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# Larimore v. Comptroller of the Currency: Agency-Ordered Liability of Bank Directors and Officers under 12 U.S.C. 1818(b)(1)

Michelle Culligan

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## **Larimore v. Comptroller of the Currency: Agency-Ordered Liability of Bank Directors and Officers Under 12 U.S.C. § 1818(b)(1)**

During a routine examination of the First National Bank of Mt. Auburn, Illinois (First National),<sup>1</sup> a bank examiner from the Office of the Comptroller of the Currency discovered that amounts outstanding on two lines of credit exceeded the bank's statutory lending limit.<sup>2</sup> The bank examiner determined that an ineffective loan approval procedure coupled with inadequate loan supervision by the bank's directors had caused the violations.<sup>3</sup> Although the examiner warned the bank's directors of potential personal liability for amounts exceeding the lending limit,<sup>4</sup> a later examination revealed additional excessive loans

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1. First National Bank of Mt. Auburn "is a small, federally chartered bank." *Larimore v. Conover*, 775 F.2d 890, 893 (7th Cir. 1985) (*Larimore I*), *rev'd on rehearing sub nom. Larimore v. Comptroller of the Currency*, 789 F.2d 1244 (7th Cir. 1986) (*Larimore II*).

2. *Larimore II*, 789 F.2d at 1245-46. When the loans were made, a line of credit to any one customer exceeding 10% of a bank's equity violated 12 U.S.C. § 84(a)(1) (1982). *Larimore II*, 789 F.2d at 1245 n.1. Congress in 1982 increased the lending limit of § 84 to 15%, providing in relevant part:

(a) Total loans and extensions of credit

(1) The total loans and extensions of credit by a national banking association to a person outstanding at one time and not fully secured . . . by collateral having a market value at least equal to the amount of the loan or extension of credit shall not exceed 15 per centum of the unimpaired capital and unimpaired surplus of the association.

12 U.S.C. § 84 (1982); *Larimore II*, 789 F.2d at 1245 n.1. The two lines of credit, to William Porter and Twin County Trucking/Robert Varvel, exceeded the statutory loan limit by \$88,632. Reply Brief of Respondent at 5, *Larimore I*, 775 F.2d 890 (7th Cir. 1985) (Nos. 84-1971, 84-1972, 84-1973, 84-1974) [hereinafter Reply Brief], *rev'd on rehearing sub nom. Larimore v. Comptroller of the Currency*, 789 F.2d 1244 (7th Cir. 1986).

3. *Larimore I*, 775 F.2d at 893. First National's president each month submitted a list of loans to the bank's Board of Directors for their approval. *Id.* The loan list, however, indicated neither the total amount of outstanding loans on any line of credit nor the statutory lending limit. *Id.* The Comptroller, noting that the information was readily available to the directors through minimal investigation, found this procedure inadequate. Reply Brief, *supra* note 2, at 12.

4. *Larimore I*, 775 F.2d at 893-94. The bank examiner, during a post-examination interview with all of First National's directors, advised them of the loan limit violations and their potential liability. Reply Brief, *supra* note 2, at 5-6. In a later report, the examiner again warned three of the bank's directors

on the same two lines of credit and four others.<sup>5</sup>

First National's troubles prompted the Comptroller to initiate administrative proceedings to obtain a cease-and-desist order against the bank and its directors.<sup>6</sup> After a hearing, an administrative law judge found that the directors had knowingly approved excessive loans and ruled that they were personally liable for the amounts of the loans in excess of the

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of their potential personal liability and strongly recommended that the directors exercise more supervision over loans. *Id.* at 6-7. Within a month, the Porter and Varvel lines of credit were reduced below the statutory limit. *Id.* at 7.

5. Beginning in July 1981, the Board again approved loans to Porter and Varvel in violation of the bank's limit. Reply Brief, *supra* note 2, at 7. By March 1982, the directors had approved 35 loans to Porter resulting in a debt of \$309,447, which was three times the Bank's loan limit. *Id.* The Board discussed the Porter loans during a March 1982 meeting, expressing the hope that present contract proceeds would reduce Porter's obligations. *Id.* During the next five months, however, the bank approved an additional 18 loans to Porter. *Id.* By July 1982, Porter owed the bank \$704,166, an amount constituting 61.92% of the bank's total capital funds and a gross violation of the existing 10% limit. *Id.* at 8. During this same time period, the bank approved 22 illegal loans on the Varvel line of credit, the amount of which increased to \$183,168. *Id.* Amounts on the other four lines of credit exceeded the lending limit by \$33,945, \$82,117, \$57,442, and \$96,000. *Id.* at 13.

6. *Larimore II*, 789 F.2d at 1246. Under 12 U.S.C. § 1818(b)(1) (1982), a banking agency initiates administrative proceedings by issuing a notice of charges to the bank and its directors. The notice of charges contains a statement of the facts constituting the alleged violation or unsafe or unsound practice and fixes a time and place for a hearing to determine whether an order to cease-and-desist is warranted. 12 U.S.C. § 1818(b)(1) (1982). If a party so served does not appear at the hearing, the party is considered to have consented to the order. *Id.* For the text of § 1818(b)(1), see *infra* note 10.

The First National directors charged in the notice included Orville Bottrell, who was also president of First National until his resignation on December 31, 1982, Berniece Larimore, who was also the cashier responsible for overall operations, Sam Taylor, William Butcher, who was appointed to fill a vacancy on the Board on January 7, 1982, and Albert Mulberry, who died after the issuance of the order and whose estate was ultimately relieved of liability. *Larimore I*, 775 F.2d at 893-94.

The parties stipulated to a cease-and-desist order on all the provisions contained in the notice of charges except those that imposed joint and several liability on the directors for the excessive loan amounts and those that demanded reimbursement from the directors for the violations. *Larimore II*, 789 F.2d at 1246 n.2; Reply Brief, *supra* note 2, at 11. In addition to imposing personal liability on the directors, the Comptroller's proposed order prohibited the bank from lending money or extending credit to any borrower in an amount exceeding the § 84 limit and required the bank to adopt procedures and policies that would prevent violations of the banking laws. *Larimore I*, 775 F.2d at 892-93. The proposed order also directed the Board to reduce all extensions of credit in excess of the lending limit to conforming amounts without loss to the bank. *Id.* at 892.

lending limit.<sup>7</sup> The Comptroller then assessed damages jointly and severally in excess of one million dollars and ordered First National's directors to reimburse the bank that amount.<sup>8</sup> The Comptroller based its authority for ordering the directors to reimburse the bank on language in section 1818(b)(1) of the Financial Institutions Regulatory and Interest Rate Control Act, which provides that an agency's cease-and-desist order may require a bank or its officials<sup>9</sup> to "take affirmative action" to correct the conditions resulting from any violation or unsafe practice.<sup>10</sup> The Comptroller argued that "affirmative action"

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7. *Larimore II*, 789 F.2d at 1247. The administrative law judge (ALJ), however, did not impose personal liability on one director because he was not on notice of the amount of the line of credit extended to any borrower.

Although 5 U.S.C. § 556(b)(3) (1982) provides for the appointment of an ALJ to preside over the taking of evidence in the hearing, the ALJ's decision is subordinate to the final decision of the Comptroller. See 12 C.F.R. §§ 19.12-.14 (1986) (authorizing the Comptroller to review the ALJ's decision). The case is thus submitted for final decision to the Comptroller, who may disregard the ALJ's findings. *Id.* Section 1818(b)(1) provides, for example, that the agency may, in its discretion, issue an order if it finds that the record of the hearing establishes a violation or unsafe practice. 12 U.S.C. § 1818(b)(1) (1982). See *infra* note 10. See also 5 U.S.C. § 557(b) (1982) (an agency not presiding over the hearing may review the presiding employee's initial decision and retain all the powers it would have had in making the initial decision).

In *Larimore I*, the ALJ ruled that all of the directors except Butcher had to reimburse the bank for the excessive loan amounts. *Larimore II*, 789 F.2d at 1247. The ALJ ruled that because Butcher became a member of the Board in January 1982 without any prior experience as a bank director and was unaware that he was violating § 84 by approving the loans, he should not be held responsible. *Id.* Comptroller Robert Clarke, however, overruled the ALJ's decision not to assess liability and damages against Butcher, ruling that he should have known of the violations. *Id.*

8. Reply Brief, *supra* note 2, at 12-13. Each director's "maximum potential liability" equalled the difference between the balance on each credit line immediately prior to the first excessive loan and the maximum subsequent outstanding balance on each of the six lines of credit. *Id.* In addition, the total potential liability of the directors varied according to their terms of office and attendance at directors meetings during which certain loans were approved. *Larimore I*, 775 F.2d at 893 n.3. Thus, of the total assessed damages of \$1,084,883, Directors Bottrell, Larimore, and Taylor would be liable for up to the full amount, while Mulberry would be liable for up to \$1,052,176 and Butcher for up to \$744,053. *Id.* at 894.

9. For purposes of brevity, the term "bank official" includes a bank director, officer, agent, or other person participating in the conduct of the affairs of the bank. The term "bank" is used generically for financial institutions.

10. Section 1818(b)(1) provides:

(b) Cease-and-Desist proceedings (1) If, in the opinion of the appropriate Federal banking agency, any insured bank, bank which has insured deposits, or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such a bank is engaging or has engaged, or the agency has reasonable cause to believe

includes reimbursing the bank for loan amounts in excess of the bank's statutory lending limit.<sup>11</sup>

On review,<sup>12</sup> a panel of the United States Court of Appeals for the Seventh Circuit in *Larimore v. Conover (Larimore I)*<sup>13</sup> upheld the Comptroller's assessment of personal liability against the bank directors.<sup>14</sup> After a rehearing en banc, the Seventh Circuit in *Larimore v. Comptroller of the Currency (Larimore II)* vacated the order,<sup>15</sup> holding that the Comptroller lacked authority under section 1818(b)(1) to require bank directors to reimburse First National.<sup>16</sup> The *Larimore II* court concluded that the Comptroller may seek damages from a director

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that the bank or any director, officer, . . . is about to engage, in an unsafe or unsound practice in conducting the business of such bank, or is violating or has violated, or the agency has reasonable cause to believe that the bank . . . is about to violate, a law, rule, or regulation, or any condition imposed in writing by the agency . . . , the agency may issue and serve upon the bank or such director, officer, employee, agent, or other person a notice of charges in respect thereof. . . . [I]f upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the bank or the director . . . an order to cease and desist from any such violation or practice . . . and, *further, to take affirmative action to correct the conditions resulting from any such violation or practice.*

12 U.S.C. § 1818(b)(1) (1982) (emphasis added).

The Comptroller interpreted the language "to take affirmative action" to permit the Comptroller to order the directors to reimburse the Bank for any losses. *Larimore II*, 789 F.2d at 1249-50. According to the Comptroller, Congress intended to give the agencies broad discretion in fashioning remedies, and reimbursement is one of the available corrective remedies. Reply Brief, *supra* note 2, at 18-21. The Comptroller argued further that the "selection of remedies for the loan limit violations should be accorded special deference since they require policy judgments on how to maintain a safe and sound banking system which fall within his particular expertise." *Id.* at 20-21.

11. *Larimore II*, 789 F.2d at 1249-50.

12. Any person against whom an order to cease-and-desist has been issued may obtain a review of that order by petitioning the court of appeals for "the circuit in which the home office of the bank is located . . . within thirty days after the date of service of such order." 12 U.S.C. § 1818(h)(2) (1982).

