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MARYLAND'S BUSINESS JUDGMENT RULE BARS FDIC'S ORDINARY NEGLIGENCE CLAIMS

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Another court has weighed in on the question of whether the FDIC can sue former directors and officers of failed banks for ordinary negligence. The latest decision comes from a federal court in Maryland, which held that a gross negligence standard must be applied when evaluating the conduct of directors and officers under Maryland's business judgment rule. FDIC v. Arthur, Civil Action No. RDB-14-604 (D. Md. Mar. 2, 2015).

The facts of FDIC v. Arthur follow a now-familiar pattern. Baltimore-based Bradford Bank failed on August 28, 2009 and the FDIC was appointed as its receiver. The four defendants are the bank's former president, a senior loan officer and two directors who served on the bank's loan committee. The FDIC alleged that the defendants were negligent, grossly negligent and breached their fiduciary duties to the bank in connection with seven commercial loan transactions, resulting in losses in excess of $7 million to the bank. FIRREA holds bank directors and officers to a gross negligence standard of conduct; however, the FDIC has routinely asserted that applicable state law holds directors and officers to a stricter ordinary negligence standard, giving the FDIC the right to sue for ordinary negligence. As a result, federal courts across the country have had to determine whether the business judgment rule, as interpreted by the appellate courts in which they sit, permits ordinary negligence claims.

In Maryland, the answer is that ordinary negligence claims are not permitted. Like many states, Maryland has enacted a statutory standard of care. Md. Code. Ann., Corps. & Ass'ns § 2-405.1(a)(3) provides that "[a] director shall perform his duties as a director, including his duties as a member of a committee of the board on which he serves…[w]ith the care that an ordinarily prudent person in a like position would use under similar circumstances." But as the court explained, decisions both before and after the enactment of § 2-405.1 make it clear that "the appropriate test to determine director liability is one of gross negligence." In the court's view, the statute did not intend to supplant existing case law applying the business judgment rule and its gross negligence standard. The court also noted that the gross negligence standard was consistent with both FIRREA and the standard of care employed by Delaware courts. Maryland, like many states, frequently finds Delaware law to be influential in answering questions of corporate governance.

This decision is good news for bank directors and officers in Maryland. For everyone else, it is important to remember that the business judgment rule, and the laws governing the duty of care owed by bank directors and officers, vary from state to state. As a result, the FDIC has had greater success pursuing negligence claims in some states than it has had in others. For instance, an Idaho federal court recently held in FDIC v. Coleman that the business judgment rule did not insulate four loan officers from the FDIC's ordinary negligence claims against them. And last year, the Georgia Supreme Court held in FDIC v. Loudermilk that process-related ordinary negligence claims could be brought against bank directors and officers, though it also recognized that the business judgment rule afforded powerful protections to the defendants.

As a final note, the court in Arthur also addressed the enforceability of tolling agreements between the FDIC and potential defendants in failed bank litigation. It has become fairly common for the FDIC to enter into such arrangements near the expiration of its three year period for bringing suit—and sometimes, to further extend the tolling agreement one or more times. In this case, the FDIC entered into five tolling agreements with the defendants which had the effect of extending its time to sue from August 28, 2012 to February 28, 2014, the date on which it finally brought suit. The defendants argued that the tolling agreements were unenforceable and could not extend FIRREA's statute of limitations. The court, however, found that the overwhelming weight of authority supported enforcing the agreements and treating the lawsuit as timely. Indeed, there are now several cases from multiple jurisdictions upholding the validity of tolling agreements in this context.

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