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## Resolution Trust Corp. v. Cityfed Financial Corp.: The State Law and Federal Common Law Distinction

Christopher S. Lam

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1996]

## Notes

### RESOLUTION TRUST CORP. v. CITYFED FINANCIAL CORP.: THE STATE LAW AND FEDERAL COMMON LAW DISTINCTION

#### I. INTRODUCTION

The passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) represents a reaction to the savings and loan crisis of the 1980s.<sup>1</sup> During that decade, a record number of banks failed.<sup>2</sup> In response, Congress enacted FIRREA so that the Federal Deposit Insurance Corporation (FDIC) could recoup a portion of its losses.<sup>3</sup> A recent report has indicated that the original \$100 billion bailout cost by the government could escalate to approximately \$1 trillion.<sup>4</sup> As a result, and for the first time in its history, Congress enacted a standard of liability applicable to directors and officers of financial depository institutions.<sup>5</sup> Congress had two main objectives for doing so. First, Congress intended to defray the bailout costs by collecting from former directors and officers of failed banks.<sup>6</sup> Second, Congress wanted to codify a standard of liability

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1. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, §§ 101(5), (9), (10), 103 Stat. 183, 187 (1989) (codified as amended at 12 U.S.C. § 1821 (1994)).

2. See Paul T. Clark et al., *Regulations of Savings Associations Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 BUS. LAW. 1013 (1990) (noting total bank failure rate from 1980 to 1988 was three and one half times rate since 1935); see also *RTC v. Chapman*, 29 F.3d 1120, 1126 (7th Cir. 1994) (Posner, C.J., dissenting) (stating during nationwide banking crisis banks "were failing like ninepins").

3. See *FDIC v. Burrell*, 779 F. Supp. 998, 1003 (S.D. Iowa 1991) (finding purpose of § 1821 is "to strengthen the civil sanctions . . . for defrauding or otherwise damaging depository institutions and their depositors"). See generally Michael P. Battin, *Bank Director Liability Under FIRREA*, 63 FORDHAM L. REV. 2347, 2347-48 (1995) (noting that "[i]n the words of President Bush, § 1821(k) was enacted to enable the FDIC to 'seek out and punish those that have committed wrongdoing in the management of these failed institutions'").

4. Christopher T. Gorman, *Liability of Directors and Officers Under FIRREA: The Uncertain Standard of § 1821(k) and the Need for Congressional Reform*, 83 KY. L.J. 653, 653 (1995) (stating loss represents over 22 million depositors in failed financial institutions).

5. See Battin, *supra* note 3, at 2348 ("To effectuate these purposes, Congress for the first time legislated on the standard of liability applicable to directors of federally insured banks.") (citing *RTC v. Rahn*, 854 F. Supp. 480, 485 (W.D. Mich. 1994)). The *Rahn* court noted that "[p]rior to enacting section 1821(k), 'Congress had not legislated on the scope of claims brought by the FDIC against directors and officers of failed savings and loan associations.'" *Rahn*, 854 F. Supp. at 485 (quoting *FDIC v. Gonzalez-Gorrondona*, 833 F. Supp. 1545, 1553 (S.D. Fla. 1993)).

6. See Gorman, *supra* note 4, at 653 (stating Congress feels bank executives were "largely responsible for the crisis in the first place"); see also Battin, *supra* note

so that current executives would more carefully manage their banks.<sup>7</sup> Under 12 U.S.C. § 1821(k) of FIRREA, the directors and officers of failed financial institutions can be held individually liable for their mismanagement if their conduct constitutes gross negligence.<sup>8</sup> The text of § 1821(k), however, is ambiguous and has resulted in a split among commentators and courts regarding its interpretation.<sup>9</sup> The source of the dispute involves whether § 1821(k) preempts state or federal common law actions for conduct less egregious than gross negligence.<sup>10</sup>

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3, at 2347 (claiming many bank failures are caused by either intentional fraud or some degree of negligent mismanagement). *But see* James T. Pitts et al., *FDIC/RTC Suits Against Bank and Thrift Officers and Directors—Why Now, What's Left?*, 63 *FORDHAM L. REV.* 2087, 2087 (1995) (claiming bank crisis was due mainly to congressional deregulation of savings and loan industry and that blame was shifted towards directors and officers only after crisis exploded).

7. Battin, *supra* note 3, at 2348.

8. 12 U.S.C. § 1821(k) (1994). Section 1821(k) provides in pertinent part: (k) Liability of directors and officers. A director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by, on behalf of, or at the request or direction of the Corporation, which action is prosecuted wholly or partially for the benefit of the Corporation—

(1) acting as conservator or receiver of such institution,

(2) acting based upon a suit, claim, or cause of action purchased from, assigned by, or otherwise conveyed by such receiver or conservator ,  
or

(3) acting based upon a suit, claim, or cause of action purchased from, assigned by, or otherwise conveyed in whole or in part by an insured depository institution or its affiliate in connection with assistance provided under section 13 [12 U.S.C.S. § 1823], for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law. Nothing in this paragraph shall impair or affect any right of the Corporation under other applicable law.

*Id.* This section also allows liability to be imposed for intentional tortious conduct. *Id.* The first sentence of the section is a substantive sentence and establishes a gross negligence cause of action. *Id.* The second sentence is a savings clause. *Id.*

9. Compare David B. Fischer, *Bank Director Liability Under FIRREA: A New Defense For Directors and Officers of Insolvent Depository Institutions—Or a Tighter Noose?*, 39 *UCLA L. REV.* 1703 (1992) (concluding sociological and psychological reasons indicate that directors should not be held to standard of liability less culpable than gross negligence), with Battin, *supra* note 3, at 2347 (concluding policy reasons support allowance for simple negligence actions), and Gorman, *supra* note 4, at 653 (concluding economic reasons demand allowance for simple negligence actions). *E.g.*, Fischer, *supra* note 9, at 1709, 1756-76 (noting regulators interpret § 1821(k) as setting threshold standard of liability at gross negligence but still permitting simple negligence actions where state or federal common law permits). Directors and officers interpret § 1821(k) as an exclusive standard of liability of gross negligence. *Id.* For a discussion of federal courts' treatment on the preemption of § 1821(k), see *infra* notes 66-95 and accompanying text

10. See Battin, *supra* note 3, at 2349 (discussing conflicts among courts due to ambiguity of § 1821(k)); Steven B. Price, *FIRREA's Statute on the Standard of Liability for Bank Directors and Officers: Through the Looking Glass of New Textualism*, 30 *IDAHO L. REV.* 219, 222-23 (1994) (same). Battin explains the distinction between simple

Recently, in *Resolution Trust Corp. v. CityFed Financial Corp.* (“*RTC v. CityFed Financial Corp.*”),<sup>11</sup> the United States Court of Appeals for the Third Circuit addressed this double-preemption issue in a case of first impression.<sup>12</sup> The Third Circuit’s conclusion differed from the holdings of the United States Courts of Appeals for the Fifth, Sixth and Seventh Circuits.<sup>13</sup> The Third Circuit justified its departure from these circuits by concluding that Congress did not intend to displace any available federal common law actions for simple negligence by enacting § 1821(k).<sup>14</sup> By preserving the state law negligence action, however, the Third Circuit’s decision is consistent with those of the other circuits.<sup>15</sup>

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and gross negligence by defining each term. Battin, *supra* note 3, at 2351 n.26. Simple negligence is the failure to use that degree of care that would be exercised by an ordinarily prudent person. *Id.* (citing BLACK’S LAW DICTIONARY 1383 (6th ed. 1990)). Gross negligence is the intentional failure to perform a duty in reckless disregard of the consequences. *Id.* Most importantly, gross negligence actions require a higher showing of wrongdoing than is necessary for simple negligence actions. *Id.*

11. 57 F.3d 1231 (3d Cir. 1995).

12. *Id.* at 1237 (noting issue is “whether Congress, by its enactment of § 1821(k), also preempted state law or displaced federal common law actions that impose liability for conduct less culpable than gross negligence”). The Third Circuit affirmed the district court on the state law preemption issue but reversed on the federal common law preemption issue. *Id.* at 1249. The district court denied the defendant’s motion for dismissal and summary judgment in holding that § 1821(k) did not preempt any simple negligence actions under New Jersey law. *Id.* The district court, however, granted the defendant’s motion to dismiss regarding the federal common law claim and held that § 1821(k) displaced any available federal common law claims for simple negligence. *Id.* Also, the Third Circuit noted that the district court ruled on the scope of the New Jersey business judgment rule. *Id.* at 1236 n.6. The circuit court concluded, however, this issue was “not ripe for decision.” *Id.*

13. *See, e.g.*, *RTC v. Frates*, 52 F.3d 295, 297 (10th Cir. 1995) (holding federal common law action for simple negligence “superseded” by § 1821(k)); *FDIC v. Bates*, 42 F.3d 369, 371 (6th Cir. 1994) (holding § 1821(k) preempted any federal common law action for simple negligence because two cannot coexist together); *RTC v. Miramon*, 22 F.3d 1357 (5th Cir. 1994) (holding any federal common law actions for simple negligence preempted by § 1821(k)); *RTC v. Gallagher*, 10 F.3d 416 (7th Cir. 1993) (holding § 1821(k) preempts any federal common law actions for simple negligence).

14. *CityFed*, 57 F.3d at 1235, 1244-49. In accordance with at least two circuit courts, this Note will refer to the preemption of the federal common law as “displacement” and continue to use the term “preemption” in regards to state law preemption. This is to avoid any confusion between the two different authorities of law. *See id.* at 1235 n.1 (“[C]onfusion can result when the term ‘preemption’ is used to refer to the displacement of federal common law by federal statutory enactments.” (citing *Milwaukee v. Illinois*, 451 U.S. 304, 317 n.9 (1981))); *RTC v. Frates*, 52 F.3d 295, 297 (10th Cir. 1995) (Alsop, J., concurring) (agreeing distinction should be made between “preemption” of state laws and “supersession” of federal common law, but this has not affected substantive reasoning by previous courts that did not use different terms: “The difference . . . is one of semantics and not one of reasoning.”).

15. *CityFed*, 57 F.3d at 1235, 1243-44.

Part I of this Note reviews the history of individual liability for directors and officers of financial institutions.<sup>16</sup> Additionally, it discusses the trend toward increasing executive liability and the state legislative reactions to this trend.<sup>17</sup> Finally, Part I discusses the rationale of FIRREA and the conflicting interpretations of § 1821(k).<sup>18</sup> Part II traces the federal courts' interpretations of § 1821(k)'s preemptive effects on simple negligence actions.<sup>19</sup> Part II describes the facts and procedural history of *RTC v. CityFed Financial Corp.* and analyzes the rationale behind the court's decision.<sup>20</sup> Part IV discusses the impact of the *CityFed* decision on the directors and officers of financial institutions and corporate executives.<sup>21</sup> This Note concludes that the ultimate resolution of the issue in *CityFed* requires either congressional reform or United States Supreme Court review.<sup>22</sup>

## II. A HISTORICAL OVERVIEW ON THE INDIVIDUAL LIABILITY OF DIRECTORS AND OFFICERS OF FINANCIAL INSTITUTIONS

### A. *Briggs v. Spaulding: The Seminal Case*

In 1891, the United States Supreme Court first ruled on the duty of care owed by directors of financial institutions in *Briggs v. Spaulding*.<sup>23</sup> The Court used broad vague language in establishing the standard of liability.<sup>24</sup> This has resulted in a variety of mixed interpreta-

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16. For a discussion of the history of liability on the part of financial institutions' directors and officers, see *infra* notes 23-65 and accompanying text.

17. For a discussion of how state legislatures responded to increasing director and officer liability standards, see *infra* notes 56-58 and accompanying text.

18. For a discussion of the enactment of FIRREA and the conflicting preemption interpretations of § 1821(k) concerning simple negligence actions, whether based on state or federal law, see *infra* notes 59-65 and accompanying text.

19. For a discussion of how the federal courts have interpreted § 1821(k) in the context of preemption of simple negligence actions, see *infra* notes 66-95 and accompanying text.

20. For a discussion of the case background and an analysis of *CityFed*, see *infra* notes 96-186 and accompanying text.

21. For a discussion of the impact of the *CityFed* decision, see *infra* note 190 and accompanying text.

22. For this Note's conclusion, see *infra* notes 187-90 and accompanying text. The *CityFed* court correctly construed § 1821(k) to permit state law negligence actions. The court, however, did not interpret § 1821(k) correctly in not displacing federal common law actions.

23. 141 U.S. 132 (1891) (involving claim by bank receiver against bank's directors for mismanagement).

24. See Fischer, *supra* note 9, at 1712-13 (discussing "imprecision" of *Briggs* standard). In *Briggs*, the Court held that "the degree of care to which [bank directors are] bound is that which ordinary prudent and diligent men would exercise under similar circumstances." *Briggs*, 141 U.S. at 152. Justifying the vagueness of this standard, the Court reasoned that the degree of care to be applied depends on the subject and the totality of the circumstances. *Id.* at 147. Thus, the Court believed it was "unnecessary to attempt to define with precision the degree of care and prudence." *Id.*; see also Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175, 181 (1995) (noting *Briggs*'s broad standard derived from tort law).

tions.<sup>25</sup> The decision advanced a fact-sensitive and result-oriented rule.<sup>26</sup> Courts have interpreted *Briggs* as establishing an ordinary care standard reasoning that the nature of managing a bank requires a greater amount of care than managing a nonfinancial institution.<sup>27</sup> Nevertheless, courts have generally adopted the *Briggs* rule as the federal common law standard.<sup>28</sup>

Many state legislatures, however, did not construe *Briggs* as establishing either an ordinary care or a gross negligence standard.<sup>29</sup> Nevertheless, most state "director-liability" statutes have incorporated the *Briggs* language in whole or in part.<sup>30</sup> Moreover, the Model Business Corporation Act used the *Briggs* language in its standard of liability for bank direc-

25. Schooner, *supra* note 24, at 181 (discussing different standards applied under *Briggs*); *see also* Fischer, *supra* note 9, at 1713 (noting that *Briggs*'s vague standard has led to "uneven" law). The difficulty lies in the fact that the Court ruled in favor of an ordinary care standard, however, it used language that pointed to a more culpable standard of gross negligence. *See* Schooner, *supra* note 24, at 183 n.45 ("*Briggs* . . . could be used to support either a simple negligence standard or a gross negligence standard."); *see also* Fischer, *supra* note 9, at 1715 ("Thus, in a single paragraph, the Court seemed to establish both a stringent 'ordinary care' standard and a more lenient 'gross inattention' standard.").

