NOTES

PROFESSIONAL MALPRACTICE AND FEDERAL COMMON LAW IN THRIFT-CRISIS LITIGATION: IS THE FDIC A "SUPER-RECEIVER"?

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INTRODUCTION

The bail-out of the troubled savings and loan (S&L) industry began in March of 1989 with the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and continues today. A recent estimate of the total cost of the bail-out, before interest, is $190 billion, and interest payments by the federal government could roughly double this estimate. Taxpayers have paid and will continue to pay the majority of the bill for the savings and loan fiasco. Consequently, under immense public pressure, federal and state regulatory agencies, in litigation throughout the country, have been aggressively attempting to identify a meaningful class of defendants able to bear financial responsibility for the catastrophic losses suffered by S&L depositors and investors.

In litigation of this sort, the defendants who appear to have the greatest complicity are usually the officers and directors of the failed S&L. However, regulators, for various reasons, cannot expect to recover actual losses sustained

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3. Id.
5. McCoy, supra note 4, at 1.
by the S&L from the S&L's officers and directors. Most officers and directors do not have personal worth near the amount of losses sustained by their failed S&L, and in some cases, those who have substantial personal assets may have absconded with them. Many failed thrifts either did not maintain an officer and director (O&D) liability insurance policy or maintained an O&D policy with relatively low liability limits. Also, many such O&D policies do not cover liability based upon fraud. Thus, because regulators frequently prove fraudulent conduct by S&L officers or directors, recovery from an O&D insurance policy is rare.

Regulators' inability to obtain adequate remuneration from most officers and directors has led to an increased focus on the role played by professionals in the demise of the S&L industry. Professionals are particularly attractive targets in this type of litigation because they typically have the "deep pockets" from which regulators seek to recover S&L losses—in the form of large malpractice insurance policies. Unlike regulators' claims against officers and directors, the claims against professionals rarely include allegations of fraud. Typically, the evidence is insufficient to prove the professional engaged in fraudulent conduct. In addition, a fraud-based judgment would not be covered by the typical professional malpractice insurance policy. Thus, claims against professionals are usually brought for professional malpractice, breach of fiduciary duty, negligent misrepresentation, and breach of contract.

This Note focuses on civil litigation where the Federal Deposit Insurance Corporation (FDIC), as receiver or conservator for a failed S&L, has brought a professional malpractice action against a professional who served an S&L

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6. Id.
7. Id.
8. For example, federal authorities allege Tom Billman, owner of the failed Community Savings and Loan, fled the country with millions of dollars stashed in a Swiss bank while the FDIC is left to deal with his insolvent S&L. Id.
9. Id.
10. Id.
11. Id.
12. The professionals involved in the litigation which is the subject of this Note are primarily accountants who audited failed thrifts' financial statements, attorneys who counseled failed thrifts, and to a lesser extent, appraisers who conducted appraisals for the thrifts. When the term "professionals" is used throughout this Note it generally refers to this class of individuals.
13. McCoy, supra note 4, at 1.
14. Id. at 3.
15. Id. In fact, regulators often have proof that professionals were defrauded by an S&L's officers and directors. E.g., FDIC v. O'Melveny & Meyers, 969 F.2d 744, 746 (9th Cir. 1992), cert. granted, 114 S. Ct. 543 (Nov. 29, 1993); FDIC v. Ernst & Young, 967 F.2d 166, 168 (5th Cir. 1992).
16. McCoy, supra note 4, at 3.
17. Id.
prior to the S&L's failure and takeover by federal regulators. To date, a split of opinion exists in the United States Courts of Appeals as to the viability of this type of action when, under state law, the S&L itself could not have maintained such an action because of state law defenses that could have been asserted by the professional against the S&L.

In June of 1992, in *Federal Deposit Insurance Corporation v. O'Melveny & Meyers*, 18 the United States Court of Appeals for the Ninth Circuit reversed and remanded the district court's grant of O'Melveny & Meyers' motion for summary judgment, holding that the FDIC could maintain such an action. In *O'Melveny*, the defendant law firm argued that the fraud of the S&L's officers and directors should be imputed to the S&L, and therefore, just as the S&L would not be able to recover as a result of its own wrongdoing, the FDIC, as conservator of the S&L, should likewise be prevented from seeking recovery. The court of appeals held that, because the acts of the officers and directors were not attributable to the S&L, the defense of unclean hands could not have been asserted against the S&L itself, and therefore, it could not be asserted against the FDIC as conservator of the S&L. 19 In addition, and most importantly for purposes of this Note, the court went on to state in dicta that, even if the acts were attributable to the S&L, the FDIC enjoyed a special status in this type of litigation and was not subject to the same state law defenses as the S&L. 20

Ignoring the *O'Melveny* opinion, in August of 1992 the United States Court of Appeals for the Fifth Circuit in *Federal Deposit Insurance Corporation v. Ernst & Young* 21 affirmed the district court's grant of the defendant accounting firm's motion for summary judgment, holding that the FDIC could not maintain such a malpractice action. The FDIC argued, among other things, 22 that the FDIC should be entitled to special protection from valid state law defenses. 23 Contrary to the special-status dicta in *O'Melveny*, the Fifth Circuit held there were no statutory or other grounds upon which to treat the FDIC differently than any other receiver or conservator under state law. 24

The losing parties in both cases petitioned for a rehearing en banc. On October 1, 1992, the Fifth Circuit denied the FDIC's motion in the *Ernst & Young* case. 25 On September 27, 1993, while continuing to await the Ninth Circuit's ruling on their petition for rehearing en banc, O'Melveny & Meyers

18. 969 F.2d 744 (9th Cir. 1992), *cert. granted*, 114 S. Ct. 543 (Nov. 29, 1993).
19. *Id.* at 750-51.
20. *Id.* at 751-52.
21. 967 F.2d 166, 172 (5th Cir. 1992), *reh'g denied*, 976 F.2d 732 (5th Cir. 1992).
22. *See infra* note 105.
23. 967 F.2d at 169.
24. *Id.* at 170.
25. FDIC v. Ernst & Young, 976 F.2d 732 (5th Cir. 1992).
petitioned the United States Supreme Court for certiorari. The Supreme Court granted O'Melveny’s petition for certiorari on November 29, 1993.

In November 1992, the FDIC and Ernst & Young reached a settlement wherein Ernst & Young paid 400 million dollars to federal regulators to settle potential claims arising out of Ernst & Young’s representation of over 300 failed S&Ls. The settlement included the above-mentioned litigation in the Fifth Circuit. Later, in an attempt to do what has been referred to as “erase unfavorable case history,” the FDIC in the Ernst & Young case petitioned the Fifth Circuit to have both the appellate decision and the district court decision vacated. In January 1993, the Fifth Circuit denied the FDIC’s motion to vacate without comment.

The resolution of this issue is crucial to both regulators and professionals because the ability to sustain or thwart a motion for summary judgment in complex and costly banking cases often decides the outcome. As evidenced by the flurry of activity that followed both decisions, neither the FDIC, O’Melveny & Meyers, nor professionals in general, are likely to allow this issue to rest until it is decided by the United States Supreme Court. In fact, one banking industry lawyer noted that the O’Melveny case “could be settled for a relatively small sum believed to be less than $1 million,” but O’Melveny refuses to settle and continues to fight the Ninth Circuit’s decision because of the important legal issues involved.

