No. 98-1933

In the Supreme Court of the United States

AZTEC GENERAL AGENCY, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL DEPOSIT INSURANCE CORPORATION IN OPPOSITION

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QUESTION PRESENTED

Whether the FDIC correctly denied petitioner's claim for deposit insurance on 24 letters of credit (LOCs) because the books and records of the failed issuing institutions revealed that the LOCs were not backed by "hard" or "tangible" assets on deposit.

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OPINIONS BELOW

The order of the court of appeals (Pet. App. 1) enforcing the determination of the Federal Deposit Insurance Corporation (FDIC) is unreported. The FDIC's denial of petitioner's claim for deposit insurance appears at Tab 7 to the Administrative Record (A.R. Tab 7).

JURISDICTION

The petition for review was denied on November 18, 1998. Pet. App. 2. The petition for a writ of certiorari was filed on February 16, 1999. The jurisdiction of the Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq.*, the Federal Deposit Insurance Corporation (FDIC) insures bank and savings association deposits in prescribed circumstances. The issue in this case is whether the FDIC properly rejected petitioner's claim that letters of credit, not backed by any hard or tangible assets, were "insured deposits" under the Act. An "insured deposit" is "the net amount due to any depositor for deposits in an insured depository institution" after deducting offsets, less any part thereof which is in excess of $100,000. 12 U.S.C. 1813(m)(1).[1] When appropriate, the FDIC pays a depositor "as soon as possible * * * in an amount equal to the insured deposit of such depositor." 12 U.S.C. 1821(f)(1). The FDIC determines the amount

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[1] A "deposit" in turn, is defined in 12 U.S.C. 1813(*l*)(1), in pertinent part, as follows:

> the unpaid balance of money or its equivalent received or held by a bank or a savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or savings association, or a letter of credit or a traveler's check on which the bank or savings association is primarily liable: *Provided*, That, without limiting the generality of the term "money or its equivalent," any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable.

of an insured deposit by examining the deposit insurance records of a failed federally insured institution. 12 C.F.R. 330.3(i). In making that determination, the FDIC may rely on the deposit account records of the failed institution. 12 C.F.R. 330.5(a)(1).[2]

Letters of credit (LOCs) are insurable as deposits only when they are issued in exchange for "tangible assets" or "hard earnings" and are reflected as a liability on the bank's books and records. *Philadelphia Gear Corp.* v. *FDIC*, 476 U.S. 426, 438-440 (1986). Without such hard assets, the FDIC treats the letter of credit for deposit insurance purposes as though no

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[2] 12 C.F.R. 330.5(a)(1) provides, in pertinent part:

> [I]n determining the amount of insurance available to each depositor, the FDIC shall presume that deposited funds are actually owned in the manner indicated on the deposit account records of the insured depository institution. If the FDIC, in its sole discretion, determines that the deposit account records of the insured depository institution are clear and unambiguous, those records shall be considered binding on the depositor, and the FDIC shall consider no other records on the manner in which the funds are owned.

Courts have held that those records provide conclusive support for the FDIC's determination. See, *e.g.*, *Nimon* v. *RTC*, 975 F.2d 240, 246 (5th Cir 1992) ("when the account records are clear and unambiguous, their statement of the capacity in which funds are owned is conclusive"); *Abdulla Fouad & Sons* v. *FDIC*, 898 F.2d 482, 484 (5th Cir. 1990) ("Congress has restricted the class of possible federal deposit insurance claimants by providing that FDIC may recognize ownership of deposit accounts only when held by persons whose name or interest is disclosed on the deposit account records."); *Philadelphia Gear Corp.* v. *FDIC*, 751 F.2d 1131, 1138 (10th Cir. 1984) ("The law provides that the records of the insolvent bank are conclusive as to a claimant's entitlement to deposit insurance."), rev'd on other grounds, 476 U.S. 426 (1986).

commitment had been made and therefore no insurable deposit had been lost. *Id.* at 440.

2. On November 20, 1995, petitioner filed a claim for deposit insurance with the FDIC for more than $6 million, plus $5 million in punitive damages, contending that 52 LOCs issued for its benefit by 47 separate depository institutions were insured deposits.[3] On January 30, 1996, the FDIC denied that claim, and petitioner sought review by the court of appeals. FDIC C.A. Br. 2. On March 28, 1997, the court of appeals vacated the FDIC's determination, stating that the agency's denial of petitioner's insurance claim "fails to provide a reasoned explanation under the appropriate standard of review." A.R. Tab 4, at 1. The court of appeals concluded that the FDIC's administrative record contained deficiencies and remanded the case to the agency. *Id.* at 5.