13. 775 F.2d 890 (7th Cir. 1985), *rev'd on rehearing sub nom.* *Larimore v. Comptroller of the Currency*, 789 F.2d 1244 (7th Cir. 1986).

14. *Id.* at 896. The court held that the chosen remedy, reimbursement, was not "arbitrary or capricious." *Id.* The court assumed the Comptroller had authority to order reimbursement, stating simply that "[s]ection 1818(b)(1) has been construed by the Ninth Circuit to authorize orders requiring directors to compensate for losses incurred by reason of violations of a bank's lending limits under Sec. 84." *Id.* at 895.

15. 789 F.2d 1244, 1245 (7th Cir. 1986).

16. *Id.* at 1256.

only through section 93(a) of the National Bank Act,<sup>17</sup> which allows the Comptroller to pursue a civil action for damages in a federal district court.<sup>18</sup>

Numerous federal agencies rely on section 1818 in their regulation of the nation's financial institutions.<sup>19</sup> Although no

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17. *Id.* The court stated:

Our review of the express language of 12 U.S.C. § 93 and 12 U.S.C. § 1818(b)(1), their statutory scheme and the Senate Reports, clearly demonstrate [sic] that Congress intended the Comptroller only be allowed to seek damages from an individual director after a suit has been filed and adjudicated in the 'proper territorial or district court' pursuant to 12 U.S.C. § 93(a).

*Id.*

18. 12 U.S.C. § 93(a) (1982). This provision states in pertinent part:

If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers [or] agents . . . to violate any of the provisions of this chapter, all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper district or Territorial court of the United States in a suit brought for that purpose by the Comptroller of the Currency . . . . And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation.

*Id.* Courts have interpreted § 93(a) to permit causes of actions against bank directors by parties other than the Comptroller. The bank, its shareholders, even its minority shareholders, have been permitted to sue bank directors under § 93(a). *See, e.g.,* Seiden v. Butcher, 443 F. Supp. 384 (S.D.N.Y. 1978) (stating that 12 U.S.C. § 93 creates a private right of action by a shareholder prior to a forfeiture suit brought by the Comptroller); First Nat'l Bank of Lincolnwood v. Keller, 318 F. Supp. 339 (N.D. Ill. 1970) (national banking association sued its former president and director to recover a loss of approximately \$250,000 from violations of 12 U.S.C. § 84). *See also* Corsicana Nat'l Bank v. Johnson, 251 U.S. 68 (1919) (holding that a private bank may sue its director under § 5239 of the National Bank Act, now codified at 12 U.S.C. § 93, for losses resulting from director's actions and holding that bank's solvency is not a defense); Chesbrough v. Woodworth, 244 U.S. 72 (1917) (an action brought against the directors for damages sustained by an individual); Spalitta v. National Am. Bank of New Orleans, 444 F.2d 291 (5th Cir. 1971) (stockholder derivative and class action suits against certain officers and directors of bank based on alleged violations of National Bank Act); Cockrill v. Cooper, 86 F. 7 (8th Cir. 1898) (forfeiture of a bank's franchise is not a condition precedent to maintenance of a suit against directors for excessive loans). *Cockrill* established that a bank's charter need not be revoked before bringing an action under § 93. 86 F. at 11-13 (suit on § 5239 of the National Bank Act, now codified at 12 U.S.C. § 93).

19. The powers in § 1818 may be employed by the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, 12 U.S.C. § 1818(b) (1982), and the National Credit Union Association, 12 U.S.C. § 1786(e)(1) (1982). The Federal Home Loan Bank Board has identical powers in the Home Owner's Loan Act, *id.* § 1464(d), and the National Housing Act, *id.* § 1730(e).

provision in section 1818 explicitly grants agencies the power to order bank officials to reimburse their bank for losses sustained from violations or unsafe practices, the agencies have increasingly interpreted "take affirmative action" to include reimbursement orders.<sup>20</sup> In a recent attempt to overrule *Larimore II*, the Comptroller has proposed an amendment to section 1818(b)(1) that would explicitly authorize reimbursement orders.<sup>21</sup> This Comment considers whether section 1818(b)(1)

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20. Between 1980 and 1983, the banking agencies implemented a total of 588 cease-and-desist orders against institutions and 22 against individuals. H.R. REP. NO. 1137, 98th Cong., 2d Sess. 154 (1984) (table of civil enforcement actions taken by the banking agencies from 1980 to 1983). This is a marked increase from the 108 orders issued from 1971 to 1976. *Id.* at 143. The inclusion of a reimbursement demand in cease-and-desist orders also has increased over the past few years. See, e.g., OFFICE OF COMPTROLLER OF CURRENCY, 5 QUARTERLY JOURNAL NO. 1, at 105, 110-11 (1986) (administrative actions 305 and 328 required directors to reimburse banks for losses resulting from violations of 12 U.S.C. § 84); OFFICE OF COMPTROLLER OF CURRENCY, 4 QUARTERLY JOURNAL NO. 3, at 136, 142, 143 (1985); OFFICE OF COMPTROLLER OF CURRENCY, 4 QUARTERLY JOURNAL NO. 1, at 78, 80, 83, 92, 109 (1985); OFFICE OF COMPTROLLER OF CURRENCY, 3 QUARTERLY JOURNAL NO. 3, at 95, 101, 106, 109 (1984). There are over 40 final cease-and-desist orders listed in the past few journal issues that include requirements that the board of directors or an individual officer reimburse the bank for losses. *Id.*

For the Comptroller's viewpoint on interpreting "take affirmative action," see Comptroller Staff Interpretive Letters, *Truth-in-Lending Act Restitution Requirements*, [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,040 (Oct. 6, 1977). In answer to a letter concerning the Comptroller's authority to require reimbursement for violations of the Truth in Lending Act, the Deputy Comptroller noted that 12 U.S.C. § 1818(b) states "affirmative action" is to be taken pursuant to cease-and-desist proceedings and the Comptroller has on numerous occasions demanded national bank reimbursements. *Id.* at 85,041. An interpretive letter responding to the question whether personal liability can be imposed against bank directors for any loss from a new extension of credit to an overline loan states that a formal administrative action can be initiated under 12 U.S.C. § 1818(b)(1). *New Bank Director is Not Personally Liable for Renewed Overline Loan*, [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,450 (Apr. 23, 1984). This action could require directors to take affirmative action, but under the circumstances posed in the letter, such an administrative action "would not result in the new directors being required . . . to reimburse or indemnify the Bank for any loss." *Id.* In one case, the Comptroller ordered a board of directors to reimburse \$63,000 to a bank for losses resulting from lending limit violations and to pay a civil money penalty of \$5,000. *OCC Issues Orders Against Bank's Board of Directors for Losses Incurred on Combined Loans Violating Legal Lending Limits*, [1984-1985 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,254 (Apr. 25, 1985). The Comptroller's release stated the Comptroller "would continue to consider appropriate administrative action in those instances where a bank violates its legal lending limit." *Id.*

21. See Letter from Robert M. Kimmitt, General Counsel, Dep't of Treasury, to Hon. George Bush, President of the Senate (Aug. 25, 1986) (recommending prompt consideration of a bill to amend 12 U.S.C. § 1818(b)(1) "to

authorizes, or should be amended to authorize, federal banking agencies to impose personal liability on bank officials. Part I briefly outlines the evolution of agency cease-and-desist orders against banks and bank officials and then discusses the conflicting *Larimore* decisions. Part II next examines in detail additional considerations raised by the legislative history of section 1818(b)(1), the legislative enforcement scheme encompassing sections 1818 and 93(a), and public policy that the Seventh Circuit overlooked in its *Larimore II* holding. This Comment concludes that *Larimore II* was correctly decided and that section 93(a) should be the avenue for imposing personal liability on bank directors.

## I. SECTION 1818(b)(1) AND THE CONFLICTING *LARIMORE* DECISIONS

### A. THE EVOLUTION OF BANKING AGENCY SUPERVISORY AND ENFORCEMENT POWERS

Until 1966, the only enforcement tools available to federal banking agencies were conservatorship and termination of the institution's insured status.<sup>22</sup> The severity of conservatorship and the time consuming procedure required to terminate insured status, however, seriously handicapped the banking agencies' supervisory efforts.<sup>23</sup> In response to the need for more

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specify examples of the forms of affirmative action that the Federal banking agencies may order to redress violations of law, or unsafe or unsound banking practices"); see also Sharpe, *Office and Director Liability*, in LEGAL PROBLEMS OF BANK REGULATION 442 (Law Journal-Seminars Press ed. 1986) (noting that an amendment to § 1818(b) is under consideration). The amendment would also prevent any other provision in the chapter—meaning § 93(a)—from restricting the use of reimbursement orders. The *Larimore II* court suggested that if the Comptroller needs the power to order reimbursement it should ask Congress to pass enabling legislation amending § 1818(b)(1). 789 F.2d at 1256.

22. See 12 U.S.C. § 1818(a) (1982) (termination of status as insured bank).

23. See S. REP. NO. 1482, 89th Cong., 2d Sess. 5, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3536. The Senate Report quotes a letter of March 20, 1966, signed by the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Federal Home Loan Bank Board, and the Chairman of the Federal Deposit Insurance Corporation, that sets forth the need for improved supervisory powers. *Id.* The letter states:

Even though few in number, improperly conducted institutions could cause public concern that might extend to the entire industry. In such cases, it is essential that the Federal supervisory agencies have the statutory and administrative facility to move quickly and effectively to require adherence to the law and cessation and correction of unsafe or improper practices.

Existing remedies have proven inadequate. On the one hand they



effective enforcement powers, Congress in 1966 enacted the Financial Institutions Supervisory Act of 1966, creating section 1818.<sup>24</sup> Congress adopted section 1818 to add strength, flexibility, and speed to the supervisory powers of the federal banking agencies.<sup>25</sup>

Foremost among the weapons of section 1818 is a cease-and-desist order issued against a financial institution following an administrative proceeding.<sup>26</sup> An agency may initiate such a proceeding when it knows or reasonably believes that a bank has violated or will violate a law, rule, or regulation or when an "unsafe or unsound practice" threatens the bank's viability.<sup>27</sup> These proceedings might culminate in a final order requiring the bank to halt the violations and unsafe practices and to "take affirmative action" to correct the problems.<sup>28</sup> Although a cease-and-desist order under the 1966 Act could only be directed against the bank,<sup>29</sup> other important enforcement tools,

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may be too severe for many situations, such as taking custody of an institution or terminating its insured status. On the other they may be so time consuming and cumbersome that substantial injury occurs to the institution before remedial action is effected.

*Id.* As for delay, the procedure for terminating insured status, as the letter notes, involved notice to the bank or offending officer or director, an opportunity to make corrections within a 120-day period, an opportunity for a hearing, and a final notice of termination issued at a later date. *Id.* at 6, 1966 U.S. CODE CONG. & ADMIN. NEWS at 3537. As for severity, the agency chairmen stated that taking custody of the institution was an immediate remedy, but was too drastic except as a last resort. *Id.* Taking custody of an institution was done only when the management was uncooperative and when it was the only means through which losses could be minimized by putting an immediate stop to violations of law or improper practices. *Id.*

24. Pub. L. No. 89-695, 80 Stat. 1028 (codified as amended at 12 U.S.C. § 1818 (1982)). The purpose of the Act was to provide "intermediate powers short of conservatorship or withdrawal of insurance, in order to prevent violations of law or regulation and unsafe and unsound practices which otherwise might adversely affect the Nation's financial institutions, with resulting harmful consequences to the growth and development of the Nation's economy." S. REP. NO. 1482, 89th Cong., 2d Sess. 1, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3533.

