

Déjà Vu All Over Again:
Preparing for Claims Against Bank Officers and Directors

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INTRODUCTION

The current financial crisis is unparalleled since the savings and loan crisis, when 1,813 financial institutions failed.² There have been a total of 181 bank failures since 2008, with projections indicating that many more bank failures may be on the horizon. Recent figures suggest that the current financial crisis may ultimately overshadow the experience twenty years ago.³ As an officer or director of a distressed financial institution, navigating through these troubled waters can be treacherous and, unfortunately, the risk of litigation is high.

The officers and directors of a failing or failed bank face scrutiny by one or more regulators, but the most likely threat of litigation is from the Federal Deposit Insurance Corporation (“FDIC”). When a federally insured bank is closed, the FDIC is appointed as conservator or receiver. The FDIC may then pursue a claim against directors or officers of the failed financial institutions in an effort to recoup losses to the bank. Of the financial institutions that failed in the period between 1985 and 1992, the FDIC

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² Between 1985 and 1992, there were 794 bank failures and 1,019 savings and loan failures. *Recent Bank Failures and Regulatory Initiatives: Hearing Before the H. Comm. on Banking and Financial Services*, 106th Cong. (2000) (testimony of Donna Tanoue, Chairman, FDIC).

³ According to an article relying upon statistics from the MIT Center for Real Estate, commercial real estate has experienced a 39% decline in prices from the peak period two years ago, which is much higher than the 27% real estate decline from the prior savings and loan crisis of the late 1980's and early 1990's. *Commercial Real Estate Crisis Threatens Recovery*, Atlanta Journal-Constitution, September 15, 2009.

initiated claims against the former officers and directors of 24 percent of those institutions.⁴

According to an FDIC Policy Statement, claims will not be brought against officers and directors “who fulfill their responsibilities, including the duties of loyalty and care, and who make reasonable business judgments on a fully informed basis and after proper deliberation.”⁵ In general, actions were brought against officers and directors during the savings and loan crisis where the FDIC believed that there was evidence of (i) dishonest conduct or abusive insider transactions; (ii) violations of internal policies, law or regulations that resulted in a safety or soundness violation; or (iii) failure to establish, monitor or follow proper underwriting procedures, or heed warnings from regulators or advisors.⁶

In a replay of the earlier crisis, the FDIC has begun to investigate many of the failed banks and to make pre-litigation demands for payment of civil damages against officers and directors of some failed banks for losses incurred by the bank. There is no public source of information regarding the number of investigations or subpoenas that have been issued by the FDIC. It is also too early to determine how aggressive the FDIC will be in filing civil actions against officers and directors of failed banks. As noted in the FDIC Policy Statement, however, “the FDIC brings suits only where they are

⁴ FDIC Financial Institution Letter (FIL-87-92), December 3, 1992. The Resolution Trust Corporation (“RTC”) pursued claims against officers and directors in one-third of the number of institutions it handled. *Final Report of the Resolution Trust Corporation Professional Liability Section and Office of Investigations*, April 1996.

⁵ FDIC Financial Institution Letter (FIL-87-92), December 3, 1992.

⁶ *Id.*

believed to be sound on the merits and likely to be cost effective.”⁷ The use of the phrase “cost effective” suggests a cost-benefit analysis on the part of the FDIC, which also reflects the approach the FDIC appears to be taking thus far with the bank failures to date.⁸

In those instances where the FDIC asserts claims against officers and directors of a failed bank, a threshold issue will be to determine the applicable standard against which the individual conduct will be judged for the FDIC to establish liability. Claims brought by the FDIC against directors and officers for civil monetary damages will be governed by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”), 12 U.S.C. § 1821(k), which provides that gross negligence is the standard of liability unless the state law imposes a more strict standard of liability, such as negligence.⁹ Thus, for claims brought by the FDIC under 12 U.S.C. § 1821(k), the standard of liability may vary depending upon state law. Accordingly, a careful analysis of the standard of liability under applicable state law is a critical first step in representing officers and directors of failed banks.

In Georgia, recent decisions have clarified that corporate directors and officers (i) are afforded the protective presumption of the business judgment rule, and (ii) are not

⁷ *Id.*

⁸ Most of the claims arising from the financial institution failures of the 1980s were closed following the investigations by the RTC or FDIC, either because of lack factual or legal support on the merits, or because it did not appear that there would be adequate resources to recover on the claim. Settlements were reached in most of the claims that were pursued, although settlement typically was reached after litigation had commenced. Federal Deposit Insurance Corporation, *Managing the Crisis: The FDIC and RTC Experience 1980–1994* 271 (1998).

