5-10-2017

The Duty of Care of Bank Directors and Officers

Douglas K. Moll
University of Houston - Law Center, dmoll@central.uh.edu

Julie Andersen Hill
University of Alabama - School of Law, jhill@law.ua.edu

THE UNIVERSITY OF ALABAMA SCHOOL OF LAW

The Duty of Care of Bank Directors and Officers

Julie Andersen Hill
Douglas K. Moll

ALABAMA LAW REVIEW
Volume 65, Page 965 (2017)

THE DUTY OF CARE OF BANK DIRECTORS AND OFFICERS†

*Julie Andersen Hill**

*Douglas K. Moll***

ABSTRACT....966
INTRODUCTION....966
I. DUTY OF CARE LIABILITY IN CORPORATIONS....969
A. *The Oversight Context*....973
B. *The Decision-Making Context*....977
1. *Substantive Due Care*....977
2. *Procedural Due Care*....983
II. DUTY OF CARE LIABILITY IN BANKS....986
A. *Pre-FIRREA*....986
B. *FIRREA*....991
C. *FDIC Guidelines*....993
D. Atherton v. FDIC....995
E. *Today*....998
III. CONTEXT MATTERS....1000
A. *Claims in Context*....1001
B. *Beyond Negligence Versus Gross Negligence*....1003
C. *FIRREA and Context Analysis*....1005
D. *FDIC Guidelines and Practices*....1007
CONCLUSION....1010

 Please direct your comments to jhill@law.ua.edu or dmoll@central.uh.edu.

* Professor of Law, The University of Alabama School of Law.

** Beirne, Maynard & Parsons, L.L.P Professor of Law, University of Houston Law Center.

ABSTRACT

In the aftermath of the 2008 financial crisis, the Federal Deposit Insurance Corporation (FDIC) brought numerous lawsuits against directors and officers of failed banks asserting that they had breached their fiduciary duty of care. Under state corporate law, duty of care claims arise in different contexts, and courts often apply different standards of liability depending upon the context of the claim. In the banking setting, the standard of liability for breach of the duty of care is governed by the federal statute FIRREA and the Supreme Court's decision in Atherton v. FDIC. *In* Atherton, *the Court held that FIRREA allows the FDIC to sue directors and officers of failed banks under either a federal gross negligence standard or any applicable state law standard that imposes liability for less culpable conduct.*

This Article integrates the academic literature on the duty of care in the general corporate setting with the literature on the duty of care in the banking setting. After discussing how duty of care claims are treated in each setting, the Article makes four primary assertions.

First, just as duty of care actions under state corporate law arise in different contexts, so too do duty of care actions in the banking setting.

Second, because the standard of liability can vary depending upon the context, it is often a misleading oversimplification to frame the banker liability debate in any particular jurisdiction as a binary choice between negligence and gross negligence.

Third, because duty of care liability is more nuanced than negligence versus gross negligence, the application of FIRREA and Atherton *to duty of care claims in the banking setting is more complicated than commentators have appreciated.*

Finally, FDIC guidelines that ignore context and suggest a nationwide standard of liability are inaccurate. The FDIC should update its guidelines to accurately reflect both the law and the FDIC's litigation practices.

INTRODUCTION

The 2008 financial crisis was catastrophic for the U.S. banking industry. Between 2007 and 2014, 510 banks failed.[1] Another 700-plus banks received some type of federal monetary assistance.[2] Unsurprisingly,

1. *Failed Bank List*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/bank/individual/failed/banklist.html (last updated Mar. 13, 2017).

2. U.S. DEP'T OF THE TREASURY, TROUBLED ASSET RELIEF PROGRAM, MONTHLY REPORT TO CONGRESS: JULY 2016 (2016), https:www.treasury.gov/initiatives/financial-stability/reports/Documents/2016.07%20July%20Monthly%20Report%20to%20Congress.pdf.

this led to calls to hold bank directors and officers legally accountable for harm they may have caused.[3]

One federal regulator with the power to hold directors and officers of failed banks financially responsible is the Federal Deposit Insurance Corporation (FDIC). The FDIC acts as a receiver for failed banks.[4] It has authority to sue directors and officers for losses they caused to failed banks[5] and has been aggressive in doing so:

> From January 1, 2009, through February 23, 2017, the FDIC has authorized suits in connection with 152 failed institutions against 1,216 individuals for D&O liability. This includes 109 filed D&O lawsuits (100 of which have fully settled, and 3 of which resulted in favorable jury verdicts) naming 832 former directors and officers.[6]

Yet even as the FDIC brings director and officer suits, the standard of liability for breach of the duty of care in the banking setting is misunderstood.

Duty of care liability in non-bank corporations is typically governed by state statute and common law. While the law differs somewhat from state to state, the standard of liability often varies depending upon the specific claim. If the shareholders (on behalf of the corporation)[7] allege that the directors and officers made poor substantive decisions, the directors and officers are largely insulated from liability by the business judgment rule.[8] If, however, the shareholders allege that the directors and officers exercised

3. *See, e.g.*, Maria Aspan, *N.Y. Regulator Lawsky Calls for Aggressive Penalties*, AM. BANKER, Mar. 20, 2014, at 3 (reporting that Benjamin Lawsky, then head of New York's Department of Financial Services, called for "putting people in jail" and "suspensions, firings, bonus claw-backs, and other types of penalties in the regulatory context"); Susan Page, *Ben Bernanke: More Execs Should Have Gone to Jail for Causing Great Recession*, USA TODAY (Nov. 13, 2015, 11:38 AM), http://www.usatoday.com/story/news/politics/2015/10/04/ben-bernanke-execs-jail-great-recession-federal-reserve/72959402/ (reporting that former Federal Reserve Chairman Benjamin Bernanke "would have favored more individual accountability" for bankers during the financial crisis); Frank Vogl, *Top Bankers Evaded Financial Crisis Justice—and Will Never Be Prosecuted for Their Crimes*, HUFFINGTON POST (Jan. 14, 2014), http://www.huffingtonpost.com/frank-vogl/rakoff-wall-street-prosecutions_b_4589648.html (last updated Mar. 16, 2014) (stating that "multi-millionaire American bankers are beneficiaries of judicial impunity that enables them to operate above the law").

4. 12 U.S.C. § 1821(d)(2)(A)(i) (2012).

5. *Id.* § 1821(k)(1).

6. *Professional Liability Lawsuits*, FED. DEPOSIT INS. CORP., www.fdic.gov/bank/individual/failed/pls/ (last updated Feb. 24, 2017).

7. A shareholder can bring a derivative action "to remedy a violation of a corporation's rights." DOUGLAS K. MOLL & ROBERT A. RAGAZZO, CLOSELY HELD CORPORATIONS § 9.01 (LexisNexis 2015). "Derivative suits permit shareholders to proceed in the corporation's name against directors and officers who have committed misconduct. Since directors and officers are unlikely to sue themselves, derivative suits serve a useful function in deterring and remedying such misconduct." *Id.* (footnote omitted).

