RECENT MISINTERPRETATIONS OF THE AVOIDABLE CONSEQUENCES RULE: THE "DUTY" TO MITIGATE AND OTHER FICTIONS

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INTRODUCTION

As a result of one unpublished district court opinion, the federal government, acting as a conservator or receiver of a federally insured failed savings and loan association,[1] enjoys an advantage shared by no similarly situated plaintiff: the defendants, as a matter of law, cannot assert the traditional, common-law affirmative defense that requires a plaintiff to take reasonable steps to minimize or mitigate damages. Federal district courts,[2] with very few exceptions, rely on the three-page *FSLIC v. Roy*[3] decision to hold that defendants in failed bank or sav-

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1. In this context, the federal government acts through the Federal Deposit Insurance Corporation ("FDIC"); the Resolution Trust Corporation ("RTC"); and prior to August 8, 1989, through the RTC's predecessor, the Federal Savings and Loan Insurance Corporation ("FSLIC").

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183 (1989)(codified in scattered sections of 12 and 15 U.S.C.) established a corporate instrumentality of the United States known as the RTC with its primary mission to manage and resolve all savings associations for which a conservator or receiver had been appointed between January 1, 1989, and August 9, 1989, or had been appointed during the 36-month period August 9, 1989, to August 9, 1992. *See* FIRREA § 501(b).

The RTC itself does not carry out its mission. Rather, the FDIC has the express statutory authority and responsibility to act as the RTC's "exclusive manager" to conduct all of the RTC's activities. *Id.* The RTC, through the FDIC, automatically succeeded the FSLIC as conservator or receiver of any institution for which the FSLIC had been appointed to such a position between January 1, 1989, and August 9, 1989. *Id.*

The FDIC may receive and accept the appointment as receiver or conservator of any insured depository institution. FIRREA § 212(a)(codified at 12 U.S.C. § 1821(c)(1) (Supp. I 1989)). The FDIC's discretion to accept the appointment vests when such appointment is tendered by the authority having supervision over the institution. *Id.*

In this article, the term *government* includes the FDIC, the RTC, the RTC's predecessor FSLIC, and other related financial regulatory entities.

2. No circuit court has yet ruled on the validity of the FDIC's motions to strike or the former officers' and directors' abilities to assert the common-law affirmative defense of failure to mitigate damages. The circuit courts generally hold, however, that absent statutory authority, the FDIC *cannot* be afforded preferential treatment as a litigant. *See infra* text accompanying notes 62-83.

3. FSLIC v. Roy, No. CIV JFM-87-1227, 1988 WL 96570 (D. Md. June 28, 1988).

ings and loan cases—unlike defendants in any other case—cannot assert a failure to mitigate damages defense to challenge the government's conduct in managing[4] or liquidating[5] a failed financial institution.[6] As a result of these decisions, once the government takes over a failed financial institution, it can act irrespective of the financial consequences, whether it liquidates the assets immediately or manages the bank for several more years.[7]

These federal district courts use essentially three rationales to strike the defendants' mitigation defense. First, and most commonly, the courts conclude that the defense must fail because the government, acting either as a conservator or a receiver of a failed bank, owes no duty to the defendants (most often the institution's former officers and directors) and therefore has no duty to mitigate its damages.[8] Second, the courts, usually in conjunction with the "duty" argument, rely on a "public policy" rationale to bar the defendants from challeng-

4. In its capacity as conservator, the FDIC is authorized to "take such action as may be necessary to put the depository institution in a sound and solvent condition" and "appropriate to carry on the institution's business and preserve and conserve" its assets and property. FIRREA § 212(a)(codified at 12 U.S.C. § 1821(d)(2)(D)(Supp. I 1989)).

5. In its capacity as receiver, the FDIC generally liquidates the institution and sells its assets. FIRREA § 212(a)(codified at 12 U.S.C. 1821(d)(2)(E)(Supp. I 1989)). As a receiver, the FDIC can also, by application to the Director of the Office of Thrift Supervision ("OTS"), organize a new federal savings association to assume such assets and liabilities of a defaulted savings association as the FDIC determines appropriate and organize a new national bank or bridge bank with respect to any insured bank. FIRREA § 212(a)(codified at 12 U.S.C. § 1821(d)(2)(F)(Supp. I 1989)).

6. *See infra* note 8.

7. The government, however, may face political consequences. For example, the RTC recently came under criticism when congressional overseers, citing "loose controls," discovered that Price Waterhouse charged the government 67 cents a page to photocopy more than 11 million pages of documents at the failed Homefed Bank in San Diego. This high cost of photocopying helped quadruple a $4 million contract to $17 million. *See* Robert A. Rosenblatt, *RTC's Costs At Homefed Are A Jolt*, L.A. TIMES, Feb. 13, 1993, at D1.

8. *See, e.g.*, RTC v. Kerr, 804 F. Supp. 1091, 1099 (W.D. Ark. 1992)("It is clear the duty owed by the RTC runs to the public and not to the institution or its officers and directors. Accordingly, if an affirmative defense includes the element of duty it is insufficient as a matter of law."); RTC v. Hecht, No. R-92-371, 1992 U.S. Dist. LEXIS 19245, at *16 (D. Md. July 27, 1992)("It is well established that federal regulators owe no duty to the officers and directors of federally insured financial institutions"); RTC v. Greenwood, 798 F. Supp. 1391, 1398 (D. Minn. 1992)(striking mitigation defenses because "the RTC did not owe a duty to defendants"); FSLIC v. Shelton, 789 F. Supp. 1367, 1370 (M.D. La. 1992); FDIC v. Stanley, 770 F. Supp. 1281, 1307 (N.D. Ind. 1991)(striking the mitigation defense because the FDIC's duty "is owed, not to bank directors, officers or even shareholders, but to the insurance fund it is charged with protecting and the banking public" (quoting FDIC v. Oakes, Civ. A. No. 89-2261-S, 1989 WL 151954 (D. Kan. 1989))); FSLIC v. Roy, 1988 WL 96570, at *1; *see also infra* note 25.

ing the government's post-takeover conduct.[9] Third, the courts[10] resort to the doctrine of sovereign immunity and to the discretionary function exception of the Federal Tort Claims Act ("FTCA")[11] to hold that the defendants cannot challenge, even by way of an affirmative defense, the government's conduct in managing a failed financial institution.[12]

This article explores all three rationales and concludes that the courts that have stricken the mitigation defense have misanalyzed the defense. Part One[13] criticizes those courts that have engaged in a "duty" analysis because the mitigation defense, more properly labelled the doctrine of avoidable consequences, is not dependent on a "duty" owed by the

9. *See* RTC v. Scaletty, 810 F. Supp. 1505, 1518 (D. Kan. 1992)("[C]onsiderations of public policy compel the conclusion that the defense of failure to mitigate should not be allowed."); FDIC v. Howse, 802 F. Supp. 1554, 1563 (S.D. Tex. 1992)("To imply that the Directors may be the beneficiary of that duty runs contrary to public policy."); FDIC v. Isham, 782 F. Supp. 524, 531-32 (D. Colo. 1992)("Although some courts have expressed this rule in terms of absence of duty between FDIC and former officers and directors, FDIC's insulation from affirmative defenses which place in issue its conduct more accurately rests on the policy embodied in the FDIC Act."); FDIC v. Eckert Seamans Cherin & Mellott, 754 F. Supp. 22, 25 (E.D.N.Y. 1990)(striking mitigation defense because of policy against burdening the public with losses due to errors in judgment by the FDIC as receiver); FSLIC v. Burdette, 718 F. Supp. 649 (E.D. Tenn. 1989); *Roy*, 1988 WL 96570, at *1; *see also infra* note 37.

10. *See* FDIC v. Renda, 692 F. Supp. 128, 134-35 (D. Kan. 1988)("[T]o the extent that the defendants' counterclaims and affirmative defenses address regulatory negligence by the FDIC and FSLIC, they must be dismissed and stricken because the United States has not waived its sovereign immunity."); *Scaletty*, 810 F. Supp. at 1517 (holding that the principle of sovereign immunity excludes mitigation defense); *Stanley*, 770 F. Supp. at 1309 ("Clearly, the FDIC's actions when acting as receiver of a failed bank are protected by the discretionary function exception to the Federal Tort Claims Act. Consequently, in determining the amount of the FDIC's recovery, the court will disregard evidence that was introduced in an effort to diminish the FDIC's right of recovery . . . .").

11. 28 U.S.C. § 1346(b) (1988).

12. A few courts also rely on the Supreme Court's decision in United States v. Gaubert, 111 S. Ct. 1267 (1991), in which the Court held that the tort claim of the former chairman of the board and largest shareholder of Independent American Savings Association ("IASA") against the federal banking regulators for their involvement with IASA before it was taken over was barred by the FTCA and its discretionary function exception.

Although *Gaubert* involved a direct monetary suit against the government challenging its *pre-takeover* conduct, a few courts have relied on *Gaubert* and its interpretation of the FTCA and the discretionary function exception to strike the mitigation defense that challenges the government's *post-takeover* conduct. *See Stanley*, 770 F. Supp. at 1309 (relying on *Gaubert* to strike mitigation defense); FDIC v. Stuart, 761 F. Supp. 31, 32 (W.D. La. 1991).

As set forth in Part III, the decision in *Gaubert* does not preclude defendants in failed savings and loan litigation from asserting the mitigation defense. *See infra* text accompanying notes 121-29.

13. *See* text accompanying notes 22-34.

government to the defendants.[14] Contrary to the now "weighty precedent"[15] established by *FSLIC v. Roy* and its progeny, and as only a few court opinions[16] have correctly held, the government should be required—as are all other plaintiffs—to take reasonable steps to minimize its damages. If it fails to do so, it should forfeit the opportunity to collect from the defendants those damages that it could reasonably have avoided.[17] Part One also demonstrates that this long-established principle does not rest on any "duty" owed to the defendant by the plaintiff, and the court opinions that mistakenly assume that a duty is inherent in the mitigation defense misanalyze the defense.

Part Two[18] of this article addresses the government's "public policy" argument, which many courts rely upon to strike the mitigation defense. No basis exists for the "public policy" created by the *Roy* court. Neither the legislative record nor any other authority supports a policy that relieves the government of the common-law consequence of aggravating a situation. On the contrary, FIRREA reflects the sound policy that the government must attempt to minimize the losses at failed financial institutions.[19] That policy, which is fully consistent with the

14. *See supra* note 8.

15. In striking the mitigation defense, the court in *Scaletty* held that defendants' argument "goes against the weight of authority." RTC v. Scaletty, 810 F. Supp. 1505, 1517 (D. Kan. 1992); *see also* FSLIC v. Shelton, 789 F. Supp. 1367, 1370 (M.D. La. 1992)(citing to the "clear weight of authority" which holds that federal receivers owe "no duty to those institutions or to those whose negligence has brought them to the brink of disaster").

16. *See, e.g.*, FDIC v. Ashley, 749 F. Supp. 1065 (D. Kan. 1990); FDIC v. Barker, No. 88-1359-R (W.D. Okla. July 25, 1990)(refusing to strike affirmative defenses of failure to mitigate damages); *see also* FDIC v. Cherry Bekaert & Holland, No. 88-1147-CIV-T-15C, 1990 U.S. Dist. LEXIS 7428 (M.D. Fla. April 18, 1990)(refusing to strike the affirmative defenses of comparative and contributory negligence and failure to mitigate damages and holding that the FDIC as plaintiff is acting in a normal commercial context and should be treated no differently than any other litigant); FSLIC v. Wagner, No. CV-F-86-436 (E.D. Cal. March 3, 1988)(allowing defendants to assert counterclaims or affirmative defenses, including set-off and recoupment, challenging the FSLIC's post-takeover conduct); FDIC v. Carter, 701 F. Supp. 730 (C.D. Cal. 1987)(allowing defendants to assert affirmative defenses challenging the FDIC's post-receivership conduct).

