was a viable institution with a profitable business that held assets which exceeded its liabilities by roughly \$65 million.<sup>151</sup> On January 6, 1991, the Maine National Bank was no longer in existence. This stark contrast was the direct result of the FDIC's exercise of its cross-guarantee power.<sup>152</sup> Moreover, the FDIC's exercise of the cross-guarantee assessment provision ignores the corporate form, forces liability on solvent banking corporations, and punishes them for the faults of their affiliate banking corporations.

### III. IGNORING THE CORPORATE FORM: THE CROSS-GUARANTEE PROVISION AS A TAKING

#### A. *The Doctrine of Corporate Separateness*

A fundamental concept of corporation law is that corporations are separate legal entities.<sup>153</sup> As separate legal entities, corporations enjoy limited liability

148. *Branch*, 31 Fed. Cl. at 629 n.1. The United States asserted at oral argument that under FIRREA, the factors of fraud, misconduct, and disregard of the separate corporate forms are irrelevant for purposes of the cross-guarantee provision. *Id.* (citing Transcript of Proceedings, *Branch v. United States*, No. 93-133C, at 42 (Fed. Cl. June 17, 1994)).

149. *Id.* at 629 n.1. See *supra* notes 63-94 and accompanying text (discussing purposes behind FIRREA's enactment).

150. *The Failure of the Bank of New England: Hearings Before the Senate Comm. on Banking Housing and Urban Affairs*, 102d Cong., 1st Sess. 26 (1991) (statement of L. William Seidman, former Chairman of the Federal Deposit Insurance Corporation). "[The FDIC] for the first time, used the cross-guarantee authority to, in effect, fail the Maine National Bank, which was otherwise in sound financial condition. This was done in order to bring all the banks under [the FDIC's] control at one time thereby allowing us to preserve franchise value to stabilize the entire system and to be able to sell the entire Bank of New England holding company banks to one purchaser . . . ." *Id.*

151. *Branch*, 31 Fed. Cl. at 631.

152. *Id.*

153. *Krivo Indus. Supply Co. v. National Distillers & Chem. Corp.*, 483 F.2d 1098, 1102, modified on different grounds, 490 F.2d 916 (5th Cir. 1974); W. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 5, 14 (perm. ed. rev. vol. 1990); 18 C.J.S. *Corporations* §§ 8, 414 (1990); 18 AM. JUR. 2D *Corporations* § 1 (1985). A corporation is "an artificial juridical person," which can sue and be sued, make contracts, buy, hold, and sell real estate, and has the "capacity of perpetual succession." *Id.*

from each other's actions or debts.<sup>154</sup> A judicially imposed exception to the concept of limited liability is the "piercing the corporate veil" doctrine.<sup>155</sup> Piercing the corporate veil involves the imposition of liability on one affiliate of a bank holding company system for actions of another affiliate arising in contract, tort, or property rights cases.<sup>156</sup> Under this doctrine, the imposition of liability upon one subsidiary of a bank holding company for the torts or contracts of an affiliate rests on a disregard for the separate corporate entity status of the two corporations.<sup>157</sup> Courts that apply the veil-piercing doctrine start with the premise that entity law<sup>158</sup> governs corporate structures, and entity law exists to serve the fundamental principle underlying the corporate system, that of limited liability.<sup>159</sup> Courts hold that limited liability for corporations and their shareholders is the general rule, not the exception.<sup>160</sup> It is on this assumption that large ventures are rested, vast enterprises are launched, and huge sums of capital attracted.<sup>161</sup> Therefore, courts are reluctant to disregard the entity, except in rare cases.<sup>162</sup>

These rare cases occur when the subsidiary in question has been so dominated and controlled by the parent corporation that the court concludes it

154. PHILLIP I. BLUMBERG, *THE LAW OF CORPORATE GROUPS: TORT, CONTRACT, AND OTHER COMMON LAW PROBLEMS IN THE SUBSTANTIVE LAW OF PARENT AND SUBSIDIARY CORPORATIONS*, § 6.01, at 106 (1987). The idea of a corporation as a separate and distinct legal entity led to the doctrine of limited liability. *Id.* at 7. Limited liability is "the rule that shareholders are not liable for the obligations of the corporation beyond their capital investment." *Id.* The liability of shareholders may arise two different ways: (1) direct liability for obligations of the corporation; and (2) indirect liability for funds required to pay obligations of assessments made against the corporation. *Id.* at 7 n.1. See generally LIMITED LIABILITY AND THE CORPORATION (T. Ornhial ed. 1982); Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985); Halpern et al., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117 (1980); Meiners et al., *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351 (1979).

155. BLUMBERG, *supra* note 154, § 6.01, at 106. Commentators have created several labels for the doctrine of disregarding the corporate entity. See HENRY W. BALLANTINE, *BALLANTINE ON CORPORATIONS* § 122 (1946). The metaphor most frequently used is "piercing the corporate veil."

156. BLUMBERG, *supra* note 154, § 6.01, at 105-06. Although different fact situations involve varying policy considerations, part of the problem with veil-piercing results from the indiscriminate application of veil-piercing theory to different problems. *Id.* § 6.10, at 136.

157. *Id.* § 6.01, at 106.

158. Entity law is "the concept that a corporation is a separate legal person with its own rights and obligations, distinct from those of its shareholders." *Id.* § 1.02, at 7.

159. *Id.* § 6.01, at 106.

160. *Anderson v. Abbott*, 321 U.S. 349, 362 (1944).

161. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1041 (1991).

162. *Perpetual Real Estate Servs., Inc. v. Michaelson Properties, Inc.*, 974 F.2d 545 (4th Cir. 1992); *Pennsylvania Eng'g Corp. v. Islip Resource Recovery Agency*, 710 F. Supp. 456 (E.D.N.Y. 1989); *Salem Tent & Awning Co. v. Schmidt*, 719 P.2d 899 (Or. Ct. App. 1986); *But see, Baldwin v. Matthew R. White Invs., Inc.*, 669 F. Supp. 1054 (D. Utah 1987).

is a "mere instrumentality" or "alter ego" of the parent.<sup>163</sup> A corporation such as this is said to have no separate mind or existence of its own.<sup>164</sup> Since courts conclude that such a corporation lacks a separate corporate existence, its veil is pierced.<sup>165</sup> As corporations stand within a holding company structure, they are not liable for the debts of another corporation.<sup>166</sup> If the veil is pierced, then corporations can be held liable for each other's debts. Nevertheless, courts are reluctant to pierce the corporate veil, and the trend is moving away from veil-piercing, especially in contracts cases.<sup>167</sup>

The problem with the veil-piercing doctrine is that the standards used to pierce the corporate veil differ in each jurisdiction.<sup>168</sup> The courts apply many different factors and tests when reviewing veil-piercing cases across the states.<sup>169</sup> Some states use the "instrumentality" doctrine; others use the so called "alter ego" theory; and still others select between a third theory which is a variation of the two.<sup>170</sup> Even so, piercing the corporate veil jurisprudence really has two main doctrines, which most courts regard as interchangeable: (1) the instrumentality doctrine; and (2) the alter ego doctrine.<sup>171</sup>

The instrumentality doctrine was created by Frederick Powell in 1931<sup>172</sup> and was adopted in *Lowendahl v. Baltimore & Ohio Railroad*.<sup>173</sup> *Lowendahl*

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163. BLUMBERG, *supra* note 154, § 6.01, at 106-07.

164. See *Lowendahl v. Baltimore & O.R.R.* 247 A.D. 144, 157, *aff'd*, 6 N.E.2d 56 (N.Y. 1936).

165. BLUMBERG, *supra* note 154, § 6.01, at 107.

166. W. FLETCHER, *supra* note 153, § 41.10.

167. BLUMBERG, *supra* note 154, § 6.03. W. FLETCHER, *supra* note 153, § 41.30, at 662, 664. For a survey of cases and percentages on how often the corporate veil is pierced, see Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1046-64 (1991).

168. See generally STEPHEN B. PRESSER, *PIERCING THE CORPORATE VEIL* (1991) (providing a state by state analysis of precedents relating to piercing the corporate veil). See also Michael J. Gaertner, Note, *Reverse Piercing the Corporate Veil: Should Corporate Owners Have it Both Ways?* 30 WM. & MARY L. REV. 667 (1989). "Courts generally have contributed little toward developing a coherent set of principles to govern corporate veil-piercing theory. . . . No universal test or theory to determine the propriety of piercing the corporate veil exists. . . . [T]he various veil-piercing theories . . . suffer[] from a number of inadequacies." *Id.* at 677-79. The choice of law for any particular corporation is the application of local law in the state of incorporation. Gaertner, *supra*, at 668.

169. *Id.*

170. BLUMBERG, *supra* note 154, § 6.01, at 111.

171. *Id.* § 6.01, at 111.

172. FREDERICK POWELL, *PARENT AND SUBSIDIARY CORPORATIONS* § 3 (1931).

173. 287 N.Y.S. 62, 78-81 (N.Y. App. Div. 1936), *aff'd*, 6 N.E.2d 56 (N.Y. 1936). The *Lowendahl* test states that one corporation will be liable for the acts of another only when it controls the subservient corporation and uses its control to cause harm through fraud or wrongdoing. *Id.* Courts are reluctant to ignore the corporate form and in general will do so only when the facts of a case satisfy some version of the *Lowendahl* test. See generally Cathy S. Krendl & James R.

outlines three elements within the instrumentality doctrine: excessive exercise of control; wrongful or inequitable conduct; and causal relationship to the plaintiff's loss.<sup>174</sup> Of these three elements, the threshold question is whether the parent corporation exercised dominion and control over the subsidiary such that the subsidiary was merely an instrumentality of the parent.<sup>175</sup> Some jurisdictions say that a showing of total domination by itself is enough to pierce the corporate veil,<sup>176</sup> while still other jurisdictions will not impose liability simply on control alone.<sup>177</sup> If a corporation acts in total control over another corporation, it is not acting as a separate corporation and should therefore be liable for the other's actions.<sup>178</sup> When determining whether a corporation controls another corporation, courts often consider several factors such as: (1)

Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENV. L. J. 1, 11-12 (1978) (discussing *Lowendahl* and courts' subsequent treatment of the test).

174. *Lowendahl*, 287 N.Y.S. at 76.

175. BLUMBERG, *supra* note 154, § 6.02, at 115; W. FLETCHER, *supra* note 153, § 43.10 (defining "dominion and control" as "[c]ontrol, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own"). It is important to note that a parent corporation will not be held derivatively liable merely because it owns all of the stock of the corporation or because no evidence exists that preserving the corporate form would perpetuate a fraud or otherwise be unfair. *Agristor Credit Corp. v. Schmidlin*, 601 F. Supp. 1307 (D. Or. 1985); *Bowling v. Jack B. Parson Co.*, 793 P.2d 703 (Idaho 1990); *Carroll v. Smith-Henry, Inc.*, 313 S.E.2d 649 (S.C. Ct. App. 1984); *Henry W. Ballantine, Separate Entity of Parent and Subsidiary Corporations*, 14 CAL. L. REV. 12, 17-20 (1925).