8. *See infra* notes 43–53 and accompanying text.

inadequate oversight or were not sufficiently informed when making a decision, the directors and officers are subject to a greater chance of liability.[9]

In contrast, duty of care liability in the banking setting is governed partly by a federal statute—the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)—that imposes liability for "gross negligence [or] similar conduct . . . that demonstrates a greater disregard of a duty of care."[10] In 1997, the United States Supreme Court held that FIRREA allows the FDIC to sue directors and officers of failed banks under either a federal gross negligence standard or any applicable state law standard that imposes liability for less culpable conduct.[11] Perhaps because FIRREA uses "gross negligence" language, nearly all the commentary on bank director and officer liability focuses on whether the standard for bankers is negligence or gross negligence.[12] Regulatory guidance and academic commentary both fail to acknowledge and incorporate a key insight from corporate law: the standard of liability for breach of the duty of care often varies depending upon the context of the particular claim.

This Article integrates the academic literature on the duty of care in the general corporate setting with the literature on the duty of care in the banking setting. It shows that just as in corporate law, in banking the context of the claim matters. This moves the discussion beyond the simplistic negligence versus gross negligence debate that pervades discussions on bankers' duty of care.

Part I discusses duty of care liability for directors and officers of non-bank corporations. It explains that claims against directors and officers arise in two contexts: oversight and decision-making. The standard of liability can vary depending upon the context and the particular claim within that context.

Part II examines duty of care liability for directors and officers of banks. It shows that in spite of nearly a century of rhetoric focused on "negligence versus gross negligence," the FDIC and courts today often rely on state corporate law that is, at times, more nuanced.

Part III explains the importance of considering context when discussing duty of care liability in the banking setting. We make four claims. First, just as duty of care actions under state corporate law arise in different contexts, so too do duty of care actions in the banking setting. Some arise from the alleged failure of bankers to oversee the bank, while others arise

9. *See infra* notes 37–40, 75–76 and accompanying text.

10. Pub. L. No. 101-73, § 212(k), 103 Stat. 183, 243 (1989) (codified at 12 U.S.C. § 1821(k) (2012)).

11. Atherton v. FDIC, 519 U.S. 213 (1997).

12. *See infra* notes 190–194 and accompanying text.

from allegedly poor banker decisions. Second, because the standard of liability can vary depending upon the context, it is often a misleading oversimplification to frame the banker liability debate in any particular jurisdiction as a binary choice between negligence and gross negligence. Indeed, the standard of liability can vary by claim within a single state. Moreover, the standard itself may require something other than a negligence or gross negligence showing. Third, because duty of care liability is more nuanced than negligence versus gross negligence, the application of FIRREA and *Atherton* to duty of care claims in the banking setting is more complicated than commentators have appreciated. Finally, because duty of care claims arise in different contexts, and because standards of liability for such claims are defined by state law, FDIC guidelines that ignore context and suggest a nationwide standard of liability are inaccurate. The guidelines are also inconsistent with the FDIC's practice of aggressively pursuing state law claims. We recommend that the FDIC update its guidelines to accurately reflect both the law and the FDIC's litigation practices.

I. DUTY OF CARE LIABILITY IN CORPORATIONS[13]

As a general proposition, a person who engages in conduct that creates a risk of harm to others has a duty to act as a reasonably prudent person would act in the circumstances. Although this proposition is usually associated with tort law, the basic concept is important to corporate law as well. Indeed, directors and officers[14] owe a fiduciary duty to their corporations to act carefully in carrying out their responsibilities. In many jurisdictions, this "duty of care" is phrased in negligence-sounding terms as a duty to act with the care that an ordinarily prudent person would exercise under similar circumstances in like positions.[15]

---

13. This Part is adapted from MOLL & RAGAZZO, *supra* note 7, § 6.02.

14. This fiduciary duty of care is owed by both directors and officers:

> Although most precedents and statutory provisions deal solely with directors, it is relatively well settled, through judicial precedents and statutory provisions in at least 18 states, that officers will be held to the same duty of care standards as directors. Sound public policy points in the direction of holding officers to the same duty of care and business judgment standards as directors, as does the little case authority that exists on the applicability of the business judgment standard to officers, and the views of most commentators support this position.

PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 4.01 cmt. a. (AM. LAW INST. 1994).

15. *See, e.g.*, Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 273 (2d Cir. 1986); Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 720 (5th Cir. 1984); Plaza Sec. Co. v. Fruehauf Corp., 643 F. Supp. 1535, 1542–43 (E.D. Mich. 1986); Harman v. Willbern, 374 F. Supp. 1149, 1162 (D. Kan. 1974); Brane v. Roth, 590 N.E.2d 587, 590, 593 (Ind. Ct. App. 1992); Francis v. United Jersey Bank, 432 A.2d 814, 820–21 (N.J. 1981); Founders Life Corp. v. Hampton, 597 S.W.2d 897, 899 (Tenn. 1980); *see also* Trieweiler v. Sears, 689 N.W.2d 807, 831 (Neb. 2004) ("Most state statutes now

Under this articulation, the duty of care has both objective and subjective components. To the extent that the duty of care is based upon the conduct of an "ordinarily prudent person," the manager's conduct is measured objectively against that of a "reasonable" manager. To the extent that the duty of care considers "similar circumstances" and "like positions," however, there is also a subjective component of the duty that accounts, at least at some level, for the manager's particular situation. Nevertheless, common sense suggests that the law would not allow a manager to lower the duty of care below some baseline level of minimal managerial competence. Customizing the duty of care for the ordinarily prudent "alcoholic" manager, or the ordinarily prudent "absentee" manager, for example, would be absurd. In *Hoye v. Meek*,[16] the Tenth Circuit captured this notion:

> There is no separate standard for an ordinarily prudent non-resident director or an ordinarily prudent semi-retired director. The standard does not vary depending upon one's residence or retirement status. The obligation to the corporation, and ultimately to the creditors and depositors, is the same. After all, we are applying a standard of care which the legislature intended to govern those who are charged with responsibility for other people's money.[17]

provide, as does Nebraska's, that the degree of care required of a director is the degree of care an ordinarily prudent person would exercise in a like position under similar circumstances."). *But see* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 284 (Va. 1999) ("[I]n Virginia, a director's discharge of duties is not measured by what a reasonable person would do in similar circumstances or by the rationality of the ultimate decision. Instead, a director must act in accordance with his/her good faith business judgment of what is in the best interests of the corporation." (citing VA. CODE § 13.1-690)).

In many jurisdictions, the applicable standard of care is now spelled out by statute. *See, e.g.*, CAL. CORP. CODE § 309(a) (West 2014) ("A director shall perform the duties of a director . . . in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care . . . as an ordinarily prudent person in a like position would use under similar circumstances."); GA. CODE ANN. § 14-2-830(a) (2003) (directors); *id.* § 14-2-842(a) (officers); N.Y. BUS. CORP. LAW § 717(a) (McKinney 2003) (directors); *id.* § 715(h) (officers); *see also* MODEL BUS. CORP. ACT § 8.30(b) (AM. BAR ASS'N 2008) (stating the standard of conduct for directors as "the care that a person in a like position would reasonably believe appropriate under similar circumstances"); *id.* § 8.42(a)(2) (stating the standard of conduct for officers as "the care that a person in a like position would reasonably exercise under similar circumstances").

16. 795 F.2d 893 (10th Cir. 1986).

