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FDIC v. D&O Litigation in Georgia Update ■

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With Georgia experiencing the greatest number of failed banks during the recent financial crisis, it is not surprising that it has also been the epicenter of FDIC litigation against former bank directors and officers ("D&Os"). The first suit was filed by FDIC as a receiver against failed bank D&Os in Georgia on January 14, 2011.[2] Since that time, twenty-four lawsuits have been filed against former D&Os in Georgia,[3] and claims against D&Os of nine other failed banks have settled without litigation.[4]

Georgia was also closely watched because it was the center of a hard-fought battle over whether negligence claims could be maintained against D&Os under Georgia law. In many of the cases, the D&Os filed motions to dismiss on the ground that Georgia's business judgment rule protected the D&Os from the FDIC's claims. Most courts agreed and dismissed the FDIC's claims of ordinary negligence.[5] Two of the cases in which motions to dismiss had been filed by the D&Os on this issue wound their way to the Georgia Supreme Court: *FDIC v. Skow and FDIC v. Loudermilk*. The Georgia Supreme Court entered its ruling in *Loudermilk* on July 11, 2014, which has become the seminal decision regarding Georgia's business judgment rule.

The Georgia Supreme Court Determines the Standard of Liability for Directors and Officers

In *FDIC v. Loudermilk*, the Georgia Supreme Court confirmed that the business judgment rule provides protection to Georgia's D&Os, including bank D&Os, from second-guessing the wisdom of their business decisions.[6] As recognized by the Court, the business judgment rule is a process-oriented standard in which both "the wisdom of the decision is

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2 *FDIC as Receiver for Integrity Bank of Alpharetta v. Skow*, Case No. 1:11-cv-00111-JEC (U.S. District Court for the Northern District of Georgia, Filed Jan. 14, 2011).

3 *See Professional Liability Lawsuits*, Federal Deposit Insurance Corporation, https://www.fdic.gov/bank/individual/failed/pls/ (last visited Jan. 18, 2015).

4 *See Professional Liability Settlement Agreements*, Federal Deposit Insurance Corporation, https://www.fdic.gov/about/freedom/plsa/ (last visited Jan. 18, 2015).

5 *FDIC v. Skow*, No. 1:11-cv-111 (N.D. Ga. Feb. 27, 2012) (J. Jones) (applying the business judgment rule to protect directors and officers), *reconsideration denied* (N.D. Ga. Aug. 14, 2012) *interlocutory appeal docketed* No. 12-15878-E (11th Cir. Nov. 26, 2012); *FDIC v. Blackwell*, No. 1:11-cv-3423 (N.D. Ga. Feb. 27, 2012) (J. Story) (applying business judgment rule); *FDIC v. Briscoe*, No. 1:11-cv-2303 (N.D. Ga. Aug. 14, 2012) (J. Jones) (applying business judgment rule); *FDIC v. Whitley*, No. 2:12-cv-170 (N.D. Ga. Dec. 10, 2012) (J. O'Kelley) (applying business judgment rule); *FDIC v. Miller*, No. 2:12-cv- 00042 (N.D. Ga. Dec. 26, 2012) (J. Story) (applying business judgment rule).

6 *FDIC v. Loudermilk, 761 S.E.2d 332 (Ga. 2014).*

ordinarily insulated from judicial review" and "the officers and directors are presumed to have acted in good faith and to have exercised ordinary care" in that process.[7] In the context of the FDIC claims against bank D&Os, only a director or officer who fails to exercise such ordinary care with respect to the process for making a decision, *as measured by ordinarily prudent officers and directors of a similarly situated bank, may be liable for negligence.*

In its opinion, the Georgia Supreme Court initially observed that the "business judgment rule is a fixture in American law," and a "settled part of our common law in Georgia."[8] As summarized by the Court, "[i]f an officer or director has honestly exercised 'judgment' with respect to a business matter – that is, if her decision was made in a deliberative way, was reasonably informed by due diligence, and was made in good faith – the wisdom of the judgment cannot ordinarily be questioned in court."[9] The Court confirmed that the business judgment rule continues to be part of Georgia law and that it "generally precludes claims against officers and directors for their business decisions that sound in ordinary negligence,"[10] basing this ruling on the traditionally "strong judicial reluctance to question the business judgments of" corporate and bank directors and officers.[11]

The FDIC had argued that O.C.G.A. § 7-1-490(a) supersedes the common law business judgment rule because it mandates that "[d]irectors 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 conditions."[12] The Court rejected the FDIC's argument that "if a bank officer or director fails to exercise ordinary care, he is liable, period."[13] The Court held that the statute was intended to retain the common law and that it is consistent with the Court's interpretation of the business judgment rule, i.e., that "the implication of liability [as set forth in the statute] means only that an officer or director who acts in bad faith or fails to exercise such ordinary care with respect to the process for making a decision is liable."[14]