26. *See generally* Fischer, *supra* note 9, at 1713 (noting courts use *Briggs* to either hold bank directors liable or absolve them). One commentator has noted that "strict courts have often invoked the *Briggs* formula to hold defendant directors liable even for acts or omissions characterized as *simple* or *ordinary* negligence, but more lenient courts have frequently cited similar *Briggs* language even when absolving directors who had committed acts of *gross* negligence." *Id.*

27. *See generally* Schooner, *supra* note 24, at 182 ("[C]onduct that amounts to ordinary care in affairs of some businesses may not amount to ordinary care in the affairs of a bank."). Even before federal deposit insurance was created, there was a recognized need to protect depositors from losing their life savings. *Id.* Some courts, however, held bank directors to a stricter standard of care even after the FDIC was formed. *Id.*

28. *See* Fischer, *supra* note 9, at 1716 ("The *Briggs* Court's stated formula has been faithfully invoked—though not necessarily applied—as federal common law for a century."). One commentator has stated that many courts have subtly bent the standard announced in *Briggs* to ensure their views were expressed in *their* standards that they established. *See id.* at 1716 n.50.

29. *See id.* at 1713 (noting *Briggs* continues to dominate common and statutory law). States that have desired to codify a standard of liability for directors of financial institutions used *Briggs* as a starting point. *Id.*

30. *Id.* Typically, the state statute incorporates the "ordinary prudent" and "under similar circumstances" phrases and contains any additional qualifications the state legislatures deemed appropriate. *Id.* at 1716 n.51. Currently, 12 states have statutes that adopt the *Briggs* language. *See* ALA. CODE § 10-2A-74 (1994); CONN. GEN. STAT. § 33-313(d) (1991); KY. REV. STAT. ANN. § 271B.8-300 (Michie 1989); MISS. CODE ANN. § 79-48.30 (1996); NEB. REV. STAT. § 21-2035 (1993); N.H. REV. STAT. ANN. § 293-A:35 (Supp. 1995); N.C. GEN. STAT. § 55-8-30(a) (1996); N.D. CENT. CODE § 10-19.1-50(1) (1995); OHIO REV. CODE ANN. § 1701.59(B) (Banks-Baldwin 1992); TENN. CODE ANN. § 48-18-301(a) (1995); WASH. REV. CODE ANN. § 23B.08.300(1) (West Supp. 1997); WYO. STAT. ANN. § 17-16-830(a) (Michie 1996).

tors.<sup>31</sup> Because of the ambiguity in *Briggs*, however, a conflict developed within the courts regarding the level of negligent culpability required by the statutes for liability.<sup>32</sup> This conflict set the stage for *Smith v. Van Gorkom*,<sup>33</sup> the landmark director-liability case in Delaware.

### B. *The Business Judgment Rule and Director Liability Crisis*

During the corporate heyday of the 1980s, substantial mergers and acquisitions, leveraged buyouts and sales of corporate assets produced significant amounts of litigation. When these deals adversely impacted the stockholders, corporate directors and officers were often targeted for liability.<sup>34</sup> This rise in personal liability lawsuits against corporate directors and officers resulted in a director and officer liability insurance crisis in the mid-1980s.<sup>35</sup> In turn, a lack of insurance led to a personal liability crisis for directors and officers.<sup>36</sup>

Historically, the business judgment rule has provided corporate directors and officers with substantial leeway in making business decisions.<sup>37</sup> When the requirements of the business judgment rule are satisfied, courts give substantial deference to directors and officers.<sup>38</sup> The purpose of the

31. See REV. MODEL BUS. CORP. ACT § 8.30(a)(2) (1990). Section 8.30(a)(2) provides: "A director shall discharge his duties as a director, including his duties as a member of a committee: . . . (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances . . ." *Id.*

32. See Fischer, *supra* note 9, at 1716 n.50 (noting that *Briggs* is ambiguous because it is capable of having either simple or gross negligence standard, as evidenced by courts' treatment of *Briggs* rule).

33. 488 A.2d 858 (Del. 1985).

34. See Roberta Romano, *What Went Wrong with Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1, 13-15 (1989) (discussing causes of directors' and officers' liability insurance crisis during mid-1980s). Specifically, Romano cites three major litigation-spawning business phenomena during that decade: (1) Mergers and acquisitions because shareholders objected either to the terms of the deal, the disclosure about the deal, or the defensive methods used to try to prevent a deal; (2) Initial public offerings of stock because the stock prices fell unexpectedly; (3) Bankruptcies in record numbers because trustees, shareholders and the Federal Deposit Insurance Corporation were attempting to collect on the directors' and officers' liability insurance policy money. *Id.*

35. *Id.* During the early 1980s, the director and officer liability insurance market endured a crisis whereby many companies were unable to obtain personal liability insurance for their directors and officers and sent a wave of fear throughout the executive community. *Id.* at 9. One commentator has postulated three general causes of the insurance crisis. *Id.* at 13-25. First, increased litigation against executives due to the three business conditions. *Id.* Second, increased reinsurance rates. *Id.* Third, changes in the substantive law of director and officer liability. *Id.*

36. See Price, *supra* note 10, at 229 (noting for first time in business history, directors and officers feared their personal assets were substantially at risk).

37. See Charles D. Lewis, *The Business Judgment Rule and Corporate Director's Liability for Mismanagement*, 22 BAYLOR L. REV. 157 (1970) (providing historical background of business judgment rule).

38. EDWARD F. BRODSKY, *LAW OF CORPORATE OFFICERS AND DIRECTORS* § 2.06 (1992). The five preconditions to application of the business judgment rule are:

business judgment rule is to prevent judicial examination of certain executive decisions.<sup>39</sup> In Delaware, the business judgment rule represents a presumption that directors have “acted on an informed basis, in good faith and in the best interests of the company.”<sup>40</sup>

State legislatures in thirty-four states have codified the duty of care required of directors and officers.<sup>41</sup> These statutes, however, are not uniform in their standards of care.<sup>42</sup> In addition, state courts have applied standards of liability ranging from simple negligence to conduct more culpable than gross negligence.<sup>43</sup> Thus, neither the state legislatures nor the state courts have agreed on one uniform formulation of the business judgment rule.<sup>44</sup> It should be noted, however, that the business judgment rule prevents liability in most cases, regardless of the standard the court employs.<sup>45</sup> This uncertainty regarding the appropriate stan-

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(1) No self-dealing by the director or officer making the decision; (2) Judgment (a decision or a conscious decision not to decide) must have actually been made; (3) Judgment must be made in good faith; (4) No gross abuse of discretion; (5) Must act with degree of care required under state law (statute or common law). *Id.*

The business judgment rule stems from the proposition that an effective corporate executive must occasionally participate in risky transactions due to competition and the nature of capitalism. Fischer, *supra* note 9, at 1717-18. Executives would be wary and become risk-averse, however, if courts were allowed to use hindsight and scrutinize every business decision that resulted in a loss to constituents. *Id.* See generally E. Norman Veasey, *New Insights into Judicial Deference to Directors' Business Decisions: Should We Trust the Courts?*, 39 BUS. LAW. 1461 (1984) (arguing business judgment rule gives undue deference to directors' decisions).

39. See BRODSKY, *supra* note 38, § 2.06.

40. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). In *Aronson*, the Delaware Supreme Court noted that the courts will not substitute their judgment for that of directors if there is no showing of abuse of discretion. *Id.* The plaintiff has the burden to rebut the presumption of the business judgment rule. *Id.*

41. BRODSKY, *supra* note 38, at 13 n.1.

42. *Id.* (noting generally four standards used: (1) prudent person in like position; (2) notice-inquiry; (3) personal business affairs; and (4) miscellaneous: i.e., KY. REV. STAT. ANN. § 271B.8-300 (Michie 1989)).

43. See Fischer, *supra* note 9, at 1713 (discussing range of *Briggs* standards); see also DENNIS BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 63 (4th ed. 1993) (noting courts' different interpretations of requisite level of negligence has resulted in business judgment rule standards ranging from simple negligence to intentional misconduct).

44. See Fischer, *supra* note 9, at 1713 (discussing variety of *Briggs* standards). Compare *Aronson*, 473 A.2d at 812 (describing Delaware business judgment rule), with *Auerbach v. Bennett*, 47 N.Y.S. 2d 619, 630-31 (N.Y. 1979) (describing New York business judgment rule).

45. See Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 594 (1983) (noting courts traditionally, and still do, use business judgment rule as excuse not to look in merits of plaintiff's complaint absent evidence of fraud or self-dealing). This is why there are only seven cases where directors have been liable for negligence where no self-dealing was present. *Id.* at 591 n.1.

See Fischer, *supra* note 9, at 1720-21 (“Thus, similar fact patterns may result in liability or absolution, depending not only on the objective circumstances and facts but also on the judge or judicial panel and on other subjective or inscrutable factors.” (citations omitted)); see also BLOCK ET AL., *supra* note 43, at 63 (“[C]ourts



dard allowed the court in *Van Gorkom* to establish some straightforward rules.<sup>46</sup>

### C. Smith v. Van Gorkom: *Increasing Director Liability*

In 1980, Jerome Van Gorkom, the Chairman and Chief Executive Officer of the Trans Union Corporation ("Trans Union"), made an offer of a cash-out merger without consulting the company's board of directors.<sup>47</sup> One day later, Van Gorkom called a special board of directors and senior management meeting without disclosing the purpose of the meeting.<sup>48</sup> At the meeting Van Gorkom disclosed the basics of the cash-out merger agreement.<sup>49</sup> Finally, after only two hours of contemplation, the board accepted the offer.<sup>50</sup>

Subsequently, the Trans Union shareholders brought a suit in equity seeking rescission of the cash-out merger.<sup>51</sup> The Delaware Supreme Court held that the Board's approval of the merger agreement did not reflect "the product of informed business judgment" and that "the Board did not deal with complete candor with the stockholders."<sup>52</sup> The court concluded that although the directors acted in good faith, their conduct constituted gross negligence.<sup>53</sup>

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have rarely held directors liable 'simply for bad judgment.'" (citing *Joy v. North*, 692 F.2d 880, 885 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1993)).

46. *Smith v. Van Gorkom*, 488 A.2d 858, 872-73, 893 (Del. 1985). The *Briggs* decision and the business judgment rule created uncertainty over whether directors should be held to a simple or gross negligence standard.

47. *Van Gorkom*, 488 A.2d at 866-67. The stock price of the offer was \$55 per share, however, over the previous five years the price had only fluctuated between \$24.25 and \$39.50. *Id.* at 866 n.5.

48. *Id.* at 867. Van Gorkom failed to disclose the purpose of the meeting. *Id.* The merger agreement was disclosed but the directors had only Van Gorkom's 20 minute oral presentation and a few other statements to use as information in weighing the soundness of the agreement. *Id.* at 868. Moreover, Van Gorkom did not tell the board how he arrived at \$55 but insisted that the market would determine the fairness of the price. *Id.* Additionally, the Trans Union lawyer cautioned the board that they could be sued if they did not accept the offer. *Id.*

49. *Id.*

50. *Id.* at 869 (noting Van Gorkom executed merger agreement at social event hosted for Chicago Lyric Opera and neither he nor anyone else on board read agreement prior to signing).

51. *Id.* at 863. The Trans Union shareholders' complaint averred that the defendant directors breached their fiduciary duties to their shareholders because they approved the cash-out merger without "due care and prudence." *Id.* at 871. Further, the plaintiffs contended that the Court of Chancery erred in finding that the directors' decision was sufficiently informed. *Id.* The Supreme Court agreed with the plaintiffs and held that the Court of Chancery's decision was illogical because the directors were ultimately found grossly negligent in their decision to approve the merger. *Id.* at 871-78.

52. *Id.* at 864.

53. *Id.* at 873-74. The court concluded that the directors were grossly negligent because they did not adequately inform themselves as to Van Gorkom's activities and were uninformed as to the value of the company. *Id.* at 874.

*Van Gorkom* signified the trend during the 1980s of increased judicial scrutiny of director decisions.<sup>54</sup> This trend resulted in state concerns that corporations would not be able to attract competent individuals to serve as directors.<sup>55</sup> In response to this concern, most states enacted legislation that limited director liability only to “reckless, willful, and wanton boardroom misconduct.”<sup>56</sup> Because these states rejected *Van Gorkom*, their statutes impliedly stated that neither simple nor gross negligence should govern directors.<sup>57</sup> Based on the same policy concerns, other states revised their corporate laws. These revisions permitted corporations to adopt a provision within its articles of incorporation eliminating or limiting director liability for simple and gross negligence.<sup>58</sup>

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54. Price, *supra* note 10, at 320. In *Van Gorkom*, the court ruled that the business judgment rule’s presumption of due care was overcome by gross negligence. *Van Gorkom*, 488 A.2d at 873. Since *Van Gorkom*, some courts have increased their scrutiny of director decisions and have held that an increasing number of mismanagement acts fall within the scope of simple, rather than gross, negligence. See Price, *supra* note 10, at 230 (stating “the [*Van Gorkom*] decision has been recognized as expanding the ambit of conduct constituting gross negligence to mirror conduct that is simple negligence”) (citation omitted); see also Romano, *supra* note 34, at 23-25 (noting after *Van Gorkom*, courts uncertain which direction to decide director-liability standard of care cases). For a detailed discussion of *Van Gorkom*, see Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437 (1985); Jonathan R. Macey & Geoffrey P. Miller, *Trans Union Reconsidered*, 98 YALE L.J. 127 (1988); Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW. 1, 8-14 (1985); William T. Quillen, *Trans Union, Business Judgment, and Neutral Principles*, 10 DEL. J. CORP. L. 465 (1985); Barry F. Schwartz & James G. Wiles, *Trans Union: Neither “New” Law nor “Bad” Law*, 10 DEL. J. CORP. L. 429 (1985).