17. *Id.* at 896; *see also id.* at 897 ("The statute sets forth an objective standard of care, one which imposes a duty that does not vary with residence or retirement status."); Theriot v. Bourg, 96-0466, p. 15 (La. App. 1 Cir. 2/14/97); 691 So. 2d 213, 224 (rejecting the argument that the jury should have considered the advanced age and limited education of several of the directors: "We find no support for and reject the contention that advanced age lessens the standard of care required of a director of a corporation. While education and experience are factors to be considered, they, too, do not relieve a director from the duty to act with due diligence."); *Francis*, 432 A.2d at 820 (noting that the trial court rejected testimony that a director "was old, was grief-stricken at the loss of her husband, sometimes consumed too much alcohol and was psychologically overborne by her sons"—testimony that was

The subjective aspect of the duty of care, however, does have some role. If a director or officer has special skills or expertise above the standard of minimum managerial competence, for example, one could argue that the manager should have to carry out his duties with those background skills and expertise.[18] After all, a director or officer brings whatever expertise he has to the corporation he serves. Similarly, some courts have distinguished between "inside" directors (directors who also hold officer or employee positions in the corporation) and "outside" directors (directors who do not hold officer or employee positions in the corporation) in determining whether the duty of care was breached.[19] The notion seems to be that inside directors, as officers or employees of the corporation, should have greater knowledge about the "goings-on" of the company, and that the duty of care should account for these differing positions.[20] The Model Business Corporation Act captures these points:

offered in an effort to exonerate the director for breach of her duty of care); MODEL BUS. CORP. ACT § 8.30 cmt. 2 (stating that "a director lacking business experience or particular expertise [is not excused] from exercising the basic director attributes of common sense, practical wisdom, and informed judgment").

18. *See, e.g.*, *In re* Emerging Commc'ns, Inc. S'holders Litig., No. Civ. A. 16415, 2004 WL 1305745, at *40, *43 (Del. Ch. May 3, 2004) (finding a director liable for breach of fiduciary duty, at least in part because he "possessed a specialized financial expertise, and an ability to understand [the company's] intrinsic value, that was unique to the [company's] board members").

19. *See, e.g.*, Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639, 652 (Iowa 1979).

20. In the well-known case of *Bates v. Dresser*, 251 U.S. 524 (1920), for example, Dresser was the president of a bank as well as a member of its board of directors. Dresser was held liable for sums stolen by Coleman, a bookkeeper at the bank, although the other directors avoided liability. As to the non-liability of the other directors, the Court stated the following:

> This fraud was a novelty in the way of swindling a bank so far as the knowledge of any experience had reached Cambridge before 1910. We are not prepared to reverse the finding of the master and the Circuit Court of Appeals that the directors should not be held answerable for taking the cashier's statement of liabilities to be as correct as the statement of assets always was. . . . Their confidence seemed warranted by the semi-annual examinations by the government examiner and they were encouraged in their belief that all was well by the president, whose responsibility, as executive officer; interest, as large stockholder and depositor; and knowledge, from long daily presence in the bank, were greater than theirs. They were not bound by virtue of the office gratuitously assumed by them to call in the pass-books and compare them with the ledger, and until the event showed the possibility they hardly could have seen that their failure to look at the ledger opened a way to fraud.

Id. at 529–30. As to Dresser, however, the Court was far less lenient:

> The position of the president is different. Practically he was the master of the situation. He was daily at the bank for hours, he had the deposit ledger in his hands at times and might have had it at any time. He had had hints and warnings in addition to those that we have mentioned, warnings that should not be magnified unduly, but still that . . . would have induced scrutiny but for an invincible repose upon the *status quo*. . . . [T]aking the whole story of the relations of the parties, we are not ready to say that the two courts below erred in finding that Dresser had been put upon his guard. However little the warnings may have pointed to the specific facts, had they been accepted they would have led to an examination of the depositors' ledger, a discovery of past and a prevention of future thefts.

Id. at 530–31; *see also Rowen*, 282 N.W.2d at 652 (noting that "an outside director does not have the same duty or responsibility that falls upon those who are in active charge and who dictate day-to-day policy"); *Trieweiler*, 689 N.W.2d at 832–33 (stating that "[t]he degree of care for directors based on

> The combined phrase "in a like position . . . under similar circumstances" is intended to recognize that (a) the nature and extent of responsibilities will vary, depending upon such factors as the size, complexity, urgency, and location of activities carried on by the particular corporation, (b) decisions must be made on the basis of the information known to the directors without the benefit of hindsight, and (c) *the special background, qualifications, and management responsibilities of a particular director may be relevant in evaluating that director's compliance with the standard of care*.[21]

Duty of care issues tend to arise in two distinct settings: oversight and decision-making.[22] In the oversight setting, directors and officers are obligated to use care in monitoring the activities of the principal employees and the general affairs of the corporation as a whole.[23] In the decision-making setting, directors and officers are obligated to use care in making decisions that affect the corporation's welfare.[24] Within these settings, the duty of care can be divided into three independent obligations: (1) an "oversight" obligation to monitor the affairs of the corporation; (2) a "decision-making" obligation to make substantive decisions that can be attributed to a rational business purpose (substantive due care); and (3) a "decision-making" obligation to be sufficiently informed when making

that which a prudent person in a like position under similar circumstances would give has been said to accommodate the various levels of director involvement in management; by depending on custom and usage, the standard protects the outside director from the expectation that he or she will give his or her undivided attention to corporate interests," but concluding that an outside director was liable for breach of fiduciary duty because he "present[ed] a textbook example of a director who 'closed his eyes' to the conduct of the corporation"); *cf. id.* at 832 ("While outside directors may not 'close their eyes' to the conduct of corporate affairs, at least until they have reason to suspect impropriety, they may within reasonable limits rely on those who have primary responsibility for the corporate business.").

21. MODEL BUS. CORP. ACT § 8.30 cmt. 2 (alteration in original) (emphasis added); *see Trieweiler*, 689 N.W.2d at 832 ("The phrase 'under similar circumstances' has been interpreted to mean that a court should take account of the director's responsibilities in the corporation, the information available at the time, and the special background knowledge or expertise the director has."); PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 4.01(a) cmt. f (AM. LAW INST. 1994) ("The terms 'good faith,' 'reasonably believes,' and 'like position,' in § 4.01(a), recognize that in determining whether reasonable care has been exercised, the special skills, background, or expertise of a director or officer are properly accorded weight. Special skills (e.g., in engineering, accounting, or law) may, for example, alert a director to a significant corporate problem before other directors would recognize it. Such a director, being obliged to act in the best interests of the corporation, cannot reasonably ignore this knowledge.").

22. The Model Business Corporation Act explicitly recognizes these separate contexts. *See* MODEL BUS. CORP. ACT § 8.31 cmt. f ("The director's role involves two fundamental components: the decision-making function and the oversight function. In contrast with the decision-making function, which generally involves action taken at a point in time, the oversight function . . . involves ongoing monitoring of the corporation's business and affairs over a period of time.").

23. *Id.*

24. *See infra* Part I.B.

decisions for the company (procedural due care). Each of these obligations will be examined in turn.

