



## **Georgia Failed-Bank Ruling Favors Execs and Boards**

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By Tod Sawicki and Austin Hall

The road to recovery for shareholders of failed banks that lost value in the wake of the recession got tougher this past January, but bank directors and officers can breathe a sigh of relief.

In *Patel v. Patel*, Charles A. Pannell Jr., a U.S. district judge for the Northern District of Georgia, granted our defendants' motion to dismiss a class action brought by shareholders of the holding company for Haven Trust Bank, one of the first banks to fail in the recent wave of Georgia bank failures.

The plaintiffs attempted to bring a class action on behalf of Haven Trust's shareholders who bought stock in its private offerings in 2006 and 2008. The shareholders claimed that the holding company's directors and officers fraudulently and negligently misled them about the condition of the bank and the soundness of its loan portfolio.

In his decision, the judge ruled that the shareholders did not have any basis to allege that the defendants acted with fraudulent intent, and could not show that the alleged misstatements were the reasons the shareholders lost their entire investment when the bank failed (i.e., "loss causation").

The court also ruled that the defendants could not be held personally liable for statements in the Haven Trust stock offering documents because under Georgia law a defendant must make a "direct communication" with a plaintiff to sustain a misrepresentation claim, and the company's statements were not statements of the individuals. The judge therefore dismissed the case in its entirety and entered judgment for the defendants.

The court's ruling on the loss causation issue will be significant and likely to have broad application in cases arising out of the myriad of bank failures and other investment losses caused by the recent economic downturn.

The judge held that the plaintiffs' allegation that the announcement that the Federal Deposit Insurance Corp. was taking over the bank, which effectively wiped out the shareholders' investment in the holding company, failed to satisfy the requirement that they show that the alleged misstatements caused their loss. Specifically, the *Patel* court concluded that the plaintiffs had "not offered any facts distinguishing between losses caused by the defendants' alleged misrepresentations and the intervening events that wreaked havoc on the banking industry as a whole."

The *Patel* court also rejected the plaintiffs' allegations about the defendants' intent to defraud, even in the face of allegations that the defendants, by virtue of their positions and attendance at meetings, knew about the concealed adverse information and had the motive to maintain a dividend stream.

Finally, the Patel court was one of the first to interpret the "direct communication" requirement for Georgia common-law fraud and negligent misrepresentation claims in the context of decisions to purchase, sell or hold securities; a requirement imposed by the recent decision of the Supreme Court of Georgia in *Holmes v. Grubman*.

Recognizing the potential for speculative or frivolous misrepresentation claims, the Holmes court held that plaintiffs must allege and prove a direct communication by each defendant and loss causation.

In *Patel*, the court concluded the individual defendants could not be held personally liable to the shareholders. The court specifically determined that the private offering memoranda sent by the holding company in 2006 and 2008 were communications from the company only — a legal entity separate and distinct from the individual defendants. As such, the statements in those company documents did not qualify as direct communications by any of the individual defendants to any of the company's shareholders.

As one of the first decisions to rule on a shareholder fraud claim arising out of the recent wave of bank failures, the *Patel* case should have a major impact on a number of other shareholder claims, and provide real comfort to directors and officers.

As *Patel* teaches, merely pointing to a bank's failure and alleging that its directors and officers became aware that the bank's condition was worsening will not be enough to even bring, let alone win, a shareholder's claim for fraud or negligent misrepresentation.

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