55. Resolution Trust Corp. v. CityFed Financial Corp. (“RTC v. CityFed Financial Corp.”), 57 F.3d 1231, 1239 (3d Cir. 1995). See generally *Business Roundtable on the American Law Institute’s Proposed Principles of Corporate Governance and Structure: Restatement and Recommendations* 50 (Feb. 1993) [hereinafter *Business Roundtable*] (explaining main policy reason for business judgment rule is to encourage highly qualified persons to become directors). The Business Roundtable generally opposed the ALI’s version of the business judgment rule as codified in § 4.01 of its Principles of Corporate Governance because it limited the deference given to directors. *Id.* at 6-7, 39-51. The Business Roundtable stated: “[Section 4.01] may well result in . . . increased costs to the corporation . . . unwillingness and inability to take the risks necessary to maintain competitiveness . . . an unwillingness of qualified individuals to serve as corporate directors. Improved corporate efficiency and accountability are not the likely result.” *Id.* at 6.

56. *CityFed*, 57 F.3d at 1239. This form of legislation has been called state insulating statutes. See Gorman, *supra* note 4, at 667 n.102 (describing nationwide movement to limit liability of officers and directors); Price, *supra* note 10, at 230 (stating that more than “four-fifths of the states enacted some form of legislation designed to insulate directors and officers from personal liability” in negligence suits). For examples of state insulating statutes, see Jon Shepherd, *The Liability of Officers and Directors Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 90 MICH. L. REV. 1119, 1120 n.7 (1992) (citing 37 statutes).

57. See *CityFed*, 57 F.3d at 1239 (stating that “‘race to the bottom’ among certain states was a reaction to the Delaware Supreme Court’s decision in *Smith v. Van Gorkom*”).

58. See Gorman, *supra* note 4, at 666-67 (noting by 1988, 42 states enacted form of this insulating legislation); Shepherd, *supra* note 56, at 1120 n.7 (listing

D. *The Federal Response: FIRREA*

In the wake of the savings and loan crisis, federal regulators attempted to recover some of the billions of dollars lost from insuring the failed financial institutions.<sup>59</sup> Recently enacted legislation, however, required the regulators to prove a high level of culpability in order to recover.<sup>60</sup> In response, Congress enacted FIRREA § 1821(k) to enhance the regulators' ability to recover.<sup>61</sup>

Section 1821(k) permits federal regulators to bring actions against failed bank directors for gross negligence.<sup>62</sup> Thus, § 1821(k) was intended by Congress to preempt state insulating legislation.<sup>63</sup> The focus of § 1821(k) is its first two sentences because they establish a standard of liability and contain a savings clause.<sup>64</sup> The savings clause is the portion of

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states that have enacted insulating statutes). Delaware was one of first to implement this type of legislation in § 102(b)(7) which provides:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law; . . . or (iv) for any transaction from which the director derived an improper personal benefit.

DEL. CODE ANN. tit. 8, § 102(b)(7) (1991).

59. See *CityFed*, 57 F.3d at 1239 (noting that "regulators of federally insured depository institutions were embarking on a concerted litigation campaign to recoup from allegedly corrupt and incompetent directors a portion of the billions of federal dollars lost in the bankruptcy of federally insured thrifts").

60. *Id.*; see also Pitts et al., *supra* note 6, at 2088 (recognizing regulators usually assert negligence claims against former directors of failed banks, not more culpable intentional misconduct claims).

61. Ronald R. Glancz, *Government Is Dealt Series of Setbacks in D&O Liability Cases*, 14 BANKING POL'Y REP. 5 (June 19, 1995); Gorman, *supra* note 4, at 667-71 (stating that Congress intended to establish a uniform liability standard which would "preempt the application of any other law, including a state law that would impose a more stringent liability standard"). Section 1821(k) was enacted so that directors and officers could be sued for conduct less egregious than the intentional misconduct standard. *Id.*

62. 12 U.S.C. § 1821(k) (1994). The statute provides: "A director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by, or on behalf of . . . the [RTC] . . . acting as conservator or receiver of such institution . . . for gross negligence." *Id.*

63. See *CityFed*, 57 F.3d at 1237 ("All parties agree that in enacting § 1821(k) Congress intended to preempt state laws that limit the liability of directors and officers . . ."); see also 135 CONG. REC. S4278-79 (daily ed. Apr. 19, 1989) (statement of Sen. Riegle) (stating that "[s]tate law would be overruled . . . to the extent that it forbids the FDIC to bring suit based on 'gross negligence' or an 'intentional tort'").

64. See 12 U.S.C. § 1821(k) (1994) (defining liability of directors and officers). The first sentence of § 1821(k) establishes the standard of liability for directors of financial institutions. It provides: "A director or officer of an insured depository institution may be held personally liable for monetary damages . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of duty of care (than gross negligence)." *Id.* The second sen-

§ 1821(k) that has caused a split among the federal courts regarding whether the savings clause preempts state or federal common law actions based on simple negligence.<sup>65</sup>

### III. CONTROVERSY IN THE FEDERAL COURTS OVER PREEMPTIVE SCOPE OF § 1821(k)

#### A. Preemption of State Law

Most courts have held that § 1821(k) only partially preempts state law.<sup>66</sup> For example, the United States Courts of Appeals for the Ninth and Tenth Circuits have held that state law actions premised upon simple negligence are not preempted by § 1821(k) because they fell under “other applicable law.”<sup>67</sup> Both Circuits used similar analysis to support their conclusions.<sup>68</sup> They relied upon the language of the statute to demonstrate

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tence contains a savings clause which provides: “Nothing in this paragraph shall impair or affect any right of the Corporation under other applicable law.” *Id.*

65. See Glancz, *supra* note 61, at 5 (“The savings clause . . . has prompted extensive debate and numerous court decisions over whether Congress intended to preempt state law and federal common law by establishing a national standard of care . . .”). Some federal courts hold that § 1821(k) does not preempt state insulating statutes that allow simple negligence liability. See, e.g., FDIC v. McSweeney, 976 F.2d 532 (9th Cir. 1992); FDIC v. Canfield, 967 F.2d 446 (10th Cir. 1992); Washington Bancorporation v. Said, 812 F. Supp. 1256 (D.D.C. 1993).

66. 12 U.S.C. § 1821(k).

67. See, e.g., *McSweeney*, 976 F.2d at 537; *Canfield*, 967 F.2d at 446. In *Canfield*, the FDIC sued former bank directors for negligent mismanagement and the district court granted the defendants’ motion to dismiss. *Id.* at 443. The Tenth Circuit reversed and held that § 1821(k) did not preempt state law simple negligence actions. *Id.* The court placed emphasis on the plain language of § 1821(k). *Id.* at 446. The court interpreted the savings clause as preserving *all* other applicable law, including state law actions for simple negligence. *Id.*

In *McSweeney*, the FDIC sued two former bank directors for breach of fiduciary duties and the district court denied defendants’ motion to dismiss. *McSweeney*, 976 F.2d at 532. The Ninth Circuit held that § 1821(k) did not preempt state law simple negligence actions. *Id.* at 539. The court began its analysis with a review of the purposes underlying FIRREA: to strengthen both the regulators’ enforcement powers and the civil sanctions for damaging depository institutions and their depositors. *Id.* at 537. The court concluded that there was nothing in the savings clause that would prohibit state law actions for simple negligence. *Id.* at 538. It analogized to a previous case where it held a savings clause allowed a common law fiduciary duty action. See *id.* (“To hold otherwise would render the [savings clause] language . . . mere surplusage.” (quoting *Reich v. Webb*, 336 F.2d 153, 158 (9th Cir. 1964))).

68. *McSweeney*, 976 F.2d at 537 (construing statutory language according to its plain meaning); *Canfield*, 967 F.2d at 446 (“In our judgment, the words used in section 1821(k) to describe the potential liability of officers and directors belie the creation of an exclusive federal liability standard.”). Both courts analyzed the term “may” as it is used in § 1821(k) and stated that it did not mean “may only.” *McSweeney*, 976 F.2d at 537 (“Had Congress intended . . . to limit the FDIC to claims alleging gross negligence or greater culpability, it would have inserted the word ‘only’ in the sentence.”); *Canfield*, 967 F.2d at 446. They interpreted “may” as merely being a permissive term and therefore not requiring the courts to infer a limitation on the standards of liability. *Id.* at 446 (“‘May’ is a permissive term, and

that Congress did not intend § 1821(k) to create a national standard of liability.<sup>69</sup> The Ninth and Tenth Circuits noted that full state law preemption would provide an incentive for a director of a failing bank to allow it to go insolvent, thereby taking advantage of the exclusive gross negligence standard.<sup>70</sup> Additionally, at the district court level, many courts have held that § 1821(k) does not preempt state law actions for conduct less culpable than gross negligence.<sup>71</sup>

The minority view regarding state law preemption is that § 1821(k) establishes an exclusive national gross negligence standard of liability for bank directors.<sup>72</sup> As a result, all other actions based upon less culpable

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it does not imply a limitation on the standard of officer and director liability.”). The courts also noted the pattern of usage of the savings clause phrase supported their conclusion that simple negligence actions were not preempted. *McSweeney*, 976 F.2d at 538 (stating that rights to proceed against “officers for negligent breach of the duty of care, whether under state or federal common law, are preserved by the plain language of the last sentence of § 1821(k)”); *Canfield*, 967 F.2d at 447 (noting Congress refers to “[the] whole universe of other laws” when it uses language of type found in § 1821(k) savings clause). Thus, reading the statute as a whole, FIRREA’s pattern of usage supports the partial preemption theory. *Id.* at 446-47.

69. *McSweeney*, 976 F.2d at 539 (finding it “evident from the . . . language of § 1821(k) that Congress did not intend to preclude the FDIC from bringing actions premised on [negligence]”); *Canfield*, 967 F.2d at 447 (“Nowhere does the statute announce its intention to create a national standard of liability . . .”). Both courts offer § 1821(k)’s language “for gross negligence . . . as such term[sic] [is] defined and determined under applicable State law” as evidence that Congress did not intend to create a uniform national standard when that standard would be defined differently in each state. *McSweeney*, 976 F.2d at 539 (stating that § 1821(k) incorporates “state definitions of gross negligence and intentional tortious conduct, which vary from state to state”).

70. *McSweeney*, 976 F.2d at 540; *Canfield*, 967 F.2d at 449. Absurd results would occur because a bank director is subject to simple negligence actions under available state law before insolvency (i.e., before § 1821(k) applies) but would then be only subject to actions based on gross negligence or worse after insolvency. *Id.*; see Battin, *supra* note 3, at 2360 (“Under the . . . full preemption interpretation, § 1821(k) creates an incentive for negligent bank directors to allow their banks to fail.”); Fischer, *supra* note 9, at 1760 (giving examples of absurd results that would ensue from interpretation of § 1821(k) as fully preemptive of state law).

71. See, e.g., *RTC v. Fortunato*, 1994 WL 478616, at \*2 (N.D. Ill. Sept. 1, 1994) (concluding § 1821(k) does not preempt simple negligence claims); *RTC v. Domenico*, 837 F. Supp. 623, 627 (D.N.J. 1993) (same); *RTC v. Hess*, 820 F. Supp. 1359, 1363-64 (D. Utah 1993) (same); *FDIC v. Mintz*, 816 F. Supp. 1514, 1545 (S.D. Fla. 1993) (same); *Washington Bancorporation v. Said*, 812 F. Supp. 1256, 1265 (D.D.C. 1993) (same); *FDIC v. Howse*, 802 F. Supp. 1554, 1568 (S.D. Tex. 1992) (same); *RTC v. Gallagher*, 800 F. Supp. 595, 601 (N.D. Ill. 1992) (same), *aff’d* 10 F.3d 416 (7th Cir. 1993); *FDIC v. Nihiser*, 799 F. Supp. 904, 907 (C.D. Ill. 1992) (same); *FSLIC v. Shelton*, 789 F. Supp. 1360, 1365 (M.D. La. 1992) (same); *FDIC v. Williams*, 779 F. Supp. 998, 1003 (S.D. Iowa 1991) (same); *FDIC v. Fay*, 779 F. Supp. 66, 67 (S.D. Tex. 1991) (same); *FDIC v. Haddad*, 778 F. Supp. 1559, 1567 (S.D. Fla. 1991) (same); *FDIC v. Isham*, 777 F. Supp. 919, 922 (W.D. Okla. 1991) (same).

72. See, e.g., *RTC v. Camhi*, 861 F. Supp. 1121, 1129-30 (D. Conn. 1994) (holding § 1821(k) established national standard of liability and therefore preempted state law actions for negligence).

conduct are preempted.<sup>73</sup> Only the Sixth Circuit, in dicta, used the legislative history of FIRREA to illustrate that the statute established a national standard of gross negligence which preempted all state law claims brought against bank directors and officers.<sup>74</sup> Specifically, the court focused on the House Conference Report's statement that, "[FIRREA] preempts State law with respect to claims brought by the FDIC in any capacity against officers or directors."<sup>75</sup>

Five federal district courts have followed the Sixth Circuit and held that § 1821(k) preempted state law simple negligence actions.<sup>76</sup> One court found express preemption in the statutory language itself in the savings clause.<sup>77</sup> The court also found that the overall legislative scheme established implied preemption because it demonstrated congressional intent to "superintend the field."<sup>78</sup>

In sum, the courts explained that the ambiguous statutory language of § 1821(k) renders it "susceptible to two valid, yet diametrically opposed interpretations."<sup>79</sup> The greatest degree of controversy in the federal court

73. *Id.*

74. *Gaff v. FDK*, 919 F.2d 384, 390-91 (6th Cir. 1990) ("The legislative history of this provision explicitly states an intent to nationalize the law of directors' and officers' liability when banks are taken over by the FDIC."). The *Gaff* court quoted the legislative history: "'[§ 1821(k)] preempts State law . . . . The preemption allows the FDIC to pursue claims for gross negligence or any conduct that demonstrates a greater disregard of a duty of care.'" *Id.* at 391 (quoting H.R. CONF. REP. NO. 101-222, at 398 (1989), *reprinted in* 1989 U.S.C.C.A.N. at 437)). The *Gaff* court concluded this showed Congress's intent to nationalize the standard of directors' and officers' liability. *Id.*

75. *Id.*

76. *See, e.g., Camhi*, 861 F. Supp. at 1129-30 (holding § 1821(k) expressly and implicitly preempted all state law actions); see also, *RTC v. O'Bear, Overholser, Smith & Huffer*, 840 F. Supp. 1270 (N.D. Ind. 1993) (concluding § 1821(k) preempts state law simple negligence claims); *FDIC v. Swager*, 773 F. Supp. 1244, 1248 (D. Minn. 1991) (same); *FDIC v. Canfield*, 763 F. Supp. 533, 539 (D. Utah 1991) (same); *FDIC v. Brown*, No. CIV.NC89-30G, 1991 WL 294524, at \*1 (D. Utah Nov. 18, 1991) (same).