25. See S. REP. NO. 1482, 89th Cong., 2d Sess. 6, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3538.

26. See H.R. REP. NO. 1137, 98th Cong., 2d Sess. 146 (1984). The Committee on Government Operations stated that the authority to issue cease-and-desist orders was one of the agencies' more powerful weapons against insider abuse because such orders are legally enforceable and may provide a basis for imposing civil money penalties. *Id.* at 145-46.

27. See 12 U.S.C. § 1818(b)(1) (1982). For the text of § 1818(b)(1), see *supra* note 10.

28. *Id.*

29. Pub. L. No. 89-695, 80 Stat. 1028, 1047 (codified as amended at 12 U.S.C. § 1818(b)(1) (1982)). The 1966 Act provided for both permanent and

such as suspension or removal of bank officials, were enforceable directly against individuals.<sup>30</sup>

Several major bank failures in the early 1970s,<sup>31</sup> and the revelation in 1977 of massive insider dealings involving President Carter's Director of the Office of Management and Budget,<sup>32</sup> publicly illuminated the inadequacy of enforcement powers under the 1966 Act and revealed a need for greater supervision of bank officials.<sup>33</sup> Thus, in 1978 Congress amended section 1818 to provide the regulatory agencies with even more comprehensive enforcement powers intended to permit the tailoring of solutions to specific problems.<sup>34</sup> A pivotal amendment

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temporary cease-and-desist orders. *Id.* An agency could seek a temporary order if the practices or violations were likely to cause any of three conditions: (1) insolvency, (2) substantial dissipation of assets or earnings, or (3) a situation that otherwise would prejudice seriously the interests of the depositors before the cease-and-desist proceedings. *Id.* at 1047 (codified as amended at 12 U.S.C. § 1818(c)(1) (1982)). A party had 10 days to apply to the United States district court for an injunction setting aside, limiting, or suspending the enforcement of the temporary order. *Id.* (codified as amended at 12 U.S.C. § 1818(c)(2) (1982)).

30. *Id.* at 1047-50 (codified as amended at 12 U.S.C. § 1818(e) (1982)).

31. See H.R. REP. NO. 1383, 95th Cong., 2d Sess. 8, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9280. In 1973, the one billion dollar United States National Bank of San Diego failed primarily because of massive insider abuses at the bank by the chief executive officer, whose own business enterprises took some \$400 million in loans from the bank. *Id.* In 1974, the five billion dollar Franklin National Bank in New York collapsed and, in 1975, the Hamilton National Bank of Chattanooga, "the flagship of a multistate bank holding company," failed. *Id.* at 9, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 9281.

32. *Id.* at 9, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 9281. The revelations of Bert Lance's insider dealings while he served as a bank official in Georgia, before he became director of the Office of Management and Budget, received widespread publicity in mid-1977. *Id.*

33. The regulatory agencies complained that the tools of the 1966 Act limited their ability to control insider abuses and to ensure that financial institutions were operated in a safe and sound manner. *Id.* at 17, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 9289. The House Report stated:

The hearing records are filled with statements that the agency has the choice of either jawboning—sending letters to officials asking for their cooperation in correcting problems—or using a blunderbuss on the institution. Agency officials have asked for powers which lie somewhere between these two approaches so that they can tailor solutions and responses to specific problems and thus more effectively do their job.

*Id.*

34. Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (codified as amended at 12 U.S.C. § 1818 (1982)). Title I of the legislation includes the amended supervisory powers over financial institutions. *Id.* For a discussion of the new enforcement powers, see *infra* note 90.

to section 1818 allowed the issuance of cease-and-desist orders directly against bank officials and employees.<sup>35</sup> Agencies could now reach the party primarily responsible for a violation or unsafe practice and could require either a bank or its officials to "take affirmative action" to correct problems.<sup>36</sup> The 1978 amendment also liberalized the issuance of suspension or removal orders.<sup>37</sup> Finally, Congress added a provision to section 1818 authorizing the assessment of a civil money penalty of up to \$1,000 for each day in which a violation of a law, rule, regulation, or final order persists.<sup>38</sup>

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35. *Id.* (current version at 12 U.S.C. § 1818(b)(1) (1982)). The original Act only applied to insured banks or a bank with insured deposits, not to directors, officers, employers, or agents. See Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028, 1046 (current version at 12 U.S.C. § 1818(b) & (c) (1982)). The 1978 amendment added the language in § 1818(b) and (c): "or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank." Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641, 3649 (current version at 12 U.S.C. § 1818(b) & (c) (1982)). The inclusion of individuals within the ambit of cease-and-desist orders was intended to allow regulatory agencies to initiate proceedings against the party responsible for the violations or unsafe practices, rather than against the bank. H.R. REP. NO. 1383, 95th Cong., 2d Sess. 18, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9290.

36. See H.R. REP. NO. 1383, 95th Cong., 2d Sess. 18, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9290. The House Committee on Banking, Finance and Urban Affairs noted the agencies' argument that in many cases it would be inappropriate to issue an order against the bank, especially in a situation where, for example, a bank is controlled and managed by one major stockholder. *Id.* In such a case the bank would be "unjustly tainted if a cease-and-desist order is entered against the institution when the practices which are to be stopped by the order may have been the sole responsibility of the stockholder." *Id.*

37. Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (codified as amended at 12 U.S.C. § 1818(e) (1982)). The amendment broadened the reach of suspension or removal from cases involving personal dishonesty to situations in which the bank official's conduct exhibits a willful or continuing disregard for the safety and soundness of the financial institution. *Id.* The House Committee on Banking, Finance and Urban Affairs believed the new standard would provide the opportunity to move "against individuals who may not be acting in a fraudulent manner but who are nonetheless acting in a manner which threatens the soundness of their institution." H.R. REP. NO. 1383, 95th Cong., 2d Sess. 18, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9290.

38. Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (codified as amended at 12 U.S.C. § 1818(i)(2)(i) (1982)). Civil money penalties for violations were intended not only as a deterrent, but also to give the agencies the flexibility they needed to secure compliance with banking laws and final orders by individuals or institutions. H.R. REP. NO. 1383, 95th Cong., 2d Sess. 17, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9289. Civil money penalties of not more than

Before 1978, banking agencies sought damages from bank directors through civil actions pursuant to section 93(a) which provides that a director can be held personally liable for knowing violations of the National Bank Act.<sup>39</sup> After Congress amended section 1818, however, agencies found it easier and quicker to impose liability directly against bank officials through a cease-and-desist order under the "take affirmative action" provision of section 1818(b)(1).<sup>40</sup>

## B. THE LARIMORE DECISIONS

Courts reviewing reimbursement orders based on section 1818(b)(1) have divided over the scope of remedial authority provided by the language "take affirmative action." Some courts have interpreted the clause liberally to permit such reimbursement orders.<sup>41</sup> These courts generally have ignored the

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\$1,000 per day for each day during which there is a violation can be imposed against any bank or bank official for any violation of the terms of any order, pursuant to 12 U.S.C. § 1818(i)(2)(i), or for any violation of banking laws, pursuant to 12 U.S.C. § 93(b). 12 U.S.C. §§ 93(b), 1818(i)(2)(i) (1982). Before this amendment, an agency faced the option of either ignoring a violation or imposing a penalty that it often considered to be an overkill. 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9289.

39. For the text of this provision, see *supra* note 18.

40. See OFFICE OF COMPTROLLER OF CURRENCY, 5 QUARTERLY JOURNAL No. 1 (1986). The numerous orders listed in recent issues of the *Quarterly Journal* show that the Comptroller is actively using this method for recovering losses to a bank, indicating the convenience of reimbursement orders compared to pursuing a civil action. See *supra* note 20.

41. In *del Junco v. Conover*, 682 F.2d 1338 (9th Cir. 1982), *cert. denied*, 459 U.S. 1146 (1983), the court stated only that "[t]he Comptroller has broad discretion to fashion a remedy." *Id.* at 1340. In *del Junco*, the Comptroller discovered three loans that the bank nominally had extended to three different debtors but that were in fact extended to the same entity. *Id.* at 1339. When aggregated under the rules of § 84, the loans exceeded the statutory lending limit. *Id.* The Comptroller ordered indemnification by the directors of the bank and held each potentially liable in the amount of \$350,000 for lost principal and interest on the two loans, attorneys fees, and collection costs of the loans. *Id.* at 1339-40. Although the court noted that past violations of § 84 were enforced through district court proceedings pursuant to § 93, the court did not question the Comptroller's authority to order reimbursement under § 1818(b)(1). *Id.* at 1342. The court instead focused on whether § 1818(b)(1) imports the scienter requirement of § 93(a). *Id.*

In *First Nat'l Bank of Eden v. Department of Treasury*, 568 F.2d 610 (8th Cir. 1978), the United States Court of Appeals for the Eighth Circuit also liberally construed § 1818(b)(1). In this case, the Comptroller's order required the bank's president and vice-president to reimburse the bank in the amount of \$61,000 for excessive bonuses paid to them. *Id.* at 611. The court, relying on the Comptroller's expertise and discretion in this area, did not analyze the scope of § 1818(b)(1) but only conclusorily stated that "[t]he requirements im-

threshold issue of whether the "take affirmative action" provision permits reimbursement<sup>42</sup> and instead have deferred to the agency's assertion of its authority to fashion such orders.<sup>43</sup> Other courts, however, have confronted the issue and have resolved it by strictly interpreting section 1818(b)(1) and refusing to allow the agencies to order reimbursement.<sup>44</sup>

The *Larimore* decisions illustrate these two approaches. The *Larimore I* court assumed that section 1818(b)(1) autho-

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posed in the order are authorized by the statute and no abuse of discretion is apparent in this regard." *Id.* at 611-12.

42. See *supra* note 41.

43. *Id.*

44. In *Citizens State Bank of Marshfield v. FDIC*, 751 F.2d 209 (8th Cir. 1984), the United States Court of Appeals for the Eighth Circuit held that § 1818(b)(1), which was employed to enforce violations of the Truth in Lending Act, did not authorize agency-ordered reimbursement as a remedy for violations of that Act. *Id.* at 219. In that case, the FDIC had found numerous violations of the Truth in Lending Act and, contrary to the ALJ's recommendation against sanctions, ordered reimbursement for overcharges resulting from the violations. *Id.* at 211. On appeal, the Eighth Circuit refused to defer completely to the FDIC's discretion, stating that "deference accorded to administrative construction of legislation does not extend to allow an agency to finally decide the limits of its powers." *Id.* at 217 (citing *Social Sec. Bd. v. Nierotko*, 327 U.S. 358, 369 (1946)). The court noted that the Truth in Lending Act grants a private right of action for violations of the Act under 15 U.S.C. § 1640 (1982). *Id.* at 217. Reasoning that an agency-ordered reimbursement serves no function beyond a civil remedy, the court held that allowing reimbursement would administratively preempt the statutory enforcement scheme designed by Congress. *Id.*

