BCLP. Client Intelligent

BankBCLP

A RUNDOWN ON GEORGIA'S FDIC FAILED BANK LITIGATION

Jun 11, 2013

As we have reported before, Georgia has the unfortunate distinction of leading the nation in bank failures since the onset of the late-2000s financial crisis. Georgia has also seen far more FDIC bank failure lawsuits than any other state: 15 of the 63 bank failure cases brought by the FDIC since 2010 involve Georgia banks and are currently pending in Georgia federal courts. While some allegations vary from case to case, the general thrust of all of these lawsuits is that the former directors and/or officers of the banks were negligent or grossly negligent in pursuing aggressive growth strategies, with these strategies usually involving a high concentration of risky and speculative speculative real estate and acquisition, construction and development loans. Here is a rundown of the most interesting and significant developments to date:

The most heavily litigated issue has been whether the business judgment rule insulates bank directors and officers from liability for ordinary negligence. Beginning with Judge Steve C. Jones' decision in *FDIC v. Skow*, concerning the failure of Integrity Bank, the district courts have consistently dismissed ordinary negligence claims, citing the business judgment rule. As we previously reported in November, the Eleventh Circuit has agreed to hear an interlocutory appeal in the *Skow* case. That appeal has now been fully briefed by the parties. The FDIC's briefs can be found here and here, while the Defendants/Appellees' brief can be found here. The parties' briefs all focus on the interplay between the business judgment rule and Georgia's statutory standard of care, with the FDIC arguing that the statute's expression of an ordinary care standard precludes the application of any more lenient standard, and the Defendants/Appellees arguing that Judge Jones correctly followed the Georgia appellate courts' interpretation of the business judgment rule. Note: This firm represents the Georgia Bankers Association and Community Bankers Association of Georgia, who have been granted leave to appear as amici curiae in support of the Defendants/Appellees. The amicus brief can be found here.

Also at issue in the Eleventh Circuit appeal is whether bank directors and officers may assert state law-based affirmative defenses, such as mitigation of damages, that are based on the FDIC's own conduct as receiver. The FDIC asserts that under federal common law, it owes no duty to former directors of a failed bank. Judge Jones denied an early motion for summary judgment by the FDIC, meaning that if the decision stands on appeal, the FDIC will be treated as any ordinary plaintiff would with regard to the duty to mitigate. As the briefs indicate, Judge Jones' decision depended on a rather complicated analysis of whether the "no duty" rule advanced by the FDIC was settled law in the Eleventh Circuit at the time FIRREA was passed.

The FDIC's gross negligence claims have received less attention in the motions to dismiss, with the courts uniformly upholding such claims when challenged so far. In *Skow*, the court held that Integrity Bank's articles of incorporation, which purported to exculpate directors from liability to the bank or its shareholders in cases of gross negligence, did not apply to the present suit because it was not a derivative suit and the FDIC as receiver is not a shareholder. In *FDIC v. Blackwell*, and again in *FDIC v. Miller*, the courts rejected challenges to the sufficiency of the FDIC's allegations, holding that allegations that the defendants repeatedly violated and/or ignored internal loan policies were generally sufficient to defeat a motion to dismiss.

More recent decisions indicate that the FDIC may rely on a failure to supervise theory against former directors, although it is unclear what the FDIC would have to allege and prove to prevail on such a claim. The leading decision on a director's duty to supervise is the Delaware Court of Chancery's 1996 decision in *In re Caremark International Inc. Derivative Litigation*, which until now had never been discussed, let alone recognized as viable, by a Georgia court. Under *Caremark*, if a director "utterly fail[s]" to implement proper internal controls, or "consciously fail[s]" to monitor or oversee operations, the director may be liable for resulting losses or liabilities. In the *Miller* case, the court held that a viable *Caremark* claim was stated against the former Chairman/CEO of Community Bank & Trust, Cornelia, Georgia for failure to monitor or oversee a loan officer who allegedly approved over 100 loans that violated internal policies. Subsequently, in *FDIC v. Adams*, the court found that more generalized allegations of failure to supervise a loan officer, that lacked any allegations of a conscious failure on the directors' part, failed to meet "the high threshold of *Caremark* claims."

Finally, bank boards and their counsel should take note of *Davis v. Bancinsure, Inc.*, a recent D&O insurance coverage decision from the Northern District of Georgia that drives home the importance of policy language in coverage disputes. In *Davis*, the directors and officers of Southern Community Bank sent a notice of circumstances shortly after receiving a cease and desist order from the FDIC (attaching the order to their notice), and then sent a second notice of circumstances days before the bank was closed. The policy in question contained fairly rigid notice requirements that, in the court's view, required the insured parties to state with particularity the alleged wrongful acts, the potential defendants, the alleged injuries, and the reasons for anticipating suit, which the court held the notices in question had failed to do. The court also found that the policy's "insured vs. insured" exclusion applied to claims brought by the FDIC as receiver, even though the policy had deleted a regulatory exclusion by endorsement, because the insured vs. insured clause (which was not deleted and remained in effect) specifically included the word "receiver." An appeal to the Eleventh Circuit was voluntarily dismissed.

MEET THE TEAM

Michael P. Carey

Atlanta

michael.carey@bclplaw.com
+1 404 572 6863

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.