77. *Camhi*, 861 F. Supp. at 1129. In *Camhi*, the court reasoned that *some* law must be impaired for a savings clause to be necessary and concluded that this means state law. *Id.* If Congress intended to save state law actions it would have drafted the savings clause to read "*any* applicable law." *Id.* Moreover, in order to remain consistent with other sections of FIRREA, the savings clause would have to read "applicable *State* law" if state law actions were intended to be preserved because Congress used those exact words when referring to state law. *Id.* at 1130. Finally, Congress did not extend the savings clause to "eviscerate" the gross negligence set forth in the preceding sentence of § 1821(k). *Id.* (citing *O'Bear*, 840 F. Supp. at 1277).

78. *Id.* at 1130. In *Camhi*, the court used the dicta of *Gaff* to find congressional intent to nationalize the standard of liability of bank directors. *Id.* Also, the relationship between the federal regulators and federally-insured financial institutions requires a uniform national standard, thus allowing the regulators to bring state law claims would interfere with the nature of this relationship. *Id.*

79. *See Gorman, supra* note 4, at 653-54 (stating that "the language of § 1821(k) is ambiguous regarding the proper standard of care by which to evaluate

system concerns whether § 1821(k) preempts federal common law actions for simple negligence.<sup>80</sup>

### B. Displacement of Federal Common Law

The § 1821(k) federal common law preemption issue has several related subissues that have likewise divided the federal courts.<sup>81</sup> First, debate exists over whether any federal common law governs bank director liability.<sup>82</sup> Second, certain courts used simple negligence as the federal common law standard of bank director liability, while other courts used gross negligence.<sup>83</sup>

The United States Supreme Court established the “speak directly” test, which states that federal common law is displaced if Congress intended to merely “speak directly” to the issue which was previously governed by the federal common law, in *Milwaukee v. Illinois*.<sup>84</sup> This standard is less stringent than that required to preempt state law.<sup>85</sup> Consequently, the federal common law may be displaced while state law may be saved from preemption.<sup>86</sup>

Federal circuit courts faced with the issue have unanimously preempted simple negligence actions brought under federal common law.<sup>87</sup>

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the conduct of . . . officers and directors”); Price, *supra* note 10, at 224 (stating that language used by Congress in § 1821(k) is subject to two interpretations).

80. See Battin, *supra* note 3, at 2349 (finding § 1821(k)'s ambiguity has caused conflicting court decisions on various issues; Fischer, *supra* note 9, at 1709 (describing debate over differing interpretations of § 1821(k)).

81. For a further discussion of the subissues surrounding the § 1821(k) federal common law preemption issue, see *infra* notes 82-95 and accompanying text.

82. Compare *First Hawaiian Bank v. Alexander*, 558 F. Supp. 1128, 1131 (D. Haw. 1983) (declining to recognize federal common law claims based on negligence), and Fischer, *supra* note 9, at 1716 n.52 (asserting state law determines liability of bank directors within their jurisdictions), with *FDIC v. Mintz*, 816 F. Supp. 1541, 1544 (S.D. Fla. 1993) (holding federal common law contains applicable negligence standard), and *Washington Bancorp. v. Said*, 812 F. Supp. 1256, 1266 (D.D.C. 1993) (same).

83. Compare *RTC v. Miramon*, 22 F.3d 1357, 1359 (5th Cir. 1994) (holding § 1821(k) preempts federal common law standard of simple negligence); *Mintz*, 816 F. Supp. at 1544 (same), with *Washington Bancorp.*, 812 F. Supp. at 1266 (noting federal common law is gross negligence standard). But see *FDIC v. Gonzalez-Gorondona*, 833 F. Supp. 1545, 1550 (S.D. Fla. 1993) (holding no federal common law cause of action exists for negligence).

84. 451 U.S. 304 (1981). The Supreme Court in *Milwaukee* held that the Federal Water Pollution Act Amendments of 1972 displaced federal common law because Congress viewed the Amendments as “‘total restructuring’ and ‘complete rewriting’ of the existing water pollution legislation.” *Id.* at 317.

85. *Id.* at 315-17 (noting distinction based on preserving states’ police powers).

86. *Id.* at 317.

87. *RTC v. Frates*, 52 F.3d 295 (10th Cir. 1995); *FDIC v. Bates*, 42 F.3d 369 (6th Cir. 1994); *Miramon*, 22 F.3d at 1357; *RTC v. Gallagher*, 10 F.3d 416 (7th Cir. 1993). The *Miramon* court noted that federal common law is “merely a necessary expedient ‘resorted to in the absence of an applicable Act of Congress.’” *Miramon*, 22 F.3d at 1360 (quoting *Milwaukee*, 451 U.S. at 314 (1981)). Furthermore, federal

These courts have concluded that Congress “spoke directly” to the issue of bank director liability through the plain language of § 1821(k).<sup>88</sup> The legislative history of § 1821(k) also served as a basis for the finding of federal preemption.<sup>89</sup> The Senate adopted and the House approved an amendment to the original version of § 1821(k) establishing gross negligence as the standard.<sup>90</sup> Because the legislative history did not reveal Congress’s

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courts lack the power to create their own rules of decision because this power is reserved to Congress alone. *Id.*

88. *See, e.g., Bates*, 42 F.3d at 371. The U.S. Supreme Court laid down the test for determining when federal legislation preempts federal common law in *Milwaukee*, 451 U.S. at 304. There is a presumption that Congress has the responsibility of establishing the appropriate standards, rather than the federal courts. *Id.* at 317. Thus, when Congress “speaks directly” to an issue previously addressed by federal common law, the federal statute governs through preemption. *Id.* at 313-15.

*See Frates*, 52 F.3d at 292-97; *Bates*, 42 F.3d at 371; *Miramón*, 22 F.3d at 1360-61; *Gallagher*, 10 F.3d at 419-20. The courts discounted the importance of the term “may” because it did not substantively qualify the statutory language. *See Bates*, 42 F.3d at 371 (noting “[t]he FDIC places undue emphasis on the word ‘may’”); *Miramón*, 22 F.3d at 1361 n.5 (noting “[m]ay’ cannot be reasonably read to qualify the gross negligence standard and is therefore irrelevant to the substance of the provision” (quoting *Canfield*, 967 F.2d at 450 n.4 (Borby, J., dissenting))); *Gallagher*, 10 F.3d at 420 (same). Moreover, the savings clause intended to preserve other powers of federal regulators but not federal common law actions for simple negligence. *See Bates*, 42 F.3d at 372 (noting FIRREA grants federal regulators power to remove negligent directors and issue cease and desist orders based on simple negligence (citing *Gallagher*, 10 F.3d at 421)); *Miramón*, 22 F.3d at 1361-62 (stating Congress did not intend savings clause to render § 1821(k)’s gross negligence standard nullity); *Gallagher*, 10 F.3d at 421 (noting savings clause only needed to ensure FIRREA was not interpreted to take away regulators’ other non-monetary powers).

89. *See Bates*, 42 F.3d at 372-73 (noting “[t]he legislative intent underlying director liability is insufficient to overcome the plain meaning of the statute”).

90. 135 CONG. REC. S4454 (daily ed. April 19, 1989) (statement of Sen. Riegle) (stating that financial institutions may be penalized only if “violation, breach, or practice . . . resulted from gross negligence”). The original version of § 1821(k) provided a cause of action for anything available at common law, “including, but not limited to, negligence.” *Id.* The amendment raised the minimum level from negligence to gross negligence. *Id.* Pub. L. No. 101-73, 103 Stat. 183, reprinted in 1989 U.S.C.A.N. 86.

The federal appellate courts noted that the need to attract and retain competent directors on corporate boards motivated this amendment. *See Bates*, 42 F.3d at 373 (noting less stringent gross negligence standard was needed to attract highly qualified directors); *Miramón*, 22 F.3d at 1362; *Gallagher*, 10 F.3d at 422; *see also* 135 CONG. REC. S4264 (daily ed. April 19, 1989) (statement of Sen. Heflin) (cautioning that “without a clarifying amendment, financial institutions may lose effective directors, maybe an entire board of directors”). As support for their decisions, the courts cited two failed post-enactment efforts at amending § 1821(k) to expressly allow simple negligence actions. *Bates*, 42 F.3d at 372 (noting “[n]o amendment would be necessary if the savings clause preserved federal common law claims for simple negligence”); *Miramón*, 22 F.3d at 1363 (noting “[t]hese two attempts . . . belie the [federal regulators’] position . . . .”); *Gallagher*, 10 F.3d at 423 (“These post-enactment efforts to amend § 1821(k) to reinstate a simple negligence standard of liability belie the RTC’s contention that § 1821(k) as enacted, preserved a federal common law action for simple negligence.”); *see also* Arthur W. Liebold, *Federal Common Law: What & Where?*, in *CIVIL AND CRIMINAL LIABILITY OF OFFICERS*,



intent regarding the appropriate standard of liability, their plain language interpretations would prevail.<sup>91</sup>

The minority view states that § 1821(k) does not preempt federal common law actions premised on conduct less culpable than gross negligence.<sup>92</sup> These courts concluded that the ambiguous statutory language

DIRECTORS, AND PROFESSIONALS: BANK & THRIFT LITIGATION IN THE 1990'S, 153, 161 n.12 (1991) (outlining FDIC's proposed amendment); *cf.* H.R. 3435, 102d Cong., § 228 (Comm. Markup Oct. 18, 1991) (outlining Congressman Richard Baker's proposed amendment). The FDIC's proposed 1991 amendment provided: "Nothing in this subsection shall impair or affect any right of the [FDIC] under other applicable State or Federal law, including a right to hold such director or officer personally liable for negligence." Liebold, *supra*, at 161 n.12. Similarly, Congressman Baker proposed an amendment in 1991 that provided that the RTC could bring an action "under any provision of applicable State law or other Federal law, including any provision of common law." H.R. 3435.

91. *See Bates*, 42 F.3d at 372 ("We are bound by the statutory language which abrogates the federal common law cause of action for simple negligence . . ."); *Miramón*, 22 F.3d at 1363-64 (stating that "'plain meaning' of the statute provides for gross negligence as the federal standard of liability"); *Gallagher*, 10 F.3d at 423 (stating that legislative history does not "demonstrate the kind of 'clearly expressed legislative intention' necessary to trump the plain meaning of the statute"). A majority of the federal district courts also held that § 1821(k) displaced federal common law actions for simple negligence. *See, e.g.*, *RTC v. Zimmerman*, 853 F. Supp. 1016 (N.D. Ohio 1994) (concluding § 1821(k) displaces federal common law).

92. *See RTC v. CityFed Financial Corp.*, 57 F.3d 1231 (3d Cir. 1995) (holding § 1821(k) does not displace federal common law). With the exception of the *CityFed* decision, this view only exists at the district court level. *See, e.g.*, *RTC v. Smith*, 872 F. Supp. 805 (D. Or. 1995) (concluding § 1821(k) does not displace federal common law simple negligence claims); *RTC v. Gibson*, 829 F. Supp. 1110, 1118 (W.D. Mo. 1993) (same); *RTC v. Hess*, 820 F. Supp. 1359, 1364 (D. Utah 1993) (same); *RTC v. Kidd*, 1993 U.S. Dist. LEXIS 18439 (D. Wyo. 1993) (same); *RTC v. Thomas*, 1993 WL 501116 (D. Kan. 1993) (same); *FDIC v. Nihiser*, 799 F. Supp. 904, 907 (C.D. Ill. 1992) (same); *FDIC v. Black*, 777 F. Supp. 919 (W.D. Okla. 1991) (same). The Ninth Circuit stated in dicta that the savings clause preserved any federal common law actions available prior to the enactment of § 1821(k). *FDIC v. McSweeney*, 976 F.2d 532, 538 n.7 (9th Cir. 1992) (noting "other applicable law" includes both state and federal common law).

A majority of the federal district courts also held that § 1821(k) displaced federal common law actions for simple negligence. *See, e.g.*, *RTC v. Zimmerman*, 853 F. Supp. 1016 (N.D. Ohio 1994) (concluding § 1821(k) displaces federal common law simple negligence claims); *FDIC v. Harrington*, 844 F. Supp. 300, 304 (N.D. Tex. 1994) (same); *RTC v. O'Bear, Overholser, Smith & Huffer*, 840 F. Supp. 1270, 1270 (N.D. Ind. 1993) (same); *FDIC v. Bates*, 838 F. Supp. 1216, 1220 (N.D. Ohio 1993) (same); *RTC v. DiDomenico*, 837 F. Supp. 623, 626 (D.N.J. 1993) (same); *FDIC v. Gonzalez-Gorronona*, 833 F. Supp. 1545, 1552 (S.D. Fla. 1993) (same); *RTC v. Farmer*, 823 F. Supp. 302, 307 (E.D. Pa. 1993) (same); *RTC v. Hecht*, 818 F. Supp. 894, 910 (D. Md. 1993) (same); *FDIC v. Mintz*, 816 F. Supp. 1541, 1545 (S.D. Fla. 1993); *FDIC v. Brown*, 812 F. Supp. 722, 726 (S.D. Tex. 1992) (same); *RTC v. Gallagher*, 800 F. Supp. 595, 602 (N.D. Ill. 1992) (same); *FDIC v. Barham*, 794 F. Supp. 187, 187 (W.D. La. 1991) (same); *FDIC v. Miller*, 781 F. Supp. 1271, 1275 (N.D. Ill. 1991) (same); *FDIC v. Majalis*, No. CIV.89-1316, 1991 WL 501602, at \*1 (W.D. La. Nov. 1, 1991) (same).

did not specify Congress's intent to preempt federal common law claims.<sup>93</sup> Construing the statute to meet its objectives required the courts to conclude that federal common law actions survived § 1821(k).<sup>94</sup> Courts on both sides of the issue have made convincing arguments to support their opinions.<sup>95</sup> Against this backdrop, the Third Circuit addressed the negligence preemption issue in *RTC v. CityFed Financial Corp.*

#### IV. *RTC v. CITYFED FINANCIAL CORP.*

##### A. *Factual Background*

In *RTC v. CityFed Financial Corp.*, two appeals were consolidated for appellate review by the Third Circuit.<sup>96</sup> The Resolution Trust Corporation ("RTC") brought individual recovery actions against former directors and officers of two insolvent depository institutions.<sup>97</sup> The RTC based its claims on simple and gross negligence and brought them under state law, federal common law and § 1821(k) of FIRREA.<sup>98</sup> The defendants moved to dismiss the RTC's complaints on the grounds that § 1821(k) either

93. See, e.g., *Nihiser*, 799 F. Supp. at 907 (finding § 1821(k) does not preempt federal common law causes of action).

94. See *id.* at 908 (finding language of § 1821(k) shows intent to preserve rights under federal common law).

95. Battin, *supra* note 3, at 2361.

96. *CityFed*, 57 F.3d at 1233.

