

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE
THE SUPREME COURT
OF THE
UNITED STATES

CAPTION: O'MELVENY & MYERS, Petitioner v. FEDERAL
DEPOSIT INSURANCE CORPORATION AS RECEIVER
FOR AMERICAN DIVERSIFIED SAVINGS BANK,
ET AL.

CASE NO: No. 93-489

PLACE: Washington, D.C.

DATE: Monday, March 21, 1994

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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 O'MELVENY & MYERS, :

4 Petitioner :

5 v. : No. 93-489

6 FEDERAL DEPOSIT INSURANCE :

7 CORPORATION AS RECEIVER FOR :

8 AMERICAN DIVERSIFIED SAVINGS :

9 BANK, ET AL. :

10 - - - - -X

11 Washington, D.C.

12 Monday, March 21, 1994

13 The above-entitled matter came on for oral
14 argument before the Supreme Court of the United States at
15 10:02 a.m.

16 APPEARANCES:

17 REX E. LEE, ESQ., Provo, Utah; on behalf of
18 the Petitioner.

19 PAUL BENDER, ESQ., Deputy Solicitor General, Department of
20 Justice, Washington, D.C.; on behalf of the
21 Respondents.

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1 PROCEEDINGS

2 (10:02 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument
4 now in Number 93-489, O'Melveny & Myers v. Federal Deposit
5 Insurance Corporation. Mr. Lee.

6 ORAL ARGUMENT OF REX E. LEE

7 ON BEHALF OF THE PETITIONER

8 MR. LEE: Mr. Chief Justice and may it please
9 the Court:

10 At issue in this case is whether Federal or
11 State law determines the elements and the defenses of a
12 negligence claim brought by the FDIC as receiver for a
13 savings and loan against an outside attorney for that
14 savings and loan.

15 The case arises out of the petitioner's
16 assisting in the preparation of two private placement
17 memoranda for American Diversified Savings Bank over the
18 period from September through December of 1985. During
19 and prior to that time, two individuals named Sahni and
20 Day, who owned 100 percent of ADSB, were engaged and had
21 been for some time in fraudulent and other illegal
22 activities which eventually resulted in Federal and State
23 regulators placing ADSB into receivership.

24 None of the O'Melveny lawyers was aware of any
25 of the illegal acts, nor are they alleged to have been,

1 nor of ADSB's financial or regulatory problems and,
2 indeed, the ADSB officers concealed this information from
3 the petitioner.

4 The Ninth Circuit created two Federal rules of
5 decision: first, that the knowledge of ADSB's 100 percent
6 owners was not imputed to ADSB, and second, that the FDIC
7 can avoid defenses to tort claims that would be good
8 against the predecessor, ADSB.

9 In response to an argument by the petitioner
10 pointing out certain provisions of State law, the Ninth
11 Circuit stated as follows, and this is a quote: "The flaw
12 in O'Melveny's argument is the law O'Melveny assumes
13 applies. It is now clear beyond doubt that Federal, not
14 State, law governs the application of defenses against the
15 FDIC," and that's the issue in this case.

16 QUESTION: Mr. Lee, you don't challenge, I take
17 it, the Ninth Circuit's view that a law firm in this
18 situation is under a duty of inquiry when it prepares a
19 private prospectus like this?

20 MR. LEE: We do challenge it, Mr. Chief Justice,
21 but it's not one of the issues -- we think they erred as a
22 matter of California law in deciding that.

23 QUESTION: But you're not asking us to --

24 MR. LEE: That is correct. That is correct.
25 That's not one of the questions before the Court. What is

1 before --

2 QUESTION: And you are satisfied that California
3 law is what governs in this case?

4 MR. LEE: That's the issue. That's the issue.
5 That's the issue on which --

6 QUESTION: But if any State law governs --

7 MR. LEE: Oh, yes, that is correct.

8 QUESTION: -- it's California.

9 MR. LEE: That is correct.

10 QUESTION: It is the law of California, and do
11 we know what the law of California is on the imputation
12 defense?

13 MR. LEE: I certainly do. My friends here have
14 a little doubt about it, but I certainly do.

15 (Laughter.)

16 QUESTION: What about the Ninth Circuit --

17 QUESTION: Mr. Lee --

18 MR. LEE: Excuse me.

19 QUESTION: There are very few cases on this
20 imputation defense, and it doesn't seem all that clear to
21 me what the California law might be in any event.

22 MR. LEE: There are enough, Justice O'Connor,
23 and I would refer you simply to four.

24 The leading case is McKenney v. Ellsworth.

25 QUESTION: Mr. Lee --

1 MR. LEE: Yes.

2 QUESTION: -- would you tell us preliminarily
3 whether the Ninth Circuit made any determination of the
4 content of California law, because if it did not, perhaps
5 it might on remand and a conflict would be unnecessary.
6 There would be no conflict.

7 You presented a question, is it State or Federal
8 law, but if the content of both is the same, then what
9 difference does it make?

10 MR. LEE: Well, the case certainly could be
11 decided on the ground that under Federal common law as it
12 existed -- and we discussed this briefly in our reply
13 brief -- as it existed prior to Erie v. Tompkins, we think
14 we would win this case, but the clearer -- the ground on
15 which certiorari was granted, and I think the clearer and
16 the easier way to decide the case, is to decide the issue
17 of State law.

18 Now, the other question that you asked, Justice
19 Ginsburg, was whether the Ninth Circuit had decided this
20 on the basis of State or Federal law. It is clear to me
21 they decided it on the basis of Federal law, for three
22 reasons.

23 The first is that that's what they said they
24 were doing. The language that I just quoted said the flaw
25 in O'Melveny's argument is its assumption that State law

1 applies. It is now clear that Federal law applies to all
2 defenses -- not just defense, but defenses -- in a suit
3 brought by the FDIC, and the second is what they did.

4 The opinion relies on three Federal opinions.
5 It does not rely on State law, and in an analogous
6 context -- Michigan v. Long -- this Court said that when
7 the opinion relies on Federal decisions, then they are
8 applying Federal law.

9 QUESTION: Mr. Lee, why should -- assuming that
10 they did rely on Federal law, why shouldn't we give them
11 the job of -- I mean, we have enough trouble figuring out
12 what Federal law is. They're closer to California law.
13 Why don't we -- if you're correct -- just send it back
14 there and let them figure out what California law is?

15 MR. LEE: That would be a possibility, Justice
16 Scalia.

17 QUESTION: It's what we normally would do, isn't
18 it?

19 MR. LEE: That would be a possibility, and in
20 the usual case, that is what you normally do. I submit
21 this is not the usual case.

22 The only thing I would say in that respect,
23 Justice Scalia, is that I would invite careful
24 consideration of four cases that are cited in our brief,
25 and those four cases make it very clear -- it's probably

1 best summarized by the West American case and by
2 Mr. Witkin, who is the leading commentator on California
3 law.