Although these cases raise other highly-debated issues, this Note focuses only on the issue of whether federal courts should fashion uniform federal common law or adopt the law of the state as the rule of decision to

26. FDIC v. O'Melveny's & Meyers, 969 F.2d 744 (9th Cir. 1992), cert. granted, 114 S. Ct. 543 (Nov. 29, 1993).
27. Id.
30. Id.
31. Id.
32. Sherry R. Sontag, Circuits Split on Regulators' Malpractice Claims, NAT'L L.J., Aug. 17, 1992, at 17. It has been suggested that one of the government’s strategies in these cases is to “pull professionals into huge litigations with large damage demands in which slugging it out on the facts becomes too expensive to defend,” forcing the defendant professionals to settle. Id. at 24.
33. A number of amicus briefs were filed by professionals, including one by Ernst & Young, in support of O’Melveny & Meyers’ petition for rehearing. Id. at 17. In addition, a number of amicus briefs were filed in opposition to the FDIC's motion to vacate the Ernst & Young decision. Brodsky, supra note 29, at 3.
34. THRIFT ACCT., supra note 31, at 3 (referring to the comments of Arthur W. Leibold, Jr., a partner in the Washington law firm of Dechert, Price & Rhoads).
35. See infra notes 85-86 and accompanying text.
determine the availability of defenses against the FDIC. The FDIC argues that, regardless of whether the failed S&L could have brought the action against the professional on its own behalf, the FDIC should be afforded special protection from defenses that could have been asserted against the failed S&L under state law. This argument is not consistent with the law in a majority of states. The FDIC is technically an assignee of the S&L, and in most states an assignee obtains only the right, title, and interest of the assignor at the time of his assignment, and no more. Thus, under state law the assignee may recover only those damages which would have been recoverable by the assignor. Under the FDIC’s argument, the FDIC becomes a “super-receiver,” impervious to state law defenses that could have been asserted against the failed S&L. There are no federal statutes which command such a result. The issue, then, is whether it is proper for a federal court to fashion and apply federal common law contrary to otherwise valid state law.

This Note discusses the split of opinion that currently exists between the Fifth and Ninth Circuits with regard to the federal common law issue and argues that the Fifth Circuit’s statement that “[n]o statutory justification or public policy exists to treat the FDIC differently from other assignees” when it acts as a receiver for a failed S&L is the conclusion mandated by decisions of the United States Supreme Court. Part I provides background on federal deposit insurance and federal regulation of the S&L industry. Part II describes the FDIC’s role when confronted with a failing or failed S&L. Part III analyzes the Ninth Circuit’s opinion in O’Melveny & Meyers. Part IV analyzes the Fifth Circuit’s opinion in Ernst & Young. Part V reviews the current state of federal common law as evidenced by recent Supreme Court opinions. Part VI analyzes the facts of cases like O’Melveny & Meyers and Ernst & Young in light of the current state of federal common law. Part VII concludes that, in accord with Supreme Court precedent, state law should be incorporated as the federal rule of decision when determining the availability of defenses against the FDIC in litigation against professionals.

I. BACKGROUND

Savings associations began to appear in the United States in the late 1920’s and early 1930’s as institutions primarily devoted to residential financing. Prior to the Great Depression, savings associations were

36. Sontag, supra note 32, at 17.
38. Sontag, supra note 32, at 17.
39. FDIC v. Ernst & Young, 967 F.2d 166, 170 (5th Cir. 1992).
chartered, regulated, and monitored by state authorities. In 1933, in an effort to help lift the nation out of the Great Depression, Congress created the FDIC to insure the deposits of commercial banks. In 1934, Congress established the Federal Savings and Loan Insurance Corporation (FSLIC) to insure the deposits of federal and state chartered savings associations.

The S&L industry remained a stable, profitable industry from its advent through the late 1960’s. Since then, the industry went through a cycle of regulation (in the late 1960’s), deregulation (in the early 1980’s), and finally collapse (in the late 1980’s). Commonly cited causes of the industry collapse include inflation and the corresponding rising interest rates that existed in the 1970’s; the extensive deregulation of the S&L industry during the 1980’s; inadequate regulatory supervision by state and federal regulators; the severe economic downturn in the southwest; incompetent management of S&L’s; and fraudulent conduct of S&L managers.

In January of 1988, the severity of the S&L crisis motivated President George Bush to announce just eighteen days after his inauguration a comprehensive plan to resolve the crisis. The result was the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).

42. In the early 1930’s the supply of money had contracted drastically due in large part to numerous bank failures. In establishing the FDIC, Congress sought to restore the public’s confidence in the nation’s banks. Michael B. Burgee, Purchase and Assumption Transactions and the Federal Deposit Insurance Act, 14 FORUM 1146, 1146 (1979).
44. National Housing Act, Pub. L. No. 73-479, § 401, 48 Stat. 1246, 1255-56 (1934). The FSLIC was created shortly after the FDIC for fear that savings association depositors might withdraw their uninsured deposits from savings associations and deposit them in federally insured commercial banks. Paul T. Clark et al., supra note 41, at 1018.
46. Roberts & Cohen, supra note 45, at 54.
48. Id. at 301. But see Melanie S. Tammen, The Savings & Loan Crisis: Which Train Derailed—Deregulation or Deposit Insurance?, 6 J. L. & POL. 311 (1990) (arguing that the collapse of the S&L industry is more a result of the nature of deposit insurance itself and political faux pas, than of deregulation).
49. H.R. REP. NO. 54, supra note 47.
50. Id.
dramatically changed the regulatory scheme governing the S&L industry.\textsuperscript{54} The Federal Home Loan Bank Board (Bank Board) was abolished,\textsuperscript{55} and the newly created Office of Thrift Supervision (OTS)\textsuperscript{56} replaced the Bank Board as the agency responsible for the regulation of the S&L industry.\textsuperscript{57} The Resolution Trust Corporation (RTC) was established to replace the FSLIC as the agency responsible for resolving failed thrifts.\textsuperscript{58} The FDIC succeeded the FSLIC in the FSLIC’s other capacities, including the FSLIC’s capacity as plaintiff in S&L crisis-related litigation.\textsuperscript{59}

II. FDIC’S ROLE IN RESOLVING FAILED THRIFTS

Before going further, it is important to understand the FDIC’s role in resolving a failed or failing S&L. It has power in its corporate capacity as insurer of S&L deposits ("FDIC/Corporate"),\textsuperscript{60} and it has power in its receiver capacity for a failed S&L ("FDIC/Receiver").\textsuperscript{61}

When an S&L’s failure appears imminent, the FDIC has two options. First, FDIC/Corporate may directly assist the S&L through loans, deposits, or contributions; by purchasing S&L assets; or by assuming liabilities of the failing S&L.\textsuperscript{62} Second, the FDIC may be appointed as conservator or receiv-

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\textsuperscript{54} For an extensive discussion of FIRREA, see Paul T. Clark et al., supra note 41, at 1013; Daniel B. Gail & Joseph J. Norton, A Decade’s Journey from “Deregulation” to “Supervisory Regulation”: The Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 45 BUS. LAW. 1103 (1990).


\textsuperscript{60} For example, such powers include the authority to invest funds held in the Bank Insurance Fund and the Savings Association Insurance Fund, the ability to assist failing institutions, and the ability to purchase assets of failed institutions. See 12 U.S.C. § 1823 (1989 & Supp. 1993).


er of the failing S&L with powers necessary to carry out its duties as conservator or receiver.

Once appointed, FDIC/Receiver has several alternatives in resolving a failed S&L, including: (1) a “deposit payoff” or liquidation where the bank is closed and depositors are paid an amount equal to their deposits up to a maximum of $100,000 per account out of the insurance fund, or (2) a “purchase and assumption” (P&A) transaction where the FDIC arranges the sale of the failed banks “acceptable” assets to another solvent bank. Before proceeding with its chosen method of resolution, the FDIC has a statutory obligation to determine which method will be “the least costly to the deposit insurance fund of all possible methods [of resolution].”

A P&A transaction involves the sale of certain acceptable assets by FDIC/Receiver to a sound, insured bank. The assets not sold to the assuming bank (i.e., the unacceptable assets) are sold by FDIC/Receiver to FDIC/Corporate. A P&A transaction is usually the most desirable alternative for several reasons. A P&A transaction minimizes deterioration of

63. The powers of the FDIC as conservator are somewhat different than those as receiver. As conservator, the FDIC has the power to take such action as may be necessary to put the S&L in a solvent condition appropriate for carrying on the business of the S&L. 12 U.S.C. § 1821(d)(2)(D) (1989). As receiver, the FDIC has the power to liquidate the failed S&L and proceed to realize upon its assets. Id. § 1821(d)(2)(E) (Supp. 1993). However, because as both conservator and receiver the FDIC succeeds to “all rights, titles, powers, and privileges of the insured institution”, Id. § 1821(d)(2)(A), for purposes of this Note no distinction is made between the FDIC as conservator or the FDIC as receiver.