The Court further determined, however, that Georgia's business judgment rule is not a complete shield to liability for all claims regarding business decisions. In reaching this result, the Court overruled two recent Georgia Court of Appeals decisions that held that the business judgment rule bars all ordinary negligence claims for money damages.[15] Both Flexible Prods. Co v. Ervast and Brock Built, LLC. v. Blake stood for the proposition that Georgia's business judgment rule relieves directors from liability for acts or omissions taken in good faith compliance with their corporate duties and "forecloses liability for ordinary negligence in discharging those duties."[16] Taken together, these cases had formed an absolute rule that barred all ordinary negligence claims against D&Os as a matter of law.

Under *Loudermilk*, business decisions of bank directors and officers may form the basis of an actionable claim if—and only if—those decisions "are shown to be made without deliberation, without the requisite diligence to ascertain

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7 *Id.* at 345.

8 *Id.* at 334.

9 *Id.* at 335.

10 *Id.* at 338.

11 *Id.* at 337.

12 O.C.G.A. § 7-1-490(a).

13 *Loudermilk*, 761 S.E.2d at 339.

14 *Id.* at 342.

15 *Brock Built, LLC v. Blake,* 686 S.E.2d 425 (GA. App. 2009); *Flexible Prods. Co. v. Ervast,* 643 S.E.2d 560 (Ga. App. 2007).

16 *Flexible Prods. Co.,* 643 S.E.2d at 564.

and assess the facts and circumstances upon which the decisions are based, or in bad faith."[17] It is significant to note, however, that decisions made "without deliberation" or in "bad faith" are not, by their nature, ordinary negligence. Therefore, in asserting claims for ordinary negligence, the FDIC should be limited to challenging whether the directors and officers had a reasonable process to evaluate the facts and circumstances in making the business decisions. The inquiry must focus on the narrow issues of whether the directors or officers in making the business decisions did so either without deliberation, without assessing the facts upon which the decision was based, or in bad faith.[18]

Loudermilk was intended to bring clarity to whether or under what circumstances bank officers and directors could be held liable for ordinary negligence under Georgia law and, in this regard, the Court provided important guidance. First, "the standard of ordinary care for bank officers and directors is less demanding than the standard of 'ordinary diligence' with which most ordinary negligence claims are concerned."[19] In considering whether D&Os' decision making processes are appropriate, the analysis is governed by the process followed by comparable banks, because "bank officers and directors are only expected to exercise the same diligence and care as would be exercised by 'ordinarily prudent' officers and directors of a similarly situated bank."[20] Second, the Court confirmed that O.C.G.A. § 7-1-490(a) conclusively presumed the reasonableness of a director's or officer's reliance on information presented by certain enumerated third-parties in making a business decision.[21] Third, the Court held that, even with respect to claims of negligence in the process involved in reaching a business decision, directors and officers are always presumed to have exercised ordinary care, and "the plaintiff bears the burden of putting forward proof sufficient to rebut it."[22] However, "whether a business decision was, in fact, a product of deliberation, reasonably informed by due diligence, and made in good faith are matters that may properly be questioned."[23]

Several months after the *Loudermilk* decision, the Georgia Supreme Court entered its ruling on closely related questions certified by the Eleventh Circuit in *FDIC v. Skow*.[24] In Skow, the Court adopted its decision in *Loudermilk* and held that a director or officer may be held liable when, "with respect to the process by which he makes decisions, he fails to exercise the diligence, care, and skill of 'ordinary prudent men [acting] under similar circumstances in like positions.'"[25] The Court explained that the term "process" refers to "the mode by which one deliberates and ascertains the facts relevant to the decision at hand."[26]

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17 *Loudermilk,* 761 S.E.2d at 338.

18 *Id.*

19 *Id.* at 344.

20 *Id.*

21 *Id.*

22 *Id.* at 349.

23 *Loudermilk*, 761 S.E.2d at 335.

24 The certified questions in *Skow* were: "(1) Does a bank director or officer violate the standard of care established by O.C.G.A. § 7-1-490 when he acts in good faith but fails to act with 'ordinary diligence,' as that term is defined in O.C.G.A. § 51-1-2?; (2) In a case like this one, applying Georgia's business judgment rule, can the bank officer or director defendants be held individually liable if they, in fact as alleged, are shown to have been ordinarily negligent or to have breached a fiduciary duty, based on ordinary negligence in performing professional duties?" *FDIC v. Skow*, 741 F.3d 1342, 1347 (11th Cir. 2013).