⁹ Bank officers and directors may also be subject to claims for statutory violations and/or administrative actions under 12 U.S.C. § 1818, which imposes different standards than 12 U.S.C. § 1821(k).

personally liable on claims for ordinary negligence. These recent Georgia decisions should also be applicable in the context of bank officer and director liability. Because Georgia does not impose the more strict negligence standard of liability, gross negligence therefore should be the applicable standard for liability in Georgia for claims brought by the FDIC under 12 U.S.C. § 1821(k).

DISCUSSION

FIRREA's Minimum Standard for Director and Officer Liability: Gross Negligence

Under FIRREA, the FDIC must show gross negligence or more culpable conduct, by a director or officer for that individual to be personally liable for money damages, unless the applicable state law imposes a stricter standard. FIRREA, therefore, sets a federally-mandated minimum threshold for liability in claims brought by the FDIC against former bank officers and directors. Enacted in the midst of the savings and loan crisis, it provides that:

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 FDIC] . . . acting as conservator or receiver . . . 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.

12 U.S.C. § 1821(k).

Therefore, gross negligence is the baseline and liability may be imposed against bank directors or officers for conduct that equals or exceeds this level of culpability (intentional torts). “The federal statute . . . sets a ‘gross negligence’ floor which applies as a substitute for state standards that are more relaxed.” *Atherton v. FDIC*, 519 U.S.

213, 216 (1997). The last sentence of Section 1821(k), the savings clause, however, makes clear that states may impose a stricter standard of liability, such as simple negligence. “[S]tate law sets the standard of conduct as long as the state standard (such as simple negligence) is stricter than that of the federal statute.” *Id.* Therefore, FIRREA requires initial reference to the state law to determine whether it has imposed a stricter threshold for officer and director liability.

The dispositive issue for discerning the potential liability of officers and directors of Georgia-based banks in claims by the FDIC is the standard under which Georgia law holds bank officers and directors liable. If it is stricter than gross negligence, Georgia law applies. If it is less strict, then the federal law mandate applies (*i.e.*, the gross negligence standard). Although this would appear to be a simple issue, the uneven development of Georgia law regarding officer and director liability has, in the past, created some ambiguity in this area. Recent decisions by the Georgia Court of Appeals, however, have now made it clear that officers and directors of Georgia corporations may not be personally liable for simple negligence. These decisions also lead to the conclusion that claims brought by the FDIC under 12 U.S.C. § 1821(k) against Georgia bank officers and directors will be governed by a gross negligence standard.

The Standard Of Conduct For Georgia Bank Directors And Officers

The seminal decision on the standard of care for bank directors is the century-old United States Supreme Court decision, *Briggs v. Spaulding*, which holds:

Directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and this includes something more than officiating as figure heads. They are entitled under the law to commit banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision, nor ought they to

be permitted to be shielded from liability because of want of knowledge of wrong-doing, if that ignorance is the result of gross inattention....

141 U.S. 132, 165-66 (1891). The Georgia Supreme Court in *Woodward v. Stewart*, 149

Ga. 620, 624, 101 S.E. 749, 750 (1919), followed *Briggs* and adopted a similar standard:

Whatever the rule is at common law or in other jurisdictions, the general rule in this state is that directors of a bank must exercise ordinary care and diligence in the administration of the affairs of the bank, and that the active management of the bank may be delegated to certain officers authorized to manage the business of the bank. A reasonable supervision of such officers, however, is incumbent upon the directors.

Georgia subsequently codified the standard of care for bank officers and directors in a statute, which provides:

(a) Directors and officers of a bank or trust company shall discharge the duties of their respective positions in good faith and with that diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances in like positions. In discharging his duties, a director or officer, when acting in good faith, shall be entitled to rely upon information, opinions, reports, or statements, including financial statements and other financial data, in each case prepared or presented by:

(1) One or more officers or employees of the bank or trust company whom the director or officer reasonably believes to be reliable and competent in the matters presented;

(2) Counsel, public accountants, or other persons as to matters which the director or officer reasonably believes to be within such person's professional or expert competence; or

(3) A committee of the board upon which the director or officer does not serve, duly designated in accordance with a provision of the articles of incorporation or the bylaws, as to matters within that committee's designated authority, which committee the director or officer reasonably believes to merit confidence;

but such director or officer shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause such reliance to be unwarranted. A director or officer who so performs his duties shall have no liability by reason of being or having been a director or officer of the bank or trust company.

O.C.G.A. § 7-1-490.¹⁰

The last sentence of this statute makes it clear that an officer or director “who performs his duties” in compliance with these standards shall have no personal liability for holding such a position.¹¹ The standard of care, however, does not provide the complete answer to the question of when an officer or director may be held personally liable.