66. Id.
68. 12 U.S.C. § 1823(c)(4)(A) (Supp. 1993). This section states in its entirety:
   Notwithstanding any other provision of this chapter, the Corporation may not exercise any authority under this subsection or subsection (d), (f), (h), (i), or (k) of this section with respect to any insured depository institution unless—
   (i) the Corporation determines that the exercise of such authority is necessary to meet the obligation of the Corporation to provide insurance coverage for the insured deposits in such institution; and
   (ii) the total amount of the expenditures by the Corporation and obligations incurred by the Corporation (including any immediate and long-term obligation of the Corporation and any direct or contingent liability for future payment by the Corporation) in connection with the exercise of any such authority with respect to such institution is the least costly to the deposit insurance fund of all possible methods for meeting the Corporation’s obligation under this section.

For a discussion of the FDIC’s obligation under this section see FDIC v. Jenkins, 888 F.2d 1537, 1540 (11th Cir. 1989).

69. Id. at 1154.
70. Id. at 1155.
71. Jenkins, 888 F.2d at 1540. For a more detailed discussion of purchase and assumption transactions see Burgee, supra note 42, at 1146.
public confidence in the banking system because the failed S&L stays open.\textsuperscript{72} Keeping the failed S&L open also avoids disruption to other solvent banks in the area which may result from the closing of a failed S&L, depending upon the extent of the "inter-bank relationships" that exist at the time of the closing.\textsuperscript{73} Further, a liquidation may cause depositors to wait several months before they can recover the insured portion of their deposits.\textsuperscript{74}

Once appointed receiver for a failed S&L, under 12 U.S.C. section 1821(d)(2)(A), FDIC/Receiver succeeds to "all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution."\textsuperscript{75} FDIC/Receiver has the power to "realize upon" these assets prior to their sale to FDIC/Corporate in a P&A transaction.\textsuperscript{76} With respect to the assets sold to FDIC/Corporate in a P&A transaction, 12 U.S.C. section 1823(d)(3)(A) gives FDIC/Corporate the same "rights, powers, privileges, and authorities" as possessed by FDIC/Receiver.\textsuperscript{77} Any amounts recovered by either the FDIC/Receiver or FDIC/Corporate are used to replenish the deposit insurance fund.\textsuperscript{78}

The litigation examined in this Note arises when the FDIC is appointed receiver of a failed S&L and attempts to realize upon the failed S&L’s assets. In this role, the FDIC endeavors to realize upon the failed S&L’s assets to the maximum extent possible in order to minimize the loss to the deposit insurance fund it administers.\textsuperscript{79} The FDIC’s litigation against professionals is a means to minimizing the loss to the deposit insurance fund.

III. THE O’MELVENY & MEYERS CASE

In February of 1986, the FDIC stepped in as conservator for the American Diversified Savings Bank (ADSB), having determined that ADSB was insolvent.\textsuperscript{80} ADSB had incurred substantial losses, violated laws and regulations, and operated the S&L using unsafe and unsound business practices. In its conservatorship capacity, the FDIC sued the law firm of O’Melveny & Meyers for professional negligence, negligent misrepresentation, and breach of

\textsuperscript{72} Burgee, \textit{supra} note 42, at 1156.
\textsuperscript{73} \textit{Id.} at 1153.
\textsuperscript{74} \textit{Id.}
\textsuperscript{78} Burgee, \textit{supra} note 42, at 1155.
\textsuperscript{80} FDIC v. O’Melveny & Meyers, 969 F.2d 744, 747 (9th Cir. 1992), \textit{cert. granted}, 114 S. Ct. 543 (Nov. 29, 1993).
fiduciary duty based on work O’Melveny had performed on a private placement for ADSB. The parties agreed on the facts and tested their legal theories on cross-motions for summary judgment. The parties stipulated that certain officers and directors of ADSB, including the chairman of the board and chief executive officer, and the president, “had intentionally and fraudulently overvalued ADSB’s assets, engaged in the sham sale of assets in order to create ‘profits,’ and generally ‘cook[ed] the books.’”

In defense to the FDIC’s claims O’Melveny argued that

(1) it owed no duty to ADSB or its affiliates to ferret out ADSB’s own fraud; (2) the conduct of ADSB’s wrongdoing officers must be imputed to ADSB, and that FDIC, as receiver, stood in the shoes of ADSB; (3) and that therefore, as an ordinary assignee, FDIC was barred from pursuing any claims against O’Melveny.

The United States District Court for the Central District of California granted O’Melveny’s motion for summary judgment, simply stating it perceived no genuine issue of material fact. On appeal by the FDIC, the Ninth Circuit held that (1) O’Melveny did owe a duty of care to its client ADSB, (2) the wrongdoing of ADSB officers and directors should not have been imputed to ADSB, and (3) even if such wrongdoing was imputed to ADSB, the FDIC

81. Id. at 746. Prior to the instigation of the action against O’Melveny, the FDIC filed suit against Ranbir Sahni, ADSB’s chairman of the board and chief executive officer, for breach of fiduciary duty and RICO violations and against Lester Day, ADSB’s president, for breach of fiduciary duty. Id. at 747.

82. The FDIC was actually acting as conservator. See id.

83. O’Melveny & Meyers, 969 F.2d at 747.

84. Id. at 747, 752.

85. Id. at 748-49. The standard of care owed by professionals and to whom the duty is owed is beyond the scope of this Note. Suffice it to say that several recent, well-publicized cases have upset long-held understandings about the scope of professional liability. McCoy, supra note 4, at 4-12; see also Goldberg, supra note 4, at 52 (The law firm of Kaye, Scholer, Fierman, Hays & Handler engaged Yale School of Law ethics Professor Geoffrey C. Hazzard, Jr. to issue an opinion in regard to their conduct in the representation of the failed Lincoln Savings and Loan. The OTS brought a $275 million law suit against Kaye Scholer for this conduct and for which Kaye Scholer eventually settled with OTS out of court for $41 million. Professor Hazzard’s opinion was “that Kaye Scholer had acted exactly as it should have in a situation that was clearly a prelude to litigation.”). Id. In part, because courts have been increasingly willing to accept regulators’ arguments extending liability to S&L industry professionals, the defense battleground has begun to shift to other issues such as those proffered by the defendants in O’Melveny & Meyers and Ernst & Young. McCoy, supra note 4, at 12.

86. O’Melveny & Meyers, 969 F.2d at 749-51. Whether the officers’ wrongdoing should be imputed to the corporation depends upon whether the court finds the officers’ actions were done for the benefit of the corporation. 11 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 819 (perm. ed. rev. vol. 1986). The Ninth and Fifth Circuits also split as to whether the actions of the officers, which were similar in each case, were conducted for the benefit of the corporation. See FDIC v. Ernst & Young,
as successor in interest to ADSB was not estopped from pursuing its claims against O’Melveny.87

The Ninth Circuit did not dispute O’Melveny’s argument and the district court’s finding that under well-established California law, a receiver occupies the same position as the party for whom it acts and any defense which is good against the original party is good against the receiver.88 However, the Ninth Circuit stated, “The flaw in this argument is the law O’Melveny assumes applies. It is by now clear beyond doubt that federal, not state, law governs the application of defenses against the FDIC.”89 The court then stated:

While we may incorporate state law to provide the federal rule of decision, we are not bound to do so. See FDIC v. New Hampshire Ins. Co., 953 F.2d 478, 481 (9th Cir. 1991), amended, 953 F.2d 478 (9th Cir. 1992). Thus, contrary to O’Melveny’s argument, we are not bound by state law, but must instead establish federal law.90

With the state law slate wiped clean, the court went on to fashion uniform federal common law as the rule of decision by “adjust[ing] the equities” between the parties.91 The court concluded that because the FDIC was not a voluntary assignee, and because the FDIC took assignment amidst “an intricate regulatory scheme designed to protect the interests of third parties who also were not privy to the bank’s inequitable conduct,” the FDIC should be afforded special protection from otherwise valid state law defenses.92

The court’s statement that federal, not state, law applies to the availability of defenses against the FDIC is not disputed. When the rights and obligations of the FDIC are implicated, it is settled that federal law governs.93 The portion of the court’s opinion that has caused the split between the circuits is its statement that it “may incorporate state law to provide the federal rule of