176. BLUMBERG, *supra* note 154, § 9.03.1, at 178.

177. Thompson, *supra* note 167, at 1063-64.

178. Since control is the most ambiguous element of the instrumentality doctrine, courts often consider 11 individual factors in determining the degrees of control exercised by the parent. These factors are as follows:

- (1) The parent corporation owns all or most of the stock of the subsidiary.
- (2) The parent and subsidiary corporations have common officers and directors.
- (3) The parent corporation finances the subsidiary.
- (4) The parent corporation subscribes to all of the capital stock of the subsidiary or otherwise causes its incorporation.
- (5) The subsidiary has grossly inadequate capital.
- (6) The parent corporation pays the salaries and other expenses or losses of the subsidiary.
- (7) The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed by the parent corporation.
- (8) In the papers of the parent corporation or in the statements of its officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own.
- (9) The parent corporation uses the property of the subsidiary as its own.
- (10) The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest.
- (11) The formal legal requirements of the subsidiary are not observed.

The courts most frequently derive or quote these factors from a treatise by Professor Frederick Powell. See POWELL, *supra* note 172, § 6, at 8-9.

intrusive exercise of control; (2) extensive economic integration; (3) utilization of a public group persona; (4) financial dependence on the group; (5) administrative dependence on the group; (6) manipulation of corporate assets; (7) inadequate capitalization; and (8) lack of compliance with corporate formalities.<sup>179</sup>

Although there are several relevant factors that courts use in analyzing whether to pierce the corporate veil, no single factor is dispositive.<sup>180</sup> Undercapitalization or inadequate capitalization is a factor commonly considered when courts are addressing the veil-piercing doctrine.<sup>181</sup> However, undercapitalization alone usually will not suffice to generate derivative liability.<sup>182</sup> Courts that use the three-factor instrumentality rule often require some further showing of "wrongful" or "unequitable" conduct.<sup>183</sup> The second and third elements appear both within the instrumentality and alter ego doctrines.<sup>184</sup> If a certain combination of these factors are not present, the first element of the instrumentality rule and, thus, the whole test fails.<sup>185</sup> Generally, courts look at several factors to assess control and to determine whether the court may pierce the corporate veil. If a court finds that the subsidiary was in fact under the dominion of the parent, the court then proceeds to the second and third elements of the rule: wrongful conduct and causal relationship to the plaintiff's loss.<sup>186</sup>

The second and third elements further assist courts in determining whether to pierce the corporate veil. The second element of the instrumentality rule requires a claimant to show that the parent, acting through its subsidiary, committed a fraud, breach of duty, or some other wrong.<sup>187</sup> Fraud may come in the form of shifting assets, mismanagement, or insider abuse.<sup>188</sup> Since the courts are reluctant to pierce the corporate veil, courts will disregard the

179. BLUMBERG, *supra* note 154, § 10.01, at 186.

180. Boyce L. Graham, *Navigating the Mists of Metaphor: An Examination of the Doctrine of Piercing the Corporate Veil*, 56 J. AIR L. & COM. 1135, 1139 (1991).

181. Thompson, *supra* note 167, at 1065.

182. *Simmons v. Clark Equip. Credit Corp.*, 554 So. 2d 398, 399 (Ala. 1989); *Walkovszky v. Carlton*, 223 N.E.2d 6, 9-10 (N.Y. 1966). *But see* Phillippe M. Salomon, Comment, *Limited Liability: A Definitive Judicial Standard for the Inadequate Capitalization Problem*, 47 TEMP. L.Q. 321, 328-51 (1974) (arguing that undercapitalization alone should be sufficient to impose derivative liability).

183. BLUMBERG, *supra* note 154, § 7.01, at 140.

184. *Id.* § 9.02, at 168.

185. Graham, *supra* note 180, at 1140.

186. BLUMBERG, *supra* note 154, § 9.02.1, at 170-71.

187. 1 W. FLETCHER, *supra* note 153, § 43.10, at 758. "Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or dishonest and unjust act in contravention of plaintiff's legal rights . . ." *Id.*

188. BLUMBERG, *supra* note 154 § 6.03, at 120.

corporate entity only when justice requires such a step in order to remedy an actionable wrong.<sup>189</sup> If the court finds that one corporation, through dominion over another corporation, committed some act of fraud, then the court moves to the third question of whether the wrong caused the plaintiff's loss. The third element of the instrumentality doctrine requires the claimant to show that the parent's fraud or other wrong, perpetrated through its subsidiary, proximately caused the claimant's injury or loss.<sup>190</sup> When the claimant establishes all three elements, the court will disregard the corporate entity of the two corporations to prevent the ongoing fraud, contravention of public policy, or other inequitable result.<sup>191</sup>

Another widely accepted standard the courts use in deciding disregard of the corporate entity cases is the "alter ego" theory.<sup>192</sup> The alter ego theory and the instrumentality doctrine are functionally interchangeable, in that a claimant must prove the same three elements of the instrumentality doctrine for the court to disregard the corporate entity.<sup>193</sup> The difference is that the instrumentality doctrine uses one corporation as an instrument of the other. In the alter ego theory the two corporations appear as one entity, so much so that they lose their separate identities. The alter ego theory holds that "piercing the veil" is only proper when a unity of ownership and interest exists so that the two affiliated corporations cease to be separate and the subsidiary is relegated to the status of the alter ego of the parent.<sup>194</sup> Again, the first step for the court is the control test, to see if one corporation acted with dominion and control over one of its affiliates.<sup>195</sup> The claimant satisfies the control test in the alter ego theory when it can show such a substantial identity of interest that one corporation does not have a personality separate from its affiliates or owners.<sup>196</sup> The second and third elements of the alter ego theory require proof of fraud, and whether the fraudulent conduct had a causal relationship to

189. *United States v. Milwaukee Refrigerator Transit Co.*, 142 F. 247, 255 (C.C.E.D. Wis. 1905). "[W]hen the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons." *Id.* at 255; 1 W. FLETCHER, *supra* note 153, § 41, at 602-03.

190. 1 W. FLETCHER, *supra* note 153, § 43.10 at 759. "The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of." *Id.*

191. *Id.*

192. *E.g.*, *Sea-Land Servs., Inc. v. Pepper Source*, 993 F.2d 1309 (7th Cir. 1993); *Wegerer v. First Commodity Corp.*, 744 F.2d 719 (10th Cir. 1984); *Talen's Landing, Inc. v. M/V Venture, II, Etc.*, 656 F.2d 1157, 1160 (5th Cir. 1981). See Note, *Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 HARV. L. REV. 853 (1982); Antoinette Sedillo Lopez, Comment, *The Alter Ego Doctrine: Alternative Challenges to the Corporate Form*, 30 UCLA L. REV. 129 (1982).

193. BLUMBERG, *supra* note 154, § 6.03., at 120.

194. *Id.* § 6.03, at 118.

195. *Id.* § 6.03, at 118-19.

196. 1 W. FLETCHER, *supra* note 153, § 41.10, at 614-17.

the plaintiff's loss.<sup>197</sup> Thus, the courts apply the alter ego doctrine when continued recognition of the separate corporate entity would promote or protect fraud or injustice.<sup>198</sup>

Courts are reluctant to ignore the corporate form, especially in the banking industry.<sup>199</sup> This reluctance is due to the excessive regulations, extensive examinations, and the required disclosure of transactions from bank holding companies to government agencies.<sup>200</sup> All of these restrictions decrease the likelihood of courts finding that banks control other entities or use such control to commit fraud.<sup>201</sup> In addition, the cross-guarantee provision attempts to make a subsidiary control a sister subsidiary, which is harder to prove than a parent's control over its subsidiary.<sup>202</sup>

The cross-guarantee provision is in contradiction to the traditional corporate law concept of separateness by allowing the FDIC to force an affiliate to bail out another affiliate.<sup>203</sup> By exercising its cross-guarantee power without first

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197. BLUMBERG, *supra* note 154, § 6.03, at 122.

198. 1 W. FLETCHER, *supra* note 153, § 41.10, at 615; *see also* 18 C.J.S. *Corporations* § 9 (1990).

199. Note, *The Demise of the Bank/Nonbank Distinction: An Argument for Deregulating the Activities of Bank Holding Companies*, 98 HARV. L. REV. 650, 661 (1985) [hereinafter *Demise*].

200. *Id.*

201. *See* Robert Charles Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 789, 833-34 (1979) (discussing the weakness of the veil-piercing argument in the banking industry).

202. *Demise*, *supra* note 199, at 661-62. *See generally* 1 W. FLETCHER, *supra* note 153, § 43.60, at 781 ("It is rarely the case that the principal may be regarded as the subsidiary's agent so that the subsidiary is liable on the principal's contract.").

203. The language of FIRREA specifies that funds seized pursuant to the cross-guarantee power are to be transferred directly to the FDIC; the FDIC does not force the sibling institution to inject its failed sibling directly with capital. 12 U.S.C. § 1815(e) (1994). Rather, the "insured depository institution shall pay the amount of any liability to the [Federal Deposit Insurance] Corporation . . . upon receipt of written notice by the Corporation . . . ." 12 U.S.C. § 1815(e)(1)(B)(1994). If the liability incurred under the provision extended to the sibling institution itself, it would be necessary to determine whether the FDIC had the power to "pierce the corporate veil" between the two sibling corporations. The law of piercing the corporate veil is complex, but the general rule is that the law will recognize the separateness of corporate entities in the absence of a showing that the corporation is a "sham" or is set up for fraudulent purposes. HARRY G. HENN & JOHN R. ALEXANDER, *LAW OF CORPORATIONS* 346 (1983). With a few exceptions, corporate separateness, and the positive and negative attributes of that status, will nearly always be recognized:

If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.