17. In an effort to spread the loss, the FDIC routinely sues the failed institution's former officers and directors as well as other defendants, including the failed institution's lawyers, accountants, and appraisers. *See, e.g.*, FDIC v. Ernst & Young, 967 F.2d 166 (5th Cir. 1992)(suing accountants); FDIC v. O'Melveny & Myers, 969 F.2d 744 (9th Cir. 1992)(suing lawyers); FDIC v. Baker, 739 F. Supp. 1401 (C.D. Cal. 1990)(suing appraisers).

18. *See* text accompanying notes 35-91.

19. *See generally* FIRREA, Pub. L. No. 101-73, 103 Stat. 183 (1989)(codified in scattered sections of 12 and 15 U.S.C.).

general doctrine of "avoidable consequences," is not served by relieving the government of the usual incentive for a plaintiff to exercise prudence and sound judgment. Sensible public policy does not give regulatory authorities in control of an institution license to engage in conduct that raises the level of losses at an institution, with the hope that someone else will pay for those increased losses.[20]

Finally, Part Three[21] of the article addresses the cases in which the courts improperly invoke the doctrine of sovereign immunity and the FTCA (and its discretionary function exception) to bar the defendants' mitigation defense in suits initiated by the government. The principles of sovereign immunity are well-established, and the FTCA, enacted to limit—not to expand—the sovereign's immunity, does not alter the analysis. Once the government sues, it subjects itself to a defendant's affirmative defenses, including the failure to mitigate defense.

I. The "No Duty" Rationale

Many of the courts that have stricken defenses of failure to mitigate damages have held that defendants cannot assert the mitigation defense because the government owes "no duty to mitigate damages" to defendants.[22] This erroneous reasoning began with the *FSLIC v. Roy*[23] decision, in which a Maryland district court struck the mitigation of damages defense because it held that the government owed no duty to the former officers and directors of the failed financial institution.[24] Other courts followed this error.[25] This "no duty" analysis fails, however,

20. In an effort to recoup the losses, the government attempts to recover, either directly or indirectly, from the director and officer liability insurance policies that protect corporate officers and directors from the costs they may incur in lawsuits brought against the corporation. *See* 1 California Corporation Laws § 109.02 (R. Bradbury Clark ed., 4th ed. 1993); 2 California Insurance Law & Practice § 43 (1991); Julie J. Bisceglia, Comment, *Practical Aspects of Directors' and Officers' Liability Insurance—Allocating and Advancing Legal Fees and the Duty to Defend*, 32 U.C.L.A. L. Rev. 690 (1985).

21. *See* text accompanying notes 92-129.

22. *See supra* note 8.

23. FSLIC v. Roy, No. CIV JFM-87-1227, 1988 WL 96570 (D. Md. June 28, 1988).

24. *Roy*, 1988 WL 96570, at *1.

25. *See* RTC v. Gallagher, No. 92 C 1091, 1992 WL 370248, at *6 (N.D. Ill. December 2, 1992)(holding that the RTC owes no duty to defendants and that the mitigation defense, which requires the existence of a duty, is therefore deficient); FDIC v. Marsiglia, Civ. A. No. 90-4999, 1992 WL 348454, at *6 (E.D. La. November 18, 1992)(striking affirmative defenses by reasoning that "[t]he FDIC's duty is to the public at large for the protection of the Resolution Fund, and not to the directors, officers or law firms that represent the failed institution"); RTC v. Hecht, No. R-92-371, 1992 U.S. Dist. LEXIS 19245, at *16 (D. Md. July 27, 1992)("It is well established that federal regula-

because the mitigation defense is not dependent on a "duty" owed by a plaintiff to a defendant.

The duty to minimize damages is more properly labelled the doctrine of avoidable consequences.[26] The doctrine of avoidable consequences, which precludes a plaintiff from recovering damages for losses which he or she could reasonably have avoided, provides:

> Where one person has committed a tort, breach of contract, or other legal wrong against another, it is incumbent upon the latter to use such means as are reasonable under the circumstances to avoid or minimize the damages. The person wronged cannot recover for any item of damage which could thus have been avoided.[27]

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tors owe no duty to the officers and directors of federally insured financial institutions."); RTC v. Greenwood, 798 F. Supp. 1391, 1395 (D. Minn. 1992)(reasoning that "the requirement to mitigate damages imposes a duty on the plaintiff"); RTC v. Kerr, 804 F. Supp. 1091, 1099 (W.D. Ark. 1992)(concluding that "if an affirmative defense includes the element of duty it is insufficient as a matter of law"); FDIC v. Crosby, 774 F. Supp. 584, 586 (W.D. Wash. 1991)(deciding that "FSLIC and FDIC owe no duty to bank officers and directors arising out of regulatory activity"); FDIC v. Stanley, 770 F. Supp. 1281, 1307 (N.D. Ind. 1991)(stating that the FDIC's duty "is owed, not to bank directors, officers or even shareholders, but to the insurance fund it is charged with protecting and the banking public"); FDIC v. Anders, No. S-87-430, 1991 U.S. Dist. LEXIS 20411 at *15 (E.D. Cal. July 1, 1991)(striking affirmative defenses because the "no duty" rule bars affirmative defenses); FDIC v. Baker, 739 F. Supp. 1401, 1406 (C.D. Cal. 1990)(holding that "no duty devolves onto the FDIC in favor of officers and directors of a failed banking institution when the FDIC's role is either regulator or receiver of that institution"); FDIC v. Oakes, No. 89-2261-S, 1989 U.S. Dist. LEXIS 14978, at *5 (D. Kan. Nov. 3, 1989)("FDIC's duty is owed, not to bank directors, officers or even shareholders, but to the insurance fund it is charged with protecting and the banking public."); FDIC v. Greenwood, 719 F. Supp. 749, 750 (C.D. Ill. 1989)(holding that the "duty of the FDIC to collect on assets of a failed institution runs to the public and not to the former officers and directors of the failed institution."); FDIC v. Carlson, 689 F. Supp. 178, 179 (D. Minn. 1988).

26. As to "the extent to which uncritical use of words bedevils the law," Justice Frankfurter once remarked, "A phrase begins life as a literary expression; its felicity leads to its lazy repetition; and repetition soon establishes it as a legal formula, indiscriminately used to express different and sometimes contradictory ideas." Tiller v. Atlantic Coast Line R., 318 U.S. 54, 68 (1943)(concurring opinion).

27. CHARLES MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 33, at 127 (1935); *see also* FDIC v. Wheat, 907 F.2d 124, 132 (5th Cir. 1992)(reasoning that "an injured party claiming damages resulting from the wrongful acts of another must take reasonable advantage of opportunities to reduce or minimize losses"); Ellerman Lines, Ltd. v. The Steamship President Harding, 288 F.2d 288, 290 (2d Cir. 1961)("[A] tort defendant is not liable for consequences preventable by action that reason requires the plaintiff to take .... [T]he community's notions of fair compensation to an injured plaintiff do not include wounds which in a practical sense are self-inflicted."); Tennessee Valley Sand & Gravel Co. v. M/V Delta, 598 F.2d 930, 932 (5th Cir. 1979)(finding that damages were recoverable where the plaintiff acted reasonably); FDIC v. Barker, No. 88-1359-R (W.D. Okla. July 25, 1990)("FDIC's objectives of recouping cash outlays, minimizing losses to the insurance fund and replenishing the insurance fund are served rather than defeated by requiring the FDIC to attempt to mitigate damages resulting from directors' violation of statutory or common law duties."); 5 ARTHUR L. CORBIN,

Indeed, the courts and the commentators have repeatedly stated that the use of the term *duty* is a misnomer. For example, Charles McCormick notes:

> [I]t has been pointed out that the "duty" if it can be so-called, is not one for which a right of action is given against the person who violates it. The penalty is merely the disallowance of damages for losses which a compliance with the "duty" would have avoided. It has been suggested that the person wronged should not be spoken of as under a "duty" to avoid damage, but rather a "disability" to recover for avoidable loss.[28]

Similarly, Arthur Corbin states:

> It is not infrequently said that it is the "duty" of the injured party to mitigate his damages so far as that can be done by reasonable effort on his part. Since there is no judicial penalty, however, for his failure to make this effort, it is not desirable to say that he is under a "duty[."] This recovery against the defendant will be exactly the same whether he makes the effort and mitigates his loss, or not; but if he fails to make the reasonable effort, with the result that his injury is greater than it would otherwise have been, he cannot recover judgment for the amount of this avoidable and unnecessary increase. The law does not penalize his inaction, it merely does nothing to compensate him for the loss that he has helped to cause by not avoiding it.[29]

The court in *FDIC v. Ashley*,[30] in refusing to strike the mitigation defense, properly disregarded the "duty" analysis and employed the doctrine of avoidable consequences:

> Our cases have frequently stated that one who is damaged by breach of contract is under a duty to minimize or mitigate damages where he can do so by the exercise of reasonable diligence. The use of the term "duty" is criticized by the text writers. The rule more properly stated, is simply that damages are not recoverable for harm that the plaintiff should

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CORBIN ON CONTRACTS § 1039, at 241 (1964); W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS § 65, at 458 (5th ed. 1984); RESTATEMENT (SECOND) OF CONTRACTS § 350 (1981); RESTATEMENT (SECOND) OF TORTS § 918 (1979).

28. MCCORMICK, *supra* note 27, § 33, at 128; *see also* Gideon v. Johns-Manville Sales Corp., 761 F.2d 1129, 1139 (5th Cir. 1985)("While it is commonly said that an injured party has a 'duty' to minimize damages, this is misnomer, for the victim owes no duty to the person who hurts him."); *Tennessee Valley Sand*, 598 F.2d at 932 ("Courts have often referred to a so-called duty to mitigate damage, but there is no such duty, for there is no correlative right upon its violation."); CORBIN, *supra* note 27, § 1039, at 241-43; RESTATEMENT (SECOND) OF TORTS § 918 cmt. a (1977); RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. b (1981).

29. CORBIN, *supra* note 27, § 1039, at 242-43.

30. 749 F. Supp. 1065 (D. Kan. 1990).

> have foreseen and could have avoided by reasonable effort without undue risk, expenses or humiliation.[31]

Notwithstanding the basic and longstanding doctrine of avoidable consequences, many of the district courts have stricken the mitigation defense because they have engaged in a duty analysis. The courts may have confused the mitigation affirmative defense, which allows defendants to challenge the government's *post-takeover* conduct in the suit brought by the government, with those cases where the defendants, usually the former officers and directors, improperly tried to argue that the government's *pre-takeover* conduct (often its failure to examine the bank properly) was negligent and therefore gave rise to a claim against the government.[32]

Affirmative claims for negligence require the plaintiff to plead and prove that the defendant owed a duty to the plaintiff to act reasonably.[33] If no duty runs from the defendant to the plaintiff, the plaintiff cannot state a claim. As established above, however, the mitigation defense does not implicate a duty owed by the government to the defendants.[34] Therefore, the *Roy* court and the courts that rely on *Roy* wrongfully eliminate the longstanding avoidable consequences doctrine by misapplying a "duty" analysis.

As set forth below, many of these courts recognize the flaw in

31. *Id.* at 1069 (citations omitted); *see also Gideon*, 761 F.2d at 1139 ("The [mitigation of damages] principle, correctly stated, is that the injured person may not recover damages that do not result proximately from the defendants' breach of duty.").