4 The Government points out, quite correctly, that
5 there is an exception to the general rule of imputation in
6 those instants where the agent is acting adversely to the
7 principal, but in the clearest language of the which the
8 English dictionary is capable, it then goes on to say --
9 in the clearest words of which the English language is
10 capable, it then goes on to say that there is an exception
11 to the exception, and that the exception to the exception
12 applies in those instances where the agent is in fact
13 acting on behalf of its principal, and there is no doubt
14 that that's what happened here. So --

15 QUESTION: Mr. Lee, can you give us instances in
16 which this Court functions as a court of first view, which
17 is essentially what you're asking us to do?

18 The Ninth Circuit -- instead of asking the Ninth
19 Circuit to determine the content of California law, you're
20 asking this Court to decide a question not on review but
21 as a mater of first view.

22 MR. LEE: There are cases that are cited in the
23 last couple of pages of our reply brief, Justice Ginsburg,
24 in which this Court has done that. I realize that that is
25 not the only option, but I would simply reiterate what I

1 said in response to Justice Scalia.

2 I would invite the Court's attention to
3 McKenney, West American, Flagg v. Seng, and Austin, and I
4 submit that no reasonable person can read those cases
5 without concluding what California law is. However, we do
6 not lose the case in the event that you do send it back
7 for consider -- I just don't think it's necessary in this
8 instance.

9 QUESTION: California have a certification
10 proceeding?

11 MR. LEE: They do not, unfortunately.

12 The first -- there are three separate reasons
13 why the judgment of the Ninth Circuit must be reversed
14 and -- and State rather than Federal law apply to this
15 case, and the first is that there is a specific statutory
16 provision which expressly addresses both the imputation
17 and also the standing-in-the-shoes issues and resolves
18 both of them.

19 Section 1821(d)(2)(A) of the Federal Deposit
20 Insurance Act, which bears the title, "Successor to
21 institution," states explicitly -- and this is a quote.
22 It's set forth in the first page of our opening brief --
23 that as conservator or receiver, the FDIC succeeds to "all
24 rights, titles, powers, and privileges of the insured
25 depository institution."

1 Now, in this instance, the insured depository
2 institution is a California chartered corporation. As
3 such, its rights are determined by California law, and
4 relevant California law, as I indicated, imputes the
5 knowledge of an agent to his principal, and on the second
6 issue, whether the FDIC is --

7 QUESTION: Mr. Lee, may I --

8 MR. LEE: -- a receiver --

9 QUESTION: I'm sorry.

10 MR. LEE: I'm sorry.

11 QUESTION: May I ask just one question?

12 It seems to me that the defense that is at issue
13 here is essentially an equitable defense, and as such is
14 essentially a personal defense, and therefore the cause of
15 action may pass but the defense doesn't necessarily pass
16 with it. Is that a fair objection to the argument from
17 California law?

18 MR. LEE: Thank you for asking that question,
19 Justice Souter, for two reasons --

20 QUESTION: I'm flattered.

21 MR. LEE: Well, I --

22 (Laughter.)

23 MR. LEE: For two reasons, the answer is no.
24 The first is that the right -- the word is not claims,
25 it's rights, and you don't have a right unless you have a

1 claim and there are no defenses to it.

2 The second is provided -- the second reason is
3 provided by this Court's decision in Holmes. v. Sipek,
4 which was authored by the Court, by you, and that makes
5 clear -- that case makes clear, as I read it, that
6 proximate causation is an essential element of the claim
7 itself.

8 And under California law, the reason that there
9 is no proximate causation is because justifiable reliance
10 is a required element of proximate causation, and there
11 was no justifiable reliance where all you are saying is,
12 should the O'Melveny lawyers have told Sahni and Day that
13 they were -- discovered that Sahni and Day were violating
14 the law and then told them so? On the second issue --

15 QUESTION: Mr. Lee, while you're still on the
16 statute -- and I'm anxious for you also to get to the
17 second point -- I take it the wording of the statute in
18 its structure would prevent us from saying that the
19 initial liability, the initial duty, is also controlled by
20 Federal law?

21 MR. LEE: That is correct, and that's my
22 point -- that's my point, and on the other, on the
23 standing-in-the-shoes, it could not be more explicit,
24 because it says, succeeds to all rights the depository
25 institution has, and that strikes right at the heart of

1 the major premise that underlies the Government's case,
2 namely that the mere presence of the FDIC as receiver
3 2-1/2 years after the conduct at issue imposed for that
4 reason alone upon petitioner additional liabilities which
5 did not exist at the time the conduct occurred.

6 Now my second reason. If you didn't have the
7 specific statute, the mere existence of FIRREA, with its
8 comprehensiveness, this 370-page statute controls the
9 issue of whether State or Federal law governs under this
10 Court's decision in City of Milwaukee v. Illinois.

11 Involved in that case was a comprehensive
12 statute, the 1972 amendments to the Clean Water Act, and
13 the question was, when you have that kind of statute,
14 which supplants preexisting State rules in some instances
15 and leaves them in place in other instances, is it then
16 the proper function for the Federal courts to come along
17 behind and displace State law in those instances where
18 Congress elected to leave them in place?

19 The Government's only answer to that City of
20 Milwaukee argument is that FIRREA is not in fact
21 comprehensive, and that, with all due respect, is
22 borderline laughable. This is a 370-page statute. It,
23 with its companion statutes, regulates all aspects of
24 banks, Federal savings and --

25 QUESTION: Mr. Lee --

1 MR. LEE: Excuse me.

2 QUESTION: -- do you think that under your
3 theory of FIRREA that the D'Oench, Duhme case could
4 survive?

5 MR. LEE: Yes. Yes, it could. D'Oench, Duhme,
6 Justice O'Connor, is going to help the Government only if
7 you interpret it not in light of what that case actually
8 involved, but as establishing a per se, automatic rule
9 that any time the FDIC enters the playing field the
10 playing field no longer becomes level, and if you'll
11 permit the further analogy, any players who are wearing a
12 State law uniform not favorable to the Government
13 immediately have to leave.

14 Now, that's not what D'Oench, Duhme says. It is
15 limited in several respects and is distinguishable from
16 this case in several respects. In the first place, it
17 involved knowing conduct, which this case does not.

18 In the second place, it involved a note, an
19 asset as opposed to a mere claim, and the third -- as I
20 read D'Oench, heavy reliance was placed on the fact that
21 between the time the conduct occurred and the time the
22 decision was reached, there was a Federal statute that was
23 actually enacted, and that Federal statute heavily
24 influenced the decision so that what the Court was really
25 doing was filling in a vacuum that existed in between the

1 time of the conduct and the time of the decision.

2 QUESTION: Well, what's the purpose of the
3 imputation defense? Is it to make sure that the
4 wrongdoers don't benefit? Is that why there is --

5 MR. LEE: Wrongdoers of a certain --

6 QUESTION: -- an imputation defense?

7 MR. LEE: Yes. Wrongdoers of a certain quality,
8 not those who only have been alleged, and I repeat in --
9 what I said earlier to the Chief Justice. We do not agree
10 that there was a lack of exercise of due care, but that's
11 not before the Court.

12 Though a difference between those who are
13 alleged not to have exercised due care and those who have
14 engaged in deliberate conduct --

15 QUESTION: Well, you agree, then, that the
16 purpose of the defense would be so that Sahni and Day
17 wouldn't benefit from any recovery?