*United States v. Milwaukee Refrigerator Transit Co.*, 142 F. 247, 255 (C.C.E.D. Wis. 1905). The standard for judging whether affiliated corporations (those with parent-subsidiary or sibling relationships) will be regarded as separate entities is the same as for other corporations:



proving fraud or wrongdoing prior to making an assessment, the FDIC is ignoring the traditional corporate law concept of separateness and limited liability.<sup>204</sup>

When a bank holding corporation operates as separate corporate organizations, then the FDIC, by exercising its cross-guarantee power, may not force a corporation to pay for the debts of another corporation. By making an assessment that exceeds a solvent bank's capital, and subsequently taking possession of all its assets the FDIC engages in a compensable taking under the Fifth Amendment.<sup>205</sup> If, however, the bank holding company simply uses the corporate structure as a veil or sham for other fraudulent business, then the FDIC may simply pierce that fiction and level a financial assessment which, though fatal to the bank, does not require compensation.<sup>206</sup>

This Note argues that by making a cross-guarantee assessment, the FDIC essentially pierces the bank holding company's corporate veil without adhering to traditional corporate law.<sup>207</sup> To pierce the corporate veil under corporate law, the FDIC must prove the corporation had control over the other corporation, and secondly, used this control to perpetuate fraud.<sup>208</sup> Once proven, the veil has been pierced and the FDIC may proceed with making the cross-guarantee assessment. After it has made the assessment, if the commonly controlled depository institution cannot pay the assessed amount, only then may the FDIC seize the assessed bank's assets and sell them for profit to satisfy the debt.<sup>209</sup> If the FDIC makes an assessment and seizes the assessed bank's assets, in complete disregard for traditional corporate law, it results in a taking under the Fifth Amendment.<sup>210</sup>

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Separate corporateness of subsidiary and other affiliated corporations will be recognized, in the absence of illegitimate purposes, where

- (a) their respective business transactions, accounts, and records are not intermingled;
- (b) the formalities of separate corporate procedures for each corporation are observed;
- (c) each corporation is adequately financed as a separate unit . . . ; and
- (d) the respective enterprises are held out to the public as separate enterprises.

HENN & ALEXANDER, *supra* at 354-55. For a survey of corporate veil-piercing theory, see Gaertner, *supra* note 168, at 667-81.

204. Gaertner, *supra* note 168, at 667. (discussing general separateness theory).

205. *Pay Up*, *supra* note 43, at 164.

206. *Id.*

207. *See infra* notes 336-67 and accompanying text.

208. BLUMBERG, *supra* note 154, § 6.01-.10, at 105-36.

209. *See supra* notes 95-124 and accompanying text.

210. *See infra* notes 288-335 and accompanying text.

*B. A Review of "Takings" Jurisprudence*

The Fifth Amendment provides that private property may not be "taken" by the federal government without just compensation.<sup>211</sup> Although the concept of a taking may originally have contemplated only physical appropriation of property by the government,<sup>212</sup> non-acquisitive governmental action may amount to a taking in a constitutional sense.<sup>213</sup> A taking, therefore, may be found when governmental activity results in significant physical damage to property that impairs its use.<sup>214</sup> Although the state possesses the power to regulate property without compensation, if the regulation goes too far a taking may be found.<sup>215</sup> When a regulation does not amount to a permanent physical occupation but nonetheless interferes with property rights, a case-by-case approach is used to determine whether the government action constitutes a taking.<sup>216</sup> Furthermore, a taking may occur as to an intangible property interest,<sup>217</sup> where the owner had a reasonable expectation that the government would not use such property and such expectation was impaired.<sup>218</sup>

211. See *supra* note 25 (discussing the Fifth and Fourteenth Amendments).

"The entire logic of the takings clause, and many of the other specific constitutional guarantees in our constitution (protection of contracts, the free exercise of religion, the guarantees of due process) are efforts to delineate the appropriate limits of that most fundamental, most necessary, and most dangerous of government powers: the power to take."

RICHARD A. EPSTEIN, *BARGAINING WITH THE STATE* 3 (1993). The just compensation clause of the Fifth Amendment was built upon the concept of a moral obligation to pay for governmental interference with private property. JOHN E. NOWAK & RONALD D. ROTUNDA, *CONSTITUTIONAL LAW* § 11.11, at 424 (4th ed. 1991).

212. FRED BOSSELMAN ET. AL., *THE TAKING ISSUE* 51 (1973); *Kaiser Aetna v. United States*, 444 U.S. 164 (1979); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982); *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987).

213. See, e.g., *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922); *United States v. Causby*, 328 U.S. 256 (1946). See generally Gregory Gelfand, *'Taking' Informational Property Through Discovery*, 66 WASH. U. L.Q. 703 (1988); RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985).

214. *Pumpelly v. Green Bay Co.*, 80 U.S. (13 Wall.) 166, 179-80 (1871). In *Pumpelly*, the Supreme Court of the United States was required to interpret the "taking" clause of a state constitution and it found that a serious interruption in the use of property might be the equivalent of a taking, so that the flooding of land by a government dam would be a "taking." *Id.*

215. *Pennsylvania Coal*, 260 U.S. at 415.

216. *PruneYard Shopping Ctr. v. Robins*, 447 U.S. 74, 83 (1980). Factors to be considered in determining regulatory takings include: "the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations." *Id.*

217. 2 RONALD D. ROTUNDA & JOHN E. NOWAK, *TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE* 486 n.4 (2d ed. 1992).

218. *Id.* "Intangibles, such as trade secrets, and other nontraditional types of property may be protected by the taking clause of the fifth amendment." *Id.* "The existence of the property right will be determined with reference to state law." *Id.* "Once it has been determined that a property interest exists in an intangible, the Court will inquire whether the holder of the interest had a reasonable investment-backed expectation that the property right would be protected." *Id.* "If the

The first step in takings analysis is to identify a property right that has been infringed upon.<sup>219</sup> Second, since property rights are formulated as interests as well as real property,<sup>220</sup> any right in property must be grounded in the property owners' legitimate expectations about what interests the law will protect.<sup>221</sup> Takings are manifested by the property owner's deprivation of a property interest, rather than by the sovereign's gain of such right or interest.<sup>222</sup> In a particular takings context, then, the third crucial issue is whether the expectations of the property owner are legitimate.<sup>223</sup> If the property owner has legitimate expectations that the property will be protected from unwarranted governmental intrusion, but the government takes the property anyway, then a taking has occurred that requires compensation by the government.<sup>224</sup> Although the government may compensate the owner and take private property, the property must be taken for a public use.<sup>225</sup> The only time the government may take property without compensating the owner is when it is in furtherance of a public good.<sup>226</sup> However, even if the government takes property under the guise of serving the public good, the government may not wipe out all of the property owner's interests, or permanently invade the

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Court finds such a reasonable investment backed expectation, the Court will determine whether governmental action impaired that expectation." *Id.* If so, the Court will find that a compensable taking has occurred. *Id.* See *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005 (1984).

219. Jerry L. Anderson, *Takings and Expectations: Toward a "Broader Vision" of Property Rights*, 37 KAN. L. REV. 529, 529 (1989).

220. William B. Stoebuck, *Police Power, Takings, and Due Process*, 37 WASH. & LEE L. REV. 1057, 1086 (1980). Property rights in physical things can be described as the rights "to possess, use and dispose" of such things. *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945); see also *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (describing types of invasions of property interest). When the government occupies property, the owner cannot use or possess his own property, nor can he exclude the occupiers from using or possessing the property. *Id.* Such power of exclusion is traditionally considered one of the most valuable aspects of an owner's collection of property rights. *Id.*; see *Kaiser Aetna v. United States*, 444 U.S. 164, 179-80 (1979) (holding that "right to exclude" cannot be taken by government without just compensation).

221. Anderson, *supra* note 219, at 529.

222. See, e.g., *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 516 (1987) (noting that property owner's loss rather than government's direct benefit is the standard for determining whether a taking occurred).

223. *Id.*

224. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984).

225. See Comment, *The Public Use Limitation on Eminent Domain: An Advance Requiem*, 58 YALE L.J. 599, 602-03 (1949).

226. See *Berman v. Parker*, 348 U.S. 26 (1954). The Court held that the public use limitation is met whenever eminent domain is exercised by the federal government as a means of realizing any object within its authority, and the purpose of the action is for the benefit of the health, safety and welfare of its citizens. *Id.* at 35. See also *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229 (1984). In *Hawaii*, the Court stated that so long as the government is willing to pay fair market value for the property interest taken, the governmental act should be upheld whenever it is rationally related to a conceivable public purpose. *Id.* at 243-245.

property, without fully compensating the owner for the loss.<sup>227</sup> Even governmental action short of occupancy or an acquisition of title, which deprives an owner of all or substantially all of the interest in the property, may constitute a taking.<sup>228</sup>

The current Supreme Court has recognized those regulations where the government authorizes physical invasion of property or actually takes title as a separate category of takings.<sup>229</sup> In the case of a physical invasion of property, the property owner is compensable without any case-specific inquiry into the public interest fostered in support of the taking.<sup>230</sup> In physical invasion takings cases, the Court applies a clear rule that requires the government to pay compensation to burdened landowners.<sup>231</sup> Although courts claim the physical invasion cases are clear *per se* takings, as the cases have shown, it may be difficult to determine when a transfer of property rights has taken place.<sup>232</sup>

The evolution of the clear *per se*<sup>233</sup> takings rule for physical invasions

227. See *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 433; *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2895 (1992); *contra Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 225 (1986); *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978).

228. See *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 516 (1987) (noting the Court's recognition that a taking may occur absent physical possession or occupation); *United States v. Causby*, 328 U.S. 256, 261 (1946) (holding that governmental action without physical invasion of property was a loss as complete as if the government took exclusive possession of property); see also *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2895 (1992) (finding that owner of property left economically idle suffers a taking); Frank Michelman, *Takings, 1987*, 88 COLUM. L. REV. 1600, 1607 (1988) (declaring that regulations failing to meet means-end appraisal of serving legitimate governmental purpose are takings requiring payment of compensation); Joseph L. Sax, *Takings, Private Property and Public Rights*, 81 YALE L.J. 149, 156 (1971) (noting that governmental action rendering private right worthless is taking of property warranting just compensation).

229. *Yee v. City of Escondido*, 503 U.S. 519 (1992).

230. *Lucas*, 112 S. Ct. at 2893; see also *Loretto*, 458 U.S. at 434-35 ("[W]hen the 'character of the governmental action' . . . is a permanent physical occupation of property, our cases uniformly have found a taking to the extent of the occupation, without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner.").

231. *Loretto*, 458 U.S. at 435.

232. For example, in *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987), the Court held that a state law restricting the previously lawful mining of coal by owners of mineral rights that might cause subsidence damage to the surface property owned by other persons was not a taking of property. *Id.* at 485. Cf. *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987). In *Nollan*, the Court ruled that a construction permit to expand an ocean front house that would have required the owners of the house to grant a public easement across their property was a taking of property for which compensation was due. *Id.* at 831-34.

233. *Loretto*, 458 U.S. at 433. A physical invasion does not effect a *per se* taking unless the invasion is permanent. *Id.*

began with *Kaiser Aetna v. United States*.<sup>234</sup> In *Kaiser*, the Court held that the application of the federal navigational servitude to a lagoon on the island of Oahu constituted a taking for which compensation was required.<sup>235</sup> The Court reasoned that even though Congress did have the power to assure public access and had an interest in maintaining free access to interstate waters, Congress could not freely authorize public trespass onto what remained private property.<sup>236</sup> The Court in *Kaiser* found a taking by focusing upon the most integral property right, the bundle of property rights commonly characterized as the right to exclude others.<sup>237</sup> By characterizing the right of the landowner to keep its property free from uninvited public visitors as a fundamental element of property ownership, the Court decided that compensation was due for any encroachment by the public on this right of exclusivity, even if sanctioned by the government.<sup>238</sup> The Court held that the government could not simply convert private property into public property without paying just compensation.<sup>239</sup>

From the decision in *Kaiser*, where physical invasion by the government created a weighty presumption in favor of compensation in order to protect a landowner's right to exclude, the Court created a *per se* rule for physical

234. 444 U.S. 164 (1979). In *Kaiser*, a development company challenged as a taking the federal government's proposed opening, under its regulatory powers, of a private marina to the public. *Id.*

235. *Id.* at 180.