A. The Oversight Context

As mentioned, in the oversight setting, directors and officers are obligated to use care in monitoring the affairs of the corporation. Disputes falling within this setting tend to involve allegations that the directors or officers were inattentive to problems in the company, and that such inattentiveness resulted in harm to the corporation. Conceptually, therefore, the oversight setting involves failures to act (i.e., omissions) rather than affirmative decisions to act in some manner. As a result, the business judgment rule is inapplicable in the oversight setting, as the rule only offers protection to affirmative decisions.[25]

In the leading case of *Francis v. United Jersey Bank*,[26] Lillian Pritchard was a director and shareholder of Pritchard & Baird Intermediaries Corp.—a reinsurance broker. Her sons, Charles and William Pritchard, were officers of the company as well as the remaining two members of the board of directors.[27] Over a five-year period, Charles and William embezzled large sums of money from the company.[28] After the corporation filed for bankruptcy, the trustees sued Lillian for negligence for failing to prevent her sons' misappropriation of funds.[29] The Supreme Court of New Jersey observed that Lillian "was not active in the business of Pritchard & Baird and knew virtually nothing of its corporate affairs."[30] The court further

25. In *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), the Delaware Supreme Court observed:

> [I]t should be noted that the business judgment rule operates only in the context of director action. Technically speaking, it has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act. But it also follows that under applicable principles, a conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment and enjoy the protections of the rule.

Id. at 813 (footnote omitted); *see also* Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982) (noting that the business judgment rule does not apply where there has been "an obvious and prolonged failure to exercise oversight or supervision"); FDIC v. Brown, 812 F. Supp. 722, 726 (S.D. Tex. 1992) (noting that "the Texas business judgment rule does not protect a director if he abdicated his responsibility and failed to exercise any judgment"); Gaillard v. Natomas Co., 256 Cal. Rptr. 702, 710 (Ct. App. 1989) ("Notwithstanding the deference to a director's business judgment, the rule does not immunize a director from liability in the case of his or her abdication of corporate responsibilities . . . A director cannot close his eyes to what is going on about him in the conduct of the business of the corporation and have it said that he is exercising business judgment."); Senn v. Nw. Underwriters, Inc., 875 P.2d 637, 642 n.13 (Wash. Ct. App. 1994) (observing that "the business judgment rule applies where a loss results from a decision or action by an officer or director, not 'where the loss is the result of failure to exercise proper care, skill and diligence'" (citation omitted)).

26. 432 A.2d 814 (N.J. 1981).

27. *See id.* at 816, 818.

28. *Id.* at 817–18.

29. *See id.* at 816–20.

30. *Id.* at 819.

noted that Lillian visited the corporate offices on only one occasion, and that she "never read or obtained the annual financial statements."[31] In fact, Lillian "was unfamiliar with the rudiments of reinsurance and made no effort to assure that the policies and practices of the corporation . . . complied with industry custom or relevant law."[32] As a result, the court concluded that Lillian had breached her duty of care, and she was held personally liable for her sons' wrongdoing.[33]

Francis represents the prevailing view that directors and officers are obligated to monitor and remain attentive to the affairs of the company. As the court observed:

> Directors are under a continuing obligation to keep informed about the activities of the corporation. Otherwise, they may not be able to participate in the overall management of corporate affairs. . . . Directors may not shut their eyes to corporate misconduct and then claim that because they did not see the misconduct, they did not have a duty to look. The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect.[34]

Decisions like *Francis* make clear that "figurehead" or "accommodation" directors—i.e., directors who consent to being named to the board, but who assume none of the responsibilities that go along with a director position—are liable just like ordinary, active directors.[35] Any person holding the position of "director," in other words, is charged with the obligation to monitor (as well as all of the other obligations and duties of directors). Failure to carry out this obligation can result in personal liability for breach of the fiduciary duty of care.[36]

---

31. *Id*.

32. *Id*.

33. *See id.* at 826, 829.

34. *Id.* at 822 (citations omitted); *see infra* notes 35–36 and accompanying text (citing cases on the failure to monitor).

35. *See, e.g.*, Harman v. Willbern, 374 F. Supp. 1149, 1162 (D. Kan. 1974) (stating that "the Court must reject the defendant's contention that his acceptance of a directorship 'in name only' in some manner immunes him from liability arising from mismanagement of the corporate affairs"); *Francis*, 432 A.2d at 823 ("A director is not an ornament, but an essential component of corporate governance. Consequently, a director cannot protect himself behind a paper shield bearing the motto, 'dummy director.'"); *id.* ("The New Jersey Business Corporation Act, in imposing a standard of ordinary care on all directors, confirms that dummy, figurehead and accommodation directors are anachronisms with no place in New Jersey law."); Kavanaugh v. Gould, 119 N.E. 237, 238 (N.Y. 1918) ("No custom or practice can make a directorship a mere position of honor void of responsibility . . . ."); Van Schaick v. Aron, 10 N.Y.S.2d 550, 563 (Sup. Ct. 1938) ("[A] person who accepts the office of a director likewise accepts the duties and responsibilities incident thereto.").

36. *See, e.g.*, Hoye v. Meek, 795 F.2d 893, 897 (10th Cir. 1986) (affirming a finding that a director breached his fiduciary duty of care by "fail[ing] to monitor the investment decisions of his son, delegat[ing] too much authority to him, and fail[ing] to respond to [the corporation's] increasing

In the oversight setting, what standard of liability is imposed by courts? There is some divergence in the law on this point. Describing the duty of

exposure to risk"); *id.* at 896 (rejecting the argument that because the corporation had been operated at a profit for seven years, the directors and president's duty to monitor activities was dissipated: "[D]irectors and officers are charged with knowledge of those things which it is their duty to know and ignorance is not a basis for escaping liability. Where suspicions are aroused, or should be aroused, it is the directors' duty to make necessary inquiries."); Joy v. North, 692 F.2d 880, 896 (2d Cir. 1982) ("Directors who willingly allow others to make major decisions affecting the future of the corporation wholly without supervision or oversight may not defend on their lack of knowledge, for that ignorance itself is a breach of fiduciary duty."); McDonnell v. Am. Leduc Petroleums, Ltd., 491 F.2d 380, 385 (2d Cir. 1974) ("The depositors of [the corporation] . . . had a right to believe that [the director and president] would exercise reasonable diligence to protect their interests rather than accede to the looting of the Company."); Barnes v. Andrews, 298 F. 614, 615 (S.D.N.Y. 1924) (stating that directors "have an individual duty to keep themselves informed in some detail, and it is this duty which the defendant . . . failed adequately to perform"); Fields v. Sax, 462 N.E.2d 983, 988 (Ill. App. Ct. 1984) ("Bank directors are not insurers of the fidelity of the corporate agents and cannot be held responsible for losses resulting from the wrongful acts of other directors or agents unless they neglect to properly supervise the business."); Brane v. Roth, 590 N.E.2d 587, 591 (Ind. Ct. App. 1992) (finding that directors of a grain elevator cooperative breached their duty of care by their "failure to supervise the manager and become aware of the essentials of hedging to be able to monitor the business"); Speer v. Dighton Grain, Inc., 624 P.2d 952, 955 (Kan. 1981) ("When [the directors] had knowledge of acts of mismanagement and misappropriation by . . . the managing officer, and failed to take steps to correct the same they breached this [fiduciary] duty."); Trieweiler v. Sears, 689 N.W.2d 807, 833 (Neb. 2004) (concluding that a director of the corporation breached his fiduciary duty by exercising "no meaningful supervisory role whatsoever," and noting that his "inattention to corporate affairs was so profound that he could not even state, with certainty, whether or not he was an officer of the corporation"); *id.* at 831 ("[W]here the duty of knowing exists, ignorance because of neglect of duty on the part of a director creates the same liability as actual knowledge and failure to act on that knowledge."); *id.* at 832 ("But lack of knowledge is not necessarily a defense, if it is the result of an abdication of directorial responsibility.").