967 F.2d 166, 171 (5th Cir. 1992); O’Melveny & Meyers, 969 F.2d at 750-51.
87. O’Melveny & Meyers, 969 F.2d at 751-52.
88. Id. at 751 (quoting Allen v. Ramsay, 4 Cal. Rptr. 575 (Cal. Dist. Ct. App. 1960)).
89. Id. (citing D’Oench, Duhme & Co. v. FDIC, 315 U.S. 447, 456 (1942); FDIC v. Bank of San Francisco, 817 F.2d 1395, 1398 (9th Cir. 1987); FDIC v. Mmahat, 907 F.2d 546, 550 (5th Cir. 1990), cert. denied, 111 S. Ct. 1387 (1991); FDIC v. Gulf Life Ins. Co., 737 F.2d 1513, 1517 (11th Cir. 1984)).
90. Id. (emphasis added).
91. Id.
92. Id. at 751-52. In fashioning this federal rule of decision by “adjusting the equities” between the FDIC and O’Melveny, the court cited two United States Supreme Court cases from the 1800’s. Id. at 751.
93. E.g., Gunter v. Hutcheson, 674 F.2d 862, 869 (11th Cir. 1982); see also Kamen v. Kemper Fin. Serv., Inc., 111 S. Ct. 1711, 1717 (1991) (“Because the ICA [Investment Company Act of 1940] is a federal statute, any common law rule necessary to effectuate a private cause of action under that statute is necessarily federal in character.”) (citations omitted).
decision,” but that it is “not bound to do so.” For this proposition the court cited one of its prior decisions regarding the federal common law issue, but did not cite to either of the two leading United States Supreme Court cases on the issue: Kamen v. Kemper Financial Services and United States v. Kimbell Foods, Inc. In Kamen, the Supreme Court indicated there is “a presumption that state law should be incorporated into federal common law,” and that federal courts should only “fill the interstices of federal remedial schemes with uniform federal rules” in certain limited situations. The Ninth Circuit did not consider the issue of incorporation of state law as the federal rule of decision in accord with Supreme Court precedent on the issue. Rather, the court apparently felt at liberty to fashion federal common law as the rule of decision. The degree to which a federal court has such liberty is the issue.

IV. THE ERNST & YOUNG CASE

The FDIC was “riding high” on its victory in O’Melveny for only a short period of time. Two months later, in August of 1992, the Fifth Circuit ignored the O’Melveny decision and ruled in favor of the defendant accounting firm in a similar action, Federal Deposit Insurance Corporation v. Ernst & Young.

In 1984, Western Savings Association’s (Western’s) financial condition was deteriorating as a result of numerous statutory and regulatory violations. The Bank Board stepped in and issued a temporary order for Western to cease and desist its improper business practices. In accordance with the order, Western engaged Arthur Young & Company to conduct audits for the calendar years 1984 and 1985. Arthur Young & Company’s certified audits showed Western had a net worth of 41 million dollars at the end of 1984 and 49 million dollars at the end of 1985. In fact, at the end of 1984 Western was insolvent by over 100 million dollars, and at the end of 1985 by over 200 million dollars.

The FSLIC was appointed receiver of Western in September of 1986. In one of the largest suits to be filed against a professional in connection with the S&L crisis, in March of 1990 the FDIC, as receiver for failed Western,

94. O’Melveny & Meyers, 969 F.2d at 751.
98. Kamen, 111 S. Ct. at 1717; see infra Part V.
99. See infra Part VI.
100. Sontag, supra note 32, at 17.
101. 967 F.2d 166 (5th Cir. 1992).
102. Under FIRREA, the FDIC succeeded the FSLIC in certain capacities, including as
filed a complaint against Ernst & Young\textsuperscript{103} for negligence and breach of contract. The complaint alleged damages of 560 million dollars as a result of Arthur Young's audits of Western in 1984 and 1985. The United States District Court for the Northern District of Texas held that: (1) the FDIC was not entitled to special protection when it brought a tort claim against a third party as receiver for a failed S&L; (2) the wrongdoing of Western's sole owner was attributable to Western; and (3) Western did not rely on Arthur Young's audits.\textsuperscript{104}

On appeal to the Fifth Circuit Court of Appeals, the FDIC argued, among other things,\textsuperscript{105} that the FDIC should be entitled to special protection from state law defenses because of the federal policies underlying FIRREA and the S&L bail-out. As in O'Melveny, state law was contrary to the FDIC's argument.\textsuperscript{106} Under Texas state law "[a]n assignee obtains only the right, title, and interest of his assignor at the time of his assignment, and no more."\textsuperscript{107} The Fifth Circuit affirmed the district court's grant of Ernst & Young's motion for summary judgment, holding that "[n]o statutory justification or public policy exists to treat the FDIC differently from other assignees."\textsuperscript{108} The Fifth Circuit stated that when the FDIC brings an action as receiver for a failed S&L against an outside accountant, the claim is "[e]ssentially ... a client case in which a client is suing its auditor."\textsuperscript{109}

Although the Fifth Circuit did not cite to specific Supreme Court precedent on the issue of federal common law,\textsuperscript{110} the cases relied upon by the court for the proposition that no statutory or policy basis exists for affording the FDIC special protection appear to apply the basic analytical structure required by Supreme Court precedent. The cases cited by the court will be more fully developed in Part VI.B.

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\textsuperscript{103} Ernst & Young is a general partnership formed in 1989 by the merger of Arthur Young & Company and Ernst & Whinney.

\textsuperscript{104} \textit{Ernst & Young}, 967 F.2d at 172.

\textsuperscript{105} The first point the FDIC argued was that the district court erred in holding that proving reliance on the part of the defunct S&L was an essential part of the FDIC's show of causation under Texas law. Next, the FDIC argued that the knowledge of the financial condition of the S&L's principal could not have been imputed to the S&L under Texas law because the principal's actions were not for the benefit of the S&L. Finally, the FDIC proffered the argument discussed in the text. The court rejected all three. \textit{Id.} at 169-72.

\textsuperscript{106} See supra note 88 and accompanying text.

\textsuperscript{107} \textit{Ernst & Young}, 967 F.2d at 169 (quoting State Fidelity Mortgage Co. v. Varner, 740 S.W.2d 477, 480 (Tex. Ct. App. 1987), \textit{writ denied}).

\textsuperscript{108} \textit{Id.} at 170.

\textsuperscript{109} \textit{Id.} at 169.

\textsuperscript{110} See infra notes 115-25 and accompanying text.
V. THE CURRENT STATE OF FEDERAL COMMON LAW

In 1938, Justice Brandeis proclaimed in the landmark case *Erie R.R. v. Tompkins*¹¹¹ that "There is no federal general common law."¹¹² However, *Erie* did not prohibit all federal common law. The same day the *Erie* opinion was announced the Court also announced its decision in *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*¹¹³ In *Hinderlider*, Justice Brandeis recognized that federal common law governed a dispute surrounding the apportionment of an interstate stream. Supreme Court decisions subsequent to *Erie* and *Hinderlider* have indeed revealed that the Court’s statement in *Erie* does not prohibit all types of federal common law.¹¹⁴

The Supreme Court has developed a two-prong test for courts to follow when confronted with the federal common law issue: first, a court should ask whether the issue before it is properly subject to the exercise of federal power; second, if it is, the court should go on to determine whether, in light of the competing state and federal interests involved, it is wise as a matter of policy to adopt a federal substantive rule to govern the issue.¹¹⁵

The Court recently revisited the federal common law issue and applied this two-prong test in *Kamen v. Kemper Financial Services*.¹¹⁶ In *Kamen*, the primary issue before the Court was whether a shareholder, in a shareholder’s derivative suit brought under the Investment Company Act of 1940 (ICA), was required to make a pre-complaint demand on the board of directors under Rule 23.1 of the Federal Rules of Civil Procedure or whether, under the futility exception of the law of Maryland, the shareholder could proceed with the suit without making such pre-complaint demand. Rule 23.1 contemplates demand upon the board of directors in derivative actions, but does not make such a demand a requirement of derivative actions.¹¹⁷ The Court began its analysis,

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¹¹¹ 304 U.S. 64, cert. denied, 305 U.S. 637 (1938).
¹¹² Id. at 78.
¹¹³ 304 U.S. 92 (1938).
¹¹⁷ Rule 23.1 states, "The complaint [in a shareholder’s derivative action] shall . . . allege with particularity the efforts, if any, made by the plaintiff to obtain the action the
addressing the first prong of the two-prong test, with the statement that "[b]ecause the ICA is a federal statute, any common law rule necessary to effectuate a private cause of action under that statute is necessarily federal in character." The Court, emphasizing that the test does indeed have two prongs, then stated, "It does not follow, however, that the content of such a rule must be wholly the product of a federal court's own devising."