236. *Kaiser*, 444 U.S. at 179-80. However, the mere presence of a public interest in private property—an interest that arose only after the landowner had improved the marina and linked it to the ocean—could not transfer private marina control from the landowner to the government and its authorized trespassers, the public. *Id.*

237. *Id.* at 176. In order to determine whether or not such a limitation of property rights constitutes a taking, a court must consider the character of the government's action in terms of the degree to which it: (1) promotes legitimate social goals, (2) diminishes the value of the property owner's economic interest, and (3) interferes with reasonable expectations regarding the use of the property. *Id.* at 175. Cf. *PruneYard Shopping Ctr. v. Robins*, 447 U.S. 74 (1980). In *PruneYard*, the United States Supreme Court upheld a decision of the California Supreme Court, which ruled that the California constitution prohibited the owners of private shopping centers from excluding persons who wish to engage in non-disruptive speech and petitioning activities. *Id.* at 78. Although the state had thus eliminated part of the shopping center owner's right to exclude other persons, the owners did not suffer a taking in the constitutional sense because they could not demonstrate that an unchecked right to exclude others was a basic part of the economic value of the shopping center. *Id.* at 83. The state court ruling was seen as a reasonable government regulation of the use of property normally open to members of the public and not a taking of property. *Id.*

The Court in *PruneYard* distinguished *Kaiser* on the basis that the taking of the right of exclusivity from property held for private use in *Kaiser* went too far in interfering with "reasonable investment backed expectations," whereas the shopping center regulation was in the nature of a reasonable regulation of commercial functions. *Id.* at 83-85.

238. *Kaiser*, 444 U.S. at 179-80.

239. *Id.* at 177-81.

invasion in *Loretto v. Teleprompter Manhattan CATV Corporation*.<sup>240</sup> *Loretto* dealt with a New York City ordinance that required apartment building owners to allow the cable television company to place cable receivers on the side of buildings.<sup>241</sup> The *Loretto* Court's inquiry began by acknowledging that, generally, takings decisions relied upon no formal rules.<sup>242</sup> The *Loretto* Court created a new category of regulations that always triggers the compensation requirement: when a physical invasion reaches a permanent physical occupation, a taking has occurred.<sup>243</sup> The Court held that the ordinance allowed for a permanent physical occupation of a small part of the building.<sup>244</sup> The diminutive size of the cable box had no bearing upon the decision that a taking had occurred.<sup>245</sup> Therefore, the *Loretto* Court held that once the government physically invaded the building by allowing permanent placement of the cable box, a *per se* taking occurred requiring compensation.<sup>246</sup>

The reasoning behind the *Loretto* decision merely extended that of *Kaiser*. In *Kaiser*, the Court focused upon the right to exclude.<sup>247</sup> When government regulation impinges upon this right, the Court will more likely find a taking because exclusivity is a fundamental incident of property ownership.<sup>248</sup> Though the invasion in *Kaiser* could not be characterized as permanent, and thus would not have triggered application of *Loretto's per se* rule, the difference between the invasion in both cases is a matter of degree.<sup>249</sup> The regulation in *Loretto* did not "simply take a single 'strand' from the 'bundle' of property rights: it chop[ped] through the bundle, taking a slice of every strand."<sup>250</sup> Permanent physical occupation deprives landowners not only of the right to exclude, but also of the rights to use and dispose of property.<sup>251</sup>

The Court applied the *Loretto per se* rule most recently in *Yee v. City of*

240. 458 U.S. 419 (1982). In *Loretto*, a landowner sued a cable television operator, alleging that the installation of a cable box, measuring one-third square foot, on the landowner's roof pursuant to a city ordinance constituted a compensable taking. *Id.* at 422. The city ordinance required the landlord building owners to allow installation of a cable television receiver on the apartment building, while denying the landlord the ability to demand payment for the intrusion. *Id.* at 423.

241. *Loretto*, 458 U.S. at 423.

242. *Id.* at 426 (citing *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978)).

243. *Id.* at 426.

244. *Id.* at 437.

245. *Loretto*, 458 U.S. at 437.

246. *Id.* at 441.

247. *Kaiser Aetna V. United States*, 444 U.S. 164, 176 (1979). See also *supra* note 237.

248. *Id.*

249. *Id.*

250. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (citing *Andrus v. Allard*, 444 U.S. 51, 65-66 (1979)).

251. *Id.* at 436.

*Escondido*.<sup>252</sup> In *Yee*, the Court held that the physical invasion rule of *Loretto* only applied when the government required the landowner to acquiesce to a trespass.<sup>253</sup> Thus, the Court stated that a rent control statute applicable to mobile home parks did not fall under the *per se* rule and did not constitute a physical occupation of the land owner's property.<sup>254</sup> The property owners real complaint was with the diminution of the economic value of their property that was caused by the legislation that prevented them from renting the property at the highest price that they might get in an unregulated market.<sup>255</sup>

Slightly more than two months after the Court rejected a physical invasion takings challenge in *Yee*, the Court reentered the takings arena by entertaining a regulatory takings challenge in *Lucas v. South Carolina Coastal Council*.<sup>256</sup> *Lucas* addressed the constitutionality of the South Carolina Beachfront Management Act against a takings claim brought by a developer, *Lucas*.<sup>257</sup>

252. 503 U.S. 519 (1992). In *Yee*, a mobile home park owner challenged as an unconstitutional taking a municipal rent control ordinance setting a ceiling on rents chargeable to mobile home park tenants. *Id.* at 527.

253. *Id.* Consideration of government-authorized trespasses onto private property has traditionally fallen under the "character of governmental action" test. *See* Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978). In *Penn Central*, after citing the familiar disclaimer that the Court has no "set formula" for takings analysis, the Court, led by Justice William Brennan, added that among the several factors that it employs in takings cases is the character of the governmental action, "a 'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government . . . than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good." *Id.* In other words, the Court devised a rough dichotomy between trespassory or physical invasions, and mere regulatory exercises of the police power. The case cited by Brennan for this proposition was *United States v. Causby*, 328 U.S. 256 (1946), in which a landowner alleged that his property, a chicken farm, had been deprived of all viable use due to constant low overflights by government aircraft. The Court agreed with the landowner's characterization of the government action as trespassory, and not regulatory, and ordered compensation. *Id.* at 261-62.

254. *Yee*, 503 U.S. at 527-28. The Court did not rule on the question of whether the rent control statute at issue in *Yee* was a regulatory taking because the Court believed that the claim was not ripe for review due to the fact that it had not been raised fully in the lower courts. 2 ROTUNDA & NOWAK, *supra* note 217, at 62 (1994 Supp.).

255. *Yee*, 503 U.S. at 529.

256. 112 S. Ct. 2886 (1992).

257. *Lucas* had purchased and developed shoreland on one of South Carolina's barrier islands in the late 1970s. *Id.* at 2889. As development of the property came to a profitable close, *Lucas* purchased two additional parcels nearby in 1986 for development of single-family residences. *Id.* When *Lucas* made this purchase, these parcels were unencumbered by building restrictions under state environmental protection laws. *Id.*

However, in 1988, the South Carolina legislature amended its coastal zone legislation with the BMA. The BMA prohibited construction of "occupiable improvements" near a line drawn parallel to the shore by the coastal council. *Id.* Unfortunately for *Lucas*, his two parcels fell within the restricted property. *Id.* *Lucas* immediately sought the aid of the courts, contending that although the BMA was a valid exercise of the state's police power, it had completely destroyed his investment in these parcels by prohibiting development. *Lucas* asserted that the state owed him compensation

The Court held that the regulation effected a compensable taking.<sup>258</sup> In its reasoning, the Court first applied the *Pennsylvania Coal Co. v. Mahon*<sup>259</sup> formulation of the regulatory takings doctrine.<sup>260</sup> The *Lucas* Court then formulated two categories of *per se* takings,<sup>261</sup> neither of which required a case specific inquiry to find a taking: a permanent physical occupation authorized by the government as enunciated in *Loretto* and the previously unrecognized category of government regulation that denies all economically beneficial or productive use of land.<sup>262</sup> The Court dispensed with the case-by-case inquiry method of takings analysis by stating that when a regulation leaves no economic value in the property, a Court can summarily conclude that the regulation is not a valid exercise of the police power.<sup>263</sup> If the value of real property is completely eliminated by governmental action the government can only defend its action by showing that the owner had acquired title to the property subject to regulations that eliminated all of the economically beneficial uses of the property.<sup>264</sup> The Court's opinion indicated that it would be impossible for the government to avoid compensation unless it could show that the individual took title to worthless land. This requirement could be met by showing that the individual had taken title to land that was already subject to

of \$1.2 million. *Id.* at 2890.

The trial court agreed with *Lucas*, finding that the developmental ban rendered his parcels "valueless." *Id.* The South Carolina Supreme Court reversed, holding that in the absence of a challenge to the statute's purpose, which *Lucas* had already admitted as valid, the legislative findings that development threatened a public resource fended off a successful takings challenge. *Id.* Relying on *Mugler v. Kansas*, 123 U.S. 623 (1887), the state supreme court reasoned that legislation, like the BMA, directed at the prevention of a public harm, constituted a valid exercise of the police power. 112 S. Ct. at 2891. As such, the BMA was valid under the Takings Clause even if the property's developmental value had been destroyed. *Id.* The United States Supreme Court granted certiorari. *Id.*

258. *Id.* at 2895.

259. 260 U.S. 393 (1922).

260. "[I]f regulation goes too far it will be recognized as a taking." *Id.* at 415.

261. *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2893 (1992). See *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) (created a *per se* takings rule that the compensation requirement of the Takings Clause will be automatically triggered when the government permanently and physically invades private property). See *supra* notes 240-51 and accompanying text. Before *Lucas*, the *Loretto* rule was the only *per se* takings rule ever explicitly recognized by the Court.

262. *Lucas*, 112 S. Ct. at 2893. This second category has never been categorized as a *per se* rule in the history of the Court's takings jurisprudence, although Chief Justice Rehnquist intimated in 1987 that he would create such a rule. See *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 517 (1987) (Rehnquist, C.J., dissenting) ("[T]here is no need for further analysis where the government by regulation extinguishes the whole bundle of rights in an identifiable segment of property . . .").