Even if a director or officer is found to have breached his duty of care by failing to monitor, such a breach does not necessarily establish liability for the company's losses. In many jurisdictions, a plaintiff is also charged with the burden of proving that particular damages were proximately caused by the breach. *See, e.g.*, *Barnes*, 298 F. at 616 ("The plaintiff must, however, go further than to show that [a director] should have been more active in his duties. This cause of action rests upon a tort, as much though it be a tort of omission as though it had rested upon a positive act. The plaintiff must accept the burden of showing that the performance of the defendant's duties would have avoided loss, and what loss it would have avoided."); *Francis*, 432 A.2d at 826 ("Nonetheless, the negligence of [the defendant] does not result in liability unless it is a proximate cause of the loss. . . . Further, the plaintiff has the burden of establishing the amount of the loss or damages caused by the negligence of the defendant. Thus, the plaintiff must establish not only a breach of duty, but in addition that the performance by the director of his duty would have avoided loss, and the amount of the resulting loss."); Senn v. Nw. Underwriters, Inc., 875 P.2d 637, 639 (Wash. Ct. App. 1994) (observing that in order to establish liability for breach of fiduciary duty, the plaintiff must show that a fiduciary duty was breached and "that the breach was a proximate cause of the losses sustained"). *But see* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 369–71 (Del. 1993) (concluding, based on the lower court's presumed findings of grossly negligent board conduct, that a prima facie case of liability had been established even without proof of an injury caused by the defendants, and shifting the burden to the defendants to demonstrate the fairness of the transaction if they wanted to avoid liability); *id.* at 370 ("While *Barnes* may still be 'good law,' *Barnes*, a tort action, does not control a claim for breach of fiduciary duty."). This causation question can be particularly difficult in the oversight setting, as a plaintiff must establish that, if the defendant had complied with his obligation to monitor, the loss would not have occurred. *Cf. Francis*, 432 A.2d at 826 ("Cases involving nonfeasance present a much more difficult causation question than those in which the director has committed an affirmative act of negligence leading to the loss. Analysis in cases of negligent omissions calls for determination of the reasonable steps a director should have taken and whether that course of action would have averted the loss.").

care generally as an obligation to use the care that an "ordinarily prudent person" would exercise suggests an ordinary negligence standard.[37] In some jurisdictions (including, notably, Delaware), however, the standard of liability is expressed as gross negligence.[38] The precise distinction between ordinary negligence and gross negligence is difficult to pinpoint, but gross negligence is usually associated with some degree of recklessness or

37. *See, e.g.*, *Francis*, 432 A.2d at 821 ("Although specific duties in a given case can be determined only after consideration of all of the circumstances, the standard of ordinary care is the wellspring from which those more specific duties flow."); *see also* FDIC v. Stahl, 89 F.3d 1510, 1516–17 (11th Cir. 1996) (concluding that pre-1987 Florida law established an ordinary negligence standard for director liability); *Brane*, 590 N.E.2d at 592 (noting that the care that an ordinarily prudent person in a like position would use in similar circumstances "is not a gross negligence standard").

38. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 748 (Del. Ch. 2005) ("Furthermore, in instances where directors have not exercised business judgment, that is, in the event of director inaction, the protections of the business judgment rule do not apply. Under those circumstances, the appropriate standard for determining liability is widely believed to be gross negligence, but a single Delaware case has held that ordinary negligence would be the appropriate standard." (footnotes omitted) (citing Rabkin v. Philip A. Hunt Chem. Corp., 1987 WL 28436, at *1–3 (Del. Ch. Dec. 17, 1987))); *id.* at 748 n.418 ("It also bears noting that no Delaware decision (until this one) has cited *Rabkin,* decided roughly eighteen years ago, and it would appear that [later Delaware cases] have since eclipsed *Rabkin* by implicitly accepting that gross negligence is the appropriate standard even in cases of alleged director inaction and lack of oversight.").

In Delaware, there is some doctrinal confusion over the standard of liability for breach of oversight obligations, at least in larger corporations. In *In re Caremark International, Inc. Derivative Litigation*, the court concluded that "a director's obligation [to be reasonably informed concerning the corporation] includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists." 698 A.2d 959, 970 (Del. Ch. 1996). Significantly, however, the court noted that "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exi[s]ts—will establish the lack of good faith that is a necessary condition to liability." *Id.* at 971. In Delaware, therefore, the standard for a *Caremark* lack of oversight claim may be articulated as bad faith rather than gross negligence.

Interestingly, although the claim in *Caremark* was explicitly pled and analyzed as a duty of care action, *see id.* at 960, 964, 967, 970–71, the Supreme Court of Delaware later recharacterized a *Caremark* lack of oversight claim as a duty of loyalty action:

> The failure to act in good faith may result in liability because the requirement to act in good faith "is a subsidiary element[,]" i.e., a condition, "of the fundamental duty of loyalty." It follows that because a showing of bad faith conduct, in the sense described in *Disney* and *Caremark*, is essential to establish director oversight liability, the fiduciary duty violated by that conduct is the duty of loyalty.
>
> . . . .
>
> We hold that *Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.

Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (alteration in original) (footnotes omitted) (quoting Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)); *see also* Desimone v. Barrows, 924 A.2d 908, 939–40 (Del. Ch. 2007) (stating that "this type of [*Caremark*] liability is founded upon a breach of the duty of loyalty").

conscious indifference.[39] It is clear that courts applying a gross negligence standard are, at least as a matter of doctrine, providing more protection to directors and officers accused of violating their oversight obligations. After all, even if a director or officer has acted negligently, a breach of duty will not be found unless the misconduct rises to the higher gross negligence standard.

B. The Decision-Making Context

Whereas the oversight context addresses general neglect and an accompanying failure to act, the decision-making context involves affirmative decisions to act in some manner. Doctrinally, the distinction between the two settings is significant, primarily because the business judgment rule is applicable in the decision-making context but not in the oversight context.[40]

In the decision-making context, the duty of care involves a substance component (substantive due care) as well as a process component (procedural due care). The substantive due care obligation requires directors and officers to make decisions that can be attributed to a rational business purpose. The procedural due care obligation requires directors and officers to be sufficiently informed when making decisions and to use a sufficient decision-making process generally.

1. Substantive Due Care

As previously discussed, the duty of care requires directors and officers to act with the care that an ordinarily prudent person would exercise under similar circumstances in like positions. As part of that duty, one might expect that directors and officers would be required to make reasonably good decisions, and that courts would correspondingly be empowered to review the substantive reasonableness of any decision that was made. That is, of course, the framework of the typical negligence claim in most contexts. In actuality, however, any judicial review of the merits of a business decision is carried out with far less scrutiny than a reasonableness inquiry would suggest.[41] Indeed, because of the so-called business

39. *See, e.g.*, Jewell v. Sal-O-Dent Labs., Inc., 69 S.W.2d 544, 546 (Tex. Civ. App. 1934) (equating gross negligence with "reckless mismanagement"); *see also* Burk Royalty Co. v. Walls, 616 S.W.2d 911, 920 (Tex. 1981) (defining gross negligence as "that entire want of care which would raise the belief that the act or omission complained of was the result of a conscious indifference to the right or welfare of the person or persons to be affected by it" (citations omitted)).

40. *See supra* note 25 and accompanying text (noting that the business judgment rule is inapplicable in the oversight setting, as the rule only offers protection to affirmative decisions).