In addressing the second prong of its test, the Court continued:

Our cases indicate that a court should endeavor to fill the interstices of federal remedial schemes with uniform federal rules only when the scheme in question evidences a distinct need for nationwide legal standards, see, e.g., Clearfield Trust Co. v. United States, 318 U.S. 363, 366-367, 63 S. Ct. 573, 574-575, 87 L.Ed. 838 (1943), or when express provisions in analogous statutory schemes embody congressional policy choices readily applicable to the matter at hand, see, e.g., Boyle v. United Technologies Corp., 487 U.S. 500, 511-512, 108 S. Ct. 2510, 2517-2518, 101 L.Ed.2d 442 (1988); DelCostello v. Teamsters, 462 U.S. 151, 169-172, 103 S. Ct. 2281, 2293-2295, 76 L.Ed.2d 476 (1983).

The Court, relying on its decision twelve years earlier in United States v. Kimbell Foods, Inc., then stated that if the facts of an individual case did not fall within one of the two general categories above, federal courts should incorporate state law as the federal rule of decision unless such state law "would frustrate the specific objectives" of the federal statutory scheme.

In applying its statement of the law to the facts in Kamen, the Court held that the congressional intent of the ICA did not evidence a need for a uniform federal rule; that application of the demand futility exception of the law of Maryland did not frustrate the federal policy objectives behind the ICA; and that therefore, the law of the state of Maryland should be adopted as the federal rule of decision.

In summary, the Kamen decision illustrates that federal courts are not free to reject incorporation of state law and instead fashion federal common law as the rule of decision. The effect of the Court's holding is that, after Kamen,
there is a presumption that federal courts should adopt state law as the rule of decision. In the opinion, the Court specifically referred to "[t]he presumption that state law should be incorporated into federal common law. . . ."124 Under Kamen, parties who believe a federal common law rule is appropriate in a given situation can rebut this presumption in three situations: (1) when the regulatory scheme in question evidences a specific need for uniform federal rules; (2) when express provisions in analogous federal enactments evidence a congressional policy to preempt state law in the area at hand; or (3) when state law would frustrate the specific objectives of federal legislation.125 Part VI analyzes the FDIC’s claims against professionals, the federal common law issue in light of the Supreme Court’s two-prong test, and the Kamen presumption of state law incorporation.

VI. FEDERAL COMMON LAW AND THE FDIC’S PROFESSIONAL MALPRACTICE CLAIMS IN LIGHT OF KAMEN

The statutory provisions in FIRREA do not declare that a uniform federal common law rule of decision should apply to all issues arising in litigation where the FDIC is a party simply because the FDIC is a creation of federal statute; nor have courts interpreted the federal statutes to require such a result.126 Because not all issues litigated by the FDIC are governed by uniform federal common law, the crucial question is where to draw the line between issues governed by federal common law and issues governed by state law in litigation involving the FDIC. This line marks a delicate constitutional balance between the power of the federal government and the power of the states, as well as between the power of the judiciary and the power of the legislature.127

Under the first prong of the Supreme Court’s incorporation test, "[i]t is. . . clear beyond doubt that federal, not state, law governs the application of defenses against FDIC."128 Because the FDIC was created by federal statute, any common law rule necessary for the enforcement of the statute is necessarily federal in character.129 This requirement leaves the second and more difficult prong of the Supreme Court’s test yet to be analyzed. In an action by the FDIC against a professional who served a failed S&L prior to its failure and takeover by federal regulators, should a federal court determining

124. Id. at 1717.
125. See supra notes 120-22 and accompanying text.
126. See, e.g., infra notes 152-71 and accompanying text.
128. FDIC v. O’Melveny & Meyers, 969 F.2d 744, 751 (9th Cir. 1992), cert. granted, 114 S. Ct. 543 (Nov. 29, 1993).
the applicability of defenses against the FDIC incorporate state law or fashion federal common law as the rule of decision?

A. The Kamen Presumption of Incorporating State Law as the Federal Rule of Decision

Analysis of this second prong begins with a presumption that state law should be incorporated as the rule of decision. In Kamen, the Court stated that this presumption is especially strong in cases where "private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards." In Reconstruction Finance Corporation v. Beaver County, the Court considered the federal common law issue and the parties' expectations in the area of property law. The Court held that state law should apply because "[c]oncepts of real property are deeply rooted in state traditions, customs, habits, and laws."

The conduct and requisite standard of care for professionals involved in litigation with the FDIC are also traditionally within the purview of state law. "[L]awyers are tested and licensed, or admitted, under state law. The Supreme (or highest) Court of the state is responsible for professional disciplinary matters, and both statutory and case law of the state or states spell out their duties, responsibilities and liabilities." The professionals involved in litigation with the FDIC, because federal statutes did not expressly or implicitly require otherwise, expected that their rights and obligations would be governed by state law. The FDIC's argument has the effect of altering these rights and obligations after the fact. Arguably then, under Kamen, the FDIC must overcome a strong presumption that a federal court should incorporate state law as the rule of decision in order to obtain the special protection of federal common law from state law defenses.

Again, the Supreme Court in Kamen indicated three situations that could rebut this strong presumption: (1) when the regulatory scheme in question evidences a specific need for uniform federal rules; (2) when express provisions in analogous federal enactments evidence a congressional policy to preempt state law in the area at hand; or (3) when state law would frustrate the specific objectives of federal legislation. If the FDIC can proffer evidence that one or more of these situations are applicable to the FDIC's position when

130. Id. (citing United States v. Kimbell Foods, Inc., 440 U.S. 715, 728-29 (1979) (commercial law); Reconstruction Fin. Corp. v. Beaver County, 328 U.S. 204, 210 (1946) (property law)).
131. 328 U.S. at 204.
132. Id. at 210.
134. See supra notes 120-22 and accompanying text.
it brings a malpractice action as receiver for a failed S&L against a professional, then federal common law should be fashioned by federal courts as the rule of decision. Otherwise, the Kamen presumption of state law governs and state law should be incorporated as the federal rule of decision.

B. Do Federal Banking Statutes Evidence a "Distinct Need for Nationwide Legal Standards"?

Courts have recognized situations where federal banking statutes have evidenced a "distinct need for nationwide legal standards." In arguing for special protection in actions against S&L professionals, the FDIC cites the 1942 Supreme Court case, D'Oench, Duhme & Co. v. Federal Deposit Insurance Corporation. D'Oench was the first judicial recognition of a special status for the FDIC in bank-crisis litigation.

1. D'Oench, Duhme & Co. v. Federal Deposit Insurance Corporation.—D'Oench, Duhme & Co., a securities dealer, sold a number of bonds to a bank. The bonds later went into default, and in order to prevent the bonds from being shown as delinquent on the bank's records, the bank asked D'Oench to issue the bank a promissory note. D'Oench did so, and the bank and D'Oench entered into a secret side agreement that the note would never be called. After the bank's insolvency, the FDIC acquired the note and brought an enforcement action against D'Oench as the bank's receiver. D'Oench raised both the existence of a side agreement and the absence of consideration as defenses. Both defenses would have been successful under state law.