25 *FDIC v. Skow*, 763 S.E.2d 879, 881 (Ga. 2014).

26 *Id.*

These rulings will now govern the FDIC lawsuits against D&Os that remain pending in Georgia. Until there are further rulings applying Loudermilk and Skow, however, the full meaning and effect of these decisions will remain subject to debate. In one unpublished order, *FDIC v. Boggus*, the Northern District of Georgia denied the defendants' motion to dismiss and, applying *Loudermilk*, held that allegations the bank directors approved loans "without reasonable diligence to ascertain the relevant facts," was sufficient to state a claim.[27] The specific procedural defects that the *Boggus* Court found sufficient to state a claim for ordinary negligence included (i) blanks left in the credit memorandum, (ii) the lack of current and complete financial information from the borrower and guarantor, and (iii) loan approvals without an appraisal.[28] The court noted that "[m]aking a wrong decision is fine. Making an uninformed decision is not."[29]

Summary Judgment Granted to D&Os under North Carolina Law

Despite over a hundred cases filed by the FDIC against D&Os, there has been only one published ruling on a motion for summary judgment based upon the business judgment rule in the recent round of FDIC litigation. Applying North Carolina's business judgment rule in *FDIC v. Willetts*, the Eastern District of North Carolina granted summary judgment in favor of the defendant D&Os on the FDIC's claims for negligence and breach of fiduciary duty.[30]

The FDIC alleged that in approving loans, the D&Os deviated from prudent lending practices established by the bank's loan policy, published regulatory guidelines, and generally established banking practices. The FDIC also alleged that the D&Os ignored prior regulatory criticisms and warnings pertaining to imprudent underwriting practices. The *Willetts* court held that North Carolina's business judgment rule defeated the FDIC's negligence and breach of fiduciary duty claims.

> The business judgment rule involves two presumptions. First, it establishes "'an initial evidentiary presumption that in making a decision the directors [and officers] acted with due care (i.e., on an informed basis) and in good faith in the honest belief that their action was in the best interest of the corporation.'" Second, the business judgment rule establishes, absent rebuttal of the first presumption, a "powerful substantive presumption that a decision by a loyal and informed board will not be overturned by a court unless it cannot be attributed to any rational business purpose."[31]

As a threshold matter, the court found no evidence that any of the directors or officers engaged in self-dealing or fraud, or were engaged in any other unconscionable conduct that might constitute bad faith.[32] Therefore, the business judgment rule precluded the court from delving into whether or not the decisions were "good."[33] Instead, the court was limited to deciding whether the business decisions at issue were made in "good faith" or were founded on a "rational business purpose."[34]

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27 Order, *FDIC v. Boggus, No.* 2:13-cv-00162-WCO, slip op. at *8 (N.D. Ga. Aug. 25, 2014), ECF No. 42.

28 *Id.* at *9-*10.

29 *Id.*

30 Order, *FDIC v. Willetts*, No. 7:11-cv-165-BO (E.D.N.C. Sep. 11, 2014), ECF 124.

31 *Id.* at *6-*7 (citations omitted).

32 *Id.* at *7.

33 *Id.*

34 *Id*.

The court held as a matter of law that the underwriting processes and practices at the bank were rational and that the defendant D&Os acted with a "rational business purpose."[35] Thus, the FDIC failed to overcome the presumption of the business judgment rule and the court granted summary judgment to the defendants. The court was strongly influenced by the Reports of Examination, in which FDIC examiners reviewed the process that the D&Os used to make the challenged loans and gave the bank favorable CAMELS 2 ratings for management, asset quality and sensitivity to market risks.[36] In light of these ratings, the court found that for the FDIC "to now argue that the process behind the loans is irrational is absurd."[37]

While *Willetts* was decided under North Carolina law, as the first summary judgment ruling to address the business judgment rule in the wave of FDIC litigation following the financial crisis, the *Willetts* decision may provide a roadmap in other D&O cases.

Conclusion

The *Loudermilk/Skow* decisions will frame the FDIC litigation against former Georgia bank D&Os as the remaining cases proceed. While the Georgia Supreme Court has now clarified the business judgment rule's presumption of good faith and informed decision making, it has also opened up the potential of ordinary negligence claims previously barred in Georgia. The FDIC litigation provides an opportunity to further develop the application of these principles in Georgia.

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35 *Id.* at *8.

36 *Id.* at *7-*8.

37 *Id.* at *7-*8.

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