The Business Judgment Rule in Georgia

The business judgment rule, developed under common law, generally protects corporate officers and directors from liability for ordinary negligence.

The business judgment rule protects directors and officers from liability when they make good faith business decisions in an informed and deliberate manner. The presumption is that they have acted “on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” Unless this presumption is rebutted, they cannot be held personally liable for managerial decisions. However, officers may be held liable where they engage in fraud, bad faith, or an abuse of discretion.

TSG Water Res., Inc. v. D’Alba & Donovan, 260 F. App’x 191, 197 (11th Cir. 2007) (internal citations omitted). *See also Medserv Corp. v. Nemnom*, No. 95-Cv-0462-TWT, 1997 U.S. Dist. LEXIS 18246, at *9-10 (N.D. Ga. 1997) (“It has been held that an action for breach of fiduciary duty by a corporate officer requires a showing of more than mere negligence or careless performance of his duties. Georgia follows the

¹⁰ Georgia has parallel statutes that set forth the standard of conduct for corporate officers and directors. *See* O.C.G.A. § 14-2-842; O.C.G.A. § 14-2-930. The corporate statutes have also been applied to bank directors and officers in the context of lawsuits under 12 U.S.C. § 1821 (k). *See RTC v. Artley*, Civ. Action No. CV492-209, at 11-12 (S.D. Ga. 1993) (unpublished). The predecessor to the current Georgia statute, O.C.G.A. § 7-1-490, was intended to codify the standard set forth in *Woodward. Boddy v. Theiling*, 129 Ga. App. 273, 275, 199 S.E.2d 379, 382 (1973).

¹¹ The corporate counterpart to this statute provides that “A director is not liable to the corporation or to its shareholders for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this Code section.” O.C.G.A. § 14-2-830(d).

business judgment rule. This protects officers and directors from liability when they made good faith business decisions in an informed and deliberate manner.”) *Id.* at *10-11 (internal citation omitted.)

The first reported decision by a Georgia court clearly holding that the business judgment rule protects Georgia officers and directors from liability for simple negligence was *Flexible Products Co. v. Ervast*, 284 Ga. App. 178, 643 S.E.2d 560, 564-65 (2007).

Georgia's business judgment rule relieves officers and directors from liability for acts or omissions taken in good faith compliance with their corporate duties. OCGA §§ 14-2-830(d); 14-2-842(d). Such rule forecloses liability in officers and directors for ordinary negligence in discharging their duties. *See* OCGA §§ 14-2-830(a)(2); 14-2-842(a)(2) (allowing officers and directors to discharge their duties under an ordinarily prudent man standard to the extent they reasonably rely on the advice of counsel, without independent knowledge, rendering such reliance unwarranted). “[O]rdinary diligence or negligence is what an ordinarily prudent man would do under the same circumstances....” Given that officers and directors thus are protected from liability for ordinary negligence, the trial court erred in refusing to direct a verdict for Flexible on Ervast's ordinary negligence claim.

284 Ga. App. 178, 182, 643 S.E.2d 560, 564-65 (2007) (internal citations omitted).¹²

Very recently, the Georgia Court of Appeals expressed more clearly the procedural and substantive application of the business judgment rule in *Brock Built, LLC v. Blake*, 300 Ga. App. 816, 821-22, 686 S.E.2d 425, 430 (2009).

Georgia law requires that corporate officers and directors discharge their duties in good faith and with the care of an ordinary prudent person in a like position. OCGA §§ 14-2-830(a); 14-2-842(a). In determining whether a corporate officer has fulfilled his or her statutory duty, Georgia courts apply the business judgment rule. The business judgment rule affords an officer the presumption that he or she acted in good faith, and absolves the officer of personal liability unless it is established that he or she engaged in fraud, bad faith or an abuse of discretion:

¹² Even with the clarity of the *Flexible* decision, some confusion remained as a result of the *Rosenfeld v. Rosenfeld*, 286 Ga. App. 61, 648 S.E.2d 399 (2007) decision, which was rendered during the same term as *Flexible*, but by a partial, and thus nonbinding, panel of the Court of Appeals. The *Rosenfeld* decision appeared to hold that an officer or director could be held liable for simple negligence, but did not consider the application of the business judgment rule.

The business judgment rule protects . . . officers from liability when they make good faith business decisions in an informed and deliberate manner. The presumption is that they have acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Unless this presumption is rebutted, they cannot be held personally liable for managerial decisions. However, officers may be held liable where they engage in fraud, bad faith, or an abuse of discretion.