In holding that D'Oench was prevented from asserting the agreement not to call the note as a defense to the FDIC's action on the note, the Court arguably fashioned a rule of federal common law. At the time, no specific statutory provision addressed such agreements. However, the Court held that federal policy evidenced in the Federal Reserve Act required such a result. The Court stated:

Sec. 12B(s) of the Federal Reserve Act, 12 U.S.C. section 264(s), provides that "Whoever, for the purpose of obtaining any loan from the Corporation . . . or for the purpose of influencing in any way the action of the Corporation under this section, makes any statement,  

137. The effect of such a transaction was an overstatement of the bank's assets because it was agreed the note would never be repaid.
139. Id. at 458-59. The concurring opinion of Justice Jackson explicitly asserted that the rule was an expression of federal common law. Id. at 471-75 (J. Jackson, concurring).
140. A statutory provision addressing such secret agreements exists today. See 12 U.S.C. § 1823(e) (1989); infra notes 147-51 and accompanying text.
knowing it to be false, or wilfully overvalues any security, shall be punished by a fine of not more than $5,000, or by imprisonment for not more than two years, or both.” Subdivision (y) of the same section provided, at the time respondent [FDIC] insured the Belleville bank, that such a state bank “with the approval of the authority having supervision” of the bank and on “certification” to respondent “by such authority” that the bank “is in solvent condition” shall “after examination by, and with the approval of” the respondent [FDIC] be entitled to insurance.\textsuperscript{141}

The Court stated that these sections of the Federal Reserve Act evidenced a federal policy to protect the FDIC and the deposit insurance fund which it administered from “misrepresentations as to the securities or other assets in the portfolios of the banks which respondent [FDIC] insures or to which it makes loans.”\textsuperscript{142} As a result, the Court held D’Oench could not assert the validity of the side agreement as a defense to the FDIC’s action on the note.\textsuperscript{143}

Since the \textit{D’Oench} opinion in 1942, courts have greatly expanded the \textit{D’Oench} doctrine.\textsuperscript{144} This expansion has been criticized by some commentators.\textsuperscript{145} The FDIC argued to expand the special-status protection of the \textit{D’Oench} doctrine in \textit{O’Melveny & Meyers} and \textit{Ernst & Young}. In order to determine whether such expansion is appropriate in these cases the interest that the Court sought to protect in \textit{D’Oench} should be clearly identified. In \textit{D’Oench}, the Court specifically stated that federal policy evidenced a need to protect the FDIC from “misrepresentations as to the securities or other assets in the portfolios of the banks.”\textsuperscript{146} In other words, the FDIC must be able to rely upon the accuracy of a bank’s or S&L’s records. This interest must be distinguished from another, more general, interest which could arguably be protected by \textit{D’Oench}: the protection of the deposit insurance fund. The remainder of this Part makes this necessary distinction and identifies the specific federal interest which the Court in \textit{D’Oench} sought to protect.

\textsuperscript{141} \textit{D’Oench, Duhme & Co.}, 315 U.S. at 456-57 (footnotes omitted).
\textsuperscript{142} \textit{Id.} at 457.
\textsuperscript{143} \textit{Id.} at 459.
\textsuperscript{144} \textit{E.g.,} Porras v. Petroplex Sav. Ass’n, 903 F.2d 379, 381 (5th Cir. 1990) (\textit{D’Oench} applies to assignees of the FDIC); Bell & Murphy & Assoc., Inc. v. Interfirst Bank Gateway, 894 F.2d 750, 754-55 (5th Cir. 1990), cert. denied, 111 S. Ct. 244 (1990) (\textit{D’Oench} applies to protect a bridge bank which takes over a failed bank); Beighley v. FDIC, 868 F.2d 776, 784 (5th Cir. 1989) (\textit{D’Oench} applies even if “borrower does not intend to deceive banking authorities”); see Flint, supra note 52, at 467; see also infra notes 147-51 and accompanying text (discussing what is referred to as the codification of the \textit{D’Oench} doctrine, 12 U.S.C. § 1823(e)).
\textsuperscript{145} \textit{E.g.,} Flint supra note 52.
\textsuperscript{146} \textit{D’Oench, Duhme & Co.}, 315 U.S. at 467.
In 1950 Congress appeared to codify the D'Oench doctrine at 12 U.S.C. section 1823(e), but much debate exists concerning whether this codification expands, contracts, or eliminates its common law roots. The content of this debate is beyond the scope of this Note. However, the Supreme Court has enunciated two major federal policies underlying section 1823(e), which help clarify the federal interest referenced in D'Oench.

In *Langley v. Federal Deposit Insurance Corporation*, the Supreme Court stated:

One purpose of section 1823(e) is to allow federal and state bank examiners to rely on a bank's records in evaluating the worth of the bank's assets. Such evaluations are necessary when a bank is examined for fiscal soundness by state or federal authorities, see 12 U.S.C. sections 1817(a)(2), 1820(b), and when the FDIC is deciding whether to liquidate a failed bank, see section 1821(d), or to provide financing for purchase of its assets (and assumption of its liabilities) by another bank, see sections 1823(c)(2), (c)(4)(A). The last kind of evaluation, in particular, must be made "with great speed, usually overnight, in order to preserve the going concern value of the failed bank and avoid an interruption in banking services." *Gunter v. Hutcheson*, 674 F.2d at 865. Neither the FDIC nor state banking authorities would be able to make reliable evaluations if bank records contained seemingly unqualified notes that are in fact subject to undisclosed conditions.

The Court stated a second purpose of section 1823(e) was to "ensure mature consideration of unusual loan transactions by senior bank officials, and prevent fraudulent insertion of new terms, with the collusion of bank employees, when a bank appears headed for failure." Like the rationale for the common law

No agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement- (1) is in writing, (2) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution, (3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) has been, continuously, from the time of its execution, an official record of the depository institution.
150. Id. at 91-92 (emphasis added).
151. Id. at 92.
doctrine espoused by the Court in D’Oench, the Court in Langley believed the congressional intent behind the passage of section 1823(e) was more specific than simply protecting the deposit insurance fund.

2. Cases cited by the Fifth Circuit in Ernst & Young.—In rejecting the FDIC’s argument in Ernst & Young for extension of the D’Oench doctrine, the Fifth Circuit cited three cases which also help to identify the specific federal interest at issue in the D’Oench line of cases: Federal Deposit Insurance Corporation v. Cherry, Bekaert & Holland,152 Federal Deposit Insurance Corporation v. Harrison,153 and Federal Deposit Insurance Corporation v. Jenkins.154

a. Federal Deposit Insurance Corporation v. Cherry, Bekaert & Holland

In Cherry Bekaert, the FDIC sued the accounting firm of Cherry, Bekaert & Holland for professional malpractice in the performance of audits.155 The FDIC argued that Cherry Bekaert’s defense of contributory negligence on the part of the bank’s former officers, a valid defense under state law, should have been dismissed because of the “doctrine set forth in D’Oench . . . and its progeny.”156 The court stated that the scope of D’Oench’s special protection was limited. Further, the court stated that “like the Jenkins157 court, this Court declines to speculate that Congress contemplated that negligence suits against third party defendants are a necessary part of the recovery of the insurance fund.”158 The court thus held Cherry Bekaert could assert the defense of contributory negligence against the FDIC.159

b. Federal Deposit Insurance Corporation v. Harrison

In Harrison, the Eleventh Circuit Court of Appeals considered the issue of whether the doctrine of equitable estoppel could be asserted as a defense against the FDIC’s action to enforce a guaranty agreement executed by Harrison.160 The FDIC argued, among other things, that it should be afforded special protection against this defense. In response, the court stated the special protection of the D’Oench doctrine should be

afforded [to the FDIC] only when necessary to further the policy of promoting the stability of the nation’s banking system by facilitating FDIC’s smooth acquisition of assets in a purchase and assumption

153. 735 F.2d 408 (11th Cir. 1984).
154. 888 F.2d 1537 (11th Cir. 1989).
155. Cherry, Bekaert & Holland, 742 F. Supp. at 612.
156. Id. at 614.
157. The court was referring to FDIC v. Jenkins, 888 F.2d 1537, 1546 (11th Cir. 1989) which was also cited by the Fifth Circuit in Ernst & Young and is discussed infra at 163-67 and accompanying text.
158. Cherry, Bekaert & Holland, 742 F. Supp. at 614.
159. Id.
160. FDIC v. Harrison, 735 F.2d 408, 409-10 (11th Cir. 1984).
transaction. It is essential that the Corporation be able to acquire assets of a failed bank without fear of unknown defenses that may have been valid against the bank.\footnote{161}

The court held that there was “no reason not to apply the traditional rules of equitable estoppel to the conduct of [the] FDIC.”\footnote{162}

c. Federal Deposit Insurance Corporation v. Jenkins

In \textit{Jenkins}, the FDIC had been appointed receiver of the failed Park Bank and was seeking a declaratory judgment against the bank’s shareholders.\footnote{163} The bank’s shareholders, in their individual capacities, filed a number of state and federal claims against several officers and directors of Park Bank, an accounting firm, and a law firm which had represented Park Bank. The FDIC later filed claims against several of the same defendants for negligence and breach of fiduciary duty, seeking 30 million dollars in damages. The issue before the court was whether the FDIC’s claims were entitled to priority over the shareholders’ claims. The FDIC argued that it was either entitled to priority over shareholder actions under the scheme of federal regulations or, in the alternative, that it was so entitled under a uniform federal common law rule of decision.