18 MR. LEE: That's part of it.

19 QUESTION: Well, who would benefit from a
20 recovery here? Would it be the taxpayers of the United
21 States, or who?

22 MR. LEE: Difficult to say whether the taxpayers
23 would really benefit or not, Justice O'Connor.

24 If I may tie that to our Kimbell Foods analysis,
25 and that's the third reason -- that's the third reason

1 that this case must be reversed. One of the three Kimbell
2 Foods factors has to do with whether there is a need for a
3 particular Federal rule in the particular instance.

4 The only argument that the Government even makes
5 with respect to why a special Federal rule is needed here
6 is the more money argument, that because otherwise it
7 would deplete the Deposit Insurance Fund.

8 I cannot emphasize too strongly that this
9 argument that the application of Federal law will result
10 in the FDIC recovering more money is entitled to no weight
11 at all, and I'm going to tie this back to your taxpayer's
12 question.

13 Kimbell Foods itself rejected that very
14 argument, and it did so on two grounds that are highly
15 relevant to this case. The first one is that in this case
16 as in Kimbell Foods the relevant statute provides other
17 means, other than just getting more money into the Federal
18 Deposit Insurance Fund, for protecting the public.

19 These include the ability of the Federal
20 regulators to increase both the capital and the capital-
21 to-assets ratios, to increase the insurance premium, and
22 in extreme cases even to remove management, and even more
23 relevant, it is also true here, as it was in Kimbell
24 Foods, that the principal purpose of these insurance
25 statutes is not to raise money.

1 Kimbell Foods made that very explicit, and I
2 would point out that what Kimbell Foods involved was two
3 Federal insurance programs, one administered by the SBA
4 and the other administered by the FHA, and Kimbell Foods
5 pointed out that these are social welfare legislation
6 statutes. Unlike tax statutes, they are not money-raising
7 statutes.

8 The same is true with the Federal Deposit --
9 well, with these various acts, FIRREA and the Federal
10 Deposit Insurance Act, whose principal purposes extend to
11 economic incentives to encourage residential lending, the
12 development of low and moderate income housing, and
13 lending in depressed real estate markets.

14 QUESTION: I don't understand your point,
15 Mr. Lee -- that Government doesn't care about losing money
16 unless it's under the tax laws. I mean, it seems to me if
17 preserving the fisc is an important value, it's an
18 important value, in whatever context.

19 MR. LEE: The point is, Justice Scalia, that it
20 is not its only purpose, and that in balancing the various
21 different objectives, of which protecting the public fisc
22 is of course one of them, the clear message that comes
23 from Milwaukee and from Kimbell Foods and a lot of other
24 cases that are cited in our brief dealing with this issue,
25 the net balancing of those competing values is for the

1 Congress of the United States, particularly where, as in
2 City of Milwaukee -- and here you have such a
3 comprehensive statute where many defenses have been
4 eliminated and others left intact, and particularly where,
5 as here, you have other objectives, other than just the
6 money raising. The balancing, in short, is for Congress,
7 and not for the courts.

8 I return now to the other two of the Kimbell
9 Foods factors. The first one is whether there's a need
10 for a uniform Federal law. The Government's conduct in
11 this very case shows that there is no such need.

12 What the Government did in this particular
13 instance was to ask for the application, and the court of
14 appeals gave it to them, of what they perceived to be
15 State law on the first issue, Mr. Chief Justice, which was
16 the issue of whether there was a duty of due care that was
17 owed.

18 Then, once they turned to the imputation and the
19 standing-in-the-shoes issues, on which State law does not
20 favor them, then the Government changed its direction and
21 asked for the application of Federal common law, which the
22 Ninth Circuit gave them.

23 This Court made very clear in Kimbell Foods, but
24 even more clear in United States v. Yazell, that when the
25 Government attempts this mix-and-match, pick-and-choose

1 combination of Federal and State law and asks for State
2 law to be applicable in certain instances, that that is
3 immensely material in the language of Yazell, immensely
4 material to the issue of whether a uniform rule really is
5 needed.

6 The final of the Kimbell Foods factors concerns
7 whether a Federal rule of decision would severely disrupt
8 commercial relationships predicated on State law. What
9 we're dealing with here is two areas of State law than
10 which there are none clearer, that are the essential and
11 traditional centuries-long prerogative of the State
12 courts -- tort law, disciplining of lawyers, and the
13 related one, the relationship of lawyer and client.

14 Each of these represents an area in which the
15 body of government State law has been developed over
16 decades, and in some cases even centuries, and to now
17 place that burden in Federal courts, displacing those
18 bodies of governmental State concern, would not only
19 severely disrupt commercial relationships predicated on
20 State law, but would also be extremely burdensome on the
21 Federal courts.

22 Mr. Chief Justice, I would like to reserve the
23 rest of my time for rebuttal.

24 QUESTION: Very well, Mr. Lee.

25 Mr. Bender, we'll hear from you.

1 ORAL ARGUMENT OF PAUL BENDER

2 ON BEHALF OF THE RESPONDENTS

3 MR. BENDER: Thank you, Mr. Chief Justice, and
4 may it please the Court:

5 Petitioner in this case is a law firm that was
6 retained by a federally insured savings institution in
7 order to prepare what are called private placement
8 memoranda in connection with the saving institution's
9 offering of a land development scheme.

10 It is alleged, and for purposes of this appeal
11 we have to assume it's true, that in the course of
12 preparing that PPM -- private placement memorandum --
13 petitioner committed malpractice.

14 Specifically, the malpractice that they
15 committed -- were alleged to have committed was this. The
16 private placement memorandum says in it that the bank in
17 this case had sufficient resources to finance the land
18 development scheme that the bank was floating. That was
19 not true. As a matter of fact, the bank was insolvent.

20 The negligence that is asserted against
21 petitioner is that they negligently failed to discover
22 that, and put in the PPM that the bank was in fact
23 solvent, and that assets would be there to lend to the
24 partnership for the purposes of the land development
25 project.

1 If petitioner had discovered, as it should have,
2 that the bank was insolvent, it never could have put that,
3 and never would have put that, in the PPM, and the scheme
4 would not have gone forward.

5 The allegation is that because the scheme went
6 forward, that cost the bank a substantial amount of money.
7 It did that because shortly after the scheme closed,
8 Federal regulators came in, discovered that the bank was
9 insolvent, and once the bank was insolvent, the land
10 development project couldn't go forward because the assets
11 of the bank were necessary for that project to go forward.

12 So petitioner's negligence directly related to
13 the viability of this project, and by negligently failing
14 to discover that the bank was insolvent, petitioner hurt
15 the bank. Now, the --

16 QUESTION: The FDIC isn't claiming the benefit
17 of the bargain on the land. It's just claiming its
18 broker's fees and that sort of thing.

19 MR. BENDER: The expenses of floating this
20 scheme, and then having to withdraw it, and those expenses
21 were considerable. They're not in proof here, they're
22 merely allegations, but that is exactly what the FDIC is
23 claiming. It's --

24 QUESTION: To whom would they have brought this
25 information? To whose attention would they have brought

1 this information?