The United States Court of Appeals for the Tenth Circuit, in *Otero Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 665 F.2d 279 (10th Cir. 1981), strictly interpreted 12 U.S.C. § 1730(e)(1), which was promulgated along with § 1818 as part of the Financial Institutions Supervisory Act of 1966 and contains identical "take affirmative action" language. *Otero Sav. & Loan Ass'n*, 665 F.2d at 287; 12 U.S.C. § 1730(e)(1) (1982). In *Otero Sav. & Loan Ass'n*, the Federal Home Loan Bank Board issued an order requiring savings and loan associations to cease offering certain services, such as customer check-in or related automatic transfer system accounts or negotiable orders of withdrawal accounts, for a period of 268 days to give competitors time to overcome disadvantages caused by banking violations. *Otero Sav. & Loan Ass'n*, 665 F.2d at 281. The court determined that the bank board's remedial authority was limited to ensuring that "institutions conduct their affairs in a legal, safe and sound manner" and that this did not include attempts to maintain the competitive balance among financial institutions. *Id.* at 288. The court noted that "[t]he purpose of the enforcement provisions is to quickly stop fraudulent practices, not to affirmatively recover for them." *Id.* (quoting *FSLIC v. Fielding*, 309 F. Supp. 1146, 1149 (D. Nev. 1969), *cert. denied*, 400 U.S. 1009 (1971)). The *Otero* court found its holding consistent with *First Nat'l Bank of Eden*, see *supra* note 41, because in that case the Comptroller's order "was properly directed to preventing future specified abuses and reversing the direct, identifiable effects of the past practices on the bank's financial soundness." *Otero Sav. & Loan Ass'n*, 665 F.2d at 288.

rizes reimbursement orders against bank officials for losses incurred from lending-limit violations.<sup>45</sup> The *Larimore I* majority instead identified the main issues as whether section 1818(b)(1) incorporates the scienter requirement of section 93(a) and whether the Comptroller's findings were supported by substantial evidence.<sup>46</sup> The court concluded that because the order was not arbitrary or capricious and because a rational basis existed for the chosen remedy, the reimbursement order was proper under section 1818(b)(1).<sup>47</sup>

Unlike the *Larimore I* court, which adopted the liberal interpretation of section 1818(b)(1), the Seventh Circuit in *Larimore II* directly confronted the issue whether the language "take affirmative action" authorizes an agency's imposition of personal liability against bank officials.<sup>48</sup> The court first examined section 93(a) of title 12, noting that it provides the Comptroller with authority to pursue an action for damages in federal court against a bank director personally for damages resulting from knowing violations of the lending limits.<sup>49</sup> The court then found that "[a]lthough the action of the Comptroller in the case before us is technically labeled as an order to indemnify, it has the effect of an enforceable personal judgment against a director for damages sustained by the bank."<sup>50</sup> Thus,

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45. See 775 F.2d 890, 895 (7th Cir. 1985), *rev'd on rehearing sub nom. Larimore v. Comptroller of the Currency*, 789 F.2d 1244 (7th Cir. 1986). The court relied on *del Junco*, see *supra* note 41, stating that "[s]ection 1818(b)(1) has been construed by the Ninth Circuit to authorize orders requiring directors to compensate for losses incurred by reason of violations of a bank's lending limits under Sec. 84." *Larimore I*, 775 F.2d at 895. Judge Coffey in *Larimore I* strongly disagreed and criticized the majority for failing to analyze the threshold issue. *Id.* at 896 (Coffey, J., dissenting). Judge Coffey conducted an extensive examination of the scope of the Comptroller's remedial authority and concluded that neither case law nor statutory authority supported the Comptroller's demand for reimbursement. *Id.* at 902 (Coffey, J., dissenting).

46. 775 F.2d at 895. Section 93(a) requires the complainant to prove that the bank director knowingly violated the National Bank Act. 12 U.S.C. § 93(a) (1982). For the text of 12 U.S.C. § 93(a), see *supra* note 18.

47. *Larimore I*, 775 F.2d at 896. The court stated that the "violations here were not minimal oversights or a mere failure to implement obscure banking regulations" and that the directors were responsible for conducting the affairs of the bank in a safe and lawful manner, regardless of whether they were "new directors" or "outside directors." *Id.* The court found that there was "a clear, rational basis for a remedy which corrects the financial harm that results from the directors' unlawful conduct." *Id.*

48. 789 F.2d 1244, 1248 (7th Cir. 1986). The court granted the rehearing en banc because the majority of the panel in *Larimore I* had failed to address this issue. *Id.*

49. *Id.* at 1249.

50. *Id.*

by ordering the directors to reimburse the bank personally, the court reasoned, the Comptroller had found the directors personally liable in an administrative proceeding without resorting to a trial in federal court and had therefore violated section 93(a).<sup>51</sup>

The *Larimore II* court next scrutinized the Comptroller's claim that section 1818(b)(1) provided authority for imposing personal liability on bank directors. The court noted that the legislative history of section 1818 fails to show that Congress intended to give federal banking agencies the powerful enforcement tool of reimbursement.<sup>52</sup> The court also noted that Congress provided for civil money penalties against irresponsible bank officials in sections 1818(i)(2)(i) and 93(b).<sup>53</sup> Section 1818(b)(1) was amended in 1978 to allow the Comptroller to issue a cease-and-desist order against a specific director, officer or employee of the bank.<sup>54</sup> That Congress added civil money penalties to section 93 without mentioning a reimbursement order under section 1818(b)(1), the court stated, illustrated that Congress did not intend to grant the Comptroller the power to order bank officials to reimburse their bank.<sup>55</sup>

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51. *Id.* The court stated that "the Comptroller in the instant case is adjudicating the Bank directors personally liable for violations of 12 U.S.C. § 84 in an administrative action, without a trial before a court of competent jurisdiction, while [§ 93(a)] mandates that such liability 'shall' be 'determined and adjudged by a proper district or territorial court of the United States.'" *Id.* (quoting 12 U.S.C. § 93(a) (1982)).

52. The Comptroller had argued that the legislative history supported the interpretation that Congress intended "a broad range of corrective remedies to protect the health of the national banks." *Id.* at 1252. The Comptroller cited as support for his position the Senate report to the 1966 Act, specifically the statement that "the federal supervisory agencies need the statutory and administrative facility to move quickly and effectively to require adherence to the law and cessation and correction of unsafe or improper practices." *Id.* at 1250 (quoting S. REP. NO. 1482, 89th Cong., 2d Sess. 4-5, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3536). The court, however, stated that "no language or indication in the legislative history of section 1818 . . . can legally, logically or reasonably be interpreted to indicate that Congress intended to give the Comptroller the authority to unilaterally assess personal liability and damages against a bank director." *Id.*

The court's interpretation of the legislative history was that it "merely enables the Comptroller to take immediate action against a director, officer or employee of the bank to prevent further deterioration of a troubled financial institution." *Id.* at 1251.

53. *Id.* at 1254.

54. *Id.* at 1251.

55. *Id.* at 1254. The court stated that "[w]hen Congress provided a specific administrative remedy for assessment of civil penalties, it is only logical that Congress would have also explicitly provided for an administrative procedure

The *Larimore II* court also distinguished the language of section 1818(b)(1) from similar "affirmative action" language in the National Labor Relations Act.<sup>56</sup> The court noted that the National Labor Relations Act explicitly provided for certain types of remedial behavior in its "affirmative action" provision,<sup>57</sup> whereas section 1818(b)(1) lacked explicit instructions concerning reimbursement.<sup>58</sup> According to the court, this distinction emphasized the lack of congressional intent to give federal banking agencies authority to impose personal liability on bank officials.<sup>59</sup>

Finally, the *Larimore II* court dismissed the earlier cases that liberally interpreted section 1818(b)(1) to authorize the imposition of personal liability, noting their failure to address the initial scope issue.<sup>60</sup> The court found support for its strict inter-

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for assessing personal liability if it intended that the Comptroller have this authority." *Id.*

56. *Id.* at 1255. See 29 U.S.C. § 160(c) (1983).

57. *Larimore II*, 789 F.2d at 1255. 29 U.S.C. § 160(c) states that cease-and-desist orders by the National Labor Relations Board may include "affirmative action including reinstatement of employees with or without backpay." 29 U.S.C. § 160(c) (1982).

58. *Larimore II*, 789 F.2d at 1255. According to the Comptroller's argument, a banking agency is entitled to authority similar to the authority to require payment of backpay because § 1818(b)(1) contains similar affirmative action language. *Id.* In *Otero Sav. & Loan Ass'n*, the bank board had advanced the same argument with respect to § 1730(e), the language of which is identical to § 1818(b)(1). *Otero Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 665 F.2d 279, 287 (10th Cir. 1981); see *supra* note 44. The Tenth Circuit, however, quickly dismissed that argument, stating "[t]he language of § 1730(e)(1) is not as broad as the provision in § 10(c) of the National Labor Relations Act authorizing an order for such affirmative action 'as will effectuate the policies of this subchapter.' In light of the wording and legislative history of the statute involved here, the Bank Board's powers appear more limited." *Otero Sav. & Loan Ass'n*, 665 F.2d at 287.

59. *Larimore II*, 789 F.2d at 1255. The court noted with approval the Tenth Circuit's interpretation of the language in *Otero Sav. & Loan Ass'n*. *Id.* The *Larimore* court said that the explicit provision in the National Labor Relations Act for the award of backpay clearly showed congressional intent that the National Labor Relations Board have the authority to assess money damages. *Id.*

60. *Id.* at 1254. The court described the holding of *First Nat'l Bank of Eden v. Department of Treasury*, 568 F.2d 610 (8th Cir. 1978), as "merely recit[ing] the language of 12 U.S.C. § 1818(b)(1) and rubberstamp[ing] the decision of the Comptroller." *Id.* The *Larimore II* court also noted the factual difference between the unjust enrichment of the directors in *First Nat'l Bank of Eden* and the lending limit violations in *Larimore I*. *Id.* Moreover, the *Larimore II* court noted that the legislative history of § 1818(b)(1) might narrowly support the holding in *First Nat'l Bank of Eden*. *Id.* The *Larimore II* court stated that, because *del Junco v. Conover*, 682 F.2d 1338 (9th Cir. 1982), similarly failed to address the scope issue, "to date, no court has analyzed, much



pretation of the statute in several cases that had denied reimbursement under section 1818(b)(1) where a separate statute provided the right to a private cause of action.<sup>61</sup>

The court in *Larimore II* thus rejected the Comptroller's argument that Congress had provided the regulatory agencies with an option to bring either an action for damages in federal court under section 93(a) or to seek reimbursement through an administrative proceeding under section 1818(b)(1).<sup>62</sup> The court instead reasoned that Congress provided for damages actions against bank directors only through section 93(a) and that had Congress intended to provide otherwise, it would have done so explicitly.<sup>63</sup> To interpret section 1818(b)(1) to authorize orders for reimbursement against bank directors and officers personally, the court stated, would effectively "eviscerate" section 93(a).<sup>64</sup>

## II. THE INTENDED SCOPE OF SECTION 1818(b)(1)

An examination of additional legislative history of section 1818(b)(1), the legislative enforcement scheme for regulating banks, and the policy concerns raised by the imposition of per-

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less set forth, any rationale that would support the alleged and usurped authority of the Comptroller of the Currency to issue an order imposing personal liability upon directors." *Larimore II*, 789 F.2d at 1255.

61. The *Larimore II* court relied primarily on *Citizens State Bank of Marshfield v. FDIC*, 751 F.2d 209 (8th Cir. 1984), and *Otero Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 665 F.2d 279 (10th Cir. 1981). For a discussion of these cases, see *supra* note 44. In particular, the court looked to the decision of the Eighth Circuit in *Citizens State Bank of Marshfield*, which held that § 1818(b)(1) does not authorize agency-ordered reimbursement as a remedy for violations of the Truth in Lending Act. *Citizens State Bank of Marshfield*, 751 F.2d at 219; see *supra* note 44. The *Larimore II* court's analysis of § 1818(b)(1)'s proper role within the statutory enforcement scheme paralleled the *Citizens State Bank of Marshfield* court's analysis. Both courts concluded that § 1818(b)(1) does not authorize reimbursement because a separate statute provides a private cause of action. *Larimore II*, 789 F.2d at 1252. 15 U.S.C. § 1640 and 12 U.S.C. § 93(a) each provide the "enforcement mechanism" for imposing personal liability on bank directors and both provide a private cause of action for damages. *Id.*; see 12 U.S.C. § 93(a) (1982); 15 U.S.C. § 1640(a) (1982).