In rejecting the FDIC’s argument, the \textit{Jenkins} court stated that the FDIC’s mission to maximize the recovery of the deposit insurance fund alone did not require a uniform federal common law rule of priority.\footnote{164} The court reasoned that the paramount issue in such a case was whether application of state law would inhibit the FDIC from performing the analysis of the bank’s records necessary to make an efficient decision as to the best method in which to resolve the failed S&L.\footnote{165} The court stated:

Of course, it would be convenient to the FDIC to have an arsenal of priorities, presumptions and defenses to maximize recovery to the insurance fund, but this does not require that courts must grant all of these tools to the FDIC in its effort to maximize deposit insurance fund recovery. Any rule fashioned must have its base on the goal of effectuating congressional policy. We are not convinced that Congress considered collections against parties such as the bank-related defendants in this case as a necessary part of the recovery to the deposit insurance fund. Any such priority over third-party lawsuits will have to come from Congress, not this Court.\footnote{166}

\begin{footnotesize}
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\item \footnote{161} {\textit{Id.} at 412-13 n.6 (emphasis added) (citing Gunter v. Hutcheson, 674 F.2d 862, 870 (11th Cir. 1982), \textit{cert. denied}, 459 U.S. 826 (1982)).}
\item \footnote{162} {\textit{Id.} at 412.}
\item \footnote{163} {FDIC v. Jenkins, 888 F.2d 1537, 1538 (11th Cir. 1989).}
\item \footnote{164} {\textit{Id.} at 1546.}
\item \footnote{165} {\textit{Id.}}
\item \footnote{166} {\textit{Id.}}
\end{itemize}
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The court reversed the district court’s decision “insofar as it created a priority for the FDIC over the claims of the shareholders.” 167

The cases cited by the Fifth Circuit in Ernst & Young for the proposition that the D’Oench doctrine is limited in scope help illustrate what federal interest is protected by D’Oench and its progeny. The cases focus on the importance of protecting the process by which the FDIC decides which method of resolution to pursue. Recall that once the FDIC has been appointed receiver of a failed S&L, it has several alternatives from which to choose in resolving the failed S&L. 168 Further, the FDIC has a statutory duty to determine which alternative it believes will cause the least amount of loss to the deposit insurance fund. 169 If a P&A transaction 170 is to be used to resolve the failed S&L, this determination “must be made ‘with great speed, usually overnight, in order to preserve the going concern value of the failed bank and avoid an interruption in banking services.’” 171 The courts in Cherry Bekaert, Harrison, and Jenkins all focused on the necessity for the FDIC to be able to rely on the accuracy of the S&L’s records in making this determination. Likewise, those courts all rejected the argument that the FDIC’s interest in minimizing the loss to the insurance fund by itself was sufficient to require fashioning of uniform federal common law.

3. Gulf Life Insurance Co. v. Federal Deposit Insurance Company.—In Gulf Life, The Eleventh Circuit Court of Appeals relied on an identical rationale in holding that federal common law afforded the FDIC special protection from the valid state law defenses of waiver, estoppel, and unjust enrichment. 172 In Gulf Life, the FDIC was appointed receiver for two failed banks. FDIC/Corporate purchased certain assets of the failed banks from FDIC/Receiver in a P&A transaction, including two group creditor insurance policies issued by Gulf Life Insurance Company (Gulf Life). FDIC/Corporate, seeking to realize upon the assets which it had purchased, filed suit against Gulf Life for the return of one hundred percent of certain unearned insurance premiums. Gulf Life contended it was only obligated to return thirty-five percent of the unearned premiums, basing its contention on theories of waiver, estoppel, and unjust enrichment, which were apparently valid under state law. The court specifically held section 1823(e) and the D’Oench progeny inapplicable because Gulf Life’s defenses were not based upon mutual consent. 173 However, the court nevertheless held that federal common law

167. Id.

168. See supra notes 66-67 and accompanying text.

169. See supra note 68 and accompanying text.

170. See supra notes 69-74 and accompanying text.


173. Id. at 1516.
limited the defenses available against the FDIC in a situation where FDIC/Corporate obtained an asset in the course of a P&A transaction for value, in good faith, and without knowledge of the defenses.\textsuperscript{174}

The court indicated two key reasons why the FDIC should be afforded special protection when it is taking over a failed bank. First, the court stated "decisions concerning the appropriate method of dealing with a bank failure must be made with extraordinary speed if the going concern value of the failed institution is to be preserved."\textsuperscript{175} Requiring the FDIC to consider each bank’s state law defenses would significantly hinder this process. Second, the court stated that because these defenses are not ordinarily apparent from the bank’s records, the FDIC would be unable to make an informed decision as to the appropriate method of dealing with a failed bank, thereby causing larger losses to the FDIC’s insurance fund.\textsuperscript{176} Thus, although the court did fashion federal common law as the rule of decision, it clearly sought to protect the FDIC’s interest in making a quick and accurate decision regarding which method of resolution to pursue, and not the FDIC’s more general interest in simply protecting the deposit insurance fund.

4. \textit{There Is Not a “Distinct Need for Nationwide Legal Standards.”}—At first glance, a "distinct need" may seem apparent in these types of cases. Under a broad interpretation of \textit{D’Oench} and its progeny, the federal interest justifying protection from state law defenses is simply the protection of the deposit insurance fund. Affording the FDIC special protection from state law defenses in these types of cases will undoubtedly increase the amount of recovery to the deposit insurance fund. If that general interest was recognized as a "distinct need for nationwide legal standards" under the \textit{Kamen} analysis, then whenever the FDIC was involved in litigation where the outcome under state law would have a negative impact on the deposit insurance fund, the FDIC would be entitled to special protection under a uniform federal common law. However, if the \textit{Erie} doctrine is to be of any substance, this general rationale cannot suffice as a reason to afford the FDIC special protection in these cases. A general need, such as protecting the deposit insurance fund, can be found in almost every federal enactment. However, federal common law is not, nor should it be, employed as the rule of decision in litigation whenever a federal enactment is involved. Federal courts must have authority to fashion federal common law, and such authority does not exist simply because there is diversity jurisdiction or a federal enactment involved. This limit on when a federal court can fashion federal common law is why the Supreme Court has required a "distinct" need be present before the presumption of state law incorporation can be rebutted and federal common law fashioned.

\textsuperscript{174} \textit{Id.} at 1516-18.
\textsuperscript{175} \textit{Id.} at 1517 (quoting Gunter v. Hutcheson, 674 F.2d 862, 869 (11th Cir. 1982), \textit{cert. denied}, 459 U.S. 826 (1982).
\textsuperscript{176} \textit{Id.}
The above cases do not justify such a broad interpretation of the FDIC’s need. Courts have emphasized that the FDIC must be able to rely upon the records of the bank to make quick and accurate decisions in order to fulfill its mission of stabilizing the S&L industry and minimizing the loss to the deposit insurance fund. A potential lawsuit against a third party professional is not an asset reflected on the books of an S&L at the time the FDIC is making the decision as to which method of resolution to pursue. The professionals have not engaged in intentional behavior to deceive federal regulators as to the value of assets on an S&L’s books. In fact, many times the professionals are intentionally deceived by the officers and directors of the S&L. The need recognized in the D’Oench line of cases does not apply to situations where the FDIC is suing third party professionals for negligence.

C. Are There Express Provisions of Analogous Statutory Schemes Which Identify Congressional Intent to Preempt?

The second situation under the Kamen analysis which can rebut the presumption that state law should be incorporated as the rule of decision is where analogous statutory schemes exist which embody congressional policy choices readily applicable to the matter at hand.177 The Federal Deposit Insurance Act which created the FDIC and the numerous amendments to that Act by FIRREA represent a comprehensive scheme to monitor, regulate, and insure the entire banking system in the United States. One would have a difficult time identifying any federal enactment that one could argue is analogous to the Federal Deposit Insurance Act and FIRREA.