263. *Lucas*, 112 S. Ct. at 2894.

264. *Id.* at 2899.



government restrictions that eliminated all beneficial use of the property.<sup>265</sup>

*Lucas* is an important case for the following three reasons:

First, *Lucas* establishes a *per se* rule that will require finding a taking of property when governmental actions result in the total loss of all economically beneficial use of real property. Second, the *Lucas per se* rule does not apply to the governmental regulations of personal property . . . . Third, the *Lucas* decision reinforces the judicial role in examining the question of when regulatory actions of government constitute a taking of property.<sup>266</sup>

As the Court explained in *Yee*, most of its cases interpreting the Takings Clause fall within two separate classes.<sup>267</sup> The first class is the *per se* takings which constitute those cases in which the government "authorizes a physical occupation of property or actually takes title."<sup>268</sup> To this class of cases, *Lucas*<sup>269</sup> would add those in which regulation denies all economically beneficial or productive use of land.<sup>270</sup> The second class are those cases in which the government merely regulates the use of property.<sup>271</sup> This distinction is important because while the first category of cases requires courts to apply a clear rule, the second necessarily entails complex factual assessments of the purposes and economic effects of government actions.<sup>272</sup>

The purpose of those complex factual assessments, of course, is to see how close the government's regulatory actions come to a *per se* taking. The

265. ROTUNDA & NOWAK, *supra* note 217, at 60 (Supp. 1994). The Court stated that the "total taking inquiry" would normally involve an examination of nuisance law, common law, the history of the use of the property, the social value of the activity, and the nature of any harm that could be avoided by government actions short of a complete taking. *Lucas*, 112 S. Ct. at 2901.

266. Note that the *Lucas* decision did not alter any of the earlier Supreme Court decisions concerning government regulations of the use of real property that diminished the value of that property but did not totally eliminate its value. *Id.* at 2901. If a government action deprives a property owner of some of the value of his property but the action does not constitute physical occupation of the property, if there is a total elimination of the value of real property, the question of whether the government action constitutes a taking for which just compensation is due must be examined under other decisions of the Supreme Court. *Id.*

267. *Yee v. City of Escondido*, 112 S. Ct. 1522, 1526 (1992).

268. *Id.*

269. *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2893 (1992); see *supra* notes 256-66 and accompanying text.

270. *Lucas*, 112 S. Ct. at 2893-94.

271. *Yee*, 112 S. Ct. at 1526.

272. *Id.* at 1526.

regulatory taking concept first appeared in *Pennsylvania Coal Co. v. Mahon*.<sup>273</sup> Since *Mahon*, the Court has frequently considered whether governmental conduct that, although does not openly and expressly confiscate property, goes so far in regulating the use of the property that it will be recognized as a taking nonetheless.<sup>274</sup> However, the Court has never abandoned the concept of a *per se* taking. Thus in the regulatory takings cases since *Mahon*, the question has invariably been how the government action compares to an actual appropriation of title or, in the case of real property, a permanent physical invasion.<sup>275</sup> But, in the case of a *per se* taking those complex factual assessments are unnecessary.<sup>276</sup>

Similarly, the Supreme Court, in *Ruckelshaus v. Monsanto Company*,<sup>277</sup> was faced with the issues of whether trade secrets were a property right protected by the takings clause of the Fifth Amendment and whether the data-consideration and data-disclosure provisions of the Federal Insecticide, Fungicide, and Rodenticide Act [hereinafter ACT] involved a taking of such property interests.<sup>278</sup> The Court first held that state law created a property interest in trade secrets and Monsanto's nondisclosure of these data to others confirmed its interest in maintaining this information as a trade secret.<sup>279</sup>

273. 260 U.S. 393 (1922). In *Pennsylvania Coal*, a statute made it commercially impracticable for the petitioner to mine certain coal on property it owned. *Id.* Although the statute did not force the state to take title of the coal, to physically invade or to oust the petitioner from possession, the Court nevertheless held that the law required compensation because it had "very nearly the same effect for constitutional purposes as appropriating or destroying" the petitioner's property. *Id.* at 414.

274. *Id.* at 415.

275. *E.g.*, *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945) (actual "acquisition of title or occupancy"); *United States v. Causby*, 328 U.S. 256, 261, 262 (1946) (same; "exclusive possession of" or "complete dominion and control over" land); *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 135 (1978) (appropriation of property by government for its own uses); *Andrus v. Allard*, 444 U.S. 51, 65 (1979) ("compel[led] the surrender" of property; "physical invasion or restraint"); *Kaiser Aetna v. United States*, 444 U.S. 164, 180 (1979) ("actual physical invasion"); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426 (1982) ("permanent physical occupation"); *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 225 (1986) ("physically invade or permanently appropriate"); *Yee v. City of Escondido*, 503 U.S. 519, 522 (1992) ("physical occupation of property," or actual taking of title); *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2286, 2896 (1992) ("permanent [physical] invasions"); *Concrete Pipe & Products of Cal., Inc. v. Construction Laborers' Pension Trust*, 113 S. Ct. 2264, 2290 (1993).

276. Hence *Mahon* and its factual inquiries were not even mentioned in *United States v. Pewee Coal Co.*, 341 U.S. 114 (1951). In *Mahon*, a unanimous Court agreed that the government's war-time seizure and operation of the plaintiff's coal mine was a taking. *Mahon*, 260 U.S. at 416. The government's action constituted an "actual taking of possession and control" which made the mines government property in as complete a sense as if the federal government held full title and ownership. *U.S. v. Pewee Coal Co.*, 341 U.S. 114, 116 (1951).

277. 467 U.S. 986 (1984).

278. *Id.* at 1000.

279. *Id.* at 1003.

Therefore, this intangible interest was protected by the taking clause of the Fifth Amendment.<sup>280</sup>

In determining whether the government action in disclosing Monsanto's trade secrets to the public involved a taking, the Court in *Monsanto* sought to determine whether there was a reasonable investment-backed expectation in the privacy of the property interest under the ACT.<sup>281</sup> The Court held that an applicant could not have a reasonable investment-backed expectation in the secrecy of the data, and thus no taking of property for applications before 1972 and after 1978.<sup>282</sup> The Court reasoned that because Monsanto had prior notice of the use to be made of the trade secrets, and because this use was rationally related to a legitimate governmental interest, the submission of the trade secrets in exchange for registration was not a taking.<sup>283</sup> However, under the terms of the ACT in effect between 1972 and 1978, a submitter was given the opportunity to protect its trade secrets from consideration and disclosure by designating the data as a trade secret upon application.<sup>284</sup> The applicant was guaranteed that these trade secrets would remain confidential.<sup>285</sup> This guarantee formed the basis of a reasonable investment-backed expectation in the privacy of the trade secrets, making consideration and disclosure of such trade secrets by the government a compensable taking under the Fifth Amendment.<sup>286</sup>

Overall, the Supreme Court has presented three main factors that are of particular importance in determining whether a government regulation of economic activity constitutes a taking of property. These factors are: (1) the economic impact of the regulation on the entity that suffers the economic loss; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the government action.<sup>287</sup> The Court applies these three factors to measure how close the government's actions actually comes to a *per se* taking. The closer a regulation comes to a *per se*

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280. *Id.* at 1004.

281. The Court considered three factors in making its determination: "the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations." *Ruckleshaus v. Monsanto Property*, 467 U.S. 986, 1005 (1984) (citing *PruneYard Shopping Ctr. v. Robbins*, 447 U.S. 74, 83 (1980)).

282. *Ruckleshaus*, 467 U.S. at 1003. Prior to 1972, the ACT was silent with respect to the Environmental Protection Agency's use and disclosure of the health and safety data submitted. *Id.* at 1008. After 1978 the Act explicitly provided for use of the submitted data by the government. *Id.* at 1011.

283. *Id.* at 1013-14.

284. *Id.* at 988.

285. *Id.*

286. *Ruckleshaus*, 467 U.S. at 1005.

287. *Penn Central Transp. Co. v. New York*, 438 U.S. 104, 124 (1978).

taking, the easier it is for the Court to hold that the taking is compensable. Applying the takings jurisprudence to the FDIC's exercise of the cross-guarantee power, this provision as it stands is unconstitutional.

*C. The Cross-Guarantee Provision in Light of the Takings Clause*

The cross-guarantee provision, as it currently stands, is unconstitutional under the Fifth Amendment of the United States Constitution<sup>288</sup> because it allows the FDIC to take a bank's assets,<sup>289</sup> without compensation, to satisfy the debts of other insured depository institutions.<sup>290</sup> The purpose of the cross-guarantee provision is to provide funds to the FDIC to aid in its task of insuring deposits,<sup>291</sup> and to prevent fraudulent banks from depleting the insurance fund.<sup>292</sup> However, when the FDIC exercises its authority on managerially sound banking corporations, it is technically taking private property for public use in violation of the Fifth Amendment.<sup>293</sup> The government has the power to regulate the activities of private enterprises so long as the regulation advances legitimate governmental interests.<sup>294</sup> In the case of the cross-guarantee provision, the purported legitimate governmental interest is recovering money to replenish the depleting FDIC funds.<sup>295</sup>

When an insured depository institution in a bank holding company system is in default or requires assistance to prevent default,<sup>296</sup> FIRREA requires the FDIC to make a good-faith estimation of the expected loss from a default and to advise each commonly controlled depository institution of this amount.<sup>297</sup> The statute requires no finding by the FDIC of wrongdoing or fraud on the part of the insolvent institution as a predicate for assessment.<sup>298</sup> Upon presentation of a written demand for this amount, and after consultation with the appropriate state and federal agencies, the FDIC is authorized to demand immediate payment

288. See *supra* note 25; see also Glass, *supra* note 112, at 25.

289. Branch *ex rel.* Maine Nat'l Bank v. United States, 31 Fed. Cl. 626, 630 (1994).

290. See *supra* note 20.

291. *Condition*, *supra* note 86, at 254.

292. H.CONF. REP. NO. 101-222, *supra* note 62, at 398-99, reprinted in 1989 U.S.C.C.A.N. at 437-38.

293. See *supra* note 25.

294. See Lucas v. South Carolina Coastal Council, 112 S. Ct. 2886, 2897 (1992) (requiring a legitimate government interest to justify regulation).

295. See FDIC v. Jenkins, 888 F.2d 1537, 1541 (11th Cir. 1989) (stating that minimizing depletion of insurance funds is the express goal of the FDIC's statutory framework); *Condition*, *supra* note 86, at 354.

296. 12 U.S.C. § 1815(e)(2)(A) (1994).