3. On remand, the FDIC conducted an exhaustive investigation of the deposit records of each issuing

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[3] In September 1991, petitioner had filed a state court action against the FDIC and Chireno State Bank (Chireno), seeking recovery on one LOC. That LOC, issued by Chireno at the request of J&D Construction, was backed by a contingent promissory note secured by equipment and was payable if petitioner drew upon it. A.R. Tab B-24, at 2-3. The FDIC, however, had been appointed Chireno's receiver in May 1991. It intervened, removed the case to federal court, and moved to dismiss on jurisdictional grounds. The district court instead granted summary judgment in petitioner's favor. Pet. App. 9. The court of appeals vacated that decision because petitioner had failed to file a claim with the FDIC for a final insurance determination. Such a determination is itself reviewable only by a court of appeals. FDIC C.A. Br. Add. A. The court of appeals remanded to the district court with instructions to dismiss. When petitioner filed its deposit insurance claim with the FDIC on November 20, 1995, however, the number of LOCs for which it claimed deposit insurance had increased to 52.

institution. It reviewed the books, records, and files of each institution for all 52 LOCs that formed petitioner's November 20, 1995, claim. As part of that investigation, the FDIC, through its claims agent in Dallas, also requested from petitioner any supplemental documentation, written evidence, or argument in support of its claim. A.R. Tab 5. Petitioner submitted no additional documentation or evidence, stating that the "LOCs need no additional documentation." A.R. Tab 6.

On June 19, 1997, the FDIC issued its deposit insurance determination on petitioner's claim. A.R. Tab 7. The FDIC first addressed 27 LOCs issued by 20 institutions that had not failed and which therefore were not eligible for payment of deposit insurance. A.R. Tab 7, Exhs. A-1 through A-20. The FDIC advised petitioner that any claims based upon theories of recovery on the 27 LOCs issued by open institutions "[are] properly addressed to those institutions." A.R. Tab 7, at 1.

The FDIC then turned to 25 LOCs issued by institutions that had failed and for which deposit insurance might be owing. A.R. Tab 7, Exhs. B-1 through B-25. The FDIC denied deposit insurance coverage as to all 25 LOCs. The FDIC set out a chart detailing the reasons for the denials, including: (1) LOCs that were not listed on the books and records of the issuing institution; (2) LOCs that had passed to a bank that had assumed the assets and liabilities of the failed bank; (3) LOCs that had expired; (4) LOCs that were the subject of an allowed receivership claim filed years before by petitioner; (5) an LOC claim that had been settled in earlier litigation; (6) LOCs that had been previously disaffirmed by the receiver as a standby letter of credit (including the Chireno LOC that was the subject of the vacated district court action); and (7) LOCs that had expired and were later disaffirmed by

the receiver. A.R. Tab 7, Exh. B.[4] In a number of instances, more than one of those defects applied. Petitioner was apprised of its right to request review by the court of appeals. Pet. C.A. Br. Add. A.

4. The court of appeals denied, without opinion, petitioner's petition for review. Pet. App. 1-2.

ARGUMENT

The court of appeals correctly enforced the FDIC's denial of deposit insurance on all 24 LOCs that petitioner included in its appeal.[5] The court's holding does not conflict with any decision of this Court or any other court of appeals. Further review therefore is not warranted.

1. Petitioner contends (Pet. 3) that the court of appeals' decision conflicts with *FDIC* v. *Philadelphia Gear Corp.*, 476 U.S. 426 (1986), which involved an insurance claim on a standby letter of credit.[6] Petitioner asserts that *Philadelphia Gear* denied deposit insurance coverage for a standby letter of credit backed only by a contingent promissory note (not hard assets), and therefore all *commercial* letters of credit (which it claims the 24 LOCs to be) are insured whether backed

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[4] In addition, two of the LOCs were issued by credit unions. The FDIC lacks regulatory authority over credit unions and does not have a legal obligation to insure deposits in those institutions. A.R. Tab 7, at 1.

[5] In the court of appeals, petitioner dropped claims to several LOCs, limiting itself to 24 LOCs issued by failed institutions. Pet. C.A. Br. 4-5.

[6] A standby letter of credit typically obligates the issuer to make payment on an indebtedness of the account party, or to make payment on a default of the account party. See *Philadelphia Gear*, 476 U.S. at 428. A commercial letter of credit, by contrast, typically obligates the issuer without regard to a default of the account party. *Ibid.* See 12 C.F.R. 337.2(a).

by hard assets or not. Pet. 4-8. That argument is incorrect.