62. 789 F.2d at 1254. The court regarded this argument of the Comptroller as "reaching for any 'straw in the wind' to support his position." *Id.*

63. *Id.* at 1253.

64. *Id.* at 1252. Reasoning that an indemnification order and an enforceable personal judgment are the same in effect, the court concluded that the Comptroller would be able to adjudicate a director's personal liability without bringing his action in federal court as mandated by § 93(a). *Id.* See *infra* note 109 and accompanying text.

sonal liability on bank directors sheds additional light on the *Larimore* decisions and buttresses the holding of *Larimore II*.

#### A. THE HISTORY OF SECTION 1818(b)(1)

##### 1. The 1966 Act

The Senate report accompanying the Financial Institutions Supervisory Act of 1966 emphasized Congress's desire to protect financial institutions and individuals from oppressive supervisory tactics.<sup>65</sup> This concern stemmed from an acute awareness of the potentially conflicting goals of banking regulation—to ensure effective supervision of the nation's financial institutions and to protect the interests of depositors yet, at the same time, safeguard financial institutions and their officials from overbearing tactics by regulatory agencies.<sup>66</sup> Recognizing the need to balance these interests, Congress was unwilling to grant the agencies a "blank check."<sup>67</sup> Rather, the Senate Banking and Currency Committee stated that the strengthened supervisory powers of section 1818 should be granted "*within carefully guarded limits*."<sup>68</sup> Congress manifested its reluctance to empower the agencies with unfettered discretion by includ-

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65. See S. REP. NO. 1482, 89th Cong., 2d Sess. 3 reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3535.

66. *Id.* at 3, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3534-35. As the chairman of the Senate Banking and Currency Committee stated:

We have here a difficult and delicate problem of reconciling conflicting interests—on one hand, the interests of depositors and savers who have their money in these insured institutions, the interests of well-run banks and savings and loan associations who contribute substantial premiums to the reserve funds of the insuring agencies, and the interests of the Government which underwrites the insuring agencies—in preventing irresponsible or even criminal individuals from looting or otherwise wrecking insured banks . . . through improper activities; on the other hand, the interests of insured banks . . . and their officials in receiving . . . a reasonable degree of protection from Government actions which might at times, for one reason or another, generate into arbitrary, capricious, and overbearing tactics.

Each of these interests deserves full and fair consideration.

*Id.* This statement led to a postponement of hearings on the bill so that further study could be conducted. *Id.* at 3, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3534-35.

67. *Larimore II*, 789 F.2d at 1253. "In granting the federal banking regulatory agencies this limited authority, we are convinced that Congress never intended to give these agencies a 'blank check' authority." *Id.*

68. S. REP. NO. 1482, 89th Cong., 2d Sess. 6, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3538 (emphasis added). This qualification illustrates that Congress did not intend the banking agencies to interpret their authorizing statutes broadly. The *Larimore II* court emphasized the restrictive phrase. 789 F.2d at 1253.

ing explicit internal safeguards in section 1818, such as the opportunity for an evidentiary hearing and direct appellate review of an agency order.<sup>69</sup>

The Senate Banking and Currency Committee's imposition of restrictions on the issuance of suspension or removal orders may best demonstrate its determination to minimize agency abuse of power in the original 1966 version of section 1818. These orders were the only enforcement actions in the 1966 Act that agencies could use directly against bank officials and the Committee was apprehensive that vague language in the provision could foster abuse.<sup>70</sup> The Committee was concerned primarily with the terms "violations of regulations," "'unsafe'" and "'unsound.'" <sup>71</sup> Taken literally, "violations of regulations" could include not only major violations, but also minor technical violations.<sup>72</sup> The terms "unsafe" and "unsound" also could

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69. See *infra* note 93. The preliminary bill did not adopt the traditional "substantial evidence" standard of review of administrative actions, but instead allowed agency findings and conclusions to be set aside if not supported by "the weight of the evidence." H.R. REP. NO. 2077, 89th Cong., 2d Sess. 6 (1966). "The purpose of the new language [was] to safeguard the rights of individuals and institutions from arbitrary and capricious agency action." *Id.* After considerable debate, Congress did not adopt the proposed language in its final enactment because it would amend the Administrative Procedure Act to treat banking agencies differently from other agencies. 112 CONG. REC. 25,002 (1966). The Committee felt that such a change should be handled by the Committee on the Judiciary. *Id.* at 24,998. Congressman Multer, who advocated the new review standard, argued that "by putting this amendment in the bill we will at least give these institutions and their officers some right to protect themselves against a capricious, an arbitrary official—and there are such people even in Government today." *Id.* at 25,001. The Senate Banking and Currency Committee also endorsed the proposal that in cases involving a state bank or savings and loan association, the appropriate state supervisory authority should be notified and given an opportunity to take corrective action, thereby providing additional protection "against arbitrary and oppressive action . . . for the benefit of the institutions and individuals affected." S. REP. NO. 1482, 89th Cong., 2d Sess. 7, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3538.

70. S. REP. NO. 1482, 89th Cong., 2d Sess. 8, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3539. The Committee said many of the terms in the suspension and removal provision were "far from clear." *Id.*

71. *Id.* In support of the "weight of the evidence" standard of review, Congressman Harvey voiced his concern about "some very hazy language which I have never seen the likes of in legislation before in this Congress." 112 CONG. REC. at 25,001. He particularly questioned the terms "unfair" and "unsound" practices: "[W]e are dealing with regulations which have not as yet been drawn and which some advisor has not even thought up as yet." *Id.*

72. See S. REP. NO. 1482, 89th Cong., 2d Sess. 8, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3539. The term "regulations" also includes regulations that have not yet been promulgated by the agencies. See *supra* note 71.

provide undesirable subjective latitude in the agency interpretations; the Committee was convinced that broad construction of these terms might result in suspension or removal orders based on nothing more than a difference of opinion about debatable management problems.<sup>73</sup>

The Banking and Currency Committee's concern illustrates that Congress had little confidence in agency ability to exercise broad grants of enforcement power fairly. In view of Congress's concern in 1966 for protecting bank officials from agency abuse of the powers of suspension and removal,<sup>74</sup> it is unreasonable to believe that Congress in 1978 discarded these apprehensions. As the *Larimore II* court noted, no provision in the legislative history of section 1818 indicates that Congress intended to allow the regulatory agencies to create a new, drastic enforcement power like reimbursement by broadly defining the ambiguous language "take affirmative action."<sup>75</sup>

The Banking and Currency Committee, moreover, considered the power to suspend or remove to be "an extraordinary power" that could disastrously affect the individual, the bank, and the financial system as a whole.<sup>76</sup> The Committee therefore adopted the explicit requirement that a violation or unsafe practice must involve personal dishonesty to warrant suspension or removal.<sup>77</sup> If the Committee viewed suspension or removal as extraordinary powers warranting careful restrictions,<sup>78</sup> it would have considered an order to reimburse equally drastic. It is doubtful, therefore, that the Committee would

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73. S. REP. NO. 1482, 89th Cong., 2d Sess. 8, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3539. The Committee believed that the terms might produce satisfactory results if strictly construed. *Id.* It is evident from the Committee's statements, however, that the Committee was not confident the terms would be strictly construed in a consistent manner. *Id.*

74. See *supra* notes 65 & 66 and accompanying text.

75. An important difference exists between interpreting the language "violation of regulations" or "unsafe" or "unsound" practice and the language "take affirmative action." Interpretation of the former affects the types of actions agencies consider deserving of administrative proceedings. Interpretation of the latter, however, creates a new administrative power that can be imposed on bank officials; there is still the initial determination of whether the conduct of the official rises to the level of a "violation" or "unsafe" practice.

76. S. REP. NO. 1482, 89th Cong., 2d Sess. 8, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3539.

77. *Id.* The additional requirement, the Committee reasoned, would prevent the undesirable result of an individual being suspended or removed "on the basis of nothing more than a difference of opinion about the most debatable of management problems." *Id.*

78. *Id.* The power to remove or suspend was to be "strictly limited and carefully guarded." *Id.*

have granted to banking agencies the power to impose personal liability on directors through such ambiguous language as "take affirmative action." In addition, as part of a cease-and-desist order, reimbursement is not restricted to cases involving personal dishonesty.<sup>79</sup> It is inconsistent to impose a personal dishonesty requirement in the context of removal or suspension yet allow reimbursement under the lesser standards required of a cease-and-desist order.

Finally, the 1966 Committee saw suspension or removal of bank officials as a "vital quasi-judicial function" requiring careful balancing between the interests of the institutions and their officials, and the interests of the institution's customers, the government, and the public.<sup>80</sup> Although the 1966 Act did not authorize cease-and-desist orders against bank officials directly, it is logical that the concern for minimizing abuse of suspension or removal powers against individuals would apply equally to cease-and-desist orders.

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79. Reimbursement is demanded through a cease-and-desist order. There is no requirement that the violation or unsafe practice involve personal dishonesty before an agency may issue an order. For the requirements of a cease-and-desist order, see *infra* note 90.

80. S. REP. NO. 1482, 89th Cong., 2d Sess. 7, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS 3532, 3539-40. The concern focused on the Comptroller of the Currency because, unlike the other banking agencies, the Comptroller's office is composed of a single individual. *Id.* at 8, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3540. "The problems involved in delegating the vital quasi-judicial function of suspending or removing directors or officers of national banks to a single official—as distinguished from a body of men—gave the committee much concern." *Id.* at 9, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3539-40. The solution was to make the Comptroller a member of the Board of Governors of the Federal Reserve and through this body the orders would be issued. *Id.* at 9, reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 3540. It is doubtful that the Committee would authorize the issuance of reimbursement orders through open-ended language when such orders are just as, if not more, quasi-judicial as suspensions or removals. In addition, the judicial power of the United States must be exercised by a proper article III body. See *Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982). In that case, Marathon sought to dismiss a suit for breach of contract brought against it in a United States bankruptcy court by Northern, which was undergoing reorganization in the court, on the ground that the act unconstitutionally conferred article III judicial power upon judges that lacked the protections of article III judges. *Id.* at 56-57. The Court held that the Bankruptcy Act of 1978, which established the bankruptcy courts, was an impermissible creation of nonarticle III adjunct courts that violated the fundamental constitutional principle that the judicial power be exercised by article III courts. *Id.* at 87. Compare *Crowell v. Benson*, 285 U.S. 22 (1932), in which the Court held that administrative agencies with the limited role of determining questions of fact as to the circumstances, and other limited functions, did not violate article III.

## 2. The 1978 Amendment

Although Congress's 1978 amendment to section 1818(b)(1) explicitly included bank officials within the scope of cease-and-desist orders, Congress did not expressly authorize reimbursement orders.<sup>81</sup> Isolated from the rest of the statute and banking laws, however, a literal interpretation of the last clause of section 1818(b)(1) arguably could support a broad scope of authority.<sup>82</sup> One must therefore read the 1978 amendment to section 1818(b)(1) within the context of its original enactment, including the 1966 Senate Banking and Currency Committee's considerable concern for protecting the interests of bank officials.