297. *Id.*

298. *Id.*

of the loss from any other bank sharing common control with the insolvent institution.<sup>299</sup>

As illustrated by the *Branch* case, on the morning of January 6, 1991, Maine National Bank was a solvent bank, historically profitable, worth approximately \$65 million.<sup>300</sup> It had been in operation since 1889, and by evening it had essentially ceased to exist.<sup>301</sup> The government seized all of its assets, took title to and acquired possession of them, and transferred them to a bridge bank newly created and operated by the government itself.<sup>302</sup> In *Branch*, there is no question about the seizure of Maine National Bank: the government directly took "full title and ownership" of Maine National Bank's assets and operations and transferred them to a bridge bank, which opened the next day as a bank owned by and operated for the complete benefit of the government.<sup>303</sup> This was an evident "appropriation of property by government for its own uses."<sup>304</sup> The *Branch* case is an example to other bank holding companies of what will happen to them if the cross-guarantee provision remains unchecked. *Branch* demonstrates the gravity of the cross-guarantee provision and the potential for further abuse on other unsuspecting bank holding company systems.

To further illustrate the misapplication of the cross-guarantee provision, consider the FDIC's total appropriation of *all* Maine National Bank's property interests in *all* of its property rights.<sup>305</sup> Compare this to regulatory takings cases where the plaintiff is never deprived of all property rights in all property: those cases invariably involve a balancing of the rights taken and the rights left untouched.<sup>306</sup> In *Branch* the government appropriated all of Maine National Bank's property for its own use.<sup>307</sup> As FDIC Chairman Seidman stated, "the government exercised a newly granted power to fail an otherwise solvent bank and transfer its property to a government-owned entity."<sup>308</sup> Under the

299. *Id.* § 1815(e)(2)(B).

300. *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed. Cl. 626, 629 (1994).

301. *Id.* at 628.

302. *Id.* "[Bridge banks] are totally owned by the FDIC . . ."; *Failure, supra* note 39, at 65 (quoting Comptroller Robert C. Clarke); see 12 U.S.C. § 1821(n) (1994).

303. *Branch*, 31 Fed. Cl. at 629.

304. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 135 (1978) (describing the facts of *United States v. Causby*, 328 U.S. 256 (1946)).

305. *Branch*, 31 Fed. Cl. at 626, 629 (emphasis added).

306. See, e.g., *Hodel v. Irving*, 481 U.S. 704, 719 (1987) (Scalia J., concurring) (the comparison of "rights taken and rights left untouched . . . is determinative of whether there has been a taking" (citations omitted)); *PruneYard Shopping Ctr. v. Robins*, 447 U.S. 74, 82-83 (1980); *Andrus v. Allard*, 444 U.S. 51, 65-66 (1979); *Penn Central Transp. Co., v. New York*, 438 U.S. 104, at 135-138 (1978).

307. *Branch*, 31 Fed.Cl. at 629.

308. *Failure, supra* note 39, at 26.

holdings of *Loretto*, *Yee*, and *Lucas*, that amounts to a *per se* taking and Maine National Bank must be compensated.<sup>309</sup>

Under *Loretto*, the total physical appropriation of a bank's assets appear to be an act that constitutes a taking.<sup>310</sup> If the government physically occupies private property, a compensable taking results.<sup>311</sup> No inquiry need be made into whether the action is for the public good or has only a minimal impact on the owner.<sup>312</sup> Prior to the enactment of FIRREA, banks had a right to exclude the FDIC from its property, even if its parent company became insolvent.<sup>313</sup> FIRREA revoked this right in a manner that is inconsistent with the Fifth Amendment.<sup>314</sup>

A more recent takings case in the banking context is *Golden Pacific Bancorp v. United States*.<sup>315</sup> In *Golden*, the court focused more on the absence of a property right than on whether the government took anything for its own use.<sup>316</sup> The court ruled that when an institution enters the highly regulated field of banking, it relinquishes the right to exclude the government from legally closing the bank and placing it in receivership.<sup>317</sup> Thus, the bank's owners could not have developed an historically rooted expectation of compensation for the seizure of the bank's assets.<sup>318</sup> It could be argued that since banks operate in a highly regulated industry and voluntarily participate in and reap the benefits of the deposit insurance system, they should not get compensation.<sup>319</sup> However, the cross-guarantee power applied to the banking

309. See *Yee v. City of Escondido*, 503 U.S. 519, 523 (1992) (stating that in a *per se* takings case the Court should not undertake "complex factual assessments of the purposes and economic effects of government actions."); *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2893 (1992) (stating that in the case of physical invasions, "no matter how minute the intrusion, and no matter how weighty the public purpose behind it, we have required compensation . . ."); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426 (1982) ("[A] permanent physical occupation . . . is a taking without regard to the public interests that it may serve.").

310. *Loretto*, 458 U.S. at 426.

311. *Id.* at 432.

312. *Hendler v. United States*, 952 F.2d 1364, 1375 (Fed. Cir. 1991).

313. *California Hous. Sec., Inc. v. United States*, 959 F.2d 955 (Fed. Cir. 1992), *cert. denied*, 113 S. Ct. 324 (1992); *Golden Pacific Bancorp v. United States*, 15 F.3d 1066 (Fed. Cir. 1994).

314. *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed. Cl. 626, 632 (1994).

315. 15 F.3d 1066 (Fed. Cir. 1994).

316. *Id.* at 1075.

317. *Id.* at 1074.

318. *Id.* at 1076.

319. See Christopher T. Curtis, *The Takings Clause and Regulatory Takeovers of Banks and Thrifts*, 27 HARV. J. ON LEGIS. 367, 389 (1990) (stating that the cross-guarantee power is not a "violation of legitimate investment-backed expectations because, . . . [investors] are aware that the overall statutory and regulatory framework is directed to protecting depositors at least cost to the insurance fund, and that this framework is subject to reasonable extension in furtherance of that purpose as circumstances require"); see also *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S.

industry constitutes a taking of property by defeating those investment-backed expectations.<sup>320</sup> Moreover, entrants into the banking industry do not forfeit all of their property rights and operate under an unfettered risk that the government may seize them at any time without compensation.<sup>321</sup>

Unlike the bank in *Golden*, prior to the enactment of FIRREA, the Maine National Bank had the right to exclude the government from seizing its assets in order to pay the debts of another bank and, thus, did have an "historically rooted expectation of compensation" for such a seizure.<sup>322</sup> Numerous cases support the proposition that the government may not alter or redefine an existing property right simply by passing a statute.<sup>323</sup> *Golden* is distinguishable from *Branch* because FIRREA caused the Maine National Bank to be held liable for debts that were not its own.<sup>324</sup> The Bank of New England brought about the conditions that caused the seizure of Maine National Bank's assets. Maine did not do anything to cause its own failure, other than share common ownership with the parent company, Bank of New England Corporation.<sup>325</sup> Under Maine National Bank's reasonable historic expectations, this relationship would not

211, 223 (1986) ("Given the propriety of the governmental power to regulate, it cannot be said that the Taking[s] Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another.").

320. *But see* Broome, *supra* note 106, at 988-89 (arguing that the cross-guarantee provision is not a taking).

321. *Id.* In *Golden Pacific*, the court looked to a savings and loan institution's historically-rooted expectation that it could exclude the government from its premises. The court analyzed the state of the law at the time plaintiff entered the banking market, as well as the changes made to this law by FIRREA. The court concluded that in deciding to enter the banking market the bank understood, with what may only be viewed as a historically rooted expectation, that the federal government would take possession of its premises and holdings as receiver if it substantially dissipated its assets or earnings due to any violation of law, or to any unsafe or unsound practices. *Id.* at 958. FIRREA had not changed the savings and loan institution's expectation in this regard. *Id.* at 959. Similarly, the court held that a bank's expectations "could only have been that the FDIC would exert control over the bank's assets if the office of the Comptroller of the Currency became satisfied that the Bank was insolvent and chose to place it in receivership." *Id.* at 1074. No showing was made that FIRREA changed the claimant's expectations in a significant, unanticipated manner. *Id.* This was not the case in *Branch*. *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed. Cl. 626, 633 (1994).

322. Plaintiff's Mem. Supp. Summ. J. at 16, *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed. Cl. 626 (1994).

323. *See* *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 833 n.2 (1987) (rejecting the "peculiar proposition that a unilateral claim of entitlement by the government can alter property rights"); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 439 (1982) ("[T]he government does not have unlimited power to redefine property rights . . ."); *New Jersey State Chamber of Commerce v. Hughey*, 600 F. Supp. 606, 627 (D.N.J. 1985), *aff'd in part and rev'd in part on other grounds*, 774 F.2d 587 (3d Cir. 1985) (rejecting the argument that the statute "redefined" an individual's property interest).

324. *Branch*, 31 Fed. Cl. at 633.

325. *Id.*

suffice to cause it to be held responsible for the Bank of New England's liabilities.<sup>326</sup> Absent some showing of fraud or wrongdoing on the part of the holding company system that would pierce the corporate veil, Maine National Bank is not liable.<sup>327</sup> For the FDIC to avoid taking property unconstitutionally, Congress must consider making an amendment to the cross-guarantee provision that would be more closely tailored to its original goals of preventing fraud and insider abuse.<sup>328</sup>

The proposed amendment could avoid a taking by requiring the FDIC to pierce the corporate veil of a bank holding company system prior to making an assessment.<sup>329</sup> Presumably, bank holding corporations' subsidiary corporations are not liable for another subsidiaries debts.<sup>330</sup> The cross-guarantee assessment provision as it stands makes subsidiaries liable for the debts of an affiliate without having to first pierce the corporate veil.<sup>331</sup> Since the cross-guarantee provision makes a commonly controlled subsidiary automatically liable for an affiliates' debts without first piercing the veil of incorporation, the cross-guarantee assessment effectuates a taking. The taking occurs when the FDIC makes an assessment against a commonly controlled solvent affiliate and the assessment exceeds the amount of capital of the solvent affiliate which makes the once solvent affiliate insolvent.<sup>332</sup> The FDIC treats the assessment as a debt and takes possession and title of the bank's assets.<sup>333</sup> Taking possession and title to assets of a corporation in satisfaction of a debt owed to the FDIC is acceptable if the bank is already an insolvent FDIC insured institution.<sup>334</sup> In the case of the Maine National Bank, the assessed bank was not insolvent, therefore the only debt it had was that imposed by the FDIC, for another bank's insolvency. The proposed amendment would resolve the takings problem by requiring the FDIC to first pierce the corporate veil.<sup>335</sup> By piercing the corporate veil, the commonly controlled subsidiary would then be liable without effectuating a compensable taking.

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326. *Id.*

327. *Id.*

328. H.R. REP. NO. 54(I), *supra* note 3, at 294, *reprinted in* 1989 U.S.C.C.A.N. at 90.

329. *See infra* notes 336-67 and accompanying text.

330. 1 W. FLETCHER, *supra* note 153, §§ 5,14.

331. 12 U.S.C. § 1815(e) (1994); *see supra* note 19.

332. *Branch ex rel. Maine Nat'l Bank v. United States*, 31 Fed. Cl. 626, 631 (1994).