97. *Id.* at 1235. The RTC was appointed receiver of United States Savings and Loan and City Federal Savings Bank. *Id.* In both actions, the RTC alleged duty of care violations in the directors' and officers' consideration, approval and oversight of several large loans. *Id.* at 1236-37. In the United Savings action, the RTC alleged duty of care violations by:

(1) not hiring experienced lending underwriters or managers; (2) failing to reduce underwriting guidelines to a written form; (3) approving large loans after closing had already taken place; (4) maintaining inadequate appraisal procedures . . . (5) failing to maintain adequate internal controls; (6) not returning funds during the construction phase of commercial properties pending issuance of final occupancy permits; and (7) generally operating United Savings in an unsafe and unsound manner.

*Id.* at 1236. In the *CityFed* action, the RTC alleged duty of care violations by: (1) failing to obtain and verify necessary financial information from borrowers; (2) maintaining inadequate appraisal procedures; (3) consistently loaning funds based on excessively high loan-to-value ratios . . . (4) making imprudent long-range commitments to future lending or funding; (5) failing to monitor loan disbursements; (6) improperly waiving risk limitations . . . ; (7) failing to require and verify that necessary permits and approvals were obtained . . . (8) improperly assessing the value of guarantees given as security for the loans; and (9) not requiring adherence to the Bank's lending policies and procedures.

*Id.* at 1237. In both actions, RTC did not allege any self dealing, fraud, bad faith or conflict of interest by any of the defendants. *Id.* at 1236. The RTC alleged \$12.7 million in damages in the United Savings action and \$100 million in damages in the City Federal action. *Id.*

98. *Id.* In the United Savings action, the RTC alleged breach of fiduciary duty and simple negligence under New Jersey law and gross negligence under both New Jersey law and § 1821(k). *Id.* In the City Federal action, the RTC alleged breach of

preempts state law or displaces federal common law.<sup>99</sup> The district court held that § 1821(k) does not preempt state law but does displace federal common law.<sup>100</sup> On appeal, the Third Circuit affirmed in part and reversed in part.<sup>101</sup>

### B. Narrative Analysis—Majority Opinion

In *CityFed*, the Third Circuit confronted the issue of whether § 1821(k) preempted state or federal common law.<sup>102</sup> The Third Circuit began its analysis of § 1821(k) with the plain meaning of the statute.<sup>103</sup> The court noted that the permissive construction of the term “may” supported its position.<sup>104</sup> Because § 1821(k)’s savings clause used general language, and because it was positioned at the end of the section, the court concluded that Congress intended to preserve *all* other applicable law.<sup>105</sup>

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fiduciary duty and simple negligence under federal common law and gross negligence under both federal common law and § 1821(k). *Id.* at 1237.

99. *Id.* at 1236-37. The United Savings defendants argued that § 1821(k) preempts state law claims for simple negligence and accordingly moved to dismiss these claims. *Id.* at 1236. The City Federal defendants argued that § 1821(k) displaces federal common law claims for simple negligence and moved to dismiss only the simple negligence allegations. *Id.* at 1237.

100. *Id.* at 1236-37. The district court denied the United Savings defendants’ motion to dismiss and granted the City Federal defendants’ motion to dismiss the simple negligence claims. *Id.*

101. *Id.* at 1235, 1249. The Third Circuit held that § 1821(k) does not preempt state law or displace federal common law simple negligence actions. *Id.* Thus, the Third Circuit affirmed the district court’s holding of no state law preemption and reversed its holding finding federal common law displacement. *Id.* at 1249.

102. *See id.* at 1237 (“At issue in these appeals is whether Congress, by its enactment of § 1821(k) . . . preempted state law or displaced federal common law actions that impose liability for conduct less culpable than gross negligence.”).

103. *Id.* The Third Circuit noted that the language of § 1821(k) would be conclusive unless Congress expressed a legislative intent to the contrary. *Id.* (citing *Kaiser Aluminum & Chem. Corp. v. Bonjorno*, 494 U.S. 827, 835 (1990)).

104. *See id.* at 1237-38 n.7 (noting *Canfield* and *McSweeney* interpreted term “may” to be empowerment rather than limitation). The Third Circuit rejected the defendants’ view that “other applicable law” language in the savings clause was intended to only preserve regulatory powers under other FIRREA sections. *Id.* at 1238. Referring to the pattern of usage of the savings clause terms throughout the remainder of FIRREA, the court noted that Congress used specific language when it referred to particular jurisdictions. *Id.*; *see* 12 U.S.C. § 1821(c)(3)(B) (1994) (referring to “powers imposed by state law”); 12 U.S.C. § 1821(c)(4) (referring to “any other provision of Federal law, the law of any State, or the constitution of any State”).

105. *CityFed*, 57 F.3d at 1238. The court cited two cases where general language in the savings clause prevented preemption of other laws. *Id.*; *see* *Patterson v. Shumate*, 504 U.S. 753 (1992) (construing general savings clause broadly to permit any relevant nonbankruptcy law); *Reich v. Webb*, 336 F.2d 153, 158 (9th Cir. 1964) (construing general savings clause of “any other law” to permit any common law fiduciary duty claims). Furthermore, the positioning of the savings clause at the end of § 1821(k) supports a broad, general savings clause interpretation. *Ci-*

The Third Circuit also found clear congressional intent for not using § 1821(k) to preempt any actions for simple negligence.<sup>106</sup> The original drafts and revisions to § 1821(k) also demonstrated Congress's intent not to preempt simple negligence actions.<sup>107</sup> Specifically, the court found that the amendment, which replaced "negligence" with "gross negligence," reflected Congress's attempt to reduce the amount of state law preemption.<sup>108</sup>

The Third Circuit used two legislative documents to support its decision of no simple negligence preemption. First, the court interpreted a section-by-section report, prepared by the Senate Banking Committee, as evidencing the Senate's intent to not preempt any claims for conduct less culpable than gross negligence.<sup>109</sup> Second, the court found that a portion

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*tyFed*, 57 F.3d at 1238 ("[I]t is difficult to think of a more appropriate place to put a *general savings clause* than where Congress placed it—at the conclusion of the section setting out a special procedure for use in certain specified instances.") quoting *Abbott Lab. v. Gardner*, 387 U.S. 136, 145 (1967)).

106. *CityFed*, 57 F.3d at 1239-42. The court recognized the context in which Congress enacted FIRREA. *Id.* at 1238-39. The court noted that *Van Gorkom* caused the deluge of state insulating legislation. *Id.* at 1239. At the same time, however, federal regulators were trying to hold failed bank directors personally liable in order to recover federal money. *Id.* Thus, FIRREA was enacted as a tool to break through the state insulating legislation barrier. *Id.* The court also examined Congress's objectives. *Id.* The court cited the two primary goals of "strengthen[ing] the enforcement powers of Federal regulators . . ." and to facilitate an effort to "seek out and punish those that have committed wrongdoing in the management of the failed institutions." *Id.*; see Pub. L. No. 101-73, § 101(9)-(10), 103 Stat. 183 (1989); *President's News Conference on Savings Crisis and Nominees*, N.Y. TIMES, Feb. 7, 1989, at D8. From this analysis, the court concluded that the only plausible reading of § 1821(k) was that it placed a floor under bank directors liability, rather than a ceiling. *CityFed*, 57 F.3d at 1238-39.

107. *CityFed*, 57 F.3d at 1239-40. Originally, the section provided a cause of action against failed bank directors for *any* negligence available at common law. *Id.* at 1240 (citing S774, 101st Cong. § 214(n) (1989)) (allowing "any cause of action available at common law, including, but not limited to, negligence"). Congress amended § 1821(k) amidst concerns that highly qualified individuals would avoid potential directorships. *Id.* at 1240.

108. *Id.* The bill's floor manager, Senator Riegle, described the purpose of the amendment: "The reported bill totally preempted state law in this area . . . . However, in light of the state law implications raised by this provision, the manager's amendment." *Id.* (quoting 135 CONG. REC. 7152-53 (daily ed. April 19, 1989)). Accordingly, the court rejected the defendants' contention that the amendment evinced an intent to establish a federal policy of attracting competent directors. *Id.* ("We reject this 'revisionism.'")

109. *Id.* at 1241; see also 135 CONG. REC. S6907-34 (daily ed. June 19, 1989) ("This subsection does not prevent the FDIC from pursuing *claims under State law or other applicable Federal law*, if such law permits the officers or directors of a financial institution to be sued (1) for violating a *lower standard of care, such as simple negligence*." (emphasis added)). The court noted that both Houses had access to the report before they passed the *final* version of FIRREA, even though it was unavailable before the *initial* version. *CityFed*, 57 F.3d at 1241. The court rejected the defendants' argument that the report should not be relied upon because it was post-enactment legislative history. *Id.* The defendants relied upon *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388 (1987), where the Supreme Court discounted a state-

of the Conference Report supported its interpretation of Congress's intent.<sup>110</sup>

The Third Circuit discredited the two unsuccessful attempts to amend § 1821(k) to provide for simple negligence actions.<sup>111</sup> Instead, the court asserted that these amendments attempted to clarify the § 1821(k) pre-

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ment in the congressional record after the law had already passed. *Id.* at 407. The Third Circuit, however, distinguished *Clarke* on the facts because Congress had the report before it in passing the final version of FIRREA, whereas the *Clarke* statement was not available to Congress in passing the statute. *CityFed*, 57 F.3d at 1241. Also, the Third Circuit noted the FIRREA report was prepared by the same committee that originated the provision rather than by an impartial commentator. *Id.*

110. *CityFed*, 57 F.3d at 1241. The portion of the FIRREA Conference Report in question was:

Title II preempts State law with respect to claims brought by the FDIC in any capacity against officers and directors of an insured depository institution. The preemption allows the FDIC to pursue claims for gross negligence or any conduct that demonstrates a greater disregard of a duty of care, including intentional tortious conduct.

*Id.* (citing H.R. Rep. No. 222, 101st Cong. at 437, reprinted in 1989 U.S.C.C.A.N. 432). The court read the first sentence of this portion as merely describing the limited preemptive scope of § 1821(k). *Id.* Thus, the court reasoned that Congress intended to preempt state insulating statutes. *Id.* Furthermore, the second sentence reiterated the point that § 1821(k) allowed gross negligence actions in states which previously precluded these actions. *Id.* The court, however, cited no limiting language that prevented simple negligence actions. *Id.* (citing *FDIC v. McSweeney*, 976 F.2d 532, 539 (9th Cir. 1992); *FDIC v. Canfield*, 967 F.2d 443, 448 n.6 (10th Cir. 1992)).

111. *Id.* at 1241-42. Because these failed attempts constituted post-enactment legislative history, they "should be afforded little or no weight, especially in the face of contradictory contemporaneous legislative history." *Id.* at 1242. The court adopted the language in Justice Scalia's concurrence in *Sullivan v. Finkelstein*, 496 U.S. 617 (1990), regarding the minimal weight that should be given to post-enactment legislative history. Scalia stated: "'Subsequent legislative history'—which presumably means the *post*-enactment history of a statute's consideration and enactment—is a contradiction in terms . . . . Arguments based on subsequent legislative history . . . should not be taken seriously, not even in a footnote." *CityFed*, 57 F.3d at 1242 (quoting *Sullivan v. Finkelstein*, 496 U.S. 617, 631-32 (1990) (Scalia, J., concurring in part)). The Third Circuit found it was settled law that little or no weight should be applied to post-enactment legislative history. *Id.*; see *United States v. Texas*, 507 U.S. 529, 535 n.4 (1993) (noting "subsequent legislative history is a 'hazardous basis for inferring the intent of an earlier' Congress" (quoting *Pension Benefit Guaranty Corp. v. LTV Corp.*, 496 U.S. 633, 650 (1990))). The rationale was that the intent of post-enactment legislative history was not a reliable reflection of the intent of the original enacting Congress. *CityFed*, 57 F.3d at 1242. Thus, relying on the post-enactment amendment attempts would improperly result in finding original congressional intent to preempt simple negligence actions. See *id.* (noting that giving weight to post-enactment legislative history could lead to court "improperly draw[ing] inferences from unsuccessful Congressional attempts to clarify ambiguities which Congress did not perceive at the time of enactment"). The Third Circuit rejected the contention that the two failed post-enactment efforts to preserve simple negligence actions evidenced an original congressional intent to preempt such actions. *Id.* at 1241-42.

emption issue in response to conflicting federal courts decisions.<sup>112</sup> Additionally, in analyzing the legislative history of § 1821(k) and FIRREA, the Third Circuit emphasized Congress's purpose of strengthening the recovery and enforcement powers of federal receivers.<sup>113</sup> From this legislative history, the court concluded that Congress intended § 1821(k) to preempt existing state insulating statutes.<sup>114</sup> The court also concluded that a uniform gross negligence standard of liability did not coincide with Congress's intent.<sup>115</sup>

### 1. *State Law Preemption*

In *CityFed*, the court decided the issue of state law preemption primarily on the basis of common law preemption principles.<sup>116</sup> The Supremacy Clause in the United States Constitution provided for preemption of state laws by acts of Congress when Congress intends to "supplant state authority in a particular area" or when state laws conflict or "stand[ ] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."<sup>117</sup>

Following this rule, the court concluded that Congress did not preempt state law actions for simple negligence.<sup>118</sup> In arriving at this conclusion, the Third Circuit also adopted several arguments from the Ninth and

112. *CityFed*, 57 F.3d at 1241-42 ("The fact that Congress subsequently sought to clarify the limited preemptive intent of § 1821(k) in the face of conflicting judicial interpretations is not surprising.").