2 MR. BENDER: In the first place to the directors
3 and officers of the bank.

4 QUESTION: Who already knew about it.

5 MR. BENDER: Yes, they already knew about it,
6 but to have the law firm bring it to their attention might
7 have stopped them from going forward with the scheme, but
8 more importantly, they shouldn't have signed on to the
9 PPM. The problem was --

10 QUESTION: Well, that might be a -- you know, a
11 dishonorable thing to do, but I don't see how there's any
12 causality here. I mean, to tell the officer what he
13 already knows --

14 MR. BENDER: Because the law firm certification
15 is necessary for shares in this partnership to be sold.
16 If the law firm had said, we can't prepare this PPM
17 because the bank isn't solvent, and therefore we can't say
18 to potential investors that the funds are there to fund
19 the development project, then the development project
20 wouldn't have gone forward. That's the causality.

21 QUESTION: If the investors were suing, it would
22 be a different matter, but they've already been made
23 whole.

24 MR. BENDER: Right, but the bank is suing, and
25 the bank is suing -- the FDIC is suing in place of the

1 bank, and that's the point I wanted to make. It's very
2 important to understand here --

3 QUESTION: Well, Mr. Bender, before you get to
4 the FDIC's position, isn't it true that so far as
5 California law is concerned -- leaving aside the
6 California law that determines what defenses will be
7 recognized, isn't it true that under California law, so
8 far as the injury that the FDIC is trying to recover for,
9 there's but-for causation in the law firm's failure, but
10 there's not proximate causation, isn't that correct?

11 MR. BENDER: No, I don't think that's correct.
12 I don't think that issue has been tried.

13 QUESTION: Let me ask you a further question
14 anyway. If, under California law, the California view of
15 proximate causation would be that under these
16 circumstances no proximate cause, would you take the
17 position that that rule should yield to a uniform Federal
18 rule, too?

19 MR. BENDER: Yes. Yes. If California law
20 provided -- as I don't think it does, but if it provided,
21 contrary to the factual causation, that there was no
22 proximate causation, then in order to adequately protect
23 the Federal interest, which I'll get to in a moment, that
24 California rule would have to yield to the Federal rule,
25 because the harm here -- because the bank was insolvent,

1 the harm here by petitioner's negligence is not harm to
2 the stockholders.

3 The stockholders -- once the bank is insolvent,
4 the stockholders' stock can't be worth any less. As the
5 petitioner's negligence drives the bank further into
6 insolvency, the harm occurs to the creditors of the bank.
7 Who are the creditors of the bank? The creditors of the
8 bank are principally the depositors.

9 QUESTION: So you do say that there has to be an
10 underlying Federal rule determining the scope of duties of
11 the counsel to its insured institution.

12 MR. BENDER: No, not the scope of duties, and
13 not the rule of negligence. Those things are determined
14 under California law. The duty here was to the bank --
15 not to the stockholders, not to the insiders, but to the
16 bank.

17 QUESTION: But I'm not sure what the source of
18 law is for you to prevail if, as Justice Souter said,
19 there's no proximate causation under the law of
20 California.

21 MR. BENDER: Because under the law of California
22 there's a duty to the bank, and under the law of
23 California, the allegation is that the petitioner was
24 negligent.

25 If the petitioner's negligence caused harm to

1 the Federal interest, which it did here, our position is
2 that California cannot have a rule of law that would
3 prevent that Federal interest from being vindicated.

4 QUESTION: Well, you're just really picking
5 whatever favors the Government out of California law,
6 then. You're saying, we like the California standard of
7 negligence, so we accept that, but we don't like what
8 might be the California standard of causation, so we
9 reject that. Is there anything more principled than just
10 whatever favors the Government in your --

11 MR. BENDER: It's not whatever favors the
12 Government in some proprietary sense. It's a question of
13 whatever furthers the interests of the Federal
14 legislation. The Federal legislation, as we all know,
15 provides that deposits in a bank like this are insured by
16 the Federal Government, and in turn they are insured by
17 the taxpayers who have to make sure that the fund has
18 enough in it to pay the Federal Government.

19 When negligence is committed to an insolvent
20 bank, that causes harm to the depositors. The money to
21 pay back their deposits, the pool of money, goes down.

22 QUESTION: Yes, but the Government is always
23 presumably acting on behalf of citizens, and it seems to
24 me that by substituting whatever furthers the interest
25 disclosed by the statute for whatever favors the Federal

1 Government really isn't a substitution at all.

2 You're saying, whatever gets us -- it seems to
3 me you're saying whatever gets us the greatest recovery,
4 or the greatest measure of success, however it's going to
5 be measured, is going to be the criterion for picking it.

6 MR. BENDER: No, it's not whatever gets us the
7 greatest recovery, it's whatever adequately provides for
8 compensation for the harm done to the Federal Deposit
9 Insurance --

10 QUESTION: Well, you never want to recover more
11 than 100 percent, so once again, I don't see the
12 distinction that you're making.

13 MR. BENDER: It's the harm done to the fund.
14 The negligence of a professional in representing an
15 insolvent bank, which causes loss of money to that bank,
16 directly causes harm to the depositors of the bank. If
17 the depositors were not insured, the bank would be held in
18 trust for them. That's ancient common law -- in trust for
19 the creditors and the depositors.

20 Here, the depositors are insured, so the FDI
21 stands in their shoes. The harm that's done here is harm
22 by negligence to the deposit fund, and all the FDIC is
23 trying to recover here is the harm to the deposit fund.

24 QUESTION: But then it seems to me that you
25 should be proceeding under something other than 12 U.S.C.

1 1821.

2 MR. BENDER: Why is that, Justice Kennedy?

3 QUESTION: Because your whole hypothesis is that
4 you are succeeding to a cause of action that exists under
5 the State law, and under Justice Souter's hypothetical
6 question, that isn't true, and you say you prevail
7 anyway --

8 MR. BENDER: No --

9 QUESTION: -- and it seems to me that what
10 you're doing is basing a substantive right of recovery,
11 one which formulates the duty of the professional, as a
12 matter of Federal law. I suppose it's a plausible enough
13 position, but it's certainly not under 1821.

14 MR. BENDER: Well, Federal law initially
15 applies, but as this Court knows, the presumption is that
16 in cases involving the FDIC we will use State law as long
17 as the State law adequately protects the Federal interest.

18 QUESTION: Mr. Bender, would you clarify,
19 because Justice Kennedy's question raised a point that I
20 didn't think you were contesting, that the claim
21 initially -- the claim for negligence against the law firm
22 arises under State law, is that not so?

23 MR. BENDER: It's almost metaphysical. This
24 Court has said on most occasions that when the FDI sues
25 the law that's applicable is Federal law, but the Federal

1 law initially presumes that State law is applicable, and
2 the Federal law borrows State law, except where the State
3 law is inconsistent with the purposes of the Federal
4 statute. It's a through --

5 QUESTION: Why do you allow the State to insist
6 on negligence? I mean, if you really want to protect the
7 Federal fisc, why don't you impose an absolute liability
8 on these lawyers to make sure that everything's okay?