333. *Id.*

334. 12 U.S.C. §§ 1814(a)(1), 1815 (e)(2)(B).

335. *See supra* notes 153-210 and accompanying text.



IV. A PROPOSED AMENDMENT TO FIRREA'S  
CROSS-GUARANTEE PROVISIONA. *Brief Overview*

This Note proposes that the Congress amend the FIRREA's cross-guarantee provision<sup>336</sup> to require the FDIC to prove that a bank's insolvency was the result of fraud or wrongdoing within the bank holding company prior to assessment. This proposal prescribes that the FDIC pierce the corporate veil of a bank holding company system prior to making an assessment on a commonly controlled subsidiary for the debts of a failed affiliate.<sup>337</sup> To pierce the corporate veil, the FDIC must show that the banks were using the corporation to commit fraud, to breach a duty, or for another wrong.<sup>338</sup> If such proof is required, FIRREA would better effectuate the Act's original purpose of preventing bank holding corporations from transferring all of their risky investments into one subsidiary and then relying on the FDIC to bail them out.<sup>339</sup>

This Note proposes an amendment that is more detailed in its application and enforcement procedures than the current statute. Furthermore, this Note contributes a resolution for the takings problem created by the current cross-guarantee provision.<sup>340</sup> By requiring that the FDIC establish fraud or wrongdoing within the bank holding company structure,<sup>341</sup> the FDIC may legally assess a solvent subsidiary liable for the debts incurred by its insolvent affiliate. Once the FDIC pierces the veil of a bank holding company, it can assess the subsidiary and take its assets without having to pay compensation because the bank holding company structure is no longer protected by limited liability. If the FDIC cannot prove that any fraud or wrongdoing acted as the catalyst for the subsidiary's insolvency, the corporate structure will not be pierced; therefore, any assessment by the FDIC exceeding the capital of a commonly controlled affiliate effectuates a compensable taking.<sup>342</sup>

B. *Purpose and Need*

The purpose of this proposed amendment is to: (1) prevent the FDIC from

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336. FIRREA, *supra* note 4, § 1815; *supra* note 19.

337. *See supra* notes 153-210 and accompanying text.

338. *See supra* notes 79-90 and accompanying text.

339. *See supra* notes 63-94 and accompanying text.

340. *See supra* notes 211-87 and accompanying text.

341. This is similar to the requirement necessary to pierce the corporate veil of a holding company system. *See supra* notes 153-210 and accompanying text.

342. *See supra* notes 211-87 and accompanying text.

abusing its discretionary cross-guarantee power; (2) protect solvent subsidiaries of legitimate bank holding companies from unwarranted assessments; and (3) force the banks that engage in fraudulent activity to bear the burden of their actions. The problem is that as FIRREA currently stands, its cross-guarantee provision automatically pierces the corporate veil of a bank holding system<sup>343</sup> and allows the FDIC to take property without just compensation.<sup>344</sup> This is contrary to both the doctrine of corporate separateness<sup>345</sup> and the takings clause of the Fifth Amendment.<sup>346</sup>

The issue of whether the FDIC's use of the cross-guarantee provision results in a taking depends entirely upon whether a bank holding company can be seen as a single corporation. If the bank holding company system is merely using the corporate structure as a veil or sham for other fraudulent business, then the corporation's limited liability status should not be upheld.<sup>347</sup> The amendment is designed to provide guidelines for the FDIC to follow when deciding to exercise its cross-guarantee power.<sup>348</sup> In addition, this amendment prevents the FDIC from exerting its authority in an unconstitutional manner by setting forth limits on what the government must prove before making a cross-guarantee assessment.<sup>349</sup> This amendment provides a method of effectuating the true purpose of the cross-guarantee provision: to prevent insider abuse and fraudulent activity.<sup>350</sup> By requiring the FDIC to prove that fraud or wrongdoing caused the bank's insolvency prior to making an assessment, the amendment implements a safeguard restricting the FDIC's abuse of its discretionary powers.

The proposed amendment is needed to provide guidelines for the FDIC to follow in exercising its cross-guarantee powers and to protect legitimate bank holding companies from being wrongly assessed. As FIRREA now stands, no safeguards, guidelines, or other provisions are preventing the FDIC from arbitrarily assessing solvent institutions for amounts exceeding their capital, thereby rendering them insolvent. No justification exists for demanding that legitimate bank holding companies carry the burden and pay the FDIC for debts the FDIC reasonably incurred. Banks pay insurance premiums to the FDIC to protect their deposits in case of insolvency, not to eventually pay their loss themselves. Because of this inequity, this amendment should be adopted to

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343. 12 U.S.C. § 1815(e) (1994); *see supra* note 19.

344. *See supra* notes 288-335 and accompanying text.

345. *See supra* notes 153-210 and accompanying text.

346. *See supra* note 25.

347. *See supra* notes 153-210 and accompanying text.

348. *See* Section 2 of the proposed amendment.

349. *See* Section 2(C) of the proposed amendment.

350. *See supra* notes 79-90 and accompanying text.

place the burden on those who deserve to carry it—those institutions who commit fraud. The following proposed amendment creates standards that discourage the FDIC from abusing its pervasive cross-guarantee assessment power.

*C. Section-by-Section Analysis*

TITLE I: PROPOSED AMENDMENT TO THE FINANCIAL INSTITUTIONS REFORM,  
RECOVERY, AND ENFORCEMENT ACT

*Section 1-Definitions.*<sup>351</sup>

- (1) **Affiliate.**—The term “affiliate” means any company that controls, is controlled by, or is under common control with another company.<sup>352</sup>
- (2) **Bank Holding Company.**—The term “bank holding company” means any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of § 1841.<sup>353</sup>
- (3) **Commonly Controlled.**—Depository institutions are “commonly controlled” if—
  - (A) such institutions are controlled by the same depository institution holding company . . . ; or
  - (B) one depository institution is controlled by another depository institution.<sup>354</sup>
- (4) **Control.**—Any company has “control” over a bank or over any company if—
  - (A) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company;
  - (B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or
  - (C) the Board of Governors of the Federal Reserve System determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling

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351. These definitions are the same as provided in 12 U.S.C. §§ 1813, 1815, 1841 (1994). They are provided here to help the reader understand the proposed amendment.

352. 12 U.S.C. § 1841(k) (1994).

353. *Id.* § 1841(a)(1).

354. *Id.* § 1815(e)(9).

influence over the management or policies of the bank or company.<sup>355</sup>

- (5) **Default.**—The term “default” means, with respect to an insured depository institution, any adjudication or other official determination by any court of competent jurisdiction, the appropriate Federal banking agency, or other public authority pursuant to which a conservator, receiver, or other legal custodian is appointed for an insured depository institution.<sup>356</sup>
- (6) **Depository Institution.**—The term “depository institution” means any bank or savings association.<sup>357</sup>
- (7) **In Danger of Default.**—The term “in danger of default” means an insured depository institution with respect to which . . . the appropriate Federal banking agency . . . has advised the [Federal Deposit Insurance] Corporation . . . that—
- (A) in the opinion of such agency or authority—
- (i) the depository institution . . . is not likely to be able to meet the demands of the institution’s . . . depositors or pay the institution’s . . . obligations in the normal course of business; and
- (ii) there is no reasonable prospect that the depository institution . . . will be able to meet such demands or pay such obligations without Federal assistance; or
- (B) in the opinion of such agency or authority—
- (i) the depository institution . . . has incurred or is likely to incur losses that will deplete all or substantially all of its capital; and
- (ii) there is no reasonable prospect that the capital of the depository institution . . . will be replenished without Federal assistance.<sup>358</sup>
- (8) **Insured Depository Institution.**—The term “insured depository institution” means any bank or savings association the deposits of which are insured by the [Federal Deposit Insurance] Corporation.<sup>359</sup>
- (9) **Subsidiary.**—The term “subsidiary”—
- (A) means any company which is owned or controlled directly or indirectly by another company; and
- (B) includes any service corporation owned in whole or in

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355. *Id.* § 1841(a)(1)-(2).

356. 12 U.S.C. § 1813(x)(1) (1994).

357. *Id.* § 1813(c)(1).

358. *Id.* § 1813(x)(2)(B)(ii).

359. *Id.* § 1813(c)(2).

part by an insured depository institution or any subsidiary of such a service corporation.<sup>360</sup>

Commentary to Section 1: The terms outlined in Section 1 are used by FIRREA and the cross-guarantee provision as enacted in 1989. The definitions are provided here for a better understanding of FIRREA as it currently stands. The terms and their definitions will also be the same terms and definitions used by the proposed amendment. The terms and their definitions do not effect the constitutionality of the cross-guarantee provision as enacted. Therefore, they will remain the same for the proposed amendment.

*Section 2-Guidelines For Establishing Liability of Commonly Controlled Depository Institutions.*

Section 2 amends § 1815(e)(1)(A) of the Act to read:<sup>361</sup>

(A) *An insured depository institution shall be liable for a loss incurred by the Federal Deposit Insurance Corporation, or a loss which the Federal Deposit Insurance Corporation reasonably anticipates incurring, in connection with—*

(i) *the default of a commonly controlled insured depository institution that acts under the dominion and control of its parent bank holding corporation, and while under such dominion and control, took such actions to commit fraud or wrongdoing, the result of which is its default; or*

(ii) *any assistance provided by the Federal Deposit Insurance Corporation to any commonly controlled insured depository institution under the dominion and control of its parent bank holding corporation, and while under such dominion and control, is currently engaging in such fraudulent activity placing such institution in danger of default.*

Commentary to Section 2(A): Part (A) of the Section 2 sets forth the changes to the current cross-guarantee provision. As amended, the cross-guarantee provision still allows the FDIC to make cross-guarantee assessments. However, the amended sections change the conditions under which the FDIC may assert the cross-guarantee power. As amended, before the FDIC may make an assessment on a commonly controlled depository institution, the amendment requires the FDIC to show that the commonly controlled depository institution

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360. *Id.* § 1813(w)(4).

361. The italic typeface indicates wording of original Act.

was acting under the dominion and control of its parent bank holding corporation, and further, while under such dominion and control, committed some act of fraud or wrongdoing. By requiring the FDIC to first prove fraud or wrongdoing places restrictions on when the cross-guarantee power is exercised, thus preventing wrongful assessments that amount in compensable takings.

**Section 2:**

(B) The determination of whether an insured depository institution is in default or in danger of default shall be made by the proper authority or banking agency.

**Commentary on Section 2(B):** The determination of default or danger of default remains the same as under 12 U.S.C. § 1813(x)(1) (1994). A part of § 1813(x)(1) is inserted here for the purposes of the proposed amendment. The agency that supervises the depository institution, the Office of the Comptroller of the Currency, or the corresponding state-chartering agency, usually determines default status. An administrative law judge or a judge sitting in a court of competent jurisdiction also has the authority to determine default status. The determination of default has no bearing on the cross-guarantee provision, except that the cross-guarantee provision may only be exerted after an agency or judge has determined that an institution is in default or is in danger of default.

