



Securities Litigation ADVISORY ■

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Bank Directors and Officers Win Summary Judgment on All FDIC Claims

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Bank directors and officers (D&Os) have scored a significant victory with the first summary judgment ruling in favor of D&Os on claims of negligence, gross negligence and breach of fiduciary duty brought by the Federal Deposit Insurance Corporation (FDIC). On September 12, 2014, the District Court for the Eastern District of North Carolina granted the D&Os' motion for summary judgment under North Carolina law for each count of the FDIC's complaint in *Federal Deposit Insurance Corporation as Receiver for Cooperative Bank v. Willetts*.¹ The district court also rejected the FDIC's argument that the D&Os could have foreseen the financial crisis when the country's economic leaders did not.

The FDIC sued the former Cooperative Bank D&Os following the closure of the bank in June 2009, in connection with their approval of 86 loans made between January 2007 and April 2008. The FDIC sought damages of at least \$40 million, alleging that in approving these loans, the D&Os deviated from prudent lending practices established by Cooperative'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.²

The legal question presented by the summary judgment motion was whether reasonable jurors could find for the FDIC by the preponderance of the evidence. The district court emphatically concluded that they could not.

With respect to the negligence and breach of fiduciary duty claims, the district court held that the business judgment rule defeated the FDIC's 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

¹ *FDIC v. Willetts*, No. 7:11-cv-00165-BO (E.D. N.C. Sept. 11, 2014), ECF No. 124. The FDIC alternatively refers to the case as *FDIC v. Rippy* on its Professional Liability Lawsuits website, available at <https://www.fdic.gov/bank/individual/failed/pls/>.

² See generally, Complaint, *FDIC v. Willetts*, No. 7:11-cv-00165-BO (E.D. N.C. Aug. 10, 2011), ECF No. 1.

"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."³

There was no evidence that any of the D&Os engaged in self-dealing or fraud or were engaged in any other unconscionable conduct that might constitute bad faith. Therefore, the court held that the business judgment rule precluded the court from delving into whether or not the decisions were "good," limiting the court to a determination of whether the decisions were made in "good faith" or were founded on a "rational business purpose."⁴ The court concluded that the evidence in the record made it clear that the D&Os employed a rational process and acted with a rational business purpose.⁵

Importantly, the court observed that the FDIC's own Reports of Examination, in which the FDIC reviewed the bank's policies and processes and gave the bank a passing "2" grade, demonstrated as a matter of law that the D&Os' decision-making processes regarding loans was rational. The court stated that in light of its acceptable ratings, the FDIC's argument "that the process behind the loans is irrational is absurd."⁶ Thus, the court concluded that the FDIC had failed to rebut the first presumption of the business judgment rule by attacking the D&Os' decision-making process.⁷

The district court also concluded that Cooperative's pursuit of the challenged loans in furtherance of its goal to grow to a \$1 billion institution and to stay competitive with other regional and national banks could not be construed as irrational, holding that:

Although there were clearly risks involved in Cooperative's approach, the mere existence of risks cannot be said, in hindsight, to constitute irrationality. Further, corporations are expected to take risks and their directors and officers are entitled to protection from the business judgment rule when those risks turn out poorly. Where, as here, defendants do not display a conscious indifference to risks and where there is no evidence to suggest that they did not have an honest belief that their decisions were made in the company's best interests, then the business judgment rule applies even if those judgments ultimately turned out to be poor.⁸

Next, the district court held that the FDIC could not show that any of the D&Os engaged in wanton conduct or consciously disregarded the bank's well-being. Thus, the court held that the FDIC's gross negligence claim failed as a matter of law.⁹

Significantly, the district court also rejected the FDIC's assertion that the "Great Recession" was not only foreseeable by the D&Os, but was actually foreseen by them. The court specifically addressed this claim "due to the absurdity of the FDIC's position."¹⁰ Observing that the FDIC's position "ignores the unique historical factors...including numerous

³ *FDIC v. Willetts*, No. 7:11-cv-00165-BO, at 6-7 (E.D. N.C. Sept. 11, 2014), ECF No. 124 (citations omitted).

⁴ *Id.* at 7.

⁵ *Id.*

⁶ *Id.* at 7-8.

⁷ *Id.* at 8.

⁸ *Id.* at 9 (citations omitted).

⁹ *Id.* at 10.

¹⁰ *Id.* at 10-11.

economists and economic forecasters' prognosis of a strong economy going forward at that time," the court found the FDIC's argument that the D&Os "were not only more prescient than the nation's most trusted bank regulators and economists, but that they disregarded their own foresight of the coming crisis in favor of making risky loans...is wholly implausible."¹¹

In closing, the district court concluded:

It appears that the only factor between defendants being sued for millions of dollars and receiving millions of dollars in assistance from the government is that Cooperative was not considered to be "too big to fail." Taking the position that a big bank's directors and officers should be forgiven for failure due to its size and an unpredictable economic catastrophe while aggressively pursuing monetary compensation from a small bank's directors and officers is unfortunate if not outright unjust.¹²

As the first summary judgment ruling to address the business judgment rule in the wave of FDIC litigation following the financial crisis, the *Willets* decision will provide a roadmap in other D&O cases. While *Willets* was decided under North Carolina law, the tenets of North Carolina's business judgment rule afford D&Os the same protections as the business judgment rule in many other jurisdictions, which should provide strong support for granting summary judgment in favor of D&Os in other cases as well.

¹¹ *Id.* at 11-12.

¹² *Id.* at 12 (citations omitted).

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