9 MR. BENDER: Because I think the presumption of
10 the Federal scheme here is that professionals who work for
11 a federally insured bank shouldn't be absolutely liable.
12 They should be liable under --

13 QUESTION: Why make that presumption? I can
14 understand the answer, the presumption is that State law
15 applies.

16 MR. BENDER: Because it would be --

17 QUESTION: The presumption is that the normal
18 responsibilities which existed before the FDIC took over
19 continue afterwards, and that nothing changes simply
20 because the Government steps in. As the statute says, it
21 steps into the rights of the bank.

22 MR. BENDER: And we don't challenge that. The
23 normal responsibilities continue to apply, but what this
24 case involves, as Mr. Lee has said, is whether a
25 particular defense should be applicable, and you've got to

1 look at the reasons for that defense and see whether the
2 reasons make it applicable here.

3 QUESTION: But you borrow -- even the initial
4 claim, it's just the Federal law picking up the State law,
5 even though this is successor liability. This is a
6 receiver succeeding to a claim that allegedly the bank
7 had.

8 MR. BENDER: But it's the bank's claim, it's not
9 the stockholders' claim. It's not Sahni and Day's claim.

10 QUESTION: But if the bank had a claim, it was
11 under California law --

12 MR. BENDER: Right.

13 QUESTION: -- not under Federal law, but you say
14 that claim that the bank had then gets transformed into a
15 Federal claim and if the State law continues to apply it's
16 only by grace of the Federal law.

17 MR. BENDER: And if State law totally eliminated
18 the bank's claim in this situation, that might raise a
19 federalism problem, and Federal law might have to come in
20 and say that that's not sufficient to protect the Federal
21 interest. That doesn't arise in this case, because State
22 law here clearly provides a cause of action for negligent
23 professionals who serve banks.

24 What the petitioner wants to do here is raise a
25 defense which it says it can raise because the insiders at

1 the bank committed wrongdoing, and as an equitable matter
2 they shouldn't be liable because the insiders committed
3 wrongdoing.

4 That would be a perfectly good defense if the
5 insiders were suing, the insiders were the 100 percent
6 stockholders. Then it wouldn't be fair, and State law
7 would provide and so would Federal law. It wouldn't be
8 fair to let the insiders recover, but that's not this
9 case.

10 QUESTION: Well, what is the State law with
11 regard to the imputation defense in these circumstances?

12 MR. BENDER: It's not entirely clear, Justice
13 O'Connor. We believe that State law would hold, as would
14 the law of most States, as most Federal courts that have
15 had to guess what State law was in this area have held,
16 that State law would hold that this imputation defense is
17 not available to petitioner in these circumstances,
18 because the people who are suing are not the wrongdoers.

19 QUESTION: Well then, why do we need a Federal
20 rule?

21 MR. BENDER: You need a Federal rule in case
22 State law should hold otherwise.

23 QUESTION: Well, wouldn't you think normally the
24 court would determine what the State law is before
25 deciding such a question?

1 MR. BENDER: In this case, the Ninth Circuit
2 divided the issue in an interesting way. The Ninth
3 Circuit first held that the wrongdoing of Sahni and Day
4 would not be imputed to the bank because the bank's
5 interest, once the bank was insolvent, was adverse to the
6 interests of Sahni and Day.

7 It's not clear whether they -- in doing that
8 they were relying on State law or Federal law. The
9 opinion relies on some Federal cases, it rejects the
10 leading Federal -- State case that petitioners cite,
11 but --

12 QUESTION: Well, maybe we should just send it
13 back.

14 MR. BENDER: Well, I don't think you should, and
15 the reason we acquiesced in certiorari here is because the
16 defense that was raised by the petitioners in the district
17 court and in the court of appeals is one which if it were
18 viable would be a very important defense. It would stop
19 the FDIC from getting compensation to the fund for all
20 kinds of wrongdoing.

21 The Ninth Circuit, we believe, correctly
22 rejected that defense. It's a very important point of
23 Federal law, we think, to affirm what the Ninth Circuit
24 did and say that this equitable defense is not available
25 when the people who were suing are not the wrongdoers, and

1 here --

2 QUESTION: Mr. Bender, this goes back to a
3 question that was raised in the course of Mr. Lee's
4 argument, is this conflict really necessary? If the State
5 and Federal law are the same on the point, then why should
6 we, at least in this case, resolve this question of what
7 if the State law were different, then would it be
8 displaced by Federal law?

9 MR. BENDER: The reason for resolution is
10 because that issue is raised -- there are many, many of
11 these lawsuits involving over \$1 billion in asserted
12 liability that are brought by the FDIC all around the
13 country. This defense, this kind of defense, imputation
14 defense that the bank is somehow responsible for the
15 wrongdoing of the insiders is raised by defendant
16 professionals in those suits over and over again.

17 The Ninth Circuit rejected that defense. That
18 rejection is an important point of Federal law, and that's
19 the reason we assume the Court granted certiorari in this
20 case, and that's the important Federal issue that needs to
21 be resolved.

22 Because if you don't -- if you permit that
23 imputation defense to be available, you do two things:
24 1) you really harm the Federal interest here. You harm
25 the Federal interest because professionals --

1 QUESTION: Of course. I mean, any defense does.
2 I'd stipulate that. Of course you do. You say -- you get
3 less money.

4 MR. BENDER: It's worse than that. It's worse
5 than that. Think about a law firm which is retained by a
6 bank, and what the incentives are if this defense were
7 available. The incentives are not to discover fraud, not
8 to discover that the bank is insolvent.

9 If you discover that the bank is insolvent,
10 what's going to happen? You'll have to say so. You won't
11 be able to finish the PPM. The project won't be able to
12 go forward. You may never even get your fee. Because the
13 bank's insolvent, you're just a creditor. The depositors
14 come first.

15 On the other hand, if you don't discover it,
16 then you get paid, the scheme goes forward, and if the
17 defense applies, you're never going to be liable. The
18 incentive --

19 QUESTION: Why is that unique to the Federal
20 Government situation? Isn't it the same in California?

21 MR. BENDER: I think it is, and therefore we
22 think that California would hold the same way.

23 QUESTION: Why isn't it State law, then, rather
24 than Federal law?

25 MR. BENDER: Well, it's Federal law if the State

1 law doesn't provide that.

2 QUESTION: I know, but that's just grabbing
3 whatever is best for the Government.

4 MR. BENDER: No, it's not grabbing what's best
5 for the Government, Chief Justice Rehnquist, it's
6 establishing a minimum base of Federal law that's
7 necessary.

8 QUESTION: But it seems to me your arguments, as
9 Justice Scalia suggest, don't show why the Federal
10 Government here is in any different position than anyone
11 else who might have been hurt by this sort of transaction.

12 MR. BENDER: I agree with that, that the Federal
13 Government is in the --

14 QUESTION: Why should there be a special rule
15 for the Federal Government?

16 MR. BENDER: There should be a special rule if a
17 State, as petitioners argue here, were to depart from that
18 rule. If a State were to say, you do impute the defense
19 to the bank, and stop the bank from suing, that rule --

20 QUESTION: But your argument seems to me simply
21 to boil down to the fact that there ought to be a Federal
22 common law rule whenever the State common law rule isn't
23 good enough.

