

# HOSTILE TAKEOVER:

## The Impact of FDIC Receivership on Bank Litigation

Unfortunately, it's an all-too-familiar image in the news these days: It's late on a Friday afternoon, and another failed bank has been taken over by federal regulators. The bank is now swarming with federal agents intent on taking possession of the bank's records, loans, and other assets in order to safeguard money belonging to the bank's depositors and ensure an orderly liquidation. As of October, 98 banks have closed so far this year and, based on the current rate of failures, the count will exceed 100 by the end of 2009. This compares with 25 bank failures in 2008 and only three failures in 2007. Completely lost in the media coverage of failed banks is any detailed consideration of the legal implications of bank failure on pending or existing litigation involving the failed bank. Nonetheless, individuals, businesses, and even other banks involved in or anticipating litigation with a distressed bank face potentially significant consequences that must be understood in order to adequately protect their interests.

Regulators can close a distressed bank upon a determination that the bank is functionally insolvent. To ensure the orderly liquidation and distribution of the failed bank's assets, the regulator appoints a receiver, which, in most instances, is the Federal Deposit Insurance Corporation ("FDIC"). As receiver, the FDIC has broad powers at its disposal: It inherits the rights, powers, and privileges of the failed bank; it may collect on any debts or obligations

owed to the bank; it may liquidate the bank's assets and property; and it may merge the bank with, or transfer its assets and liabilities to, another bank.

Less obvious, but no less important to anyone possessing a legal claim against a failed bank, are the FDIC's powers to minimize the receivership's loss exposure.

As receiver, the FDIC may:

- request a mandatory temporary stay from the court, within 90 days of its appointment, in order to evaluate the lawsuit;
- remove a pending state court lawsuit to federal court;
- administratively review claims against the failed bank; and
- avoid certain types of claims, defenses, and remedies.

After appointment as receiver, the FDIC publishes—typically in a local newspaper—a notice to the bank's creditors. Anyone possessing a claim against the bank (including a claim asserted in litigation) must file a proof of claim by a certain specified "bar" date. (Failure to seek administrative review of the claim may subsequently bar the claimant from litigating the claim in court.) Once a proof of claim has been filed, the FDIC has 180 days to decide whether to allow or disallow the claim. If the claim is disallowed, the claimant may still file a federal lawsuit or continue pending litigation; however, if the claimant does neither within 60 days of the claim's denial, the claim is barred.

An otherwise properly submitted claim may be disallowed for failure to meet strict documentation requirements under what is often referred to as the *D'Oench, Duhme* doctrine. Specifically, the FDIC can disallow claims, and seek dismissal of related litigation, if the basis for the claims is not contained within the bank's written records. As a result, certain claims and defenses based on oral representations may not be available to a claimant involved in litigation with the failed bank once the FDIC is appointed receiver.

Federal law also prohibits courts from issuing injunctions or other equitable relief that would interfere with the FDIC's activities as receiver for the failed bank. While these statutory provisions do not bar the recovery of monetary damages, they preclude the issuance of any order to seize assets in the possession of the receiver.

Many industry observers predict that bank failures will continue to increase before the current credit crisis finally subsides. Consequently, individuals, businesses, and other banks involved in, or anticipating, litigation with a potentially distressed bank should take a few simple precautions, including:

- monitoring the bank's status through the FDIC's web site ([www.fdic.gov](http://www.fdic.gov)) and other news sources.
- being prepared to file a proof of claim as soon as possible (and before the specified bar date) to preserve their rights.

Finally, litigants should appreciate that appointment of the FDIC as receiver may result in various litigation-related hardships, including delays, removal of the lawsuit to federal court, unavailability of certain claims and defenses, and limited remedies.

By Jason Lien &  
Julian Zebot



Jason Lien practices complex commercial litigation in a wide range of substantive areas, with a special emphasis on litigation involving financial institutions, commercial real estate and international trade. [jason.lien@maslon.com](mailto:jason.lien@maslon.com)

Julian Zebot focuses his practice on business torts, class actions, and other complex commercial litigation, including litigation involving banks and other financial service businesses. [julian.zebot@maslon.com](mailto:julian.zebot@maslon.com)