41. *See, e.g.*, Mueller v. Zimmer, 2005 WY 156, ¶ 21, 124 P.3d 340, 353 (Wyo. 2005) ("Whether or not a particular action by a Board is 'reasonable' is not for us to decide—that determination is vested

judgment rule, courts are largely prevented from second-guessing the substantive wisdom of a decision.[42]

The business judgment rule is an especially deferential standard of review that insulates directors and officers from liability for a poor decision so long as the decision can be attributed to a rational business purpose.[43] From a liability standpoint, therefore, the scrutiny given to the merits of a decision is practically nonexistent, as only a de minimis rationality standard must be met.[44] As one commentator observed:

in the discretion of the Board. A court does 'not apply an objective reasonableness test . . . to examine the wisdom of the decision itself.'" (citations omitted)); *see also* Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Courts do not measure, weigh or quantify directors' judgments. We do not even decide if they are reasonable in this context.").

42. *See* Lamden v. La Jolla Shores Clubdominium Homeowners Ass'n, 980 P.2d 940, 944 (Cal. 1999) (noting that the business judgment rule is a "rule of judicial deference to corporate decisionmaking" that "exists in one form or another in every American jurisdiction" (quoting Frances T. v. Village Green Owners Ass'n, 723 P.2d 573, 583 n.14 (Cal. 1986))); Rosenfield v. Metals Selling Corp., 643 A.2d 1253, 1262 (Conn. 1994) (describing the "business judgment doctrine" as "a rule of law that insulates business decisions from most forms of review"); Fields v. Sax, 462 N.E.2d 983, 986 (Ill. App. Ct. 1984) ("[W]here the acts complained of are corporate decisions which fall within the purview of the business judgment rule, this court is without authority to substitute its judgment for the lawful decisions of the directors."); Sneed v. Webre, 465 S.W.3d 169, 178 (Tex. 2015) ("In Texas, the business judgment rule protects corporate officers and directors from being held liable to the corporation for alleged breach of duties based on actions that are negligent, unwise, inexpedient, or imprudent if the actions were 'within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved.'" (quoting Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889))).

For a fifty-state chart that provides descriptions of the business judgment rule, see MOLL & RAGAZZO, *supra* note 7, at app. to ch. 6, fig. 6.3.

43. *See, e.g.*, *In re* Reading Co., 711 F.2d 509, 517, 520 (3d Cir. 1983); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1374 (Del. 1995); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); *supra* note 42 and accompanying text; *see also Reading*, 711 F.2d at 520 (concluding that "[e]ach of the challenged policies can be attributed to a rational business purpose"); Kahn v. M & F Worldwide Corp., 88 A.3d 635, 654 (Del. 2014) ("We have determined that the business judgment rule standard of review applies to this controlling stockholder buyout. Under that standard, the claims against the Defendants must be dismissed unless no rational person could have believed that the merger was favorable to MFW's minority stockholders. In this case, it cannot be credibly argued (let alone concluded) that no rational person would find the Merger favorable to MFW's minority stockholders." (footnote omitted)); Ironite Prods. Co. v. Samuels, 985 S.W.2d 858, 862 (Mo. Ct. App. 1998) ("[The directors] both articulated rational reasons to relocate Mark to the Saint Louis office and to implement the organizational changes of the Companies. We will not interfere with that decision, despite a possible detriment to the corporations."); *Mueller*, 2005 WY 156, ¶ 21, 124 P.3d at 353 (concluding that the board's decisions could be attributed to a rational business purpose).

In most jurisdictions, the business judgment rule protects officers as well as directors. *See, e.g.*, *Rosenfield*, 643 A.2d at 1261 n.16 ("Although the business judgment rule is usually defined in terms of the role of corporate directors, it is equally applicable to corporate officers exercising their authority and is also applicable in certain instances to controlling shareholders when exercising their more extraordinary management functions."); *see also Sneed*, 465 S.W.3d at 173 (noting that "[t]he business judgment rule in Texas generally protects corporate officers and directors"). *But see infra* notes 163–167 and accompanying text (citing cases holding that the business judgment rule does not protect bank officers).

44. There is, therefore, some obligation to act with "substantive due care," so long as that obligation is understood to simply mean that a decision must be attributable to a rational business purpose—not that a decision must be "reasonable" in some manner. *See supra* note 41 and

> This rationality standard of review is much easier to satisfy than a prudence or reasonability standard. To see how exceptional a rationality standard is, we need only think about the judgments we make in everyday life. It is common to characterize a person's conduct as imprudent or unreasonable, but it is very uncommon to characterize a person's conduct as irrational. Unlike a subjective-good-faith standard, a rationality standard preserves a minimum and necessary degree of director and officer accountability.[45]

Not surprisingly, examples of irrational decisions are hard to find. Decisions that cannot be coherently explained would likely be characterized as irrational.[46] Corporate waste likely rises to the level of irrationality as well.[47] Significantly, even if it is difficult to pinpoint the outer bounds of rational behavior, it is fairly clear that a rationality standard is intended to be easily satisfied.[48] Moreover, directors and officers do not necessarily have to prove rationality; instead, courts have stated that a decision must simply be "attributed" to a rational business purpose.[49] A

---

accompanying text. Thus, although the Supreme Court of Delaware has stated that the concept of "substantive due care" is "foreign to the business judgment rule" and that "[d]ue care in the decisionmaking context is *process* due care only," the court has also acknowledged that "[i]rrationality is the outer limit of the business judgment rule" and that courts will respect decisions unless directors "act in a manner that cannot be attributed to a rational business purpose." Brehm v. Eisner, 746 A.2d 244, 264 & n.66 (Del. 2000); *see supra* note 43 and accompanying text.

45. Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 442–43 (1993).

46. For example, in *Selheimer v. Manganese Corp. of America*, liability was imposed upon directors and officers who failed to utilize a plant that could have been operated profitably (the Colwyn plant), but who continued to pour money into a plant that they knew could not be operated profitably (the Paterson plant). 224 A.2d 634, 639, 645–46 (Pa. 1966). As the court observed:

> Defendants' actions in respect to the Colwyn plant were not the result of errors in judgment or a calculated business risk nor can such actions be classified as mere negligence. With the knowledge which defendants had of the unsuitability of the Paterson plant for profitable production, the pouring of Manganese's funds into this plant defies explanation; in fact, the defendants have failed to give any satisfactory explanation or advance any justification for such expenditures.

Id. at 646.

47. *See, e.g.*, *Brehm*, 746 A.2d at 263 (characterizing successful waste claims as "unconscionable cases where directors irrationally squander or give away corporate assets"); *id.* at 264 (noting that "[i]rrationality may be the functional equivalent of the waste test"); *see also In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 74 (Del. 2006) ("This onerous standard for waste is a corollary of the proposition that where business judgment presumptions are applicable, the board's decision will be upheld unless it cannot be 'attributed to any rational business purpose.'" (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971))).

48. *See supra* note 45 and accompanying text.

49. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose."); *supra* note 43 and accompanying text.

court can presumably attribute a decision to a rational business purpose on its own without the defendants having to adduce any proof.[50]

If the business judgment rule is applicable, therefore, liability will hardly ever be imposed on directors and officers simply because a decision turned out poorly.[51] For the business judgment rule to apply, however, three prerequisites must be met. The decision must be made (1) in good faith, (2) on an informed basis, and (3) with no conflicts of interest.[52] If these prerequisites are met, the rule upholds the decision so long as it can be attributed to a rational business purpose.[53] If the prerequisites are not met,

50. *See, e.g.*, Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 100 (2004) ("[T]he reference to a rational business purpose requires only the possibility that the decision was actuated by a legitimate business reason, not that directors must prove the existence of such a reason.").