24 MR. BENDER: Isn't adequate to protect the
25 Federal interest. That's what Kimbell Foods holds.

1 You have a national Federal program here of
2 insuring these institutions. You have a program where the
3 FDIC becomes subrogated to the claims of the depositors.
4 It is important for that National Federal program 1) to
5 make sure that the depositors' claims, which the FDIC is
6 subrogated to, are compensated, so if the fund --

7 QUESTION: Well, what is there intrinsic in your
8 argument that addresses the need for a common law rule as
9 distinct from the need to amend the statute?

10 MR. BENDER: The statute was written, we
11 believe, in light of the background that this Federal
12 common law necessary to preserve the Federal interest
13 would be available. We don't think you can read --

14 QUESTION: How do we know that?

15 MR. BENDER: The Federal --

16 QUESTION: I mean, it seems to me the rabbit is
17 coming out of the hat, but I mean, you put the rabbit in
18 the hat. How do we know that?

19 MR. BENDER: Well, the question is -- the
20 statute I take it you're referring to is FIRREA in 1989.

21 QUESTION: Yes.

22 MR. BENDER: The question is, assuming that
23 there was -- and we think it's clear that prior to that
24 time there was this minimum base of Federal common law
25 necessary to preserve the interests of the Federal

1 program. Just like in D'Oench, Duhme, the Court said
2 there's a rule of Federal law that says that unwritten
3 side agreements can't be applied against the FDIC.

4 QUESTION: But nobody could identify that common
5 law, nobody could identify that debt until we first apply
6 the statute and find some deficiency in the statute, and
7 then we say, aha, there must have been the bed of common
8 law that was assumed to prevent this unfortunate result.

9 MR. BENDER: No, I don't think so, Justice
10 Souter.

11 QUESTION: You've got to be able to discover it
12 some way other than in order to chink up whatever's wrong
13 in your case.

14 MR. BENDER: I don't think so, because I don't
15 think the statute purports to be a total package of what
16 the Federal Government's rights are, nor does petitioner.

17 Petitioner admits, and we agree, that State
18 common law of negligence would be available to the FDIC
19 here, so it's clear that the -- and that's after FIRREA
20 was enacted in 1989. It's clear that FIRREA didn't mean
21 to take over exclusively all of the rights of the FDIC in
22 suing the professional in this case. Everybody agrees
23 that they at least have the rights provided by State and
24 common law.

25 QUESTION: But I don't know why that isn't a

1 good argument simply for concluding that the Feds take the
2 common law as it was, including the common law defenses,
3 and you take the bitter with the sweet.

4 MR. BENDER: Well, because that's not what the
5 Court has held over the years, and I think it would be
6 wrong to hold that.

7 The Feds presumptively take the common law as it
8 is, but if there's something in the common law that would
9 be applied by the State that insufficiently protects the
10 Federal interest, as in D'Oench, Duhme, for example --

11 QUESTION: Let's talk about D'Oench, Duhme. The
12 Federal statute, you're there. I think you could make the
13 argument which you're trying to make about FIRREA -- the
14 FIRREA statute, that it was legislated against a
15 background of Federal common law. D'Oench, Duhme was
16 decided 3 years after Erie.

17 MR. BENDER: Right.

18 QUESTION: And the legislation at issue in that
19 case was undoubtedly enacted on the assumption that
20 Federal courts applied Federal law, period. You wouldn't
21 have to dance around Erie and Claxton and all of that
22 stuff.

23 But we're in a different age now. You can't --

24 MR. BENDER: Right.

25 QUESTION: -- and I don't think Congress when it

1 passes a statute like this assumes that there's some
2 brooding Federal law that governs all of this stuff.

3 MR. BENDER: Well, they assume that there's a
4 body of common law that is going to be applicable and
5 available to the FDIC.

6 QUESTION: Oh, I think they assume there's a
7 body of State common law, State by State, and that the
8 rights of parties on financial transactions are going to
9 be determined by State law.

10 MR. BENDER: Even when State law would mean that
11 the Federal interest was not adequately protected.

12 QUESTION: Which is why they have exceptions in
13 there. They have some specific rules eliminating certain
14 defenses because they think those are important enough
15 that they're willing to override State law.

16 MR. BENDER: Then the question in this case is
17 whether you can assume that Congress, in passing FIRREA,
18 meant to say, all defenses that the State would provide
19 are available, except those we specifically exclude here.

20 QUESTION: Why shouldn't we assume that?

21 MR. BENDER: You shouldn't assume that because I
22 don't think that was Congress' purpose in passing it. It
23 would be especially ironic to assume that in this case
24 when we know that Congress' principal purpose in passing
25 FIRREA was to shore up the ability of the system to stop

1 malfeasance from draining the Federal Treasury, as had
2 happened many times during the decade before this statute.

3 Many banks became insolvent because of the
4 wrongdoing of insiders of the banks, and in part because
5 outside professionals called in by those insiders did not
6 act carefully to protect the Federal fisc.

7 QUESTION: But not at all costs. I mean, this
8 is the old argument that since an act has some purpose,
9 anything that impedes that purpose has to be overridden.
10 Nobody enacts legislation that way.

11 MR. BENDER: But there's no -- there's no
12 significant cost here. The only cost that would be
13 present here is the cost of not permitting the petitioners
14 to use a defense against people who the defense was never
15 meant to be usable against.

16 As Justice O'Connor said during Mr. Lee's
17 argument, the purpose of this defense is to stop
18 wrongdoers from collecting for their own wrongdoing. That
19 would --

20 QUESTION: Was there any attempt, Mr. Bender, in
21 the district court to determine whether that was indeed
22 the content of California law, so you don't need to -- you
23 don't need to displace California law? We can't tell from
24 the summary judgment that's included in the appendix what
25 the district court went on.

1 MR. BENDER: No. You can -- the only way I can
2 tell is from the same thing that you have before you.

3 The district judge said, very summarily, that he
4 didn't think the law firm owed any duty to anybody except
5 the investors in the scheme, and the finding that the
6 investors had been compensated -- the investment was
7 cancelled and they got their money back. Finding that the
8 investors had been compensated, he said, well, there's no
9 duty to anybody else, and therefore I grant summary
10 judgment. That was patently wrong.

11 The duty of the professionals -- maybe they do
12 have a duty to the investors, but their primary duty is to
13 their client, and the client here is the bank, so the
14 district court just went off on something that was wrong.
15 There was a duty to the bank.

16 QUESTION: Mr. Bender, you said a second ago
17 that the point here is to prevent the defense from being
18 used against someone against whom under State law it
19 couldn't have been used. Mr. Lee's argument was that you
20 succeeded to rights and not to claims, and so that in fact
21 the right is determined by reference to those against whom
22 the defense would in fact have been assertable under State
23 law. What is your answer to that?