Allegations amounting to mere negligence, carelessness, or “lackadaisical performance” are insufficient as a matter of law.

Id. (Citations and punctuation omitted.)

In *Brock Built*, the court granted summary judgment to the corporate defendants, where the plaintiff had only alleged negligence or carelessness in the performance of the officers’ duties. The *Brock Built* court recognized the business judgment rule as a rebuttable presumption, rather than a defense. The court held that an allegation of negligent or careless performance is not enough to rebut the presumption that officer acted in an “informed and deliberate manner.” Accordingly, claims of simple negligence, without more, should be dismissed at the pleading stage.

**CLAIMS UNDER 12 U.S.C. § 1821(K) AGAINST GEORGIA
BANK OFFICERS AND DIRECTORS**

The only decision considering the standard of liability under 12 U.S.C. § 1821(k) applying Georgia law is the unpublished decision, *RTC v. Artley*, Civ. Action No. CV492-209, at 11-12 (S.D. Ga. 1993). In *Artley*, the RTC filed suit against former officers and directors of a failed bank, alleging negligence, gross negligence, breach of fiduciary duty and breach of contract. The RTC alleged that the bank suffered \$53 million in loan losses as a result of the shift from traditional mortgage business to the higher risk and more speculative real estate ventures. The RTC further alleged that the bank had an incentive plan, which rewarded employees for loans, regardless of the soundness of the loans.

The officers and directors in *Artley* moved to dismiss the simple negligence claims, arguing that Georgia does not require a standard of conduct of officers and directors higher than gross negligence.¹³ The *Artley* court rejected this argument, holding that *Woodward* set forth an ordinary negligence standard of conduct for Georgia bank directors.

A review of the Georgia law of directors and officer shows that the level of care required of them is that of an ordinarily diligent person. Failure to exercise this amount of care is characterized as ordinary negligence. Georgia does, therefore, permit actions against directors and officers for simple, or ordinary, negligence.

Id. at 13. That, however, was not the end of the analysis. The court went on to recognize that the business judgment rule applies to bank directors and officers, holding that:

Defendants also argue that the business judgment rule should insulate them from liability. The business judgment rule is a common law development designed to shield directors from liability for good faith decisions which later turn out to be disadvantageous to a company. . . . In order for directors to be liable, they must be action *ultra vires*, fraudulently, or in their own interests in a manner destructive of the company. This third element is precisely what Defendants have been accused of by RTC. Defendants may rely on this doctrine in their defense at trial if they can show that they are entitled to use it. The Court will not read this doctrine so broadly, however, as to eliminate liability for all business decisions taken by the directors.

See Artley, Civ. Action No. CV492-209, at 13. Thus, the *Artley* court found that the RTC had pled sufficient facts regarding the officers' self-dealing to rebut the presumption of the business judgment rule. At trial, the defendants would still be entitled to demonstrate that they had acted on an informed, good faith basis and without self-

¹³The defendants relied upon *Vernon Bowdish Builder, Inc. v. Spalding Lake Homeowners' Ass'n*, 196 Ga. App. 370, 396 S.E.2d 24 (1990), citing *Regenstein v. J. Regenstein Co.*, 213 Ga. 157, 97 S.E.2d 693 (1957).

interest. As a result, the business judgment rule would then protect their decisions from being second-guessed by RTC or the court.

The *Artley* decision comports with what the recent controlling Georgia decisions, *Flexible Products* and *Brock Built* have made more clear: the business judgment rule applies to all officers and directors in Georgia. The *Artley* court recognized that the business judgment rule requires a showing of conduct that is *ultra vires*, fraudulent or actions by the officer or directors in their own self-interest to the detriment of the entity. The *Brock Built* court couched this showing in terms of fraud, bad faith, or an abuse of discretion. Under either approach, the plaintiff has the burden to plead facts that rise to the level of gross negligence or more. Simple negligence is not enough. Accordingly, in claims brought under 12 U.S.C. § 1821(k), the FDIC must, at a minimum, meet the gross negligence standard to establish liability against Georgia officers and directors.

CONCLUSION

In Georgia, bank officers and directors are protected by the rebuttable presumption of the business judgment rule, as is also afforded to corporate officers and directors. Officers and directors of banks should not be personally liable for simple negligence, consistent with the holding of Georgia courts with respect to bank and corporate officers and directors. Accordingly, Georgia law does not impose a stricter standard of liability than gross negligence upon bank officers and directors. As a result, under 12 U.S.C. § 1821(k), gross negligence should be the threshold for liability in claims brought by the FDIC against officers and directors of Georgia banks.