In *Philadelphia Gear*, this Court held that a standby letter of credit does not constitute an insured deposit if it was issued in exchange for a contingent note. 476 U.S. at 439-440. The beneficiary of a letter of credit is entitled to recover deposit insurance upon the issuing bank's failure only if the account party deposited "hard assets" or "tangible assets" in exchange for the letter. See 476 U.S. at 440. As the Court noted, that situation typically occurs with a standard commercial letter of credit. *Ibid.* Where hard assets back up a letter of credit, the rationale of deposit insurance—that "someone who put tangible assets into a bank could always get those assets back"—is demonstrably met. *Id.* at 435.

Petitioner errs in interpreting *Philadelphia Gear* to mean that "only standby letters of credit must be backed by hard assets to become insured deposits." Pet. 5. The absence of *hard assets* on deposit, and not the LOC's status as "standby," is what rendered the standby letter of credit uninsurable in *Philadelphia Gear*. Petitioner's erroneous understanding of *Philadelphia Gear* leads it to assert incorrectly (Pet. 5) that all *commercial* letters of credit must be fully insured. Although this Court in *Philadelphia Gear* noted that commercial letters of credit are "typically" backed by hard assets, it did not find that *every* commercial letter of credit is so backed and therefore is an insured deposit. See 476 U.S. at 440 ("With a standard 'commercial' letter of credit, Orion would typically have unconditionally entrusted Penn Square with funds before Penn Square would have written the letter of credit, and thus Orion would have lost something if Penn Square became unable to honor its obligations."). By

the same token, the Court did not rule that standby letters of credit can *never* be backed by hard assets and therefore can never qualify for federal insurance. A *standby* letter of credit may indeed qualify for deposit insurance when "hard assets" have been deposited in the bank to back it up. See *id.* at 438.[7]

In short, this Court's decision in *Philadelphia Gear* makes clear that an LOC is an insured deposit only when it is backed by hard assets. The court of appeals properly applied that test here. Petitioner offers no authority from any court of appeals to support its position.

2. The FDIC exhaustively examined the underlying documentation of the LOCs and properly found that none of the 24 LOCs at issue was backed by "hard assets." The FDIC claims agent located and examined in detail the books and account records of every issuing institution, and not one of the LOCs for which petitioner claims deposit insurance was listed as a liability on any of the books and records of those failed banks. A.R. Tab 7, Exhs. B-1 through B-25. The absence of appropriate documentation in those account records—which include all types of records that "relate to the insured depository institution's deposit taking function"

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[7] Petitioner also wrongly suggests that "commercial" letter of credit is synonymous with "clean" letter of credit. Pet. 3. A letter of credit is "clean" when the beneficiary may draw upon it upon presentation of a sight draft; the issuing bank may not require other documents, such as proof of the account, party's performance, or default. See, *e.g.*, *Ensco Envtl. Serv., Inc.* v. *United States*, 650 F. Supp. 583, 589 (W.D. Mo. 1986). A standby letter of credit, however, may also be "clean." *Baker* v. *National Boulevard Bank*, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975). The FDIC's deposit insurance determination does not turn on whether a letter of credit is "clean."

(12 C.F.R 330.1(e))—is dispositive. The FDIC may rely exclusively on the account records of the failed institution in making deposit insurance determinations. See *In re Collins Sec. Corp.*, 998 F.2d 551, 554 (8th Cir. 1993) ("FDIC's longstanding practice of looking primarily at the failed bank's deposit account records in determining insurance claims is clearly a permissible interpretation of [its] statutory mandate[]").[8]

Accordingly, the court of appeals correctly held that petitioner has no entitlement to deposit insurance for any of its LOCs. Furthermore, any case-specific dispute over the adequacy of the FDIC's factual inquiry in this case would not warrant the Court's review.

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[8] In this case, the FDIC did not limit itself to the books and records of the failed institutions in determining that each of the LOCs upon which petitioner sued was not an insured deposit. The FDIC also exercised its discretion to inquire into whether petitioner had evidence to support its claim and invited petitioner to produce any such evidence. See 12 C.F.R. 330.5(a)(1); A.R. Tab 5. Petitioner's response—that the LOCs "need no further documentation as they are insured deposits" (A.R. Tab 6)—provides no contrary evidence that would call into question the FDIC's determination.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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