32. *See* Harmsen v. Smith, 586 F.2d 156, 158 (9th Cir. 1978)("We agree with every other court that has considered the issue that the federal scheme of bank regulation creates no duty from the Comptroller to shareholders and directors of national banks."); *In re* Franklin Nat'l Bank Sec. Litig., 445 F. Supp. 723 (E.D.N.Y. 1978) ("Franklin I"); *In re* Franklin Nat'l Bank Sec. Litig., 478 F. Supp. 210 (E.D.N.Y. 1979) ("Franklin II")(reasoning that, absent a showing that the FDIC acted arbitrarily and capriciously, the FDIC owes no duty to a bank or its officers and directors in the ordinary course of regulation).

33. The prima facie elements of a negligence claim include (1) a duty extending from the defendant to plaintiff; (2) defendant's breach of that duty; (3) harm to the plaintiff that results in actual loss or damage; and (4) a sufficient causal connection between the breach of duty and the harm to the plaintiff. PROSSER & KEETON, *supra* note 27, § 30, at 164-65.

34. Only a few courts in the savings and loan litigation have recognized that duty considerations are irrelevant. *See* FDIC v. Ashley, 749 F. Supp. 1065, 1069 (D. Kan. 1990)("Further, even if the FDIC as receiver owes no duties to anyone, the defense of failure to mitigate damages is still available to the Ashley defendants because the legal requirement to mitigate damages is not actually a 'duty,' but a limitation on the amount of damages recoverable by the plaintiff."); *see also* FDIC v. Blackburn, 109 F.R.D. 66, 74 (E.D. Tenn. 1985)(reasoning that the failure to find a duty running from the FDIC to defendants' bank officers and directors did not "interfere in any way with defendants' attempt to raise the defense of failure to mitigate damages").

their duty analysis and therefore take their analysis one step further by relying on considerations of "public policy" to justify striking the mitigation defense.

II. The Public Policy Rationale

The *Roy* court recognized that under traditional principles of law, the defendants would be entitled to assert common-law defenses:

> If this were an ordinary tort case, defendants' argument would have merit. In that event, if the evidence were to show that FSLIC's own negligence . . . had caused or contributed to its losses, its claims would be barred or reduced. However, this is not an ordinary tort case. Rather, it is one which arises in a special context, invoking special considerations of public policy.[35]

This leap in logic from the rules applicable in an "ordinary tort case" to the creation of new rules for cases arising "in a special context" has pervaded the opinions that have struck affirmative defenses in cases involving failed financial institutions.[36] The *Roy* progeny have adopted this ill-founded public policy.[37]

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35. No. JFM-87-1227, 1988 WL 96570, at *1 (D. Md. June 28, 1988).

36. Several courts simply acknowledge that different rules apply to the FDIC. *See, e.g.*, FDIC v. Isham, 782 F. Supp. 524, 530 (D. Colo. 1992)("Many courts considering this question have concluded that federal banking regulators are to be treated differently than a normal plaintiff in a civil action."); FDIC v. Dempster, 637 F. Supp. 362, 366 (E.D. Tenn. 1986)("The defendants contend that no duty is required for the affirmative defense of contributory negligence. The assertion is correct when applied to general tort law. However, the case currently before the court involves banks and banking practices . . . .").

37. The court in FSLIC v. Burdette, 718 F. Supp. 649 (E.D. Tenn. 1989), adopted and expanded on the public policy created by the *FSLIC v. Roy* court:

> In cases of the failure of a savings institution, it is important to the public that the receiver rapidly and efficiently convert the assets of that institution to repay the losses incurred by the insurance fund and depositors for deposits not covered. Suits by the FSLIC as receiver to recover assets, or to recover damages for wrongdoing, should not be encumbered by an examination in court of the correctness of any specific act of the FSLIC in its receivership. The rule that there is no duty owed to the institution or wrongdoers by the FSLIC/Receiver is simply a means of expressing the broad public policy that the banking laws creating the FSLIC and prescribing its duties are directed to the public good . . . .

Id. at 663.

Subsequent cases rely heavily on both *Roy* and *Burdette* for the public policy rationale. For example, the court in RTC v. Youngblood, 807 F. Supp. 765 (N.D. Ga. 1992), relied on *Roy* and *Burdette* in stating:

> [I]t is in the public interest that the RTC be able to pursue its tasks without being subject to criticism by former officers and directors of the failed institution, endowed with 20/20 hindsight.
>
> . . . . The rule that there is no duty owed to the institution or wrongdoers by

Finding no other way to mold their holdings that the defendants cannot assert such affirmative defenses, these courts draw artificial distinctions between the "ordinary tort case" and the savings and loan situation.

In addition to misapplying the "duty" analysis, the *FSLIC v. Roy* court created a public policy that eliminates the common-law mitigation defense. The court made it clear that its decision was based entirely upon its own assessment of what federal public policy should be:[38]

> Self-evidently, it is the public which is the intended beneficiary of FSLIC, just as it is the public which is the beneficiary of the common law duty imposed upon officers and directors to manage properly the institutions entrusted to their care. Thus, nothing could be more paradoxical or contrary to sound policy than to hold that it is the public which must bear the risks of errors of judgment made by its officials in attempting to save a failing institution . . . .[39]

The *Roy* court provides *no* citations for this novel principle of law. Significantly, it could provide no references to any Congressional legislation.[40]

> the FSLIC/Receiver is simply a means of expressing the broad public policy that the banking laws creating the FSLIC and prescribing its duties are directed to the public good . . . .

Id. at 772; *see also* RTC v. Hecht, No. R-92-371, 1992 U.S. Dist. LEXIS 19245, at *16 (D. Md. July 27, 1992)(relying on *Roy* and *Burdette* to strike affirmative defenses); FDIC v. Howse, 802 F. Supp. 1554, 1563 (S.D. Tex. 1992)(relying on *Roy* "To imply that the Directors may be the beneficiary of that duty runs contrary to public policy"); RTC v. Kerr, 804 F. Supp. 1091 (W.D. Ark. 1992)("The Court believes the public policy rationale of the no duty rule as expressed in *Burdette* is persuasive and that the affirmative defenses of contributory fault and mitigation of damages should be stricken."); RTC v. Scaletty, 810 F. Supp. 1505, 1516 (D. Kan. 1992)(citing *Burdette* in reasoning that the FDIC owes no duty to defendant directors or officers); FDIC v. Greenwood, 719 F. Supp. 749, 750 (C.D. Ill. 1989)(agreeing "with the position taken by the district court in *Roy* [that p]ublic policy concerns mandate a finding that the duty of FDIC . . . runs to the public and not to the former officers and directors of the failed institution").

38. At least one court has criticized the *Roy* decision. *See* Gibraltar Financial Corp. v. FHLBB, No. 89-3489 WDK (C.D. Cal. June 15, 1990), in which the court disagreed with the public policy articulated in *FSLIC v. Roy*, noting:

> Furthermore, this Court disagrees with the dictum in *FSLIC v. Roy*, 1988 U.S. Dist. LEXIS 6840 (D. Md. 1988) which Defendants urge in support of their argument. Notwithstanding the important public policy function served by FSLIC, nothing in the statutory or regulatory scheme would indicate the need to permit FSLIC to function in its capacity as conservator with impunity . . . .

Id.

39. *Roy*, 1988 WL 96570, at *2.

40. In fact, none of the pre-FIRREA cases that have stricken the mitigation defense on public policy grounds consider whether the alleged public policy in favor of maximizing the FDIC's recovery at the expense of common-law defenses arose from some explicit decision on Congress's part. *See* FDIC v. Carlson, 698 F. Supp. 178 (D. Minn. 1988)(following *Roy* without consideration of congressional intent); *Greenwood*, 719 F.

The "public policy" created in *Roy* and its progeny eviscerates longstanding common-law defenses. Such a sweeping change in the law is the exclusive province of Congress.[41]

In *United States v. Standard Oil Company*,[42] the executive branch of the federal government argued that the federal judiciary should extend the common law so that the government could pursue a claim for medical expenses and other costs that the government incurred when a vehicle used in Standard Oil's business struck and injured a soldier. The government argued that a new common-law cause of action should be created to promote the "policy" of shielding the federal treasury from the financial consequences of torts perpetrated on government employees.[43] The Supreme Court rejected this argument, noting that federal courts have no authority to decide what policies should become law:

> Congress, not this Court, or the other federal courts, is the custodian of the national purse. By the same token, it is the primary and most often the exclusive arbiter of federal fiscal affairs. And these comprehend, as we have said, securing the treasury or the government against financial losses however inflicted, including requiring reimbursement for injuries cre-

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Supp. at 750-51 (following *Roy* and *Carlson* without consideration of congressional intent); *Burdette*, 718 F. Supp. at 662-64 (following *Roy*, *Carlson*, and *Greenwood* without consideration of congressional intent).

One post-FIRREA case, FDIC v. Baker, 739 F. Supp. 1401, 1406 (C.D. Cal. 1990), cites to FIRREA sections 21A(b)(3)(C)(i),(ii) and 21A(b)(12)(D) for support of a public policy to maximize the net present value of return and to avoid economic impact for those real estate markets that are distressed. However, as set forth in Part II, *see infra* text accompanying notes 47-57, the *Baker* court did not test the public policy articulated in Section 21A with the policy behind the doctrine of avoidable consequences. *Cf.* FDIC v. Barker, No. 88-1359-R (W.D. Okla. 1990).

Significantly, as set forth in Part II, *see infra* text accompanying notes 70-75, in FDIC v. Jenkins, 888 F.2d 1537, 1546 (11th Cir. 1989), the Eleventh Circuit rejected the FDIC's public policy arguments by finding that Congress did not intend to give the FDIC absolute priority over shareholder claims.

41. *See* Northwest Airlines v. Transport Workers Union of Am., 451 U.S. 77 (1981)("[F]ederal courts, unlike their state counterparts, are courts of limited jurisdiction that have not been vested with open-ended law making powers."); Tennessee Valley Auth. v. Hill, 437 U.S. 153, 195 (1978) ("[I]n our constitutional system the commitment to the separation of powers is too fundamental for us to preempt congressional action by judicially decreeing what accords with 'common sense and the public weal' . . . . Our Constitution vests such responsibilities in the political branches."); United States v. Gilman, 347 U.S. 507, 511 (1954)("The selection of [a] policy . . . involves a host of considerations that must be weighed and appraised . . . . *That* function is more appropriately for those who write the laws, rather than for those who interpret them."); United States v. Standard Oil Co., 332 U.S. 301, 314 (1947)("Whatever the merits of the policy, its conversion into law is a proper subject for congressional action, not for any creative power of ours.").

42. 332 U.S. 301 (1947).

43. *Id.* at 310-11.

> ating them, as well as filling the treasury assets.[44]

The Supreme Court, in refusing to create a public policy, recognized the power that the United States brings to a lawsuit as a plaintiff because it, unlike any other litigant, has the power to create liability:

> Here the United States is the party plaintiff to the suit. And the United States has power at any time to create the liability. The only question is which organ of the government is to make the determination that liability exists. That decision, for the reason we have stated, is in this instance for the Congress, not the Courts.[45]

Thus, in *Standard Oil*, as in the savings and loan context, federal legislation does not contain, and courts do not have the authority to shape, a public policy that gives the government preferred status as a litigant.[46]

Congress has not adopted a public policy that allows the courts to ignore common-law defenses and effectively permit the FDIC to act without legal consequences. None of the statutes governing the law relating to federally insured banks or savings and loan associations contain such a public policy.[47] Even FIRREA,[48] Congress's recent pronouncement of law relating to federally insured savings and loan associations—enacted "to combat the crisis in the thrift industry"[49]—provides no support for a policy eliminating the government's duty to mitigate damages.

Indeed, any public policy that can be found in FIRREA allows, rather than prevents, defendants to assert traditional common law defenses. For example, FIRREA Sections

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44. *Id.* at 314-15.

45. *Id.* at 316-17.