51. *See, e.g.*, Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982) ("Whereas an automobile driver who makes a mistake in judgment as to speed or distance injuring a pedestrian will likely be called upon to respond in damages, a corporate officer who makes a mistake in judgment as to economic conditions, consumer tastes or production line efficiency will rarely, if ever, be found liable for damages suffered by the corporation."); *id.* ("Whatever the terminology, the fact is that liability is rarely imposed upon corporate directors or officers simply for bad judgment and this reluctance to impose liability for unsuccessful business decisions has been doctrinally labelled the business judgment rule."); Cramer v. Gen. Tel. & Elec. Corp., 582 F.2d 259, 274 (3d Cir. 1978) ("Absent bad faith or some other corrupt motive, directors are normally not liable to the corporation for mistakes of judgment, whether those mistakes are classified as mistakes of fact or mistakes of law."); Kamin v. Am. Express Co., 383 N.Y.S.2d 807, 812 (Sup. Ct. 1976) ("The directors are entitled to exercise their honest business judgment on the information before them, and to act within their corporate powers. That they may be mistaken, that other courses of action might have differing consequences, or that their action might benefit some shareholders more than others presents no basis for the superimposition of judicial judgment, so long as it appears that the directors have been acting in good faith.").

52. *See Joy*, 692 F.2d at 886; *Brehm*, 746 A.2d at 264 n.66.

53. *See, e.g.*, *Brehm*, 746 A.2d at 264 n.66 ("The business judgment rule has been well formulated by . . . other cases. Thus, directors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available." (citation omitted)); *supra* note 43 and accompanying text.

The prerequisites of the business judgment rule, as well as the rule itself, are often articulated in different ways. *See, e.g.*, FDIC v. Stahl, 89 F.3d 1510, 1516 (11th Cir. 1996) (noting that the business judgment rule has been defined to mean that "[t]he law will not hold directors liable for honest errors, for mistakes of judgment, when they act without corrupt motive and in good faith," and stating that "[i]n order to come within the ambit of the rule, directors must be diligent and careful in performing the duties they have undertaken; they must not act fraudulently, illegally, or oppressively, or in bad faith" (emphasis omitted) (quoting Int'l Ins. Co. v. Johns, 685 F. Supp. 1230, 1238 (S.D. Fla. 1988))); Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 721 (5th Cir. 1984) (stating that "Texas courts to this day will not impose liability upon a noninterested corporate director unless the challenged action is ultra vires or is tainted by fraud," and observing that "[s]uch is the business judgment rule in Texas"); *Joy*, 692 F.2d at 886 (noting that the business judgment rule does not apply where "the corporate decision lacks a business purpose, is tainted by a conflict of interest, is so egregious as to amount to a no-win decision, or results from an obvious and prolonged failure to exercise oversight or supervision" (citations omitted)); Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980) ("Under the business judgment rule, directors are presumed to have acted properly and in good faith, and are called to account for their actions only when they are shown to have engaged in self-dealing or fraud, or to have acted in bad faith."); Fields v. Sax, 462 N.E.2d 983, 986 (Ill. App. Ct. 1984) ("A corporate director will not be held liable for honest errors or mistakes of judgment as long as the decision does not involve the courts dispense with the deferential rationality standard and proceed to evaluate the substantive wisdom of the decision. In many circumstances, this evaluation requires the director or officer defendants to establish the "entire fairness" of the decision[54]—a far more exacting standard than the rationality focus of the business judgment rule.

In operation, the business judgment rule and its prerequisites can be viewed primarily as an inquiry into the "inputs" of a decision (i.e., was the decision made in good faith, on an informed basis, and with no conflicts of interest). If the inputs are adequate, the rule largely prevents courts from evaluating the "output" of the decision (i.e., the outcome) by restricting the evaluation to a rationality review. Thus, the business judgment rule embodies a considerable judicial deference to managerial decisions—even if, in hindsight, the decisions could be characterized as "wrong," "mistaken," or "unwise."

The function of the business judgment rule and its accompanying rationality standard is nicely illustrated by the leading case of *Kamin v. American Express Co.*[55] In *Kamin*, the board of directors of American Express declared a special dividend whereby shares of Donaldson, Lufken and Jenrette, Inc. (DLJ)—shares which had decreased in value—were distributed in kind to the American Express shareholders.[56] The plaintiffs alleged that if the American Express board had instead sold the declining DLJ shares on the market, the company would have generated capital losses that would have produced a tax savings of approximately $8 million.[57] In effect, therefore, the plaintiffs asserted that the board's decision was unwise. The *Kamin* court noted that the American Express board members had considered and rejected the plaintiffs' proposed course

fraud, illegality or conflict of interest."); Ironite Prods. Co. v. Samuels, 985 S.W.2d 858, 862 (Mo. Ct. App. 1998) ("We will not interfere with the decisions of the Board of Directors absent fraud, illegal conduct, or an irrational business judgment."); Auerbach v. Bennett, 393 N.E.2d 994, 1000 (N.Y. 1979) (noting that the business judgment rule "bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes").

54. *See, e.g.*, Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 265 (2d Cir. 1984) ("Once self-dealing or bad faith is demonstrated, the duty of loyalty supersedes the duty of care, and the burden shifts to the directors to prove that the transaction was fair and reasonable to the corporation." (quoting *Treadway*, 638 F.2d at 382)); *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006) (noting that the presumptions of the business judgment rule "can be rebutted if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith," and that "[i]f that is shown, the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders"); *see also* Lewis v. S. L. & E., Inc., 629 F.2d 764, 769 (2d Cir. 1980) ("But the business judgment rule presupposes that the directors have no conflict of interest. When a shareholder attacks a transaction in which the directors have an interest other than as directors of the corporation, the directors may not escape review of the merits of the transaction.").

55. 383 N.Y.S.2d 807 (Sup. Ct. 1976).

56. *See id.* at 809.

57. *See id.* at 809–10.

of action.[58] The court also noted that the board had at least a colorable justification for its decision—i.e., obtaining the tax savings would have required American Express to take a $25 million loss from the sale of the DLJ shares, which would have affected the company's stock price.[59] As a result, the court upheld the board's decision:

> A complaint which alleges merely that some course of action other than that pursued by the Board of Directors would have been more advantageous gives rise to no cognizable cause of action. Courts have more than enough to do in adjudicating legal rights and devising remedies for wrongs. The directors' room rather than the courtroom is the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations, or tax advantages. . . .
>
> It is not enough to allege, as plaintiffs do here, that the directors made an imprudent decision, which did not capitalize on the possibility of using a potential capital loss to offset capital gains. More than imprudence or mistaken judgment must be shown. . . .
>
> . . . .
>
> . . . What we have here as revealed both by the complaint and by the affidavits and exhibits, is that a disagreement exists between two minority stockholders and a unanimous Board of Directors as to the best way to handle a loss already incurred on an investment. The directors are entitled to exercise their honest business judgment on the information before them, and to act within their corporate powers. That they may be mistaken, that other courses of action might have differing consequences, or that their action might benefit some shareholders more than others presents no basis for the superimposition of judicial judgment, so long as it appears that the directors have been acting in good faith. . . . The Court will not interfere unless a clear case is made out of fraud, oppression, arbitrary action, or breach of trust.[60]