113. *Id.*

114. *Id.*

115. *See id.* (noting "[t]he intent of Congress was to strengthen, not weaken, the [federal bank receivers'] hand in pursuit of directors and officers").

116. *Id.* at 1242-43. The Third Circuit also used two Courts of Appeals decisions as persuasive authority. *Id.* at 1243-44 (mentioning *Canfield* and *McSweeney* courts).

117. *Id.* at 1243 (citing *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). The Third Circuit noted this congressional intent can be either explicit or implicit. *See Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) (noting implied congressional intent to preempt is evident if federal regulatory scheme is "so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it.").

Congressional preemption of state law is premised on the Supremacy Clause. U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in pursuance thereof . . . shall be the Supreme Law of the Land."); *see Wisconsin Pub. Intervenor v. Mortier*, 501 U.S. 597, 604 (1991) ("[S]tate laws that 'interfere with, or are contrary to the laws of congress, made in pursuance of the constitution' are invalid." (quoting *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 211 (1824))).

118. *CityFed*, 57 F.3d at 1243. Because the court determined the statutory language and legislative history of § 1821(k) established an intent to strengthen the receivers' power of recovery, it thereby concluded that simple negligence actions were intended as a supplemental power. *Id.* (concluding "Congress intended to leave room for state law to supplement § 1821(k)"). Additionally, the court found § 1821(k) did not conflict with state law simple negligence actions because of the congressional intent to expand the RTC's and FDIC's recovery powers. *Id.*

Tenth Circuits to further support its decision.<sup>119</sup> The Third Circuit agreed that Congress did not intend § 1821(k) to be a national liability standard.<sup>120</sup> The court reasoned that because Congress did not attempt to define gross negligence by one standard, a national uniform standard of liability could not result.<sup>121</sup>

Moreover, the Third Circuit noted that an unintended anomaly would occur if Congress preempted simple negligence actions.<sup>122</sup> The court also rejected the argument that potential § 1821(k) liability would deter bank executives from their own intentional misconduct.<sup>123</sup> The court noted that directors and officers were frequently advised about their legal obligations and potential exposure to personal liability.<sup>124</sup> Thus, a national-standard interpretation would encourage these executives to engage in simple negligence.<sup>125</sup> Based on this concern and its own preemption analysis, the court concluded the RTC could assert any available state law simple negligence actions against the former bank executives.<sup>126</sup>

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119. *Id.* at 1243-44. For a discussion of the Third Circuit's analysis, see *supra* notes 102-66 and accompanying text.

120. *CityFed*, 57 F.3d at 1243-44. Because the statute defined gross negligence by the appropriate state law definition, § 1821(k) could not establish a national standard of gross negligence. *Id.*; see *FDIC v. McSweeney*, 976 F.2d 532, 539 (9th Cir. 1992) ("Nowhere does FIRREA indicate an aim to create national uniformity . . . ."); *FDIC v. Canfield*, 967 F.2d 443, 447 (10th Cir. 1992) ("Nowhere does the statute announce its intention to create a national standard of liability . . . ."). There was no one universal definition of gross negligence for § 1821(k) to adopt, even if Congress had intended as such. See *CityFed*, 57 F.3d at 1243 ("There is no generally accepted meaning [of gross negligence].") (quoting W. PAGE KEETON, PROSSER & KEETON ON THE LAW OF TORTS § 34, at 212 (5th ed. 1984)). The Third Circuit stated, "'the statute cannot possibly, even without the [savings clause], create a national standard of liability.'" *Id.* (quoting *Canfield*, 967 F.2d at 447).

121. *CityFed*, 57 F.3d at 1243-44.

122. *Id.* at 1244. If only gross negligence actions were valid against failed bank executives, then they would seek the protection of § 1821(k) by allowing their bank to continue to financially decline into bankruptcy. *Id.* The court referred to the *Canfield* court's remarks where this problem was described as follows: "Prior to failure, liability would attach for simple negligence . . . . As the institution struggles, therefore, section 1821(k) would create an incentive for the officers and directors to allow the bank to fail. It simply cannot be that FIRREA would indirectly encourage such behavior." *Canfield*, 967 F.2d at 449. Such conduct would be inconsistent with the clear purposes of FIRREA. See *McSweeney*, 976 F.2d at 540 (noting preempting simple negligence actions "would lead to absurd results, creating [a] 'perverse incentive for a director . . . to permit the thrift to fall into ruin'" (quoting *FDIC v. McSweeney*, 772 F. Supp. 1154, 1159 (S.D. Cal. 1991))).

123. *CityFed*, 57 F.3d at 1244. Assuming that bank directors and officers were aware of the § 1821(k) standard, they "would undoubtedly be aware that federal receivership would insulate them from claims of negligence." *Id.*

124. *Id.* The existence of the directors' argument that a simple negligence is evidence of an awareness of the § 1821(k) standard on their part. *Id.*

125. *Id.* The directors would have an incentive to "engage in conduct, which the RTC could not necessarily prove rises to the level of intentional misconduct or gross negligence, but which nonetheless placed the institution at greater risk of receivership." *Id.*

126. *Id.*

## 2. *Federal Common Law Displacement*

The Third Circuit followed a similar analytical approach in addressing the issue of federal common law displacement.<sup>127</sup> The court interpreted congressional intent through the statutory language and legislative history of § 1821(k).<sup>128</sup> In interpreting the plain language of the savings clause of § 1821(k), the court focused on the preservation of “any right of the Corporation.”<sup>129</sup> The court construed the plain language of § 1821(k) as preserving federal common law actions brought by federal receivers against failed bank executives.<sup>130</sup> Furthermore, the court rejected the contention that the savings clause only refers to FIRREA enforcement powers outside § 1821(k).<sup>131</sup>

The Third Circuit also rejected the application of the “spoke directly” test because it did not stand alone.<sup>132</sup> The court noted that the Supreme Court was consistent with its own approach, but the presence of congressional intent in the *CityFed* case was the distinguishing factor.<sup>133</sup> Because

127. *Id.* at 1245 (“The answer to the question of federal common law displacement, like state law preemption, must turn, in the first instance, on an interpretation of congressional intent, looking to the text of the statute and then to its legislative history.”).

128. *Id.* at 1244-45. Adopting the Supreme Court’s language in *Milwaukee*, the Third Circuit stated, “it is unnecessary to find that Congress ‘had affirmatively proscribed the use of federal common law.’” *Id.* at 1244 (quoting *Milwaukee v. Illinois*, 451 U.S. 304, 315 (1981)). The court added, however, “any terms of the statute explicitly preserving or preempting judge-made law are of course controlling.” *Id.* (quoting *In re Complaint of Oswego Barge Corp.*, 664 F.2d 327, 339 (2d Cir. 1981)).

129. *Id.* at 1245. Recall, the savings clause of § 1821(k) provides “[n]othing in this paragraph shall impair or affect any right of the Corporation under other applicable law.” 12 U.S.C. § 1821(k) (1994). Federal receivers have the same rights as the failed bank upon receivership. *O’Melveny & Meyers v. FDIC*, 114 S. Ct. 2048, 2054 (1994). Thus, they obtain the right to bring actions under the federal common law. *CityFed*, 57 F.3d at 1245.

130. *CityFed*, 57 F.3d at 1245.

131. *Id.*

132. *Id.* at 1245-46. In *Milwaukee v. Illinois*, the Supreme Court established a test to be used to determine whether a federal statute displaces federal common law. *Milwaukee*, 451 U.S. at 304. If a federal statute does not explicitly address the issue of federal common law displacement, the statute displaces the federal common law if the legislative scheme spoke directly to the question previously addressed by federal common law or if the statute “occupied the field through the establishment of a comprehensive regulatory program.” *Id.* at 315, 317. In that case, the Court held that amendments to a federal statute displaced the federal common law because they spoke directly to the claim previously addressed by federal common law. *Id.* at 304.

133. See *CityFed*, 57 F.3d at 1245 (noting Supreme Court first evaluated whether federal statute spoke directly to previously-covered federal common law claim and examined scope of legislation). The Third Circuit stated “we do not believe the Supreme Court’s opinion . . . is inconsistent with our approach.” *Id.* The Court in *Milwaukee* applied the “spoke directly” test only after first concluding the federal statute contained no congressional intent to preserve federal common law. *Id.* In the case at bar, however, the Third Circuit found congressional intent for § 1821(k) not to displace federal common law through interpretation of the



the precondition to applying the "spoke directly" test was not met, the court concluded this analysis was not appropriate.<sup>134</sup>

Furthermore, because Congress did not intend to create an "anomalous situation," § 1821(k) did not speak directly to the standard of care previously covered by federal common law.<sup>135</sup> A national uniform standard of gross negligence would provide greater protection to directors and officers in the event that their banks become insolvent.<sup>136</sup> Congress did not want to encourage executives of failing banks to allow their institutions to become bankrupt so that they could limit their personal liability.<sup>137</sup> Moreover, assuming the federal common law standard involves gross negligence, Congress did not intend to establish a national post-receivership standard while the pre-receivership standard remained unclear.<sup>138</sup>

The Third Circuit also rejected the argument that the exhaustive scope of FIRREA evinced a Congressional intent to displace the federal common law.<sup>139</sup> In contrast, the court found nothing in § 1821(k)'s plain

savings clause. Also, the court read the Senate Report as clearly expressing congressional intent to preserve federal common law actions for simple negligence. *Id.* at 1245-46; see CONG. REC. S6912 (daily ed. June 19, 1989) (stating "this subsection does not prevent the FDIC from pursuing claims under . . . other Federal law . . . for . . . simple negligence").

134. *CityFed*, 57 F.3d at 1246. Nevertheless, the Third Circuit held that § 1821(k) would not pass the "spoke directly" test even if it applied. *Id.* The court reasoned that in enacting § 1821, Congress only spoke directly to the standard of care for directors and officers in states where the federal receivers were confronted with state insulating legislation. *Id.* Section 1821(k) was necessary for the federal receivers to bring gross negligence actions in states with such protective legislation. *Id.* at 1242. Congress did not intend § 1821(k) to speak directly to the standard of care for bank executives previously governed by federal common law because the statute did not provide for one definition of gross negligence. *Id.* In cases where the bank was federally chartered, such as the one at bar, "no state law standard is 'applicable' since federal law governs the liability of such individuals." *Id.* According to the court, Congress would have provided a definition if it had intended to displace. *Id.*

135. *Id.*

136. *Id.* For a discussion of a national uniform standard of gross negligence, see *infra* notes 183-84 and accompanying text.

137. *CityFed*, 57 F.3d at 1242. The Third Circuit added "[i]f Congress had intended to codify a federal standard of liability . . . it would not have limited its application to circumstances where the institution entered receivership." *Id.*

138. For a discussion of the rationale behind the *CityFed* court's holding of no preemption under § 1821(k), see *supra* notes 106-07 and accompanying text. *Id.* at 1246-47.

The *CityFed* court recognized the debate over whether the pre-receivership federal common law standard is one of simple or gross negligence, due in part to the ambiguity of the decision in *Briggs v. Spaulding*. *Id.* at 1247 n.16. The court declined to resolve the question of what standard of liability is provided for in federal common law. *Id.* The RTC should be allowed to assert a claim for negligence under the existing federal common law, even if the standard is interpreted to be simple negligence. *Id.*

139. *Id.* at 1247. Although FIRREA created several regulatory agencies and granted them numerous enforcement powers, the statute was not intended to be a

language or the legislative history of FIRREA that indicated a congressional intent to enact such a comprehensive program.<sup>140</sup> Instead, the court concluded that § 1821(k) represents a supplementary power to, for example, federal common law powers to sue failed bank executives for negligence.<sup>141</sup> Therefore, Congress limited the scope of FIRREA to merely preempting state insulating legislation.<sup>142</sup>

The Third Circuit agreed with the Seventh and Tenth Circuits that § 1821(k) did not preempt state law actions, but disagreed with their displacement of federal common law actions for simple negligence.<sup>143</sup> The plain language of § 1821(k) and its legislative history demonstrated that Congress did not intend to apply § 1821(k) to federally chartered banks.<sup>144</sup> As a result, the court in *CityFed* overcame the presumption of federal law displacement.<sup>145</sup>

The court also rejected the argument that construing § 1821(k) to allow federal simple negligence actions would invalidate § 1821(k)'s gross

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"wholesale [displacement] of longstanding principles of corporate governance." 135 CONG. REC. S6912, at 7151 (daily ed. June 19, 1989) (statement of Sen. Sanford). Senator Sanford further noted that § 1821(k) did not "represent a major step in the direction of establishing . . . Federal standards of care of corporate officers and directors." *Id.*; see *CityFed*, 57 F.3d at 1247 (disussing Senator Sanford's opinion about § 1821(k)). The defendants' reliance on the reasoning in *Milwaukee* was not appropriate because in that case there were several express statements regarding the comprehensiveness of the federal legislation. *CityFed*, 57 F.3d at 1247; see *Milwaukee v. Illinois*, 451 U.S. 304, 319 (1981) (noting Senate Report which stated, "[t]he 'major purpose' of the Amendment was 'to establish a comprehensive long-range policy.'" (quoting S. REP. NO. 92-414, at 95)).

140. *CityFed*, 57 F.3d at 1247.

141. *Id.* (noting court cannot conclude "that Congress intended to occupy the field and supplant existing powers already available as a matter of federal common law").