46. The Supreme Court, in Patton v. United States, 281 U.S. 276 (1930), also cautioned against the creation of "public policy":

> [T]he theory of public policy embodies a doctrine of vague and variable quality, and, unless deducible in the given circumstances from constitutional or statutory provisions, should be accepted as the basis of a judicial determination, if at all, only with the utmost circumspection. The public policy of one generation may not, under changed conditions, be the public policy of another.

Id. at 306.

47. *See* Federal Deposit Insurance Act, 12 U.S.C. § 1811 (1988); Home Owners' Loan Act of 1933, 12 U.S.C. § 1461 (1988).

48. Pub. L. No. 101-73, 103 Stat. 183 (1989)(codified in scattered sections of 12 and 15 U.S.C.).

49. United States v. Gaubert, 111 S. Ct. 1267, 1271 n.1 (1991).

21A(b)(3)(C)(i)(ii) and 21A(b)(12)(D)[50] express the policy of requiring the government to use all of its efforts to "maximize the net present value return from the sale or other disposition of institutions," to "minimize the impact of such transactions on local real estate markets . . . ," and to "minimize the amount of any loss realized in the resolution of cases . . . ."[51]

These requirements express exactly the purpose behind the doctrine of avoidable consequences. The doctrine exists not only to prevent individual loss and injustice, but also to protect and conserve the economic welfare and prosperity of the entire community.[52] Consequently, the doctrine of avoidable consequences serves to discourage "even persons against whom wrongs have been committed from passively suffering economic loss which could be averted by reasonable efforts, or from actively increasing such loss where prudence would require that such activity should cease."[53] Accordingly, the doctrine is wholly consistent with FIRREA Section 21A, which requires the government to make efforts to maximize its recovery.

In *FDIC v. Barker*,[54] the district court recognized that the policy articulated in FIRREA Section 21A is the same policy promoted by the doctrine of avoidable consequences. The court stated that requiring the FDIC to mitigate damages furthers, rather than frustrates, the FDIC's objectives in maximizing its recovery.[55] The court "disagreed on all counts" with the argument that permitting a mitigation of damages defense would defeat the FDIC's statutory mandate of minimizing loss to the insurance fund.[56] Other courts have failed to compare the pub-

50. FIRREA § 21A (codified at 12 U.S.C. § 1441a(b)(3)(C)(Supp. I 1989)), provides:

> The duties of the Corporation shall be to carry out a program, under the general oversight of the Oversight Board and through the Federal Deposit Insurance Corporation (or any replacement authorized pursuant to subsection (m) of this section), including: the operations of the Corporation in a manner which—maximizes the net present value return from the sale or other disposition of institutions described in subparagraph (A) or the assets of such institutions; minimizes the impact of such transactions on local real estate and financial markets; minimizes the amount of any loss realized in the resolution of cases; and maximizes the preservation of the availability and affordability of residential real property for low- and moderate-income individuals.

51. *Id.*

52. McCormick, *supra* note 27, § 33, at 127.

53. *Id.*

54. No. 88-1359-R (W.D. Okla. July 25, 1990).

55. *Id.*

56. As the *Barker* court explained:

lic policy articulated in Section 21A with the policy behind the doctrine of avoidable consequences.[57]

FIRREA has one section that specifically addresses the liability of directors and officers.[58] This section does not eliminate any common-law affirmative defenses and it does not explicitly impose strict liability on the most typical defendants, the financial institutions' former directors and officers.[59] In short, it provides no support for the argument that former officers and

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> The FDIC's objectives of recouping cash outlays, minimizing losses to the insurance fund and replenishing the insurance fund are served rather than defeated by requiring the FDIC to attempt to mitigate damages resulting from director's violations of statutory and common law duties.
>
> . . . . Contrary to the FDIC's argument, it is obvious that the FDIC's prospects for recovery are enhanced rather than reduced or eliminated by imposition of a duty to mitigate damages; two or more avenues for potential recovery are necessarily better than one. The FDIC's glib argument that permitting the defense of failure to mitigate will obscure the true issues of liability is refuted by the historical fact that juries are regularly asked to determine and do capably determine whether and to what extent an injured plaintiff could have minimized damages caused by the defendant's conduct and to distinguish that issue from the issues of the defendant's liability and the amount of damages caused by the defendant's conduct.
>
> . . . . Finally, because imposition of a duty to mitigate on the FDIC in a suit to establish directors' liability for violations of statutory and common law duties furthers rather than frustrates objectives and interests of the federal deposit insurance program, imposition of such a duty cannot be contrary to public policy, as the FDIC also argues.

Id.

57. *See, e.g.*, FDIC v. Baker, 739 F. Supp. 1401, 1406 (C.D. Cal. 1990)(analyzing FIRREA policy directives without consideration of policy behind avoidable consequences doctrine).

58. This provision reads:

> 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 . . . 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.

See FIRREA § 212(k)(codified at 12 U.S.C. § 1821(k)(Supp. I 1989)).

59. Courts have disagreed on whether Section 1821(k) preempts state negligence law and imposes a federal gross negligence standard. *Compare* FDIC v. McSweeney, 976 F.2d 532 (9th Cir. 1992) *and* FDIC v. Canfield, 967 F.2d 443 (10th Cir. 1992)(both holding that § 1821(k) does not preempt state law negligence claims) *with* FDIC v. Gaff, 919 F.2d 384 (6th Cir. 1990), *modified on other grounds*, 933 F.2d 400 (6th Cir. 1991) (holding that § 1821(k) preempts state law and establishes a federal gross negligence standard).

For the in-depth debate as to the standard of liability imposed by § 1821(k), see David B. Fischer, Comment, *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); Jon Shepherd, Note, *The Liability of Officers and Directors Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989*, 90 MICH. L. REV. 1119 (1992).

directors cannot assert common-law defenses. Therefore, the question becomes whether the government's policy argument (that it is not subject to common-law defenses because such defenses might hinder its recovery) can be inferred from Congressional silence.

Although it was once fashionable to interpret Congressional silence as approval of any policy that was arguably consistent with the statutory scheme, the Supreme Court has repeatedly rejected this approach.[60] The Supreme Court cases are clear: Congressional silence on a particular policy is generally construed as a *rejection* of that policy.[61] Therefore, because FIRREA contains no provisions eliminating common-law defenses, Congressional silence in FIRREA is a rejection of the "public policy" fashioned in *Roy*.

While the circuit courts have not yet decided whether the doctrine of avoidable consequences applies when the government tries to recover a failed financial institution's losses,[62] the circuit courts have consistently held, in a variety of situations, that the government should not be given preferential treatment in failed savings and loan litigation.

For example, the circuit courts have uniformly refused to void on public policy grounds provisions in former directors' and officers' insurance policies that preclude the FDIC or the RTC from recovering from the insurance carriers.[63] One of the

60. *See* Merrell Dow Pharmaceuticals Inc. v. Thompson, 478 U.S. 804, 811-12 (1986); Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 374-78 (1982); Tennessee Valley Auth. v. Hill, 437 U.S. 153 (1978); Cort v. Ash, 422 U.S. 66, 82-84 (1975).

61. *See, e.g., Merrell Dow*, 478 U.S. 804; California v. Sierra Club. 451 U.S. 287, 296-97 (1981); Touche Ross & Co. v. Redington, 442 U.S. 560, 571 (1979).

62. In FDIC v. Wheat, 970 F.2d 124 (5th Cir. 1992), which involved a suit against a former director for breach of fiduciary duty, the Fifth Circuit decided that the trial court's refusal to submit a jury instruction on the FDIC's requirement to mitigate damages was not erroneous. *Id.* at 132.

The *Wheat* court assumed (without any discussion) that the FDIC has an obligation to minimize its losses: "After all, an injured party claiming damages resulting from the wrongful acts of another must take reasonable advantage of opportunities to reduce or minimize losses." *Id.* The court concluded, however, that no jury instruction was required on mitigation because it found that the FDIC had already exercised mitigation attempts. *Id.*

Similarly, in FSLIC v. Texas Real Estate Counselors, 955 F.2d 261, 269 (5th Cir. 1992), which involved a suit against real estate appraisers, the Fifth Circuit revisited the record to reassess whether the trial court erred in concluding that the FDIC did not fail to mitigate its damages. The Fifth Circuit made no mention of a public policy forbidding inquiry into the FDIC's disposition of a failed bank's assets.

63. *See* FDIC v. American Casualty Co., 1993 WL 1055 (4th Cir. Jan. 4, 1993)(upholding regulatory exclusion); Fidelity & Deposit Co. v. Conner, 973 F.2d 1236 (5th

most important of these exclusions, the so-called regulatory exclusion, provides:

> It is understood and agreed that the [Insurer] shall not be liable to make [any] payment for Loss in connection with any claim made against the Directors or Officers by any State or Federal Official or Agency, including but not limited to the Federal Deposit Insurance Corporation or [the] Federal Savings and Loan Insurance Corporation.[64]

Because the insurance companies are generally the "deep pockets" in savings and loan litigations, if the exclusion is upheld, then the government's recovery is seriously reduced. Therefore, not surprisingly, the government has argued that the regulatory exclusion should be void as against public policy.[65]

The circuit courts have uniformly rejected the FDIC's policy arguments. For example, one court stated:

> The power to refuse to enforce contracts on the ground of public policy is therefore limited to occasions where the contract would violate "some explicit public policy" that is "well defined and dominant, and [which] is to be ascertained" by reference to the laws and legal precedents and not from general considerations of supposed public interests.[66]

These circuit courts have relied, in large part, on the Supreme Court's ruling in *Muschany v. United States*,[67] where the Court held:

> Public policy is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests . . . . As the term "public policy" is vague, there must be found definite indications in the law of the sovereignty to justify the invalidation of a contract as contrary to that policy.[68]

Thus, the circuit courts have at times rejected the government's policy arguments, even where crafting such a policy

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Cir. 1992)(holding that public policy does not void regulatory or insured-versus-insured exclusions); FDIC v. American Casualty Co., 975 F.2d 677 (10th Cir. 1992); St. Paul Fire and Marine Ins. Co. v. FDIC, 968 F.2d 695 (8th Cir. 1992); American Casualty Co. v. FDIC, 944 F.2d 455 (8th Cir. 1991).

64. *Conner*, 973 F.2d at 1238.

65. *See, e.g., St. Paul Fire*, 968 F.2d at 702 (rejecting the FDIC's argument that the regulatory exclusion violated public policy).

66. *See* St. Paul Mercury Ins. Co. v. Duke Univ., 849 F.2d 133, 135 (4th Cir. 1988) (citing United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29, 43 (1987)).

67. 324 U.S. 49 (1945).

68. *Id.* at 66.

would save the Resolution fund millions of dollars.[69]

In other situations, the circuit courts have refused to create a public policy that gives the FDIC preferential status as a litigant. For example, in *FDIC v. Jenkins*[70] the FDIC argued that it had absolute priority over the shareholders' claims because absolute priority "would best aid the FDIC in replenishing the permanent insurance fund."[71] It also argued that public policy required the court to minimize the depletion of the insurance fund by finding an "implicit" priority rule in the FDIC's statutory scheme.[72] The Eleventh Circuit rejected this public policy argument:

> We agree that preservation of the permanent insurance fund is vital to the continued health of the nation's banking system. The FDIC should take all feasible measures authorized in the Federal Deposit Insurance Act[73] to maximize recovery of the fund. *We cannot, however, approve of judicial expansion of the express powers and rights granted to the FDIC in the Act by Congress* . . . . [W]e must reverse the district court's finding based on policy considerations in favor of such a rule for the FDIC.[74]

The *Jenkins* court also refused to fashion an absolute priority rule under federal common law:

> 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 defendants] in this case as a necessary part of the recovery to

69. Similarly, in FDIC v. Aetna Casualty and Sur. Co., 903 F.2d 1073, 1079 (6th Cir. 1990), the Sixth Circuit rejected the FDIC's public policy argument. In *Aetna*, the FDIC sought coverage under two banker's blanket bonds issued by Aetna. Discovery of the claimed loss did not occur until after the FDIC took over the bank. Aetna denied coverage on the grounds that any loss was excluded because the bond was terminated immediately upon taking over of the insured by a receiver or other liquidator. The FDIC argued that the termination provision was contrary to public policy. The district court accepted this argument, but the Sixth Circuit disagreed, holding that in the absence of statutory authority the exclusion is valid and enforceable. *Id.* at 1076.