The 1978 amendment to section 1818(b)(1) resulted directly from Congress's determination to curb the growing problems engendered by insider abuses in banks.<sup>83</sup> The 1978 amendment did not alter the basic purpose of the 1966 Act of correcting a

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81. Under the 1966 Act, cease-and-desist orders could only be issued against the financial institution. See Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028 (codified as amended at 12 U.S.C. § 1818 (1982)). The 1978 amendment explicitly provided for orders issued directly against bank officials. Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (current version at 12 U.S.C. § 1818(b)(1) (1982)).

82. According to this view, Congress gave the agencies a general authorization to issue orders, leaving the exact enforcement provisions in any order to the expertise of the agency. Reimbursement, therefore, is just one option in an agency's arsenal of supervisory and enforcement tools. That was the Comptroller's view in *Larimore II*. See 789 F.2d at 1250.

83. H.R. REP. NO. 1383, 95th Cong., 2d Sess. 1, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273. The House Report declared that "[p]roblem banks and insider abuses have been virtually synonymous. Nothing appears more often on the fever chart of sick financial institutions than self-dealing ailments." *Id.* at 10, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 9282. The Committee's bill was considered "a reasonable response to the problems associated with insider abuses of financial institutions." *Id.* The types of abuses considered to pose the most serious threat to the safety and soundness of banks were loans to insiders from their own banks and from correspondent banks, and interlocking directorates where the position of responsibility and control was used personally to reap privileges unavailable to others, carelessly endangering the safety of the bank. *Id.* The bill also provided statutory language spelling out the board of directors' responsibilities with respect to insider loans. *Id.* at 15-16, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 9287. The Report cites the *Comptroller's Handbook of Examination Procedure*, *id.* at 15, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 9287, which states in part that "[t]he directors of a national bank may delegate the day-to-day routine of conducting the bank's business, but they cannot delegate to their officers and employees responsibility for the consequences resulting from unsound or imprudent policies and practices." *Id.* at 16, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 9288.

bank's problems and preventing future violations or unsafe practices.<sup>84</sup> It did, however, provide a more direct means for accomplishing that purpose. By authorizing the issuance of cease-and-desist orders against individuals, Congress hoped the regulatory agencies could stop the party directly responsible for violations or unsafe practices.<sup>85</sup> The amendment of section 1818(b)(1) thus was intended to stop unsafe practices or banking violations by directors, not to recover affirmatively for the losses.<sup>86</sup>

One sentence of the legislative history of section 1818(b)(1) does suggest that an insider who unjustly enriches himself at the expense of an institution may be required to reimburse the institution.<sup>87</sup> This lone sentence, however, cannot support the issuance of general reimbursement orders. Rather, the suggestion of restitution in one narrow situation emphasizes the absence of congressional intent to grant the agencies such general authority.<sup>88</sup> Requiring restitution for money unjustly obtained,

84. *Larimore II*, 789 F.2d at 1251.

85. See H.R. REP. NO. 1383, 95th Cong., 2d Sess. 18, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9290. See *supra* note 36.

86. See *infra* note 90 and accompanying text.

87. S. REP. NO. 323, 95th Cong., 1st Sess. 7 (1977). The Senate Report states:

Under the expanded authority of the bill, cease-and-desist action can be taken directly against individuals without the necessity for naming the financial institution in the proceeding. The regulatory agencies will have to exercise their authority in a manner so as not to intrude on the management prerogatives of the institution by commencing unwarranted actions against particular managers. It will be expected that this authority will be utilized only in those cases where adequate relief cannot otherwise be obtained . . . . In other circumstances where an insider has unjustly enriched himself at the expense of the institution the regulatory agency having jurisdiction over the matter may find it more effective to take action directly against the individual for return of property rightfully belonging to the institution.

*Id.* (emphasis added). When the sentence relied upon by the Comptroller is read in context, no support exists for stretching it beyond the limited situation of unjust enrichment by the bank official. See *Larimore II*, 789 F.2d at 1252 ("We are at a loss to understand how the Comptroller can even attempt to interpret this one phrase in the Senate Report as providing the authority to impose personal damages in the instant case, where there is absolutely no proof of personal enrichment.").

88. The Congress's total lack of discussion regarding the power of reimbursement is striking. For example, in proposing that a financial institution be allowed to pay the legal expenses of its officers or directors if it so chose, Congressman Long expressed the concern of his constituents over the expansion of personal liability under the amendment. 124 CONG. REC. 33,309 (1978). He stated that "[c]ertainly it would be our concern that the management of financial institutions have adequate safeguards to protect their legal rights in circumstances which could lead to penalties, or cease and desist orders, or even

moreover, differs greatly from requiring the same for a violation that did not enrich an insider or bank official.<sup>89</sup>

#### B. SECTION 1818(b)(1) IN THE STATUTORY ENFORCEMENT SCHEME

Section 1818 provides federal banking authorities with an array of effective tools to regulate bank officials, including permanent and temporary cease-and-desist orders, removal or suspension orders, and civil money penalties.<sup>90</sup> These tools

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removal from office." *Id.* Omitted from this statement is any reference to reimbursement, another potential personal liability faced by directors and officers.

89. The critical difference between *First Nat'l Bank of Eden v. Department of Treasury*, 568 F.2d 610 (8th Cir. 1978), and *Larimore* is that the president and vice-president in *First Nat'l Bank of Eden* had approved excessive bonuses for themselves, and they had received the benefit of the money directly. *First Nat'l Bank of Eden*, 568 F.2d at 611, 611 n.1. It was this type of self-dealing and abuse of position Congress wanted to eliminate with the improvements in the 1978 amendment. H.R. REP. NO. 1383, 95th Cong., 2d Sess. 10, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9282. There was no evidence of any self-dealing in *Larimore*. See *Larimore II*, 789 F.2d at 1252; *Larimore I*, 775 F.2d at 900.

90. 12 U.S.C. § 1818(b)(1) (1982). Title I of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 prescribes the improved supervisory authority over depository institutions. Pub. L. No. 95-630, 92 Stat. 3641. This Act gave the agencies the three powers mentioned in the text as well as control over changes in control of financial institutions.

The permanent and temporary cease-and-desist provisions of § 1818 were amended in 1978 to authorize cease-and-desist proceedings against bank officials. See *supra* note 35 and accompanying text. For the text of § 1818(b)(1) governing permanent orders, see *supra* note 10.

A temporary order may be issued whenever the violation or unsafe practice "is likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or is likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors prior to the completion of the proceedings [for a permanent order]." 12 U.S.C. § 1818(c)(1) (1982). Within 10 days after the bank or bank official has been served with a temporary order, the party may apply to a United States district court for an injunction "setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order pending the completion of the administrative proceedings." 12 U.S.C. § 1818(c)(2) (1982).

The 1978 amendment relaxed the standard for suspensions or removals of bank officials. An agency may serve upon a director or officer an intention to suspend or remove the individual from office if: (1) the agency believes the individual has committed a banking violation or violated a final cease-and-desist order, or has engaged in unsafe or unsound practices, or "has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer"; (2) "the agency determines that the bank has suffered or will probably suffer substantial financial loss or other damage or that the interests of its depositors could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty or that the di-



supplement the traditional action for damages under section 93(a), which can be brought against a bank director for knowing violations of the national banking laws.<sup>91</sup> Each enforcement tool was enacted with careful safeguards and limitations on the agencies. For example, a permanent cease-and-desist order can be issued for violations of a law, rule, regulation or for "unsafe and unsound practices," but a temporary cease-and-desist order is restricted to emergency cases where the violation or unsafe practice is likely to cause insolvency or seriously weaken the condition of the bank.<sup>92</sup> The detailed subsections of section 1818 map out precise procedures for exercising the new powers, including notice, the opportunity for a hearing, and direct review by a court of appeals.<sup>93</sup>

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rector or officer has received financial gain by reason of such violation"; and (3) the case involves "personal dishonesty on the part of such director or officer, or one which demonstrates a willful or continuing disregard for the safety or soundness of the bank." 12 U.S.C. § 1818(e)(1) (1982). See Galbraith & Seidel, *FDIC vs. Imprudent Banking Officials: The Enforcement Apparatus*, 104 BANKING L.J., 92, 96 n.3 (1987) (outline of the elements of a § 1818(e) action).

A civil money penalty may be imposed for any violation of a final order under § 1818(i)(2)(i), 12 U.S.C. § 1818(i)(2)(i) (1982), and for a violation of the national banking laws under § 93(b). 12 U.S.C. § 93(b) (1982). The penalty may not exceed \$1,000 per day for each day during which the violation continues. 12 U.S.C. §§ 93(b), 1818(i)(2)(i) (1982); see also *supra* note 38. The agency is authorized to "compromise, modify, or remit any civil money penalty." 12 U.S.C. § 1818(i)(2)(i) (1982). The provision for civil money penalties, unlike the other enforcement provisions, defines the term "violates" to include "without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation." *Id.* Subsection (ii) demands that the agency imposing the penalty "take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the insured bank or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require." 12 U.S.C. § 1818(i)(2)(ii) (1982).

91. See *infra* note 18.

92. The terms "unsafe" and "unsound" when included in the original Act of 1966 were considered too vague by some members of Congress. 112 CONG. REC. 25,007 (1966). The Chairman of the Home Loan Bank Board defined an "unsafe or unsound practice" as "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." *Id.* at 25,008. For a discussion of the judicial definition of the terms, see Galbraith & Seidel, *supra* note 90, at 108-15.

93. 12 U.S.C. § 1818(h) (1982). Every enforcement proceeding requires the agency to give the person charged a notice stating the facts constituting the violation and fixing the time and place for the hearing. *Id.* § 1818(b)(1) (cease-and-desist proceedings); *id.* § 1818(e)(5) (removal of a director or officer). Any hearing provided for in § 1818 is to be conducted in accordance with the Ad-

Although the *Larimore II* court noted that a liberal interpretation of section 1818(b)(1) allowing reimbursement orders would preempt section 93(a), it failed to provide a detailed comparison of the two provisions.<sup>94</sup> A civil action under section 93(a) affords a defendant-director greater procedural safe-

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ministrative Procedure Act (5 U.S.C. §§ 500-576). 12 U.S.C. § 1818(h) (1982). Within 90 days after the hearing and after notification to the person charged that the case has been submitted to the agency for final decision, the agency must render its decision. *Id.* Any party to the proceeding may obtain judicial review of any order (other than one issued with the consent of the bank or bank official) by a court of appeals. *Id.* Petition for review must be filed within 30 days after the date of service of the order. *Id.* Review of the administrative proceedings shall be conducted in accordance with 5 U.S.C. §§ 701-706. 12 U.S.C. § 1818(h) (1982).

The House Report on the 1978 amendment summarizes each power, noting the due process requirements built into the statutes. H.R. REP. NO. 1383, 95th Cong., 2d Sess. 18-19, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 9273, 9290-91. The basic protections include the requirement of notice and the opportunity for an evidentiary hearing and direct appellate review. *Id.* For suspensions and removals, the statute requires a showing of either personal dishonesty or a willful or continuing disregard for the safety of the bank. *Id.* Additional protections in the civil money penalty provision include a requirement that the agency in determining the amount of the penalty "shall take into account the appropriateness of the penalty with respect to the size of the financial resources and good faith of the institution or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require." *Id.* For a discussion of the protections built into the various powers, see *supra* note 90. The restrictions on the powers limit the use of each to narrow situations, which indicates that Congress did not intend to grant the agencies the power to create implied remedies such as reimbursement.