142. *Id.* at 1248. "To read any more into the enactment of § 1821(k) would 'make traps of its word' [because] Congress intended this provision to strengthen, not weaken, the RTC's ability to recover for director and officer misconduct." *RTC v. Chapman*, 29 F.3d 1120, 1125 (7th Cir 1994) (Posner, J., dissenting)).

143. See, e.g., *RTC v. Frates*, 52 F.3d 295, 297 (10th Cir. 1995) (agreeing that state law was not preempted); *FDIC v. Bates*, 42 F.3d 369, 373 (6th Cir. 1994) (agreeing that federal common law actions were preempted); *RTC v. Miramon*, 22 F.3d 1357, 1360 (5th Cir. 1994) (noting that federal common law was preempted); *RTC v. Gallagher*, 10 F.3d 416, 418 (7th Cir. 1993) (noting federal common law was preempted). *CityFed*, 57 F.3d at 1248. The *CityFed* court noted that these courts explained the distinction based on the need for stronger evidence of Congress's intent to displace federal common law as opposed to preempting state law. *Id.* (citing Seventh Circuit's rationale that federalism concerns require greater congressional to preempt state law than to displace federal common law and therefore "same sort of evidence of clear and manifest purpose is not required.'" (quoting *Milwaukee*, 451 U.S. at 316))). The Third Circuit agreed with this proposition, but did not apply it to the present case. *Id.* at 1248 (noting certain instances which required application of presumption would result in statute preempting state law but not displacing federal common law).

144. *CityFed*, 57 F.3d at 1247.

145. *Id.*

negligence standard.<sup>146</sup> Because many states have insulating statutes, federal receivers need § 1821(k) to bring a negligence action for conduct less culpable than intentional misconduct.<sup>147</sup> The court noted that allowing federal common law actions would ensure that directors and officers would be held accountable for conduct less culpable than intentional misconduct, regardless of where the bank was chartered.<sup>148</sup> Therefore, the court concluded that § 1821(k) did not preempt simple negligence actions based on either state or federal common law.<sup>149</sup>

### C. *Dissenting Opinion*

Circuit Judge Mansmann agreed that simple negligence actions based on state law were not preempted by § 1821(k).<sup>150</sup> Judge Mansmann disagreed, however, with the majority by stating § 1821(k) displaced federal common law actions.<sup>151</sup> Judge Mansmann believed the majority's interpretations of the statute's plain language and legislative history were erroneous.<sup>152</sup> Furthermore, she articulated that § 1821(k) established an exclusive national standard of liability for gross negligence in suits involv-

146. *Id.* (noting Fifth, Sixth and Seventh Circuits relied, in significant part, on this argument). The Seventh Circuit stated that "[i]t is illogical that Congress intended in one sentence to establish a gross negligence standard of liability and in the next sentence to eviscerate that standard by allowing actions under federal common law for simple negligence." *Gallagher*, 10 F.3d at 420. Similarly, the Sixth Circuit claimed that such an interpretation would render § 1821(k)'s gross negligence standard "redundant, meaningless surplusage." *Bates*, 42 F.3d at 372.

147. *CityFed*, 57 F.3d at 1249. The Fifth Circuit asked: "Why would [federal receivers] ever bring an action under section 1821(k) where it would have to prove gross negligence, when it could bring an action under the federal common law and only be required to prove simple negligence?" *Miramón*, 22 F.3d at 1361. The Third Circuit responded by noting that federal common law is not applicable to state-chartered banks, therefore § 1821(k) is necessary to overcome any state insulating legislation. *CityFed*, 57 F.3d at 1249. The court cited *RTC v. Chapman* for the conclusion that the forum where corporation is chartered is the applicable law governing liability of directors and officers. *Id.* Thus, § 1821(k) would not be meaningless because all federal common law claims would be barred by the state insulating statutes and § 1821(k) would be the only available gross negligence claims. *Id.*

148. *CityFed*, 57 F.3d at 1249. The court admitted that § 1821(k) would have no relevance when the bank was federally-chartered because a stricter federal common law simple negligence action would be available. *Id.* Instead, this result reflects the intent behind § 1821(k) of ensuring that state-chartered banks' executives are not insulated from negligence actions. *Id.* Thus, allowing simple negligence actions based on federal common law "was precisely the purpose underlying the enactment of § 1821(k)." *Id.*

149. *Id.*

150. *Id.* (Mansmann, J., dissenting). Judge Mansmann's opinion joins the two Courts of Appeals that addressed both state and federal preemption questions like the Third Circuit. The Seventh and Tenth Circuits held that § 1821(k) does not preempt state law actions but does displace federal common law actions. *Id.* (Mansmann, J., dissenting).

151. *Id.* (Mansmann, J., dissenting).

152. *Id.* (Mansmann, J., dissenting).

ing federally-chartered bank executives.<sup>153</sup> As such, Judge Mansmann noted that more evidence of congressional intent was needed to displace federal common law than to preempt state law.<sup>154</sup> Moreover, she noted that Congress displaced federal common law when it “speak[s] directly” to the issue previously governed by the federal common law.<sup>155</sup>

Unlike the majority, Judge Mansmann interpreted the substantive portion of § 1821(k) as establishing a gross negligence standard in the area previously governed by federal common law.<sup>156</sup> Thus, Judge Mansmann joined the other circuits and construed the § 1821(k) savings clause as not preserving federal common law actions for simple negligence.<sup>157</sup> Further, Judge Mansmann disagreed with the conclusion that

153. *See id.* (Mansmann, J., dissenting) (noting conclusion would align himself with Fifth, Sixth, Seventh and Tenth Circuits); *RTC v. Frates*, 52 F.3d 295, 296 (10th Cir. 1995) (applying gross negligence standard); *FDIC v. Bates*, 42 F.3d 369, 371 (6th Cir. 1994) (establishing gross negligence standard for federal cause of action); *RTC v. Miramon*, 22 F.3d 1357, 1364-65 (5th Cir. 1994) (applying gross negligence standard to former bank officers); *RTC v. Gallagher*, 10 F.3d 416, 418 (7th Cir. 1993) (applying gross negligence standard to former bank officer's breach of duty).

154. *CityFed*, 57 F.3d at 1250 (Mansmann, J., dissenting). Judge Mansmann adopted the language of the Supreme Court and stated that “the historic police powers of the States are not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.” *Id.* (Mansmann, J., dissenting) (quoting *Milwaukee v. Illinois*, 451 U.S. 304, 316 (1981) (citations omitted)). In federal common law displacement cases, however, “it is for Congress, not federal courts to articulate the appropriate standards to be applied as a matter of law.” *Milwaukee*, 451 U.S. at 317 (footnote omitted). In connection with this assumption, Judge Mansmann noted that federal common law is a “‘necessary expedient,’ resorted to in the absence of a federal statute and is ‘subject to the paramount authority of Congress.’” *CityFed*, 57 F.3d at 1250 (Mansmann, J., dissenting) (quoting *Milwaukee*, 451 U.S. at 313-14) (citations omitted)).

155. *CityFed*, 57 F.3d at 1250 (Mansmann, J., dissenting) (citing *United States v. Texas*, 507 U.S. 529, 534 (1993)). Judge Mansmann disagreed with the majority and found that the “spoke directly” test applied to the present case and concluded the federal common law was displaced. *Id.* at 1250-52 (Mansmann, J., dissenting). Through an analysis of § 1821(k)'s plain language, she found Congress spoke directly to the standard of liability of failed bank executives. *Id.* at 1250 (Mansmann, J., dissenting).

156. *See id.* at 1250 (Mansmann, J., dissenting) (noting “[t]hus, that Congress has spoken directly to the standard of liability for the directors and officers of all failed federally-insured depository institutions . . . is, I believe, not open to question”); *see also* 12 U.S.C. § 1821(k) (1994) (providing “[a] director or officer . . . may be held personally liable . . . for gross negligence”).

157. *Id.* at 1250-51 (Mansmann, J., dissenting). Such an interpretation avoided rendering § 1821(k) as “meaningless surplusage.” *Id.* at 1251 (Mansmann, J., dissenting). Judge Mansmann also disagreed that the savings clause was clear on its face. *Id.* at 1250 (Mansmann, J., dissenting). Judge Mansmann could properly interpret its meaning only after referring to the legislative history. *Id.* at 1250 n.4 (Mansmann, J., dissenting). Furthermore, Judge Mansmann argued that the majority opinion contradicted itself by finding that § 1821(k) did not address the standard of liability of bank executives while also holding that § 1821(k) preserved simple federal negligence actions. *Id.* (Mansmann, J., dissenting) (claiming “[t]he majority can not have it both ways; either section 1821(k) addresses the issue or it does not”). Judge Mansmann also did not agree that the substantive provision of

§ 1821(k) exclusively applied to state-chartered banks.<sup>158</sup> She asserted that Congress would have referred to “state” depository institutions if it intended to have § 1821(k) apply only to state-chartered banks.<sup>159</sup> The majority opinion on the other hand displaced federal common law because they believed Congress intended to apply § 1821(k) to all banks.<sup>160</sup> Judge Mansmann found the state law reference to indicate that courts should define gross negligence, in federally-chartered bank cases, by the law of the state most closely connected to the subject bank.<sup>161</sup>

In analyzing § 1821(k)’s legislative history, Judge Mansmann concluded that Congress ultimately adopted § 1821(k) to establish a federal standard of care at gross negligence.<sup>162</sup> The passage of § 1821(k) involved an evolution of liability from simple to gross negligence.<sup>163</sup> Further, the two post-enactment amendments attempting to permit simple negligence actions, evinced Congress’s intent to eliminate the federal common law.<sup>164</sup> Finally, Judge Mansmann argued that the majority overemphasized the more stringent pre-receivership standard as compared to the

§ 1821(k) applied only to state-chartered banks and the savings clause applied to both state and federally-chartered banks. *Id.* at 1251 n.5 (Mansmann, J., dissenting). Judge Mansmann found no support for this view in either the plain language or legislative history. *Id.* (Mansmann, J., dissenting).

158. *Id.* at 1251-52 (Mansmann, J., dissenting). For support, she noted that FIRREA distinguished between state and federally-chartered banks, yet § 1821(k) merely referred to banks generally. *Id.* (Mansmann, J., dissenting); 12 U.S.C. §§ 1813(c)(4), (5), 1821(k).

159. *CityFed*, 57 F.3d at 1251 (Mansmann, J., dissenting).

160. *Id.* at 1251-52 (Mansmann, J., dissenting). Judge Mansmann also specified that defining gross negligence by the applicable state law did not create the serious problem that the majority suggested. *Id.* at 1246 (claiming “[t]o read [§ 1821(k) as supplanting] federal common law would be to create an additional (and serious) problem, because it is unclear which formulation of gross negligence . . . appl[ies]”).

161. *Id.* (noting this suggestion is “sensible and reasonable” because “[c]oncepts of negligence fall squarely within the province of the state courts”).

162. *Id.* (Mansmann, J., dissenting).

163. *Id.* at 1252-54 (Mansmann, J., dissenting) (noting Senate removed simple negligence standard in § 1821(k) and House approved of removal and enacted form contained gross negligence language). Thus, the gross negligence standard was what both Houses agreed on in § 1821(k), and they rejected the simple negligence standard. *Id.* at 1254 (Mansmann, J., dissenting) (citing House-Senate Conference Report for confirmation of gross negligence standard (H.R. CONF. REP. No. 222, 101st Cong., at 398 (1989), reprinted in 1989 U.S.C.A.N. 432, 437)).

164. *Id.* at 1254-55 (Mansmann, J., dissenting). Judge Mansmann realized that post-enactment legislative history should not be given as much weight as pre-enactment history, however Supreme Court language demonstrated that she “would ‘be remiss’ to ignore it.” *Id.* at 1254 (Mansmann, J., dissenting) (citing *Cannon v. University of Chicago*, 441 U.S. 677, 687 n.7 (1979)). Judge Mansmann concluded, “had Congress preserved the federal common law standard in section 1821(k), as the majority contends, these amendments would not have been necessary.” *Id.* at 1255 (Mansmann, J., dissenting).

post-receivership standard.<sup>165</sup> She noted that this discrepancy represents a problem for Congress, not the courts, to redress.<sup>166</sup>

#### D. Critical Analysis

The Supreme Court established standards to decide whether a federal statute preempted state law or displaced federal common law in *Milwaukee v. Illinois*.<sup>167</sup> Different levels of congressional intent are required to preempt or displace such pre-existing law.<sup>168</sup> The Third Circuit majority properly recognized this distinction, as well as the Supreme Court's instruction to apply the different standards.<sup>169</sup> It erred, however, in summarily dismissing the applicability of *Milwaukee*.<sup>170</sup>

##### 1. State Law Preemption—Majority Opinion

The Third Circuit correctly concluded that § 1821(k) did not preempt state law. In the process, however, the court drew several questionable conclusions. The court analyzed the plain language and the legislative history to determine if Congress intended § 1821(k) to be the exclusive standard of liability or if it was meant to be supplemented by some other law.<sup>171</sup> The Third Circuit's conclusion that Congress intended § 1821(k) to preserve state law actions goes beyond the requirements of *Milwaukee*.<sup>172</sup> The Third Circuit should have used *Milwaukee* to shift the burden

165. *Id.* (Mansmann, J., dissenting). Judge Mansmann contended that directors and officers would not permit their banks to become insolvent solely to obtain §1821(k)'s gross negligence standard. *Id.* (Mansmann, J., dissenting) (noting "the public policy consideration the majority raises regarding the 'perverse incentive' . . . may be more imagined than real").

166. *Id.* (Mansmann, J., dissenting) (citing *FMC Corp. v. United States Dep't of Commerce*, 29 F.3d 833, 846 (3d Cir. 1994)).

167. 451 U.S. 304 (1981).

168. *Id.* at 315-17. Displacing federal common law requires a lesser showing of congressional intent than that required to preempt state law. *Id.* (noting distinction based on assumption of not interfering with states' police powers, which is not present in federal common law displacement issue). Thus, federal common law is displaced if there is congressional intent to merely "speak directly" to the issue which the federal common law previously governed. *Id.* at 315.