24 MR. BENDER: I think you have to see it in time
25 sequence. The bank is insolvent. The professional

1 commits negligence. The negligence harms the bank, and
2 with an insolvent bank, the negligence harms the creditors
3 of the bank. The negligence harms the depositors.

4 At that time, the depositors have a claim which
5 is held in trust for them by the bank. The depositors
6 have a claim against the petitioner, against the outside
7 professional.

8 The defense doesn't come in until that suit is
9 brought. When that suit is brought, the professional
10 says, we have a defense. What's the defense? The defense
11 is equitable estoppel, because the insiders of the bank
12 were wrongdoers. That just doesn't apply.

13 QUESTION: So you're saying the claim is -- the
14 relevant claim is the depositors' claim, not the bank.

15 MR. BENDER: Exactly. Exactly, and I think it's
16 really important -- there are a number of amicus briefs
17 filed in this case which say that the thing that's wrong
18 with the Ninth Circuit decision is it changes the rules of
19 professional responsibility, and that that's an
20 inappropriate thing for the Federal Government to do, and
21 we think that by and large that is an inappropriate thing
22 for the Federal Government to do, but that's not what the
23 Ninth Circuit decided in this case.

24 Nothing the Ninth Circuit decided has anything
25 to do with the duty of care of the professionals. They

1 had a duty of care when they took on this assignment. If
2 you had said to them the moment after they were retained
3 by the bank, do you have a duty of care to discover things
4 that should be in the PPM that aren't there, or do you
5 have a duty of care to make sure the statements said in
6 there are correct, the answer would be yes. For them to
7 say --

8 QUESTION: -- things that they already know.
9 Isn't that a new duty?

10 MR. BENDER: But Justice Scalia, it's not just
11 the directors. The PPM isn't for the benefit of the
12 directors. The PPM is for the benefit of the investors,
13 and they --

14 QUESTION: Whatever. Doesn't that constitute a
15 new duty, a duty that they didn't have before?

16 MR. BENDER: No, no. It's a duty that they have
17 because the bank is insolvent. They have a duty to their
18 client, and their client is the bank, and at the moment of
19 insolvency the bank is no longer the directors, and the
20 bank is no longer the shareholders.

21 At the moment of insolvency, the bank becomes
22 the creditors of the bank, and the bank holds those
23 creditors' claims in trust, so their duty is, at that
24 moment, to those creditors, and it's just not plausible
25 that they are absolved from that duty because of the

1 wrongdoing of somebody completely different.

2 QUESTION: The duty is the same, it's just that
3 people who didn't used to be able to sue for the violation
4 of that duty can now sue for the violation of that duty.
5 That's a pretty big change.

6 MR. BENDER: I wouldn't concede that they didn't
7 used to be able to sue. These people could always sue.
8 The question is whether --

9 QUESTION: The bank?

10 MR. BENDER: The bank. The creditors. They
11 can't sue --

12 QUESTION: I'm not talking about the creditors.
13 I'm talking about the bank or the FDIC, which is now
14 standing in the shoes of the --

15 MR. BENDER: The bank is the creditors when the
16 bank becomes insolvent. That's the key to understanding
17 this case. If this had happened while the bank was
18 solvent, there would be a perfectly good defense, because
19 while the bank was solvent, then the harms caused here --
20 the \$10 million, let's say, that was spent on this aborted
21 scheme -- would come out of the pockets of the
22 shareholders. Their stock would be worth less.

23 So while the bank is solvent, then this defense
24 applies, but once the bank becomes insolvent, then the
25 interests of the creditors are the important interests,

1 and there was never a defense against those creditors.
2 They never did anything wrong. It's utterly absurd to say
3 that.

4 What the Ninth Circuit held was that if State
5 law purported to say that absurdity, if State law
6 purported to get in the way of a lawsuit that's
7 1) necessary to compensate the fund, and 2) -- and I think
8 this is important -- necessary to make sure that
9 professionals who act on behalf of insured savings
10 institutions do so carefully, if State law got in the way
11 of that and tried to erect a law that didn't protect those
12 interests, then that's just where the theory of Kimbell
13 Foods comes into play.

14 Then the State law is not adequately protecting
15 the Federal interest, and under Kimbell Foods and under
16 D'Oench, Duhme, under a long line of this Court's
17 decisions, that State law is discarded, is not used
18 because it's not adequate to protect the Federal interest.

19 It's really important to understand here what's
20 really going on is the need to have a system of law that
21 adequately protects insured institutions against looting
22 by insiders. That's not fanciful. Looting by insiders of
23 insured institutions cause billions of dollars to the
24 Federal fisc.

25 Sometimes, in a significant number of those

1 cases, Congress found that the negligent conduct of third
2 party professionals was causal in permitting those
3 insiders to do the looting. It's important, it's vital
4 under Kimbell Foods, it would frustrate the Federal
5 interest under Kimbell Foods, if you had State law
6 applying that didn't protect that interest.

7 QUESTION: Mr. Bender, was it in FIRREA that
8 they specifically provided for directors' liability in
9 certain cases where the liability might have been doubtful
10 under State law?

11 MR. BENDER: Yes.

12 QUESTION: Isn't that a pretty good reason to
13 assume that Congress did it's picking and choosing when it
14 decided the extent to which State common law might need to
15 be modified to protect the Federal interest?

16 MR. BENDER: No, because I don't think FIRREA --
17 FIRREA added administrative claims against directors or
18 administrative penalties, but that's different from --

19 QUESTION: Well, didn't it do it -- I may be
20 wrong on this, but didn't it do it at least on an arguably
21 more -- on a standard of liability that was arguably more
22 onerous to the directors than any standard of liability at
23 common law that would have sufficed for recovery?

24 MR. BENDER: For those administrative penalties.

25 QUESTION: Yes.

1 MR. BENDER: But that did not supplant the State
2 common law, the Federal common law which will absorb the
3 State common law, of directors' liability for negligence.
4 That was -- that gross negligence standard was for
5 administrative penalties.

6 Those penalties, by the way, do not go to the
7 same place, and that's very important. Those penalties do
8 not go into the insurance fund, so that cannot be seen as
9 an attempt to protect the insurance fund. That's more of
10 a penal way of controlling the directors' behavior.

11 I don't think petitioner urges, and we certainly
12 don't, that that provision of FIRREA was meant to displace
13 the State common law of negligence of directors and
14 officers. That's still in place, and even more clearly
15 the law here is.

16 QUESTION: Thank you, Mr. Bender. Mr. Lee, you
17 have 9 minutes remaining.

18 REBUTTAL ARGUMENT OF REX E. LEE

19 ON BEHALF OF THE PETITIONER

20 MR. LEE: We're told that Federal common law is
21 necessary in order to vindicate the Federal interest.
22 What vindicates the Federal interest is for Congress, and
23 Congress here has spoken.

24 We have heard not one word in response to
25 section 1821 as governing both of these two issues, and

1 there is no response.

2 QUESTION: May I ask you, Mr. Lee, on 1821, do
3 your California cases address the question whether this
4 defense would be available if the suit had been brought by
5 a depositor as opposed to the bank?