94. The *Larimore II* court noted only that the imposition of the agency-ordered reimbursement had the same effect to the bank directors as an enforceable judgment for personal damages under 12 U.S.C. § 93(a) (1982), 789 F.2d at 1249, and based its analysis primarily on this reasoning. The court's view is bolstered by the fact that the formula used by the Comptroller to compute the amount of reimbursement in the administrative proceedings in *Larimore I* was the identical formula used by the district court to figure damages under § 93(a) in *First Nat'l Bank of Lincolnwood v. Keller*, 318 F. Supp. 339, 346-47 (N.D. Ill. 1970). See *Larimore I*, 775 F.2d at 896. In a suit brought by the national banking association against bank president Keller, the district court concluded that Keller had knowingly permitted excessive loans. *Keller*, 318 F. Supp. at 345. Finding that the legal limit was exceeded by a series of transactions, the court ruled that the amount of damages was the difference between the total outstanding obligations and the balance of the line of credit before the illegal loans were made. *Id.* at 346-47. The use of the identical formula underscores that a reimbursement order has the same effect as a personal judgment for damages. In addition, the *Larimore II* court stated that to allow the Comptroller to issue a reimbursement order unilaterally under § 1818(b)(1) would be to grant the Comptroller "the authority to act as prosecutor, judge, and jury" instead of as complainant under § 93(a). *Larimore II*, 789 F.2d at 1255-56.

guards, such as complete evidentiary and due process protections.<sup>95</sup> A reimbursement order pursuant to section 1818(b)(1) provides no such safeguards.<sup>96</sup> Another distinction is the relative ease with which an agency may issue a cease-and-desist order as compared to the agency-complainant's strict burden in a civil action under section 93(a). A much lower burden of proof is required of an agency in an administrative proceeding for a cease-and-desist order than that required when pursuing a civil action under section 93(a). Under section 93(a), the agency-complainant has the burden of proving multiple elements in the cause of action by a preponderance of the evidence; if the evidence fails to support any single element, the cause of action must be dismissed.<sup>97</sup>

No corresponding burden of proof is imposed on the agency in a cease-and-desist administrative proceeding. Section 1818(b)(1) allows the regulatory agency to initiate proceedings if the agency believes the party is engaging, has engaged, or will engage in a banking violation or unsafe practice.<sup>98</sup> To initiate proceedings the belief need only be reasonable. Although a hearing is conducted, after which an administrative law judge

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95. 12 U.S.C. § 93(a) (1982).

96. See 5 U.S.C. § 556 (1977); *Cooper v. United States*, 639 F.2d 727, 730 (Ct. Cl. 1980) (hearsay evidence is admissible in an administrative proceeding and it may by itself constitute substantial evidence); *Johnson v. United States*, 628 F.2d 187, 190 (D.C. Cir. 1980) ("[F]actfinder in administrative adjudication may consider relevant and material hearsay." Such hearsay "may constitute substantial evidence."); *Garcia v. Califano*, 463 F. Supp. 1098, 1105 (N.D. Ill. 1979) ("[E]vidence may be received at an administrative hearing even though it is inadmissible under the rules of evidence which control judicial proceedings.").

97. Under § 93(a), the complainant must establish there has been a *knowing* violation of the national banking laws, and that damages were sustained as a result of the violation. 12 U.S.C. § 93(a) (1982). For a successful prosecution of these elements against a bank director, see *Keller*, 318 F. Supp. 339 (N.D. Ill. 1970). In attempting to hold the bank president responsible for the failure of certain obligors to repay loans, the bank in *Keller* first had to establish that the loans exceeded the limit of § 84 after proper aggregation of related loans. *Id.* at 342-45. The bank presented insufficient evidence to prove that loans to two companies should be aggregated, however, and was able to establish excessive loans on only two lines of credit. *Id.* at 345. The bank had no difficulty proving that the president knowingly permitted the excessive loans. *Id.* at 345-46. As for the damages element, the defendant prevailed on his contention that only the excess over the 10% limit could be recovered rather than the total uncollected obligations, as the bank had contended. *Id.* at 347.

98. 12 U.S.C. § 1818(b)(1) (1982). For the text of § 1818(b)(1), see *supra* note 10. For a discussion of the similarities and differences between an administrative enforcement action under § 1818(b) and a civil action based on common-law negligence, see Galbraith & Seidel, *supra* note 90, at 121-26.

makes findings of fact and recommends a decision, the agency is under no obligation to follow the administrative law judge's determinations.<sup>99</sup> Instead, the regulatory agency may review the administrative law judge's findings, make independent findings, and then fashion its own remedy.<sup>100</sup> There is no requirement that the agency prove that the violation was intentional. Moreover, once the violation or unsafe practice is established, the agency need not prove causation between the violation or practice and the actual or potential losses incurred by the bank.<sup>101</sup>

That a defendant director has an opportunity to appeal the agency order to a court of appeals does not neutralize the agency's power. On appeal, a court will vacate the order only if the factual findings are not supported by substantial evidence or if the order is arbitrary and capricious.<sup>102</sup> Thus, the appellant-bank director, not the agency, bears the burden of proof on appeal. Consequently, the agency does not have to prove the elements of a cause of action as it would under section 93(a). The traditional deference courts afford to agency discretion further compounds the difficulty of overturning the agency decision.<sup>103</sup>

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99. See *supra* note 7. See also Barnett, *Responsibilities and Liabilities of Bank and Bank Holding Company Directors*, [1985 Extra Addition No. 1066] Fed. Banking L. Rep. (CCH) ¶ 155 (Mar. 12, 1985) ("The agency "is not bound by the determination of the administrative law judge. It may ignore those recommendations entirely if it so chooses.").

100. See *supra* note 99 and accompanying text. In both *Larimore I* and *Citizens State Bank of Marshfield*, the respective banking agency ordered reimbursement even though the administrative law judges who presided over the evidentiary hearings recommended against it. *Larimore I*, 775 F.2d at 892-93; *Citizens State Bank of Marshfield*, 751 F.2d at 211.

101. See 12 U.S.C. § 1818(b)(1) (1982). For a discussion of the agency's burden in instituting an order, see *supra* note 90. The court in *Larimore II* indicated that there is not even a requirement that the repayment be necessary to restore the bank to financial soundness. 789 F.2d at 1257 (Easterbrook, J., concurring). The concurring judge in *Larimore II* noted that "at oral arguments the Comptroller disclaimed any contention that the repayment [was] necessary to maintain the Bank's soundness." *Id.* In an action under § 93(a), the agency must prove that the damages sustained resulted from the director's violation of the banking laws. See *supra* note 97.

102. See 5 U.S.C. § 706(2)(E) (1977) (substantial evidence standard). See, e.g., *del Junco v. Conover*, 682 F.2d 1338, 1340 (9th Cir. 1982) (a "substantial evidence" standard applies to judicial review of administrative findings), *cert. denied*, 459 U.S. 1146 (1983); *First Nat'l Bank of Eden v. Department of Treasury*, 568 F.2d 610, 611 (8th Cir. 1978) (Comptroller's order can only be disturbed if it is shown to be arbitrary or capricious).

103. See *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984) ("considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer"). See Galbraith & Seidel, *supra* note 90, at 118-19 (stating that the

Before 1978, section 93(a) was the only avenue open to the agencies for recovering damages from bank directors for violations of the national banking laws. Congress, by amending section 1818(b)(1) in 1978 to include individuals within the scope of cease-and-desist orders, opened the door to the Comptroller's assertion that section 1818(b)(1) authorizes orders that directors reimburse their bank. It is unlikely, however, that Congress, aware of section 93(a),<sup>104</sup> intended to render section 93(a) obsolete.<sup>105</sup> A new statute should not be read to amend a prior statute wholly or partially unless there is no way to reconcile the two.<sup>106</sup> If Congress intends for a statute to qualify an earlier one, it should do so through an express manifestation.<sup>107</sup> A strict interpretation of the scope of remedial authority granted under section 1818(b)(1) allows the two acts to coexist effectively, each performing a separate function.<sup>108</sup> Conversely, a broad interpretation of section 1818(b)(1) turns section 93(a)

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judiciary and ALJs give great deference to the regulators, and "the administrative enforcement process favors the regulators").

104. Congress is presumed to know its laws. *Larimore II*, 789 F.2d at 1253 (citing *United States v. Hawkins*, 228 F.2d 517, 519 (9th Cir. 1955)). See also *Cannon v. University of Chicago*, 441 U.S. 677, 696-97 (1979) ("It is always appropriate to assume that our elected representatives, like other citizens, know the law . . .").

105. The *Larimore II* court believed it reasonable to expect Congress to recognize that agency-ordered reimbursements would "effectively eviscerate" § 93(a). 789 F.2d at 1253-54.

106. *Id.* at 1253. See also *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 133-34 (1974) (Since the acts are "capable of co-existence, it is the duty of the courts, absent a clearly expressed intention to the contrary, to regard each as effective." (quoting *Morton v. Mancari*, 417 U.S. 535, 551 (1974))); *Kokoszka v. Belford*, 417 U.S. 642, 650 (1974) ("Congress did not enact the Consumer Credit Protections Act in a vacuum. The drafters of the statute were well aware that the provisions and the purposes of the Bankruptcy Act and the new legislation would have to coexist.").

In addition, the ambiguous clause in § 1818(b)(1) should not be interpreted to defeat the general purpose of the careful legislative enforcement scheme designed by Congress to regulate the nation's financial institutions. See *Larimore II*, 789 F.2d at 1253 ("[A] single provision will not be interpreted so as to defeat the general purpose that animates and informs a particular legislative scheme. We . . . attribute to [Congress] a general overriding intent to avoid results that would undermine or vitiate the purposes of specific provisions." (quoting *Milwaukee County v. Donovan*, 771 F.2d 983, 986 (7th Cir. 1985))); *Bob Jones Univ. v. United States*, 461 U.S. 574, 586 (1983) ("[I]t is well settled that, in interpreting a statute, 'the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute . . . and the objects and policy of the law . . .'" (quoting *Brown v. Duchesne*, 19 How. 183, 194 (1851))).

107. See *Regional Rail Reorganization Act Cases*, 419 U.S. at 133-34.

108. The *Larimore II* court followed these statutory construction rules in determining the proper scope of § 1818(b)(1). See 789 F.2d at 1253-54.

into an unattractive option, rather than the sole means of recovering damages from bank directors.<sup>109</sup>

The scope of enforcement under section 1818(b)(1), therefore, should not include affirmatively recovering from bank officials. Section 1818(b)(1)'s role within the enforcement scheme is to empower agencies to act quickly to stop practices harmful to the health of the bank, and to demand the implementation of practices and policies that will strengthen the bank and prevent future problems.

Thus, in the context of the complete legislative enforcement scheme, the language "take affirmative action" means requiring the persons subject to the order to take actions such as retaining acceptable management, revising the loan procedure, reducing assets classified as "loss," "doubtful," or "substandard," and maintaining an adequate reserve for loan losses, actions that will prevent violations or unsafe practices in the future.<sup>110</sup>

### C. PUBLIC POLICY CONSIDERATIONS

Public policy considerations overlooked by the Seventh Circuit also lend support to the *Larimore II* decision and demand that Congress reject the recent proposal to amend section 1818(b)(1) to provide explicitly for reimbursement orders.<sup>111</sup> A reimbursement order is a severe measure,<sup>112</sup> more catastrophic than removal or suspension, because it could instantaneously bankrupt an individual.<sup>113</sup> Bank directors and officers already are held to a high standard of conduct under both statutory and

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109. The *Larimore II* court recognized that if § 1818(b)(1) was held to authorize reimbursement orders, agencies would have little incentive to institute a civil action against bank directors to recover losses. 789 F.2d at 1255-56. Section 93(a)'s usefulness would be confined to the extremely limited purpose of providing an implied cause of action for private parties against bank directors.