169. *CityFed*, 57 F.3d at 1248.

170. *See id.* The viability of *Milwaukee* rendered the holding of no federal common law displacement implausible. *Id.*

171. *Id.* at 1237-49.

172. *See Milwaukee*, 451 U.S. at 316 (Mansmann, J., dissenting) (defining test for determining whether federal statutory law governs question previously subject to federal common law). The Supreme Court described its state law preemption test as follows: "When considering state law preemption, 'we start with the assumption that the historic police powers of the States are not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.'" *Id.* (emphasis added) (citations omitted). Thus, it appears the test creates a presumption against preempting state law. *See CityFed*, 57 F.3d at 1248 (recognizing *Milwaukee* as establishing presumption in favor of displacing federal common law). Because the issue involved federal displacement of state law, the test enunciated by the Supreme Court in *Milwaukee* applied to the facts of *CityFed*. *See also Milwaukee*, 451

of proof to Congress to demonstrate that their “clear and manifest purpose” in enacting § 1821(k) involved preempting state law.<sup>173</sup> If the court found that Congress did not meet this onerous burden, § 1821(k) would not preempt the state law.

The court’s findings regarding preemption was consistent with its interpretations of the plain language of § 1821(k) and its legislative history.<sup>174</sup> Because the savings clause preserves “all other applicable law,” Congress did not intend § 1821(k) to be an exclusive standard of liability.<sup>175</sup> Furthermore, by analyzing the legislative history, the Third Circuit concluded that Congress primarily enacted § 1821(k) to preempt state insulating statutes, not to preempt simple negligence actions.<sup>176</sup> The legislative history, however, lacked clarity.<sup>177</sup> Thus, the *CityFed* court drew weak conclusions in its attempt to support its interpretations regarding § 1821(k)’s legislative history.<sup>178</sup> Specifically, the court misinterpreted the

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U.S. at 1243-44 (“Congress intended to leave room for state law to supplement § 1821(k).”).

173. See *Milwaukee*, 451 U.S. at 316 (preempting state law).

174. See *CityFed*, 57 F.3d at 1237-43 (noting that federal law preempts state law). The court pieced together various Supreme Court decisions to form a rule that indicates when federal law preempts state law. *Id.* The other circuits that addressed the state law preemption issue did not use this rule. See, e.g., *FDIC v. McSweeney*, 976 F.2d 532 (9th Cir. 1992) (holding that state law is not preempted by federal law); *FDIC v. Canfield*, 967 F.2d 443 (10th Cir. 1992) (same). Instead, these courts performed a pure statutory interpretation analysis. See *McSweeney*, 976 F.2d at 536-41 (construing statute to allow use of federal and state law); *Canfield*, 967 F.2d at 445-52 (construing statute to not preempt state statutory claims).

175. See *id.* at 1239-40 (acknowledging state law applies as well). The Ninth and Tenth Circuits went further and found that the substantive portion of § 1821(k) also evinced an intent to supplement the statute’s standard. See *McSweeney*, 976 F.2d at 537-38 (noting that nothing precludes FDIC from seeking remedies available under state law); *Canfield*, 967 F.2d at 446 (same). The Third Circuit adopted other arguments from these circuits except this point. See *CityFed*, 57 F.3d at 1243-44 (adopting statutory interpretation and public policy arguments). The lack of plain language analysis reflects the Third Circuit’s hesitancy to emphasize the face of the statute. The court merely discussed two aspects of the plain language of § 1821(k).

176. See *CityFed*, 57 F.3d at 1241 (discussing legislative history of § 1821(k)).

177. See Gorman, *supra* note 4, at 669-70, 679 (discussing legislative history of § 1821(k)). The Senate Report stated simple negligence claims survived § 1821(k) while the House Conference Committee stated § 1821(k) establishes a national gross negligence standard. *Id.*; see also 135 CONG. REC. S6912 (daily ed. June 19, 1989); H.R. CONF. REP. NO. 101-222, at 398, *reprinted in* 1989 U.S.C.A.N. at 437 (discussing the establishment of a negligence standard).

178. See *CityFed*, 57 F.3d at 1238-42 (interpreting § 1821(k)’s legislative history). For example, the Senate Report involved post-enactment legislative history and is “not entitled to substantial weight.” *Gallagher*, 10 F.3d at 421 (discussing weight that should be given to post-enactment legislative history). This position is also held by the Sixth and Fifth Circuits. See *Bates*, 42 F.3d at 372 (applying simple negligence standard and applying court’s construction in *Gallagher*); *Miramón*, 22 F.3d at 1362 (giving no substantial weight to post enactment legislative history). By treating the report as if it were published before the voting occurred, the court justified its reliance on a vague distinction between publication and having a re-

intent of the Conference Report.<sup>179</sup> Therefore, the Third Circuit wrote an ambiguous opinion because it hopelessly attempted to locate an affirmative congressional intent not to preempt state law. The court should have adopted stronger reasoning by concluding that § 1821(k) is too ambiguous to overcome the *Milwaukee* presumption against state law preemption.

## 2. Federal Common Law Displacement—Majority Opinion

The majority used this state law preemption analysis to support its conclusion that Congress did not displace federal common law actions.<sup>180</sup> Consistent with its earlier findings, the court concluded the savings clause explicitly preserved federal common law actions.<sup>181</sup> Similarly, the court found that the legislative history evinced an intent not to displace federal common law actions.<sup>182</sup>

The court, however, incorrectly distinguished *Milwaukee* by not applying the “speak directly” test.<sup>183</sup> Nevertheless, the court’s basis for hypothetically concluding that § 1821(k) did not meet the “speak directly” test coincided with its holding that Congress did not displace federal common law actions for simple negligence.<sup>184</sup> Because the court found Congress

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port “before it.” *CityFed*, 57 F.3d at 1241. In fact, the Third Circuit is the only circuit to give weight to this late report.

179. See *Gallagher*, 10 F.3d at 421 (noting Congress intended gross negligence to be agreed-upon standard); Gorman, *supra* note 4, at 670 (noting report implies intent to establish uniform gross negligence standard).

180. *CityFed*, 57 F.3d at 1244-49. The dissent, however, argued that § 1821(k) displaced federal common law because the state law preemption analysis used by the majority is inappropriate in federal displacement questions. *Id.* at 1249 (Mansmann, J., dissenting).

181. *Id.* at 1245.

182. *Id.*

183. See *id.* at 1248 (Mansmann, J., dissenting) (noting that *Milwaukee*’s “speak directly” test governed and that majority should apply it). Judge Mansmann explained that federal common law is merely “resorted to in the absence of a federal statute and is ‘subject to the paramount authority of Congress’” *Id.* (Mansmann, J., dissenting). Thus, *Milwaukee* mandates that federal common law is displaced when Congress “speaks directly” to that issue. *Id.* (Mansmann, J., dissenting).

Moreover, the *Milwaukee* test applied because the only difference between the present case and *Milwaukee* involved the existence of congressional intent in this case. *Id.* at 1245. The *Milwaukee* court applied the “speak directly” test after it concluded no congressional intent to preserve the federal common law was present. *Milwaukee*, 451 U.S. at 327-32. This distinction fails because the *CityFed* court found congressional intent only after interpreting notoriously ambiguous statutory language and legislative history.

184. See *CityFed*, 57 F.3d at 1245-46 (noting § 1821(k) was not enacted to define standard of care applicable to federally chartered institutions governed by federal common law). After dismissing the applicability of the “speak directly” test, the court stated, “we do not believe . . . that § 1821(k) ‘spoke directly’ to the standard of care.” *Id.* at 1246. The dissent concluded, however, that § 1821(k) spoke directly to the standard of liability previously addressed by federal common law. *Id.* at 1252 (Mansmann, J., dissenting) (noting that “speaking directly” standard is applied). Judge Mansmann interpreted the plain language as clearly applying to



enacted § 1821(k) only to preempt state insulating statutes, it concluded that § 1821(k) did not address the standard of liability currently governed by federal common law.<sup>185</sup> The court, however, failed to note that the preemption of state insulating statutes requires a statute establishing the standard of care.<sup>186</sup>

## V. CONCLUSION

The savings and loan crisis of the 1980s prompted Congress to hurriedly enact remedial legislation to aid federal regulators in recovering federal monies.<sup>187</sup> This pressure to confer greater powers upon the RTC and FDIC caused congressional debate concerning the need to attract competent directors, to what extent Congress may preempt state law and what standard of liability would apply to directors and officers of failed banks. The haste to enact FIRREA left some of these issues unresolved.

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both state *and* federally chartered institutions. *Id.* at 1250 (Mansmann, J., dissenting). Also, the savings clause of § 1821(k) must not preserve federal common law actions in order to prevent the substance provisions from becoming “meaningless surplusage and rendered a nullity.” *Id.* at 1250-51 (Mansmann, J., dissenting) (discussing the clarity of the savings clause).

185. *Id.* The court stated that “While portions of FIRREA were enacted to govern both state and federally chartered institutions, . . . § 1821(k) was simply *not* enacted to define the standard of care applicable to federally chartered institutions governed by federal common law.” *Id.*

The dissent took a more plausible approach because it recognized that a greater level of congressional intent was needed to preempt state laws than to displace the federal common law. Instead of making its own affirmative conclusions regarding the meaning of the plain language or Congress’s intent, the dissent criticized the majority’s interpretation. *See id.* at 1250-52 (Mansmann, J., dissenting) (criticizing majority’s: (1) interpretation of savings clause as *clearly* preserving federal common law actions, (2) view that § 1821(k) does not address standard of liability of *federally* chartered banks and (3) position that lack of gross negligence definition in § 1821(k) shows Congress’s intent to displace federal common law). The dissent appropriately conceded that any affirmative interpretation of this ambiguous statute and its confusing legislative history could be easily refuted. Because the Supreme Court presumed in favor of federal common law displacement, the dissent appropriately applied the “speak directly” test.

186. *See id.* at 1251 (Mansmann, J., dissenting). The dissent used this argument in concluding that § 1821(k) displaced federal common law. *Id.* (Mansmann, J., dissenting). Judge Mansmann stated:

The majority informs us that section 1821(k) does not address the liability if directors and officers of federally-chartered depository institutions . . . and was enacted only to preempt state insulating statutes. I have difficulty comprehending how section 1821(k) can preserve the RTC’s right to sue the directors and officers of federal financial institutions for simple negligence under federal common law, and at the same time, not address the liability of these individuals in RTC actions.

*Id.* (Mansmann, J., dissenting).

187. *See Fischer, supra* note 9, at 1746-53 (explaining Congress was pressured by President Bush and voters to take some legislative action due to allegations of bank executive fraud, corruption and overspending). For a detailed account of the short schedule that the Senate labored under to enact FIRREA and the many debates that were sparked among the senators, *see Fischer, supra* note 9 at 1746-53.

Specifically, § 1821(k)'s language and the legislative history of § 1821(k) are ambiguous regarding the availability of state or federal common law actions for simple negligence.

The *CityFed* decision places a heavy burden on directors and officers of financial institutions because it validates simple negligence claims, regardless of their source of law. Nonetheless, one must distinguish between state law and federal common law claims. The Supreme Court recognized the significance of this distinction by emphasizing that acts of Congress need not meet a high threshold to displace the federal common law.<sup>188</sup> By ignoring this distinction, *CityFed* will result in bank executives altering their management conduct to avoid personal liability. These executives will become overly cautious managers in an industry that requires a certain level of risktaking.<sup>189</sup> As a result, productivity and growth will decline at a time when the banking industry needs the freedom to act in ways that will ensure its future stability.

Because the states control the substance of their own common law, the Third Circuit properly allowed state law simple negligence actions. The state may decide whether parties can bring simple negligence actions against bank directors and officers. Because § 1821(k) does not demonstrate an intent to usurp this right of the states, *CityFed* properly did not preempt state law.

Conversely, no clear intent to preempt is required to displace federal common law. Despite its ambiguity, § 1821(k)'s scope and coverage speaks directly to the standard of care for bank executives. Thus, *CityFed* improperly permitted federal common law actions to be brought alongside § 1821(k).

In the wake of *CityFed*, bank directors and officers face simple negligence liability regardless of how or where they are chartered.<sup>190</sup> Their

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188. See *Milwaukee v. Illinois*, 451 U.S. 304, 316-17 (1981) (noting Congress displaces federal common law if its statute merely "speaks directly" to that area of law and that higher showing of Congress's intent is needed to preempt state law).

189. See DeLisa R. Kilpatrick, *FDIC v. Canfield: A Death Penalty for Banks and Their Directors for Breach of Fiduciary Duty*, 3 GEO. MASON INDEP. L. REV. 281, 303 (1994) (concluding § 1821(k) should preempt all simple negligence actions for policy reasons, thus, *Canfield* was wrongly decided). The concept of risk is inherent in the banking industry and cannot, and should not, be totally eliminated. *Id.* at 300-02. "[A] simple negligence standard . . . forc[es] the decision-maker to be risk-adverse instead of risk-neutral." *Id.* at 303.

190. The Business Roundtable discussed the negative impacts that result from subjecting corporate directors to simple negative liability. See *Business Roundtable*, *supra* note 55, at 6 (noting Model Draft would make simple negligence actions more likely and thus, "[t]he board would become myopic in setting the planning horizon for management policies, and the corporation would become more concerned with short-term rather than long-term profit maximization.") (statement of Professor Paul W. MacAvoy). The Roundtable also stated that increased director liability through the ALI Model Draft would result in "corporate inability to be flexible . . . increased costs to the corporation . . . unwillingness and inability to take the risks necessary to maintain competitiveness . . . an unwillingness of qualified individuals to serve as corporate directors." *Id.*

performance must survive stricter scrutiny, and innocent executives may be held accountable merely for trying to maintain competitiveness. Simple negligence conduct did not cause the majority of the bank failures during the 1980s crisis, and it generally will not cause a bank to decline into receivership. As such, the emphasis of the decision in this regard may be misplaced. Under *CityFed*, because bank executives will be subject to federal common law, they cannot “shop” for a federally chartered bank to manage. In order to manage effectively, bank directors and officers should have the ability to decide whether they will be held to a simple or gross negligence standard of liability.

*Christopher S. Lam*