70. 888 F.2d 1537 (11th Cir. 1989).

71. *Id.* at 1540.

72. *Id.*

73. Although this case was decided in November 1989, *after* the enactment of FIRREA, the Court applied FIRREA's predecessor statute, the Federal Deposit Insurance Act, 12 U.S.C. § 1821 (1988).

74. *Jenkins*, 888 F.2d at 1541 (emphasis added).

> the deposit insurance fund. Any such priority over third-party lawsuits will have to come from Congress, not this Court.[75]

Similarly, in *First Empire Bank v. FDIC*[76] the Ninth Circuit rejected the FDIC's argument that it should have special status when it acts either in its corporate capacity or as a receiver in a purchase-and-assumption transaction.[77] In *First Empire*, creditors of an insolvent bank brought an action against the FDIC-Receiver, which had entered into a purchase-and-assumption agreement excluding the creditor's claims. The FDIC argued that it was "authorized to act upon such terms and conditions as it may determine" without any preference restrictions imposed by Sections 91 and 194 of the National Banking Act.[78] The FDIC, though conceding that it had a duty to act "reasonably," argued that its rejection of the creditor's claims was reasonable.[79]

The Ninth Circuit disagreed, noting that under the FDIC's interpretation of the statutes, "the FDIC could (subject only to its concession that it must act 'reasonably,' but without any apparent applicable standard), pick and choose which creditors should be preferred, or permit the acquiring Bank to pick and choose."[80] Thus, the Ninth Circuit rejected a public policy that would have allowed the FDIC to discriminate among creditors.[81]

Again, in a suit against a failed financial institution's accountants for negligence and breach of contract, the Fifth Circuit refused to grant the FDIC any special status as a litigant where it chose as the failed institution's assignee to sue the accountants:

> We affirm the district court's holding that the FDIC is not entitled to special protection when it brings a tort claim

75. *Id.* at 1546.

76. 572 F.2d 1361 (9th Cir. 1978), *cert. denied*, 439 U.S. 919 (1978).

77. *Id.* at 1371. In order to assist a failing bank with the hope that it may be able to avert the bank's closure, the FDIC can resort to a purchase-and-assumption agreement, by which the FDIC encourages the failing bank to agree to a takeover of its business by a sound bank. *Id.* at 1364.

78. *Id.* at 1370.

79. *Id.*

80. *Id.* at 1371.

81. *Id.* Other Ninth Circuit decisions are in accord. *See* Woodbridge Plaza v. Bank of Irvine, 815 F.2d 538, 542 (9th Cir. 1987)(holding that while an FDIC/Receiver has the authority to transfer assets and liabilities and to sell assets, it may not arbitrarily exclude liabilities or act in contravention of California state law); FDIC v. Glickman, 450 F.2d 416, 418 (9th Cir. 1971)(holding that when the FDIC acts as a receiver for a failed bank, it merely "stands in the shoes of the insolvent bank").

> against a third party on behalf of a defunct financial entity. No statutory justification or public policy exists to treat the FDIC differently from other assignees when the FDIC as a matter of choice in this case has limited its claim to that of an assignee.[82]

Thus, circuit courts have not only refused to eliminate affirmative defenses in the post-takeover context, but, in other contexts, the circuit courts have repeatedly rejected public policy arguments giving the government preferred status as a litigant.[83]

The public policy created in *FSLIC v. Roy* eliminates the common-law mitigation defense in order to maximize the govern-

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82. FDIC v. Ernst & Young, 967 F.2d 166, 170 (5th Cir. 1992).

83. *But cf.* D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942), where the Supreme Court held that a party is estopped from asserting against the FDIC claims or defenses based on secret or side agreements or arrangements tending to mislead banking regulators as to the terms of assets or existence of potential liabilities.

In *D'Oench, Duhme*, the debtor gave a note to the bank and entered into a side agreement that the note would not be called. After the FDIC acquired the note, the debtor attempted to avoid the obligation by alleging that the note was given without consideration. The Supreme Court held that an accommodation maker is not allowed the failure of consideration defense against the receiver of a bank or its creditors "where his act contravenes a general policy to protect the institution of banking from such secret agreements." *Id.* at 458.

The *D'Oench, Duhme* Court relied on the decision in Deitrick v. Greaney, 309 U.S. 190 (1940). In *Deitrick*, the receiver of a national bank sought to compel payment of a promissory note knowingly given to the bank by one of its directors for shares of the bank's own stock which the director had purchased illegally. Relying on the common-law estoppel doctrine, the Court held that the illegal agreement could not be asserted to defeat the obligation on the note. The common-law doctrine of estoppel applied in the *D'Oench, Duhme* and *Deitrick* cases had been previously recognized and applied by several state courts. *See generally* BARRY S. ZISMAN, BANKS AND THRIFTS: GOVERNMENT ENFORCEMENT AND RECEIVERSHIP 25-5 n.5 (1992).

In 1950, Congress passed 12 U.S.C. § 1823(e), which provides that an agreement tending to defeat or diminish the rights of the FDIC in its corporate capacity in an asset acquired by it from a bank is invalid unless the agreement is (1) in writing; (2) executed by the bank and the person claiming an adverse interest thereunder contemporaneously with the acquisition of the asset by the bank; (3) approved by the bank's board of directors or loan committee, and the board or committee's approval is reflected in the minutes of the bank; and (4) has been continuously, from the time of its execution, an official record of the bank. *Id.* Although § 1823(e) did not codify *D'Oench, Duhme*, it is often referred to as the statutory analogue to *D'Oench, Duhme*. *See* ZISMAN, *supra*, at 25-5-7.

The *D'Oench, Duhme* doctrine does not bar the mitigation defense because *D'Oench, Duhme* precludes only the assertion of claims or defenses arising from acts which occurred prior to the date of insolvency. *See, e.g.*, FDIC v. Blue Rock Shopping Center, Inc., 766 F.2d 744, 753 (3rd Cir. 1985)(holding that the FDIC's recovery is barred when it impairs collateral, noting that nothing in *D'Oench, Duhme* or § 1823(e) was designed to protect the FDIC against the consequences of its own conduct); FDIC v. Harrison, 735 F.2d 408, 412 (11th Cir. 1984)("[W]hen the FDIC acts in its corporate capacity as receiver, its liability must be determined in the same fashion as that of a private party."); Santonin v. FDIC, 677 F.2d 174, 178 (1st Cir. 1982); Beverly Hills Sav. & Loan Ass'n v. Highfield Assocs., No. 87-259-M, (D.N.M. Aug. 28, 1987)("*D'Oench* does not protect the FDIC or FSLIC from [its] own conduct after acquiring a bank".).

ment's recovery in lawsuits against the defendants in cases involving failed financial institutions. The *Roy* court's stated purpose was to increase the deposit insurance fund and simultaneously decrease the burden on the taxpayers. As a result, the government is shielded from common-law affirmative defenses, and even the necessity of proving causation in its claim for negligence, because these rules of law might eliminate or reduce the FDIC's recovery.[84]

This "public policy" has no logical limit. For example, if causation—an element of the government's affirmative claim for

84. *See* FSLIC v. Roy, No. JFM-87-1227, 1988 WL 96570 (D.Md. June 28, 1988). Several courts have followed *Roy* and eliminated the FDIC's requirement of proving causation. For example, in RTC v. Hecht, No. R-92-371, 1992 U.S. Dist. LEXIS 19245, at *18-19 (D. Md. July 27, 1992), the court held:

> [T]he Court must also strike the portion of Hecht's defense of lack of causation that relies on the conduct of regulatory authorities or on conditions, like an economic downturn, which took effect after the loans at issue were made. On this point, *Roy, supra*, is again instructive. Under similar circumstances, Judge Motz struck the proximate cause defense to the extent it relied on the conduct of the regulators or on any extrinsic factors that are not relevant to the basic fact that the defendants made the loans at issue. The court reasoned that even if conditions arising after the loans were made contributed in some way to the size of the loss, the basic fact that the defendants made the loans remains.

Id. (citation omitted). Based on this "logic," the *Hecht* court followed *Roy* and "[struck] the affirmative defense of lack of causation to the extent that the defendant relies on the conduct of regulatory authorities or on conditions, like an economic downturn, which took effect after the loans at issue were made." *Id.* at 19; *see also* RTC v. Scaletty, No. 92-1101-K, 1992 WL 276628, at *15 (D. Kan. Sept. 30, 1992)(holding that while "defendants can use proximate cause to prove that the losses incurred by Peoples Savings were not caused by their actions . . . , [w]hat they cannot do is attempt to shift the focus of the trial onto the actions of the federal regulatory agencies."); FDIC v. Isham, 782 F. Supp. 524, 532 (D. Colo. 1992)("The defense of lack of causation is stricken to the extent that defendants seek to put FDIC's conduct at issue."); RTC v. Greenwood, 798 F. Supp. 1391 (D. Minn. 1992)("The lack of causation defense, to the extent it seeks to put the conduct of the federal regulatory agencies at issue, also fails as a matter of law."); Vogel v. Grissom, No. CA3-89-467-D (N.D. Tex. May 3, 1989)(order of magistrate), *aff'd by district court* (N.D. Tex. Sept. 7, 1989)(holding that the causation argument is "one based on semantics rather than a distinction from the non-availability of a defense based upon the negligence of the FDIC.").

One recent court, although relying on the *Roy* court's duty and public policy analyses, has refused to take *Roy* to the same extreme. *See, e.g.*, RTC v. Kerr, 804 F. Supp. 1091, 1100 (W.D. Ark. 1992)(striking the mitigation defense but noting: "The defendants may contend that any one of a number of causal facts were the proximate cause of the losses, including the conduct of the FDIC." (quoting *In re* Sunrise Sec. Litig., 138 F.R.D. 60, 62 (E.D. Pa. 1991)). As the *Kerr* court held:

> Proximate cause is therefore an element of the claim and not an affirmative defense. While this appears to be a fine distinction, the court believes it is a distinction made necessary under the law.

Id.; *see also Sunrise Securities*, 138 F.R.D. at 62 (dismissing the FDIC's argument that the defendants were attempting to bring in contributory negligence and the mitigation defense under the guise of proximate cause, holding that the FDIC and the cases on which it relied "confused FDIC's status as a party plaintiff with its potential status as a causative factor in the losses which it claims").

negligence—cannot be challenged by defendants,[85] then theoretically, defendants should not be able to challenge *any* element of the government's case. This would preclude defendants from challenging the government's proof that defendants did not exercise sound business judgment at the time the loans were made or that they reasonably relied on the ad-

85. The *Roy* court cited no authority for its holding that the former officers and directors could not challenge the FDIC's proof as to causation. Indeed, such a proposition goes against the weight of authority. *See, e.g.*, FDIC v. Imperial Bank, 859 F.2d 101, 104 (9th Cir. 1988)(finding no liability for common-law negligence because the FDIC failed to prove that the bank's breach of duty *proximately caused* losses); *Sunrise Securities*, 138 F.R.D. at 62 ("In order to prove its negligence claims . . . the FDIC must demonstrate first that the defendants were negligent and second that such negligence was a proximate cause of the losses sustained."); FDIC v. Renda, 692 F. Supp. 128, 133 (D. Kan. 1988)(holding that proximate cause defenses were improperly stricken because "defendants should not be precluded from presenting evidence that other parties contributed to the plaintiff's damages in an attempt to reduce their own liability"); FSLIC v. Williams, 622 F. Supp. 132 (D. Md. 1985), *aff'd in part, rev'd in part*, 816 F.2d 130 (4th Cir. 1987)(holding that the defendant savings and loan director could put forth at trial his contentions that there were intervening causes of losses claimed); First Nat'l Bank v. Keller, 318 F. Supp. 339, 347-49 (N.D. Ill. 1970)(finding no liability for common-law negligence or breach of fiduciary duty because the plaintiff failed to prove that the former bank president and director's breach of those duties *proximately caused* losses).