110. See Galbraith & Seidel, *supra* note 90, at 104-06 (listing the provisions of a typical order). For examples of recent cease-and-desist orders, see M. COBB, FEDERAL REGULATION OF DEPOSITORY INSTITUTIONS, ENFORCEMENT POWERS AND PROCEDURES apps. 3-2 to 3-7 (1984).

111. See *supra* note 21 and accompanying text.

112. The *Larimore II* court realistically asked: "What could be more drastic than imposing a possible judgment of a million dollars?" 789 F.2d at 1250 n.5.

113. The majority of the civil money penalties imposed on a \$1,000 per day basis do not exceed \$2,500, even though technically such penalties could be much higher. H.R. REP. NO. 1137, 98th Cong., 2d Sess. 169 (1984). This contrasts drastically with the \$1,084,883 reimbursement order assessed against the directors in *Larimore I*, 775 F.2d at 893, or the \$350,000 assessed in *del Junco v. Conover*, 682 F.2d 1338, 1340 (9th Cir. 1982), *cert. denied*, 459 U.S. 1146 (1983).

common law.<sup>114</sup> Under a liberal interpretation of section 1818(b)(1), however, the potential personal liability of bank officials reaches an unbearable level.<sup>115</sup> The benefits gained by serving on a bank's board of directors may become negligible when compared to the expansive exposure to personal liability.

A growing reluctance of insurance companies to issue director and officer liability policies compounds this dilemma.<sup>116</sup> Moreover, even if the bank has insurance coverage for its bank officials, the Comptroller has ruled that banks cannot insure directors against a final order issued by a supervisory agency assessing civil money penalties or otherwise requiring an individual officer to make payments to the bank.<sup>117</sup> (On the other hand, most director and officer liability insurance policies would cover personal judgments resulting from section 93(a)

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114. The common law standard of care for bank directors is "that which ordinarily prudent and diligent men would exercise under similar circumstances." *Briggs v. Spaulding*, 141 U.S. 132, 152 (1891). See *Bowerman v. Hamner*, 250 U.S. 504, 510 (1919) (directors always subject to the common-law duty to be honest and diligent); *Fleishhacker v. Blum*, 109 F.2d 543, 547 (9th Cir. 1940) ("In the discharge of his high trust the law holds a responsible agent such as [a bank director] to standards of probity and fidelity more lofty than those of 'the market place.'"). For a discussion of the high common-law and statutory standards of care placed on bank directors, see Deal, *Liability of Bank Directors*, 39 BUS. LAW. 1033 (1984) (discussing a course of conduct that should enable an honest and diligent bank director to avoid liability); Grunewald & Golden, *Bank Director Liability Post-FIRA: How to Avoid It*, 98 BANKING L.J. 412, 413-18 (1981) (discussing what directors can do to avoid common-law liability).

115. In *Larimore I*, the defendant directors were ordered to reimburse the bank jointly and severally for over a million dollars. 775 F.2d at 894; see *supra* note 8.

116. See Sparks, *D & O Liability Insurance: The Latest Crisis*, LEGAL BULL., Mar. 1985, at 88. Sparks had recently visited with the leading director and officer liability underwriters in London, and he stated that "the talk there was of rapidly increasing rates and also curtailed capacity in the wake of disastrous underwriting results in the general D & O market and for financial institutions in particular." *Id.* Emphasizing the "major crunch in the availability of D & O insurance for financial institutions," Sparks asserts many institutions will be unable to secure renewal or replacement of D & O liability coverage in 1985. *Id.* at 93. See also Nicholas, *FIRA: Emerging Patterns of Director Liability*, 103 BANKING L.J. 151, 153-54 (1986) (noting that insurance companies are increasingly reluctant to issue director and officer liability policies); Raiden, *Perspectives, Issues, and Answers from the Office of the General Counsel*, LEGAL BULL., Mar. 1985, at 97 (Because of the difficulty of assuring a director that performance and service on a board will not cost him his life savings, "the task of obtaining directors to run a savings institution, to act in good faith, and to sit in on a situation that becomes difficult and remain with it is becoming more and more difficult all the time.").

117. See 12 C.F.R. § 7.5217(b) (1986).

actions.)<sup>118</sup> Not only is the bank official faced with an ominous exposure to personal liability, but there is the possibility of no relief from insurance. Consequently, potential reimbursement orders give the banking agencies an extremely powerful bargaining tool for negotiating with bank officials to achieve stipulations to a proposed cease-and-desist order. Indeed, the Comptroller sometimes uses the threat of substantial civil money penalties to induce voluntary reimbursement.<sup>119</sup>

Another consideration is that even if a director is ordered by an agency to repay the bank, a private party may still bring an action under section 93(a), exposing the bank official to double damages.<sup>120</sup> The Comptroller asserts that claims under section 1818 for reimbursement do not affect or nullify any claims that could be brought by a private party.<sup>121</sup> The Comptroller may even require notice to shareholders that a reimbursement order settles only the agency supervisory claims.<sup>122</sup> Such a practice encourages double damages and at the same time promotes civil actions by private plaintiffs who no longer can plausibly claim an injury.<sup>123</sup>

A liberal interpretation of section 1818(b)(1)'s "take affirm-

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118. For a discussion of director and officer liability insurance, see generally LEGAL BULL., Mar. 1985.

119. See 12 U.S.C. § 1818(i)(2)(i) (1982). An important feature of civil money penalties is that any violation of a final cease-and-desist order subjects the bank officials to imposition of a penalty. *Id.* This means that if the order requires increased supervision over loans or the reduction of excessive loans, the directors must abide by the order or face a civil money penalty of up to \$1,000 for every day the violation persists. *Id.* If a reimbursement order is included in the cease-and-desist order, the director is forced to reimburse or violate the cease-and-desist order, thereby triggering the civil money penalty provision.

The Comptroller has stated that it is free to use its civil money penalty powers to induce voluntary reimbursement of violations of laws. See Sharpe, *supra* note 21, at 442. This puts pressure on bank officials to agree to voluntary reimbursement orders, whereas if the Comptroller had to bring a civil action under § 93(a), the bank officials could not be coerced into a potentially oppressive reimbursement order.

120. Neither § 1818(b)(1) nor § 93(a) prohibits a civil action against a bank director even though the regulatory agency has already recovered by ordering reimbursement. See *Citizens State Bank of Marshfield v. FDIC*, 751 F.2d 209, 218 (8th Cir. 1984) ("[A]llowing reimbursement under section 1818 would give rise to the prospect of double recovery for consumers who had not yet let their one-year civil remedy expire.").

121. See Sharpe, *supra* note 21, at 444.

122. *Id.*

123. In fact, the private party plaintiffs would be unjustly enriched if they recovered damages through a civil action after the director had already reimbursed the bank because the reimbursement necessarily made the bank whole.



ative action" language could cause an exodus of competent and qualified management from bank boardrooms. Competent bank officials may depart rather than risk the potential for overwhelming personal liability and at the same time give up the procedural safeguards of a civil action in a federal court.

Arguably, a liberal interpretation of "affirmative action" would enable the agencies to fashion any remedy regardless how oppressive, as long as it has some rational connection to the violation or unsafe practice.<sup>124</sup> The traditional tendency of courts to uphold agency actions that are not manifestly arbitrary or capricious,<sup>125</sup> provides little restraint on the agencies. If an official is clearly incompetent, the appropriate remedy is either removal or suspension. Ordering a bank official to reimburse the bank and then leaving the official on the bank's board solves nothing.

It is difficult to see how a strict interpretation of section 1818(b)(1) would have harmful consequences. The threat of civil money penalties and removal or suspension would still deter insider abuse and neglect of duties. In addition, the threat of a civil action for damages under section 93(a) or a common-law action for negligence or breach of fiduciary duty provides strong incentive for bank officials to perform their duties responsibly and strong sanctions for those who do not.<sup>126</sup> In addition to the Comptroller, a bank, shareholder, or any other person with standing may sue a bank director under section 93(a).<sup>127</sup> Absent reimbursement under section 1818(b)(1), the statutory enforcement scheme designed by Congress contains adequately strong tools for deterrence and punishment.

### CONCLUSION

The *Larimore II* court correctly decided that section 1818(b)(1) does not authorize the unilateral imposition of per-

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124. The court in *Larimore I* upheld the reimbursement order because the court believed there was "a clear, rational basis for a remedy which corrects the financial harm that results from the directors' unlawful conduct." 775 F.2d at 896.

125. See *supra* notes 102-03.

126. Cf. *First Nat'l Bank of Lincolnwood v. Keller*, 318 F. Supp. 339, 342 (N.D. Ill. 1970) (The bank asserted a second count based on common-law liability for negligence, mismanagement, and violation of fiduciary duties.).

127. See *supra* note 18. See also *Harmsen v. Smith*, 542 F.2d 496, 499-500 (9th Cir. 1976) (holding that minority shareholders of insolvent bank are entitled to bring a direct action against the directors under § 93, but must show that damages sought are personal).

sonal liability on bank officials. The legislative history of section 1818, as well as the inability of section 93(a) to coexist effectively with a broad interpretation of section 1818(b)(1), mandates such a strict interpretation. The legislative history of both the 1966 Act and the 1978 amendment to section 1818 give no indication that Congress intended to allow agencies to order reimbursement or that section 93(a) was no longer the proper avenue for obtaining damages from directors of banks. Moreover, policy considerations underscore the need to restrict the enforcement actions of the banking agencies to the current explicit provisions of section 1818.

For these reasons, Congress should reject the Comptroller's proposed amendment to section 1818(b)(1) that would explicitly authorize orders for reimbursement.<sup>128</sup> If Congress does pass an amendment to section 1818(b)(1), it should carefully restrict the use of reimbursement orders to cases of intentional violations or personal dishonesty to minimize the potential for abuse by the regulatory agencies.<sup>129</sup> Furthermore, to eliminate double damages, Congress should expressly prohibit civil actions against a bank official who has reimbursed the bank.

*Michelle Culligan*

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128. See *infra* note 21 and accompanying text.

129. Other commentators addressing this issue before the *Larimore II* decision concluded that if § 1818(b)(1) includes reimbursement orders within the language "take affirmative action," there should be a scienter requirement. See Nicholas, *supra* note 116, at 180 (The power to use civil money penalties and indemnification orders against directors should be used sparingly, and only for willful or intentional statutory violations because "[t]he exposure to liability is too pervasive; the criteria for imposition of liability are too vague."); Comment, *Imposition of Personal Liability on Bank Directors for Violation of Lending Limits under Section 1818(b)(1) Enforcement Proceedings*: Tirso Del Junco v. Conover, 3 ANN. REV. OF BANKING L. 355, 367 ("[U]se of the scienter requirement is appropriate where the Comptroller seeks to impose liability on bank directors for violation of the provisions of section 84."). Similarly, the dissenting judge in *Larimore I* stated "[e]ven if I were to agree with the majority's interpretation of 12 U.S.C. § 1818(b)(1) granting authority to the Comptroller to impose personal liability upon directors, which I do not, I firmly believe that such liability cannot be imposed absent knowledge of a statutory violation on the part of the individual director." *Larimore I*, 775 F.2d at 896 (Coffey, J., dissenting).