6 MR. LEE: I think not, but let me address that
7 right now, because --

8 QUESTION: Then is it not fair to say that the
9 State law is unclear on the precise issue that we have
10 before us?

11 MR. LEE: No, because the precise issue of the
12 depositors is not before this Court, and I -- that's one
13 of the most important things that I need to clarify in
14 this rebuttal.

15 QUESTION: We wouldn't have this suit, I
16 suppose, if the provision read that FDIC shall acquire all
17 rights of the depositors, as opposed to saying, all rights
18 of the bank.

19 MR. LEE: Of course, and you don't even turn to
20 State law because the Federal statute is --

21 QUESTION: Doesn't the statute say precisely
22 that, it succeeds to all rights, titles, powers, and so
23 forth, of the institution, and of any stockholder, member,
24 account-holder, depositor, and so forth?

25 MR. LEE: Yes, but on the second issue of the

1 standing in the shoes, it deals with that expressly and on
2 its own.

3 But let me just cut right through, Justice
4 Stevens, and tell you that the real answer to this is that
5 the claims of the creditors are not involved in this case
6 for two separate and independently sufficient reasons.
7 The first is that under this Court's decision in Dietrich
8 v. Standard Surety, in order for the FDIC to assert claims
9 on behalf of creditors, those have to be alleged and
10 proven. They have been neither in this case.

11 Moreover, under this Court's recent decision in
12 Holmes v. Sipek, they could not be proven. Why? Because
13 in the language of that decision there is too much -- the
14 link is too remote between the O'Melveny & Myers law firm
15 and those creditors.

16 This is not -- the proximate cause defense is
17 not just a -- it's not just a defense, it is also an
18 element of the claim, as Holmes v. Sipek makes very clear.

19 The Ninth Circuit did not rely on the claims of
20 creditors. The Government did not rely on the claims of
21 creditors when it originally brought this suit, and those
22 claims of creditors simply are not at issue in this case.

23 Now, coming back to the vindication of Federal
24 interests, in addition to the specific statute, which
25 stands unassailed, you also have this comprehensive

1 statute, FIRREA.

2 Mr. Bender says -- and it's absolutely essential
3 to his case to say this -- that this is not a total
4 package of Federal law. I assert to you, it is a total
5 package of Federal law under City of Milwaukee, and if the
6 Court were to determine that this is not a total package
7 of Federal law, then City of Milwaukee has got to be
8 overruled.

9 It did, Justice Souter, establish a higher duty
10 of obligation on behalf of officers and directors.

11 It also, Justice Scalia, eliminated a lot of
12 defenses, probably dozens of defenses, but some of them it
13 left intact, and if City of Milwaukee and Kimbell Foods
14 mean anything at all, it is that when Congress has spoken
15 definitively and comprehensively, picking out some to be
16 left in place and others to be displaced, it is not the
17 job, then, of the lawyers for the Federal Government and
18 the Federal courts to come along behind and declare what
19 Federal policy is.

20 Now, with regard to causation, the only way that
21 the Government can satisfy the causation responsibility in
22 this case is to argue for a but-for House-That-Jack-Built
23 type of causation. Necessarily, the causation that we're
24 talking about in this instance if California law applies,
25 as it must, is proximate causation and not but-for

1 causation.

2 I invite the Court's attention to Flagg v. Seng,
3 which is very clear on this point, and is squarely
4 consonant with Holmes v. Sipek. That case says that
5 unless there is justifiable reliance, which there is not
6 if you impute the knowledge of the agent to the
7 corporation, then there is no proximate cause, and it's
8 not, as I say, just a defense, it is also an element of
9 the claim.

10 With regard to Kimbell Foods, let me just point
11 out I've heard nothing today, and really there is nothing
12 effective in the brief, that disputes as to all three of
13 those Kimbell Foods factors the following: 1) they are
14 mixing and matching. The argument that has been made here
15 today that they're now asserting the claims of creditors,
16 when they didn't even assert them in their complaint, is
17 another classic example of mixing and matching. With
18 regard to the second, the --

19 QUESTION: Mr. Lee --

20 MR. LEE: Yes.

21 QUESTION: -- I mean, there's always to some
22 extent mixing and matching. I don't know any Federal
23 common law scheme that -- individual property rights, for
24 example, are still always determined by State law.

25 MR. LEE: Exactly.

1 QUESTION: There's always some mixing and
2 matching.

3 MR. LEE: Exactly, and we don't object to that.
4 All we object to is the Government, in those instances
5 when it does mix and match, come in and then say that it's
6 absolutely essential to have a uniform body of law,
7 because as this Court said in Yazell, that is rejected by
8 their own conduct.

9 QUESTION: With regard to the second, we have
10 heard nothing in response to what this Court said in
11 Kimbell Foods that there are two other purposes that
12 underlie these Federal insurance statutes, and these
13 Federal insurance statutes do have other purposes.

14 And with regard to that, Justice O'Connor, as to
15 how the taxpayers and the citizens will ultimately be
16 served, let me just turn Mr. Bender's point around and ask
17 us to put ourselves in the position of the O'Melveny
18 partners when the next case comes up in which they're
19 asked to represent a savings and loan and the Ninth
20 Circuit law still remains in place.

21 Probably the reaction is going to be, we don't
22 know what law is going to apply, we don't know what has
23 happened, we have no -- absolutely no indication at this
24 time of any wrongdoing, and we certainly didn't in this
25 instance, let's just stay out of it altogether. Or at the

1 very least, if we get into it, the price is going to have
2 to go up. Either way, ultimately, it's the public that
3 will pay.

4 Now, finally, the one thing that is clear from
5 the briefs and from this argument is that the judgment of
6 the Ninth Circuit must be reversed. They erred. They
7 erred in holding that it was Federal rather than State law
8 that applied. The only question is, should it be
9 remanded, or should this Court just make final disposition
10 of the case?

11 I submit that there is no doubt as to what
12 California law is, and if the Court will permit, I will
13 simply -- well, I won't read it. I will simply refer you
14 to West American Financial, which states very clearly
15 there is an exception governing the circumstance where the
16 agent is acting on his own behalf, but there is also an
17 exception to the exception, and that exception to the
18 exception applies where the agent is in fact acting for
19 his principal, and that's on page 969 of that opinion.

20 QUESTION: Mr. Lee, what's your best example of
21 this Court reaching out to decide a question of State law
22 contrary to what the alleged Federal common law rule would
23 be, contrary to what is the law in many other States?

24 MR. LEE: Oh, I think not contrary to what the
25 law is many other States, but --

1 QUESTION: In some other States.

2 MR. LEE: Yes -- well, the best example is West
3 v. AT&T, which is cited at footnote 9 of our reply brief.

4 Mr. Chief Justice, unless the Court has
5 questions, I have nothing further.

6 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Lee.

7 The case is submitted.

8 (Whereupon, at 11:02 a.m., the case in the
9 above-entitled matter was submitted.)

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CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

O'MELVENY & MYERS, Petitioner v. FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER FOR AMERICAN DIVERSIFIED SAVINGS BANK, ET AL., No. 93-489

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY *Ann Marie Federico*

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