Indeed, during prior bank failures, courts absolved bank directors, finding that economic or other events (such as the Depression and the Vietnam War) were unforeseeable intervening causes that superseded banking officers' and directors' conduct. *See generally, e.g., First Nat'l Bank*, 318 F. Supp. at 348; Anderson v. Akers, 7 F. Supp. 924, 928 (W.D. Ky. 1934), *modified*, Atherton v. Anderson, 86 F.2d 518 (9th Cir. 1936), *rev'd on other grounds*, 302 U.S. 643 (1937); Williams v. Fidelity Loan & Sav. Co., 128 S.E. 615 (Va. 1925).

The *First National Bank* court specifically declined the FDIC's request to eliminate the causation requirement:

> No evidence was introduced to show that these loans were excessive in light of the net worth of these individuals, or that they were risky investments in other respects . . . . In the final analysis, plaintiff's evidence of negligence amounts only to the fact that a portion of the loans to these six obligors was not repaid. Plaintiff is, in effect, asking this court to apply the doctrine of *res ipsa loquitur* and conclude, from the fact of default, that these loans were unsold from their inception and that the authorization was negligence. If this were the rule, however, bank directors would be required to respond in damages every time a loan proved uncollectible. And this is clearly not the law. Thus, the only possible conclusion from the evidence in this case is that there is a failure to proof of negligence of mismanagement on defendant's part.

Id. at 348. Thus, case law did not support the *Roy* court's elimination of the causation element of the FDIC's case.

Moreover, neither FIRREA nor its predecessor statutes provide support for the proposition that the government need not prove causation in its lawsuits to recoup a failed financial institution's losses. FIRREA incorporates the element of proximate cause by defining "recoverable damages" as those damages "determined *to result from* the improvident or otherwise improper use or investment of any insured depository institution's assets. . . ." 12 U.S.C. § 1821(l)(Supp. I 1989); *cf.* Holman v. Cross, 75 F.2d 909, 911 (6th Cir. 1935)(interpreting statutory language limiting damages to those "sustained in consequence of such violation" in National Banking Act, 12 U.S.C. § 21 *et seq.*, as establishing a proximate cause requirement for losses incurred from violation of statute).

vice of their accountants or attorneys. In fact, this public policy requires any rule, procedure, or doctrine that could be asserted by former directors in defense of the government's lawsuit to be disregarded, because it might interfere with the government's effort to maximize its recovery.

More importantly, the result of allowing the government to ignore traditional affirmative defenses effectively permits the government—as a failed institution's conservator or receiver—to act without legal consequences in managing the institution.[86] A rule that allows the government to conduct the management of a failed bank in any way it sees fit assumes that the government will always make only correct and reasonable decisions. If the government is wrong, however, it can charge the defendants with the damages that the government itself caused or exacerbated. Moreover, the government could act arbitrarily in any management decision, including giving itself absolute priority over shareholders' claims or arbitrarily excluding random creditors' claims. As previously shown, however, the circuit courts have rejected the government's argument that it should be entitled to such special rules.

Defendants in lawsuits initiated by the government have traditionally been allowed to assert common-law defenses. Specifically, when the government is forced to act because of a defendant's negligence, that defendant is entitled to assert defenses that directly challenge the government's actions.[87] Even

86. The government, in managing a failed institution, necessarily acts through individuals. Prior to the passage of FIRREA, the congressional record is filled with remarks that one of the factors leading to the savings and loan crisis was the failure of the Federal Home Loan Bank Board and state regulators to supervise savings associations properly. *See, e.g.*, H.R. REP. No. 54, 101st Cong., 1st Sess. at 305, *reprinted in* 1989 U.S.C.C.A.N. 86; S. REP. No. 19, 101st Cong., 1st Sess. 2, at 4, 9 (1989).

The government is not infallible and a public policy which gives it carte blanche in running a failed institution cannot be what Congress intended. *See* Gibraltar Fin. Corp. v. FHLBB, 1990 U.S. Dist. LEXIS 19197 (C.D. Cal. June 15, 1990)("[N]othing in the statutory or regulatory scheme would indicate the need to permit FSLIC to function in its capacity as conservator with impunity. . . .").

87. *See* Wyandotte Transp. Co. v. United States, 389 U.S. 191 (1967)(noting, but not reaching the issue of whether all the government's expenses were necessary or whether the government could recover all of them in an action by the United States against the owners of a negligently sunken vessel declared a major disaster); Lone Pine Steering Comm. v. EPA, 777 F.2d 882, 885 (3rd Cir. 1985), *cert. denied*, 476 U.S. 1115 (1986)(holding that in government's action for cleanup costs of hazardous waste sites, including removal as well as remedial measures, defendants have the opportunity to raise issues of the EPA's cost effectiveness and statutory compliance as defenses); Town of East Troy v. Soo Line R. Co., 653 F.2d 1123, 1133 (7th Cir. 1980), *cert. denied*, 450 U.S. 922 (1981)(holding that in town's public nuisance action against a railroad to recover its costs in remedying ground water pollution caused by the railroad's negli-

in situations where the government has an interest in recovering money from a defendant which, if uncollectible, will ultimately be charged to taxpayers, the government is subject to traditional defenses.[88]

Moreover, when the government involves itself in commercial transactions, it functions in a proprietary capacity, and, therefore, its activities are analogous to those of a private concern.[89] Indeed, one court has held that the FDIC, as receiver, is acting in a proprietary capacity and therefore is subject to the rules of equitable estoppel.[90] Defendants have traditionally as-

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gence, the reasonableness of the town's costs was a question for the jury); United States v. Chesapeake & O. Ry. Co., 130 F.2d 308, 310 (4th Cir. 1942)(holding that in an action by the United States to recover the expenses incurred by the Forest Service in extinguishing a fire resulting from the defendant's negligence, whether the United States was justified in the steps it took to extinguish the fire was a question for the jury).

Indeed, in *Lone Pine Steering Committee*, the Third Circuit noted:

> The courts are not unaware of bureaucratic excesses and will undoubtedly look carefully at the claims made by the government when suit for reimbursement is brought under § 9607. . . . The reimbursement trial will not be a pro forma proceeding but will permit presentation of adequate evidence for careful and exacting study by the court. The statute requires the EPA to observe cost effectiveness, and the mandate is a limitation, not a license to squander.

777 F.2d at 887; *see also* United States v. Hardage, 733 F.Supp. 1424, 1433 (W.D. Okla. 1989)(holding that the defendants bear the burden of proving that the response costs sought by the United States are inconsistent with the National Contingency Plan: "As long as the actions taken by the government were in harmony with the N.C.P., the costs incurred pursuant to those actions are presumed to be reasonable and therefore are recoverable.").

88. *See* United States v. Yazell, 382 U.S. 341, 349 (1966)("[N]o contention will or can be made that the United States may by judicial fiat collect its loan[s] with total disregard of state laws . . . ."). Similarly, when the United States sues under the Medical Care Recovery Act, it is subject to the same state law defenses as any other litigant. *See* United States v. Dairyland Ins. Co., 764 F.2d 750, 751-52 (8th Cir. 1982)(holding that North Dakota's no-fault insurance law precluded the United States from maintaining an action under the Medical Care Recovery Act for expenses paid for injuries sustained by a serviceman), *accord*, Heusle v. National Mut. Ins. Co., 628 F.2d 833, 838 (3d Cir. 1980); United States v. Theriaque, 674 F. Supp. 395, 399 (D. Mass. 1987)(holding that in an action by the United States for recovery of costs of treating a veteran, the federal government is subject to state law defenses).

89. *See* FDIC v. Harrison, 735 F.2d 408, 411 (11th Cir. 1984)(holding that the FDIC as receiver is subject to the defense of equitable estoppel because "[a]ctivities undertaken by the government primarily for the commercial benefit of the government or an individual agency are subject to estoppel"); Portmann v. United States, 674 F.2d 1155, 1165 (7th Cir. 1982)(holding that a customer may estop the Postal Service in a claim for loss of "Express Mail" package); United States v. Georgia-Pacific Co., 421 F.2d 92, 103 (9th Cir. 1970)(holding that the federal government is estopped from enforcing a contract whereby owner of timberlands agreed to convey parcel to government at later date); Emeco Indust, Inc. v. United States, 485 F.2d 652, 657 (Ct. Cl. 1973)(holding that the government was estopped from denying the terms of a purchase agreement); *accord*, Dana Corp. v. United States, 470 F.2d 1032, 1045 (Ct. Cl. 1972); McQuagge v. United States, 197 F. Supp. 460, 469 (W.D. La. 1961)("When the government enters the [marketplace] . . . seeking to enforce a contractual right . . . it submits to the same rules which govern legal relations among its subjects.").

90. *Harrison*, 735 F.2d at 411 (11th Cir. 1984).

serted common-law defenses against business plaintiffs. Thus, defendants in cases involving failed financial institutions should be allowed to assert the common-law mitigation defense against the government acting as a proprietor.

In summary, the "public policy" rationale for dismissal of the mitigation defense is fundamentally flawed. It usurps the authority of Congress to fashion rules governing banking institutions, it allows the FDIC and RTC to manage failed institutions with no regard for the preservation of their value, and it ignores precedent that treats the government, when acting in its proprietary capacity, as a private litigant. Indeed, sound public policy suggests that Congress, instead of the courts, should have the authority to enact laws that strike a balance between the government's need for broad power to manage a failed financial institution and the individual defendant's right to limit his or her personal civil liability to those damages that the defendant actually caused.[91]

III. The Sovereign Immunity Rationale

The courts have relied on a third, equally flawed basis to strike the defendants' mitigation affirmative defense: the doctrine of sovereign immunity and the discretionary function exception of the Federal Tort Claims Act ("FTCA").[92] In addition, a few recent opinions have cited to *United States v. Gaubert*,[93] the Supreme Court's most recent pronouncement on the FTCA and its discretionary function exception, to preclude defendants in a failed savings and loan association case from asserting the traditional common-law mitigation defense.[94]

The proper analysis of whether the doctrine of sovereign immunity, the FTCA, or the *Gaubert* decision operate to bar the mitigation defense begins with a review of the doctrine of sovereign immunity. The *Gaubert* decision interprets the FTCA, which was enacted to *limit* (not expand) the sovereign's immunity. Accordingly, if defendants were able to assert affirmative defenses under the more restrictive principles of sovereign im-

91. *But cf.* David G. Oedel, *Private Interbank Discipline*, 16 Harv. J.L. & Pub. Pol'y 327 (1993)(questioning whether it is sound public policy for the government to regulate banks at all and suggesting that the private sector can perform that function better).

92. *See, e.g., supra* note 10.

93. 111 S. Ct. 1267 (1991).

94. *See supra* note 12.

munity, they certainly should be able to assert such defenses irrespective of the FTCA and the *Gaubert* decision.