In addition, certain provisions within this regulatory scheme (i.e., FIRREA) arguably indicate Congress did not intend to preempt state law in litigation by the FDIC against professionals. Sections of FIRREA do specifically enunciate a congressional intent to preempt state law in certain other areas. For example,178 12 U.S.C. section 1821(i)(1) states in pertinent part,

Notwithstanding any other provision of Federal law or the law of any State and regardless of the method which the Corporation determines to utilize with respect to an insured depository institution in default or in danger of default, including transactions authorized under subsection (n) of this section and section 1823(c) of this title, this subsection shall govern the rights of the creditors (other than insured depositors) of such institution.179

177. See supra notes 120-22 and accompanying text.
178. Other examples can be found at 12 U.S.C. §§ 1821(c)(8)(E) (1989), 1821(g)(1), and 1823(f)(4)(A).
Congress did not include such preemptive language in the sections of FIRREA which deal with the FDIC’s receivership and conservatorship powers in litigation.\textsuperscript{180}

Also, there are FIRREA provisions which specifically address liability of professionals for their representation of a failed S&L. Certain professionals can be subject to civil and criminal penalties for violations of FIRREA as an “institution-affiliated party”.\textsuperscript{181} An “institution-affiliated party” is defined as:

(4) any independent contractor (including any attorney, appraiser, or accountant) who \textit{knowingly or recklessly} participates in-

(A) any violation of any law or regulation;
(B) any breach of fiduciary duty; or
(C) any unsafe or unsound practice,

which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.\textsuperscript{182}

If Congress intended to make professionals liable for negligence without regard to whether they might be able to assert valid state law defenses, it could have simply added the word “negligently” to the above definition.\textsuperscript{183}

The absence of a provision specifically granting the FDIC special protection and the absence of the word “negligently” from the definition of an “institution-affiliated party” arguably indicate that Congress intended the negligence of S&L related professionals to be determined in accordance with state law. This conclusion should be afforded even more weight given the circumstances which led to the enactment of FIRREA. When the magnitude of the S&L crisis became known in the late 1980’s, Congress held endless hearings on the alleged causes of the debacle and the tools needed by regulators in order to restore health to the industry.\textsuperscript{184} Given the volume of

\textsuperscript{180} See § 1821.

\textsuperscript{181} 12 U.S.C. § 1818(i)(2) (1989). An “institution-affiliated party” may be fined: (1) up to $5,000 per day for violation of any law or regulation, \textit{id.} § 1818(i)(2)(A); (2) up to $25,000 per day for any violation of law or regulation that is a pattern of misconduct, causes or is likely to cause more than a minimal loss to the S&L, or results in a benefit to such party, \textit{id.} § 1818(i)(2)(B); or (3) up to $1,000,000 per day for knowingly or recklessly causing substantial losses to the S&L or substantial benefits to itself. \textit{id.} § 1818(i)(2)(C), (D). An “institution-affiliated party” who knowingly violates an order issued by a federal regulatory agency could be subject to a criminal penalty of up to $1,000,000 and a prison term up to five years, or both. \textit{id.} § 1818(j).

\textsuperscript{182} \textit{id.} § 1813(u)(4) (emphasis added).

\textsuperscript{183} Monies collected under the penalty provisions for institution-affiliated parties are deposited into the United States Treasury and do not go to the failed S&L, \textit{see} § 1818(i)(2)(J), and consequently, do not go to the failed S&L’s depositors and creditors. Recovery by the FDIC in a negligence action, as an assignee for a failed S&L, would on the other hand go to the failed S&L, and ultimately to the S&L’s depositors and creditors.

\textsuperscript{184} \textit{E.g., Failure of Independent CPA’s to Identify Fraud, Waste and Mismanagement
hearings and deliberation that led to the passage of FIRREA, arguably, it should be assumed that Congress included within FIRREA "all the necessary tools to go after the wrongdoing that Congress thought had happened." 185 Apparently, Congress did not feel special protection from state law defenses in actions against professionals was one of the “necessary tools to go after the wrongdoing” which occurred in the demise of the S&L industry.

D. Would Incorporating State Law Frustrate Specific Objectives of Federal Banking Statutes?

The FDIC argues that by not being afforded special protection from state law defenses federal courts are hindering its efforts to accomplish one of the primary objectives of FIRREA: the protection of the deposit insurance fund. It is undoubtedly true that minimizing the loss to the deposit insurance fund is one of the primary objectives of FIRREA. However, this objective alone should not be relied on by federal courts to fashion federal common law. As stated earlier, every federal enactment has general objectives similar to the protection of the deposit insurance fund, and if these general objectives were enough to allow a federal court to fashion federal common law, the Erie doctrine would be all but forgotten. The Court instead requires that state law frustrate “specific” legislative objectives.

As discussed above, the only specific objective of FIRREA which courts have recognized as one that should not be frustrated by state law is the protection of the FDIC’s ability to quickly and accurately conduct an analysis of a failed S&L’s assets so that the failed S&L is optimally resolved. Incorporating the law of the state in these cases would not hinder the FDIC’s ability to make quick and accurate decisions when it takes over as receiver for a failed S&L. The D’Oench doctrine and 12 U.S.C. section 1823(e) already adequately protect the FDIC’s need for accuracy in S&L records. In addition, a potential lawsuit against third parties can only be viewed as a contingency at the time the FDIC is making its decision. 186 In this regard, granting the


186. FDIC v. Jenkins, 888 F.2d 1537, 1544 (11th Cir. 1989) ("The value of a potential lawsuit against solvent third parties cannot be assessed during the quick review of a failed bank’s books which occurs during a purchase and assumption transaction.").
FDIC special protection may actually have a detrimental effect on the insurance fund. When evaluating a failed S&L, the FDIC may place too much value on potential lawsuits against third parties. Thus, the decision regarding the proper resolution method may become skewed, and as a result, the FDIC would not be complying with its statutory duty to proceed in the manner which will cause the least amount of loss to the deposit insurance fund.  

VII. CONCLUSION

An example may help to illustrate the tremendous power the FDIC argues it has. On a Friday afternoon, the ABC S&L is represented by the XYZ law firm. The law firm was negligent in a real estate development offering which the firm handled for the S&L a few months ago. However, the officers and directors of the S&L had intentionally deceived the law firm by providing false financial information regarding the offering. On this Friday afternoon, in most states, the law firm most probably could not be sued by the S&L because it could assert a number of state law defenses such as contributory negligence, unclean hands, etc. Unfortunately for the law firm, the S&L is declared insolvent over the weekend, and the FDIC is appointed as receiver. The FDIC argues on Monday that it can file a negligence action against the law firm and that the law firm cannot now assert those same defenses it could have asserted against the S&L on Friday afternoon.

Congress could legislate to require such a result. However, Congress has not done so. Furthermore, cases like O’Melveny & Meyers and Ernst & Young fall outside the contours defined by the Supreme Court for application of federal common law fashioned by a federal court. The Court has set forth a two-prong test for determining when a federal court should fashion federal common law in the absence of specific congressional intent. Under the first prong, when the FDIC is involved in this type of litigation, it is clear the rule of decision is federal in character. However, the Court has stated, “[I]t does not follow . . . that the content of such a rule must be wholly the product of a federal court’s own devising.”  

In fact, the Court has stated a “presumption that state law should be incorporated into federal common law.” In addition, the Court has stated this presumption is especially strong in areas that are traditionally within the purview of state law. Professional negligence is argued as one such area, and as a result the FDIC must rebut a strong presumption of state law incorporation in order to prevail on its special protection argument. The Court has espoused specific instances where this presumption can be rebutted and a federal court may fashion federal common law, and cases like O’Melveny & Meyers and Ernst

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187. See supra note 68 and accompanying text.
189. Id.
& Young are not such instances. When the Supreme Court renders its decision in the O'Melveny & Meyers case it should reverse the Ninth Circuit's opinion in that case, holding that state law governs the applicability of defenses against the FDIC in suits brought by the FDIC against professionals for negligence.