**Section 2:**

(C) Once it has been determined by the proper authority that an insured depository institution is in default or in danger of default, the Federal Deposit Insurance Corporation will be appointed as receiver or conservator by the Resolution Trust Corporation (RTC)<sup>362</sup> in order to cover the deposits of the insolvent institution or assist the institution in danger of insolvency. If the Federal Deposit Insurance Corporation intends to use its cross-guarantee powers, then it shall engage in a two-pronged analysis to determine whether it may make an assessment on a commonly controlled depository institution to recover any loss incurred by the Federal Deposit Insurance Corporation in bailing out an affiliate. The two-pronged analysis is as follows:

(i) The determination of whether a commonly controlled insured depository institution is under the dominion and control of its parent bank holding company shall be made by the FDIC on a case-by-case basis using the

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362. See *supra* note 112.

factors and guidelines as set out in Section 3(A) of this amendment.

(ii) After a determination that a commonly controlled insured depository institution is dominated and controlled by its parent bank holding company, the Federal Deposit Insurance Corporation shall be required to establish that the bank holding company was using the corporation as a veil for fraud or other wrongdoing. The Federal Deposit Insurance Corporation must show that the corporation's fraudulent activity or other wrongdoing caused the insured depository institution to be in default; or that the insured depository institution's fraudulent activity or other wrongdoing is placing the insured depository institution in danger of default. In making its determination the FDIC will use the factors set out in Section 3(B) of this amendment.

Commentary to Section 2(C): Section 2(C) is completely new to the cross-guarantee provision. The importance of this amendment is that it requires the FDIC to prove some type of fraud or wrongdoing before making a commonly controlled depository institution automatically liable for the debts of an affiliate corporation. The two-pronged analysis provides the FDIC with some restrictions on how and when the FDIC will be allowed to make a cross-guarantee assessment. If the FDIC proves both prongs, then it will effectively pierce the corporate veil of the bank holding company and may take the assets of a commonly controlled subsidiary in satisfaction of the debt incurred by its insolvent affiliate. If the FDIC cannot make a proper showing of both prongs, then it will be unable to make the assessment, making this a conjunctive test. If the FDIC does not establish fraud or wrongdoing, and still makes an assessment on a commonly controlled insured depository institution, then that institution may bring a cause of action under Section 7 of this amendment for wrongful assessment. A wrongful assessment results in a taking without just compensation and is unconstitutional under the Fifth Amendment.

### *Section 3-Factors To Be Considered.*

(A) The factors to be considered for determining whether a depository institution holds dominion and control over another depository institution are as follows:<sup>363</sup>

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363. Additional factors that the FDIC may want to consider in making its determination of control.

- (1) Intrusive exercise of control by one corporation over another corporation's management or day-to-day activities;
  - (2) Extensive economic integration of assets and liabilities between the two banking corporations;
  - (3) Utilization of a public group persona, as if to appear to be one banking corporation;
  - (4) Financial dependence of one banking corporation from the other banking corporation(s) in the same bank holding company;
  - (5) Administrative dependence of one banking corporation on the bank holding company for adherence to regulatory examinations;
  - (6) Manipulation or shifting of corporate banking assets;
  - (7) Inadequate capitalization, and;
  - (8) Lack of compliance with corporate formalities.
- (B) The factors to be considered for fraudulent activity are:
- (1) Mismanagement within bank holding company;
  - (2) Collusion within the bank holding company to perpetuate mismanagement, shifting of assets between corporations, falsifying records;
  - (3) Ventures that are too risky for the capital/asset ratio of the banking corporation;
  - (4) Insider abuse of funds, and;
  - (5) The factors already established in § 1816(1)(7).<sup>364</sup>

**Commentary to Section 3:** The factors outlined in Section 3(A)-(B) are to be used as guidelines for Section 2(C)(i) in determining whether or not a parent bank holding company has control over its subsidiaries such that they are not separate corporate entities. Entity law is the fundamental concept underlying corporation law and courts are reluctant to undermine it.<sup>365</sup> Since courts are

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364. 12 U.S.C. § 1816(1)-(7) (1994).

"The factors . . . that are required, to be considered by the Board of Directors in connection with any determination by such Board pursuant to section 1815 of this title are the following:

- (1) The financial history and condition of the depository institution.
- (2) The adequacy of the depository institution's capital structure.
- (3) The future earnings prospects of the depository institution.
- (4) The general character and fitness of the management of the depository institution.
- (5) The risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund.
- (6) The convenience and needs of the community to be served by such depository institution.
- (7) Whether the depository institution's corporate powers are consistent with the purposes of this Chapter."

365. See *supra* notes 153-210 and accompanying text.



reluctant to pierce the corporate veil, this is even more reason for the FDIC to have to prove both prongs of the analysis prior to making an assessment under the cross-guarantee provision. Requiring the FDIC to first prove fraud or wrongdoing prior to making a cross-guarantee assessment helps to prevent the FDIC from arbitrarily forcing liability on legitimate banking corporations.

*Section 4-Payment Upon Notice.*

*An insured depository institution shall pay the amount of any liability to the Federal Deposit Insurance Corporation under Section 1 of this amendment upon receipt of written notice by the Federal Deposit Insurance Corporation that proves that the insured depository institution which is in default or in danger of default was under the control of another corporation and acted fraudulently while under such control.*

Commentary to Section 4: The amended portion adds the condition of proof of fraudulent activity, in addition to the notice requirement. The notice requirement of the cross-guarantee provision stays the same. When a banking corporation receives written notice of the assessment and proof of fault, then the bank shall become automatically and immediately liable for the debts of its affiliate corporation, unless the bank seeks administrative or judicial review under Section 6 of this amendment. Further, if the banking institution upon receiving written notice decides that it has been wrongly assessed by the FDIC, the banking corporation may assert a cause of action for a remedy under Section 7 of this amendment.

*Section 5-Notice Required To Be Provided Within Two Years of Loss.*

*No insured depository institution shall be liable to the Federal Deposit Insurance Corporation under Section 1 unless the Federal Deposit Insurance Corporation establishes both requiring of liability under section 2(C), and unless written notice with respect to such liability is received by such institution before the end of the 2-year period beginning on the date the Federal Deposit Insurance Corporation incurred the loss.*

Commentary to Section 5: The requirement of receiving notice within two years remains the same as the current statute. However, the amended portion inserts that the FDIC must prove both prongs of liability under Section (2)(C) of this amendment. If two years elapse, beginning from the date that the FDIC originally incurs the loss, and the FDIC has not given written notice to the assessed institution, the institution is not liable. In addition to providing written notice within two years of incurring the loss, the FDIC must prove that the

assessed institution, while acting under control of the bank holding corporation, acted in a fraudulent manner. If neither of these requirements are met, then the assessed banking institution may seek review under Section 6 by bringing a cause of action under Section 7 of this proposed amendment.

*Section 6-Review.*

*(A) Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.*

*(B) A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof.*

Commentary to Section 6: Section 6 is inserted into the proposed amendment from 5 U.S.C. §§ 701-06 (1988). The policies and procedures for administrative and judicial review remain the same in the proposed amendment. A bank that feels it has been wrongly assessed by the cross-guarantee provision must first seek administrative review with the Board of Directors of the FDIC and then may proceed to judicial review.

*Section 7-Remedies.*

(1) A violation of this amendment may result in the bringing of a civil action in a court of competent jurisdiction by a bank which was wrongly assessed by the Federal Deposit Insurance Corporation. Recovery is limited to the amount of the Federal Deposit Insurance Corporation's assessment, plus court costs and attorney fees.

(2) A violation of this amendment constitutes a prima facie cause of action for improper assessment. There is a presumption that a bank holding company and its subsidiaries are a corporation and each subsidiary shall not be held liable for debts incurred by another subsidiary within the bank holding corporation.<sup>366</sup> This presumption can be rebutted by the government if it can show, by a preponderance of the evidence, that the bank holding company structure used the

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366. See *supra* notes 153-210 and accompanying text.

corporations as a veil for fraud or other wrongdoing prior to the assessment under Section 2(C) of this amendment. If the government can prove such fraud, or wrongdoing, then it may pierce the corporate veil and assess the solvent commonly controlled depository institution without having to pay compensation.

Commentary to Section 7: Section 7 is a new addition to the cross-guarantee provision. There are currently no causes of action available for improper assessment the only remedy available under the current statute is administrative and judicial review. Section 7 grants a banking corporation that feels it has been wrongly assessed with a potential remedy. This amendment provides a check against the FDIC's unleashed discretion of making arbitrary assessments.

The proposed amendment is intended to avoid previous problems of wrongful assessment which result in a taking without just compensation against solvent commonly controlled depository institutions. First, the amendment requires the FDIC to pierce the corporate veil prior to making an assessment. Second, the amendment clarifies that any assessed sister subsidiary may bring a cause of action for wrongful assessment. Third, it demands compensation for solvent corporations if the FDIC makes an assessment without the proper showing of fraud or wrongdoing on the part of the bank holding company. In addition, the burden is on the government to establish fraud or wrongdoing within the bank holding company structure prior to making its assessment. Moreover, this amendment helps to more closely tailor the cross-guarantee provision to its original purpose of minimizing fraud and insider abuse within banking institutions.

## V. CONCLUSION

The state of bank failures during the past decade has caused two related developments. First, it has motivated Congress to belatedly review this nation's outdated banking laws. Second, it has caused both the regulators and Congress to search for ways to offset the effects of these failures on the publicly guaranteed deposit insurance funds. Spurred by this second motivation, Congress developed the cross-guarantee provision, which requires that a subsidiary within a bank holding system reimburse the FDIC for bailing out a troubled or failing subsidiary in the same system.

If a government agency possesses unrestricted power to seize the assets from a solvent banking corporation merely because of its affiliation with an insolvent financial institution, a strong possibility exists that the government may abuse its power. As the failure of the Bank of New England illustrates, the

power may be used in ways for which it was not originally intended.<sup>367</sup> More respect for the rights of sibling institutions is necessary, even if the only adjustment in FIRREA is a requirement of a showing of fraud within the bank holding company structure prior to an assessment by the FDIC. Weighing the need for the cross-guarantee assessment provision against the injurious effects the provision has on the safety and soundness of the banking industry is pivotal. By pursuing legislative and regulatory programs that seek to reverse the declining competitiveness of the banking industry and to restore its profitability, Congress and the regulators can best insure that bank holding companies have the resources and the profit-motive to provide capital to a troubled bank subsidiary. Such programs also offer the best hope of providing long-term solutions to the problem of bank failures. The courts and Congress have the capacity to protect the property rights of managerially sound banking institutions and should exert their expertise to do so.

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367. See *supra* notes 37-48, 124-52 and accompanying text.