The doctrine of "sovereign immunity" embodies the principle that the United States is immune from a suit for "monetary damages" unless it has consented to be sued.[95] The Supreme Court, in *Feres v. United States*,[96] remarked:

> While the political theory that the King could do no wrong was repudiated in America, a legal doctrine derived from it that the Crown is immune from any suit to which it has not consented was invoked on behalf of the Republic and applied by our courts as vigorously as it had been on behalf of the Crown.[97]

Sovereign immunity does not, however, bar a defendant from asserting affirmative defenses in the government's lawsuit against him. This longstanding legal principle was first enunciated in *United States v. Ringgold*:[98]

> No direct suit can be maintained against the United States. But when an action is brought by the United States, to recover money in the hands of a party, who has a legal claim against them [sic] for costs; it would be a very rigid principle, to deny to him the right of setting up such claim in a court of justice, and turn him round to an application to [C]ongress[99]. If the right of the party is fixed by the existing law, there can be no necessity for an application to [C]ongress, except for the purpose of remedy. *And no such necessity can exist, when this right can properly be set up by way of defence, to a suit by the United States.*[100]

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95. *See* United States v. Mitchell, 463 U.S. 206, 212 (1983); Feres v. United States, 340 U.S. 135 (1950); United States v. Shaw, 309 U.S. 495, 500-01 (1940).

96. 340 U.S. 135 (1950).

97. *Id.* at 139.

98. 33 U.S. (8 Pet.) 150, 163 (1834).

99. Before the enactment of the Federal Tort Claims Act, relief for injuries caused by the Government could be obtained only by means of private bills. *See* Dalehite v. United States, 346 U.S. 15, 25 (1953).

100. *Id.* (emphasis added); *accord*, Bull v. United States, 295 U.S. 247 (1934); *see also* United States v. Norwegian Barque "Thekla," Her Tackle, Etc., 266 U.S. 328, 339-341 (1924)("When the United States comes into Court to assert a claim it so far takes the position of a private suitor as to agree by implication that justice may be done with regard to the subject matter . . . the reasons are strong for not obstructing the application of natural justice against the Government by technical formulas when justice can be done without endangering any public interest. . . . It joined in the suit, and that carried with it the acceptance of whatever liability the courts may decide to be reasonably incident to that act."); The Siren, 74 U.S. (7 Wall.) 152, 154 (1869)("[A]lthough direct suits cannot be maintained against the United States, or against their property, yet when the United States institute a suit, they waive their exemption so far as to allow a presentation by the defendant of set-offs, legal and equitable, to the extent of the demand. . . ."); United States v. Longo, 464 F.2d 913, 915 (8th Cir. 1972)("The Gov-

Thus, under principles of sovereign immunity, the defendants in failed bank litigation are entitled to assert traditional common-law affirmative defenses in the government's lawsuit against them.

The FTCA, passed in 1946, is a consensual waiver of sovereign immunity that was enacted to "mitigate unjust consequences of sovereign immunity."[101] It confers federal court jurisdiction over civil lawsuits for "money damages" against the United States.[102] The FTCA thereby *limited*, rather than expanded, the Sovereign's immunity under common law.[103] Accordingly, because under more restrictive principles of sovereign immunity these defendants had the right to assert affirmative defenses against the government, they should retain that right in spite of the FTCA and its discretionary function exception. Furthermore, even if the defendants' right to assert affirmative defenses were analyzed under the FTCA, it is clear that the FTCA does not apply to affirmative defenses by its own terms, nor does its discretionary function exception apply to affirmative defenses. Additionally, under fundamental principles of tort law, affirmative defenses are *not* encompassed by the FTCA or its discretionary function exception.

The FTCA concerns only the United States as a defendant, because it applies to claims that assert that the United States is "liable" for "money damages."[104] Section 1346 provides that federal courts have exclusive jurisdiction of:

> *civil actions* on *claims* against the United States, for *money damages* . . . for injury or loss of property, or personal injury or

ernment by commencing the . . . action has doubtless precluded itself from raising sovereign immunity as a bar to any appropriate defense to its action."); United States v. Moscow-Idaho Seed Co., 92 F.2d 170, 173 (9th Cir. 1937)("When the United States comes into court and institutes a suit for redress . . . it, by implication, waives any immunity as sovereign and its adversary is entitled to set up any defense which would be available to him were his opponent another citizen instead of the government.").

101. Feres v. United States, 340 U.S. 135, 139 (1950).

102. *See* 28 U.S.C. § 1346(b)(1988).

103. *See* Rayonier Inc. v. United States, 352 U.S. 315, 319 (1957)("It may be that it is 'novel and unprecedented' to hold the United States accountable for the negligence of its [employees], but the very purpose of the Tort Claims Act was to waive the Government's traditional all-encompassing immunity from tort actions and to establish novel and unprecedented governmental liability."); Dalehite v. United States, 346 U.S. 15, 24 (1953)(stating that the FTCA "was the offspring of a feeling that the Government should assume the obligation to pay damages for the misfeasance of employees in carrying out its work."); *Feres*, 340 U.S. at 139 ("The Tort Claims Act was not an isolated and spontaneous flash of congressional generosity. It marks the culmination of a long effort to mitigate unjust consequences of sovereign immunity from suit.").

104. *See* 28 U.S.C. § 1346(b)(1988).

> death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be *liable* to the claimant . . . .[105]

Indeed, in *United States v. Gaubert*,[106] the Supreme Court addressed the scope of the "discretionary function" exception with respect to determining the *liability* of the United States. The Court explained that "the purpose of the [discretionary function] exception is to 'prevent judicial 'second-guessing' of legislative and administrative decisions grounded in social, economic, and political policy *through the medium of an action in tort*. . . .' "[107] In fact, the four leading Supreme Court cases on the discretionary function exception all involved affirmative tort claims filed by private parties to impose liability against the government for money damages.[108]

The affirmative defense of failure to mitigate damages does not serve to impose *liability* on a plaintiff. As Professor McCormick states:

> [I]t has been pointed out that the "duty," if it can be so-called, is not one for which a *right of action* is given against the person who violates it . . . . The penalty is merely the disallowance of damages for losses which a compliance with the 'duty' would have avoided.[109]

Professor Corbin also notes that "[s]ince there is no *judicial penalty*, however, for his failure to make this effort, it is not desirable to say that he is under a 'duty.' "[110] The affirmative defense that the government failed to mitigate a failed bank's damages

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105. *Id.* (emphasis added).

106. 111 S. Ct. 1267 (1991).

107. *Id.* at 1273 (quoting United States v. S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines), 467 U.S. 797, 814 (1984))(emphasis added).

108. *See Gaubert*, 111 S. Ct. at 1271 (invloving a suit against the government for property and stock losses that allegedly resulted from governmental negligence in regulating the affairs of a savings and loan); Berkovitz v. United States, 486 U.S. 531 (1988)(bringing a wrongful death suit against the FDA for negligent drug certification procedures); United States v. S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines), 467 U.S. 797 (1984)(alleging that the government was liable for a wrongful death from a plane crash because of inadequate aircraft inspection); *Dalehite*, 346 U.S. at 17 (suing the government for a death caused by an explosion at a government-controlled fertilizer plant).

109. *See* McCormick, *supra* note 27, § 33, at 128 (emphasis added).

110. Corbin, *supra* note 27, § 109, at 742-43 (emphasis added); *see also* Tennessee Valley Sand & Gravel Co. v. M/V Delta, 598 F.2d 930, 932 (5th Cir. 1979)("Courts have often referred to a so-called duty to mitigate damages, but *there is no such duty, for there is no correlative right upon its violation.*")(emphasis added)(citation omitted); Restatement (Second) of Contracts § 350 cmt. b (1981)("It is sometimes said that it is the

does not implicate the liability of the United States for purposes of Section 1346 of the FTCA. Therefore, such defenses cannot be barred by the FTCA's discretionary function exception.[111]

The FTCA does not apply because the mitigation defense, even if successful, does not entitle the defendants to recover money damages from the United States.[112] Accordingly, by the FTCA's own terms, the mitigation defense, which does not impose "liability" on the United States and which does not entitle defendants to recover "money damages," simply does not fall within the purview of the FTCA.[113]

As shown earlier, Section 1346 contains the sovereign's waiver of immunity for "claims against the United States[] for money damages." The Act in Section 2680 specifically lists thirteen classes of "claims" to which the waiver of sovereign immunity does not apply.[114] Affirmative defenses are not listed among these exceptions, and are therefore not barred by the FTCA.[115] In fact, the Supreme Court, in *United States v. Yellow Cab Company*, stated:

> Where a statute contains a clear and sweeping waiver of immunity from suit on all claims with certain well defined exceptions, resort to that rule [of strict construction] cannot be had in order to enlarge the exceptions.

'duty' of the aggrieved party to mitigate damages, but this is misleading because he incurs *no liability* for his failure to act")(emphasis added).

111. *See, e.g.*, United States v. Muniz, 374 U.S. 150, 165-66 (1963)("We should not, at that same time that [courts] are striving to mitigate the hardships caused by sovereign immunity, narrow the remedies provided by Congress" in the FTCA)(footnote omitted); Rayonier Inc. v. United States, 352 U.S. 315, 320 (1957)("There is no justification for this Court to read exemptions into the [FTCA] beyond those provided by Congress. If the Act is to be altered that is a function for the same body that adopted it.")(footnote omitted); Wright v. United States, 719 F.2d 1032, 1036 (9th Cir. 1983)(holding that courts should not read exemptions in the FTCA beyond those provided).

112. *See* FDIC v. Ashley, 749 F. Supp. 1065, 1069 (D. Kan. 1990)(holding that the failure to mitigate damages affirmative defense applies only by way of *reduction, mitigation, or abatement of damages claimed by the plaintiff*); *see also* United States v. Finn, 239 F.2d 679, 682, 684 (9th Cir. 1956)(barring a counterclaim because it "did not plead a set-off. Instead it sought affirmative relief . . . [and was] a claim for money damages.")(citation omitted).

113. *See* Woodbridge Plaza v. Bank of Irvine, 815 F.2d 538, 543 (9th Cir. 1987)(refusing to apply FTCA to "protect" FDIC from suit where "[i]n arguing that the FTCA should apply to this suit, the FDIC overlooks limitations of the Act" set forth in § 1346(b)).

114. *See* 28 U.S.C. § 2680 (1988).

115. *See* United States v. Yellow Cab Co., 340 U.S. 543, 548 (1951)(holding that claims for contribution were allowed against the government because "Section 421 [Section 2680's predecessor] lists 12 classes of claims to which the waiver shall not apply, but claims for contribution are not so listed.").

> The significance of the failure to list a claim for contribution as excepted from the waiver is emphasized by such exceptions as the following:
>
> "(a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid . . . ."[116]

Thus, had Congress meant to exclude affirmative defenses, it would have included it in the Section 2680 list of exceptions. If it had, the discretionary function exception would read: "Any claim *or affirmative defense* based upon an act or omission . . . ." As it stands, however, the discretionary function exception applies only to "claims," not to affirmative defenses. Therefore, it does not bar the defendants' mitigation defense.[117]

In *United States v. Gilman*,[118] decided shortly after the FTCA was passed, the government tried to expand its rights beyond those expressly set forth in the FTCA and obtain indemnity from its employee who was found to be negligent. The Supreme Court, in refusing to insert provisions into the FTCA that Congress had not specified, held:

> [T]he claim now asserted, though the product of a law Congress passed, is a matter on which Congress has not taken a position. It presents questions of policy on which Congress has not spoken. The selection of that policy which is most advantageous to the whole involves a host of considerations that must be weighed and appraised. That function is more appropriately for those who write the laws, rather than for those who interpret them.[119]

Because Congress could have, but did not, specifically list affirmative defenses in Section 2680's list of exclusions, there is no basis under the FTCA for striking affirmative defenses. This is particularly true because the United States (unlike any other litigant) has the power to pass laws to determine a party's liabil-

116. *Id.* at 548 n.5 (citations omitted).

117. *See* Andrus v. Glover Const. Co., 446 U.S. 608, 616-17 (1980)(holding that where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied); Foxgord v. Hischemoeller, 820 F.2d 1030, 1035 (9th Cir.), *cert. denied*, 484 U.S. 986 (1987)("[U]nder the maxim of statutory construction, 'expressio unius est exclusio alterius,' where a statute names the parties who come within its provisions, other unnamed parties are excluded."); *In re* McLinn, 744 F.2d 677 (9th Cir. 1984)(holding that under the doctrine of *expressio unius est exclusio alterius*, where the statute expressly excluded certain vessels, non-excepted vessels did fall in scope of the statute).

118. 347 U.S. 507, 510-11 (1954).

119. *Id.* at 511-12 (footnote omitted).

ity to it.[120]

Like the doctrine of sovereign immunity and the FTCA, the Supreme Court's recent decision in *United States v. Gaubert*,[121] which interpreted the discretionary function exception of the FTCA, does not bar the mitigation defense. In reversing the Fifth Circuit, the Supreme Court held that Thomas Gaubert, former chairman of the board and largest shareholder of Independent American Savings Association ("IASA"), could not maintain a negligence claim against the federal banking agencies. According to the Court, the federal regulators' pre-takeover actions fell within the FTCA's discretionary function exception.

The Fifth Circuit[122] had allowed Gaubert to assert the claim because it found that government banking agencies had become so involved with IASA, without actually taking it over, that the government had effectively assumed operational control of the institution.[123] The Fifth Circuit's decision was anomalous, however, as virtually every court had held that pre-takeover conduct by the government could not be the basis of a lawsuit for money damages. These prior decisions rested on one of two alternate grounds: either the regulators owed no duty to the banks, or such conduct was within the FTCA's discretionary function exception.[124]

The Supreme Court's *Gaubert* decision reaffirmed the predominant view that the federal regulators' *pre-takeover* conduct cannot be the basis of a suit for money damages. At least one court[125] has held, however, that *Gaubert* may be extended to

120. *See United States v. Standard Oil Co.*, 332 U.S. 301, 316 (1947).

121. 111 S. Ct. 1267 (1991).

122. Gaubert v. United States, 885 F.2d 1284 (5th Cir. 1989), *rev'd*, United States v. Gaubert, 111 S. Ct. 1267 (1991).

123. Among other things, the federal regulators required Gaubert to remove himself from IASA's management and post security for his personal guarantee that IASA's net worth would exceed regulatory minimums. Gaubert sought damages for the lost value of his shares and for the property forfeited under his personal guarantee on the ground that the FHLBB and FHLB-Dallas had been negligent in carrying out their supervisory activities.

124. *See* Harmsen v. Smith, 586 F.2d 156, 158 (9th Cir. 1978)(holding that government conduct with respect to bank examinations, even if negligent, does not grant the bank, its directors, or its officers a claim against the government); First Sav. & Loan Ins. Corp. v. Alexander, 590 F. Supp. 834, 838 (D. Haw. 1984)(barring under the FTCA bank officers' allegation that the FHLBB failed to warn them of the bank President's questionable activities). Thus, the Fifth Circuit, persuaded by particularly egregious facts, deviated from the majority rule.

125. *See* FDIC v. Israel, No. CV 87-4124 WDK (C.D. Cal. May 10, 1991).

overrule the line of cases[126] holding that the government exposes itself to liability for its *post-takeover* conduct, either because a duty arises once it assumes the day-to-day operations of a failed institution or because such conduct falls outside the scope of the FTCA's discretionary function exception.

As has already been demonstrated, neither the FTCA nor concepts of sovereign immunity bar affirmative defenses. Therefore, even if *Gaubert* is construed broadly to overrule decisions imposing a post-takeover "duty" on the government, it still does not apply to the defense of failure to mitigate. As explained earlier, the defendants' mitigation defense is *not* dependent on a "duty."[127] Thus, the *Gaubert* decision does not affect defendants' affirmative defenses, which are *not* dependent on the existence of a duty.[128] Consequently, while the *Gaubert* holding may prevent defendants from maintaining counterclaims based on pre- and perhaps post-takeover regulatory and operational governmental negligence, the fact that such *counterclaims* might be barred does *not* lead to the conclusion that defendants' *affirmative defenses* are barred.[129] That one may not

126. *See Harmsen*, 586 F.2d at 158 (stating that while government conduct with respect to bank examinations, even if negligent, does not grant the bank or its directors or officers a claim against the government, "a case could arise in which the Comptroller so far participated in the management of a bank that his conduct could create a duty to the stockholders."); *First Savings and Loan*, 590 F. Supp. at 839 ("[O]nce the government undertakes an operative task, [such as managing a bank,] it cannot act negligently without liability."); *In re* Franklin Nat'l Bank Sec. Litig., 445 F. Supp. 723, 733-34 (E.D.N.Y. 1978)("Franklin I")("[I]f the Government goes beyond the normal regulatory activities and substitutes its decisions for those of the officers and directors . . . the Government may assume a duty to those parties. . . ."); Gibraltar Financial Corp. v. FHLBB, 1990 WL 394298 (C.D. Cal. June 15, 1990)(allowing shareholders of a failed institution to maintain a breach of fiduciary duty claim against the conservator because when the government imposed a conservatorship upon an institution, it exceeded its normal regulatory and supervisory activities by assuming control of the operations of the institution).

127. Affirmative claims against the government for negligence or breach of fiduciary duty require the existence of a "duty" in order to maintain the cause of action. *See* KEETON ET AL., *supra* note 27, § 30, at 164 (stating that the elements of negligence include a "duty" extending from the defendants to the plaintiff). As set forth in Part I, affirmative defenses challenging the post-takeover conduct of a failed bank are not dependent on a "duty" owed to the defendants.

128. *See* FDIC v. Ashley, 749 F. Supp. 1065, 1069 (D. Kan. 1990)("[E]ven if the FDIC as receiver owes no duties to anyone, the defense of failure to mitigate damages is still available to the Ashley defendants because the legal requirement to mitigate damages is not actually a 'duty,' but a limitation on the amount of damages recoverable by the plaintiff").

129. *But see* FDIC v. Carter, 701 F. Supp. 730 (C.D. Cal. 1987), in which the court held:

> The better view is that the substantive portions of the FTCA which relate to the determination of liability do apply both to affirmative suits brought against the government and to counterclaims and affirmative defenses in suits

force the government to pay for damages done in performing discretionary acts is not equivalent to saying that the government can collect money from a citizen notwithstanding its own contribution to the injury. The government's interest is not the same, nor is the citizen's predicament. Permitting suits for damages would expose the government to never-ending litigation over its decisions. Permitting affirmative defenses carries no such risk: the government decides when to sue.

CONCLUSION

In government-initiated savings and loan litigation, the defendants—typically the failed institution's former officers and directors—like all other tort defendants, should be able to assert the traditional common-law avoidable consequences or failure to mitigate damages affirmative defense. The district courts that have stricken the defense have relied on three flawed rationales to support their rulings: the "no-duty" rationale; the public policy rationale; and the doctrine of sovereign immunity.

The mitigation defense, more properly labelled as the doctrine of avoidable consequences, is not dependent on a "duty" owed by the government to the defendants. Instead, the mitiga-

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brought originally by the government. To grant a litigant additional substantive rights against the government as a defendant over those rights the litigant would have as a plaintiff would result in an unacceptable anomaly.

Id. at 734.

The *Carter* court's "unacceptable anomaly" resulted because the court failed to consider the fundamental, substantive differences between counterclaims (that impose liability on the United States and entitle the counterclaimant to a recovery of money damages) and affirmative defenses (that do not impose liability on the United States or entitle a defendant to recover money damages). Indeed, the *Carter* court did not analyze the overwhelming Supreme Court authority which draws such a distinction.

Notwithstanding its failure to analyze correctly the difference between a counterclaim and an affirmative defense, the *Carter* court held that the defendants, the former officers and directors of the failed institution, could allege that the FDIC as receiver "failed to minimize the bank's damages, for instance by employing improper loan collection procedures." *Id.* at 738. The *Carter* court reached its conclusion through an analysis of the discretionary function exception of the FTCA, holding that after the government took over the bank, it was acting in a proprietary function (outside the discretionary function exception) and, therefore, the FDIC could be held liable for negligence. *Id.*

The *Carter* decision has been criticized by other district courts that have stricken the mitigation defense. *See, e.g.*, FDIC v. Stanley, 770 F. Supp. 1281, 1309 (N.D. Ind. 1991) (holding that *Gaubert* overruled *Carter*, "insofar as *Carter* held that the FDIC's actions, when disposing of a bank's assets, can serve as a basis for reducing the amount of the FDIC's recovery because such actions by the FDIC are ministerial and operational"); FDIC v. Baker, 739 F. Supp. 1401, 1407 (C.D. Cal. 1990)("[T]he court must reach a different conclusion from that expressed in *Carter* . . . .").

tion defense requires the government, like every other plaintiff, to take reasonable steps to limit its damages. If it fails to do so, the government forfeits the opportunity to collect damages from the defendants that it could reasonably have avoided.

The courts have also wrongfully relied on the "public policy" rationale announced in *FSLIC v. Roy*, stating that defendants in government-initiated savings and loan litigation should not be entitled to challenge the government's conduct in taking over the failed financial institution. This asserted "policy" has never been articulated by Congress. In fact, the only policy reflected in FIRREA, Congress's recent pronouncement on the savings and loan industry, is a policy to minimize the losses at failed financial institutions. Fully consistent with the general doctrine of "avoidable consequences," loss minimization is not served by relieving the government, as plaintiff, of its usual incentive to exercise prudence and sound judgment.

Finally, courts have also improperly invoked the doctrine of sovereign immunity, the FTCA, and the FTCA's discretionary function exception to bar the defendants' mitigation defense in government-initiated suits. A review of the doctrine of sovereign immunity, a close reading of the FTCA, and an analysis of the Supreme Court's recent interpretation of the FTCA in *United States v. Gaubert* show that, while defendants in failed financial institution litigation cannot in most circumstances assert affirmative claims against the government for monetary relief, they *can* assert traditional common-law defenses, including the government's failure to mitigate its damages.

The courts have relied on three incorrect rationales to strike the defendants' mitigation defense and thus to afford the government special protections not granted to it by Congress. Apparently, the judiciary has felt it improper for defendants to challenge the so-called "rescue" attempts or "clean-up" efforts of the government during the savings and loan crisis.[130] While there may be good reasons to adopt a policy that affords the

130. For example, the *Roy* court appeared offended by a legal doctrine that would afford defendants the opportunity to challenge the government's conduct:

> Thus, nothing could be more paradoxical or contrary to sound policy than to hold that it is the public which must bear the risk of errors of judgment made by its officials in attempting to save a failing institution—a risk which would never have been created but for defendants' wrongdoing in the first instance.

FSLIC v. Roy, 1988 WL 96570 (D. Md. June 28, 1988).

government special protections during such a crisis, that policy must come from Congress, which has yet to happen.

In light of the consequences flowing from the elimination of a longstanding common-law affirmative defense, it is appropriate to recall Justice Holmes's famous description of the effect that great public controversies and problems can have upon even the best legal minds:

> Great cases, like hard cases, make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend.[131]

By eliminating the mitigation of damages affirmative defense, the *Roy* court and its progeny have succumbed to the "hydraulic pressure" of the savings and loan crisis.

131. Northern Securities Co. v. United States, 193 U.S. 197, 400-01 (1904)(Holmes, J., dissenting).