Believers in efficient markets might credibly assert that the market was aware of the decrease in value of the DLJ shares and had already factored that decline into the American Express stock price—regardless of whether

58. *Id.* at 810.
59. *See id.* at 811.
60. *Id.* at 810–12.

those shares were sold by American Express or not. As a result, a decision to recoup $8 million in tax savings from the failed investment seems like the wiser course of action. Nevertheless, the result in *Kamin* highlights that, absent a conflict of interest, an uninformed decision, or other reason to doubt the good faith of the directors, a court will not second-guess a managerial decision that can be attributed to some rational basis, even if the decision seems far from optimal.[61]

When a plaintiff asserts a substantive duty of care claim, notice that the standard of liability is neither negligence nor gross negligence. Instead, under an irrationality standard, a decision that produces a negligent (i.e., unreasonable) outcome should not result in liability if the decision can be attributed to a rational business purpose. As a doctrinal matter, even a grossly negligent outcome should not result in liability if a rational business purpose exists.[62]

2. *Procedural Due Care*

It is widely believed that good decision-making processes tend to produce better substantive decisions. Not surprisingly, therefore, courts subject the quality of a board's decision-making process to scrutiny. This obligation of directors and officers to engage in a sufficient decision-making process (more commonly known as the obligation to be sufficiently informed when making decisions, or "procedural due care" for short) is part of the fiduciary duty of care, and it is a prerequisite to the application of the business judgment rule.[63] According to the Supreme Court of Delaware, such an obligation does not require the board to be informed of every fact when making a decision; instead, "[t]he Board is responsible for considering only *material* facts that are *reasonably available*, not those that are immaterial or out of the Board's reasonable reach."[64]

61. *Cf. In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 35, 75 (Del. 2006) (rejecting a claim of waste arising from a $130 million severance payment to a terminated president because the employment agreement providing for the severance served the rational business purpose of inducing the president to leave his former employment).

What is the basis for the business judgment rule and its considerable deference to management? For a discussion of the conventional justifications for the rule, see MOLL & RAGAZZO, *supra* note 7, § 6.02[C][1].

62. *Cf. infra* note 197 and accompanying text.

63. *See, e.g.*, Cramer v. Gen. Tel. & Elecs. Corp., 582 F.2d 259, 275 n.20 (3d Cir. 1978) ("Underlying the [business judgment] rule is the assumption that *reasonable diligence* has been used in reaching the decision which the rule is invoked to justify." (quoting Miller v. Am. Tel. & Tel. Co., 507 F.2d 759, 762 (3d Cir. 1974))); *supra* note 53 and accompanying text.

64. Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000); *see also* Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 274–75 (2d Cir. 1986) ("Directors may be liable to shareholders for failing reasonably to obtain material information or to make a reasonable inquiry into material matters.").

This judicial focus on process is best illustrated by the Supreme Court of Delaware's landmark decision in *Smith v. Van Gorkom*.[65] *Van Gorkom* involved a cash-out merger between Trans Union Corporation and New T, an entity affiliated with takeover specialist Jay Pritzker.[66] The Trans Union board approved the merger at a price that was approximately 45% higher than the market price of Trans Union's stock.[67] Nevertheless, the court found that the Trans Union board members had breached their duty of care by acting in a grossly negligent manner (which precluded the application of the business judgment rule).[68] The court cited a number of problems with the board's decision-making process, including the following: (1) the board did not seek a fair value analysis of Trans Union; (2) the board was not presented with (nor, obviously, did it review) the merger documentation (or even a summary of the merger's terms); (3) a two-hour board meeting was too hasty to make the decision to merge, particularly without prior notice of the subject of the meeting and without the exigency of a crisis or emergency; and (4) the board did not adequately inform itself as to Van Gorkom's role (Van Gorkom was Trans Union's Chief Executive Officer) in initiating the merger discussions with Pritzker and in unilaterally establishing the merger price.[69] According to the court, these process defects were not excused by the short timeline established by Pritzker for completion of the transaction, the collective experience of the Trans Union board members, or the significant premium over market price achieved in the merger.[70] The case was remanded to the trial court with instructions to "conduct an evidentiary hearing to determine the fair value of the shares represented by the plaintiffs' class, based on the intrinsic value of Trans Union on [the date of the board decision and the execution of the merger agreement]."[71] The trial court was further instructed to award damages against the Trans Union directors "to the extent that the fair value of Trans Union exceeds $55 per share [the merger price]."[72]

Van Gorkom is a striking opinion. A board decision to accept a merger proposal at a price approximately 45% higher than the company's current market price was found to be a breach of the directors' fiduciary duty.[73] It

65. 488 A.2d 858 (Del. 1985).

66. *See id.* at 863–64.

67. *See id.* at 869 n.9.

68. *See id.* at 884, 893.

69. *See id.* at 874, 876–77, 883.

70. *See id.* at 875–77, 880.

71. *Id.* at 893.

72. *Id*.

73. For this reason (as well as others), the *Van Gorkom* decision has been heavily criticized. *See, e.g.*, Daniel R. Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437, 1455 (1985) (describing *Van Gorkom* as "one of the worst decisions in the history of corporate law"). More cynically, some observers have suggested that, as a result of *Van Gorkom*, boards are now

is important to recognize, however, that the substantive merits of the board's decision were not the focus of the court's analysis. Instead, it was the decision-making process that was condemned as a breach of the duty of care, as the court believed that the defective process resulted in an uninformed board decision. Of course, the precise steps required for a director or officer to satisfy his procedural due care obligation will vary with the circumstances of the particular dispute. While the goal of the obligation is to ensure that directors act on an informed basis and with sufficient deliberation, the specifics are highly fact-dependent:

> There is no precise way to measure how much information will be required . . . in given circumstances. Among the factors that may have to be taken into account in judging a director's reasonable belief as to what was "appropriate under the circumstances" are: (i) the importance of the business judgment to be made; (ii) the time available for obtaining information; (iii) the costs related to obtaining information; (iv) the director's confidence in those who explored a matter and those making presentations; and (v) the state of the corporation's business at the time and the nature of competing demands for the board's attention. The different backgrounds of individual directors, the distinct role each plays in the corporation, and the general value of maintaining board cohesiveness may all be relevant when determining whether a director acted "reasonably" in believing that the information before him or her was "appropriate under the circumstances."[74]

As with oversight claims, the standard of liability imposed by courts in procedural duty of care claims varies. Some opinions suggest that ordinary

compelled to hire outside experts for advice in order to give the appearance of informed decision-making and deliberation. *See, e.g.*, Robert W. Hamilton, *Reliance and Liability Standards for Outside Directors*, 24 WAKE FOREST L. REV. 5, 28–29 (1989) ("On another level, general counsels made recommendations to boards of directors that they hire expensive financial advisers, commission extensive studies, and otherwise improve the paper record of their decisional process in order to reduce the risk of liability in situations similar to *Van Gorkom*. It was a widely held belief that the cost of this exercise exceeded the benefits to the decisional process."); Leo Herzel & Leo Katz, Smith v. Van Gorkom*: The Business of Judging Business Judgment*, 41 BUS. LAW. 1187, 1191 (1986). If true, the real winners in *Van Gorkom* would appear to be lawyers, investment bankers, and other experts who are guaranteed to receive fees when boards engage in mergers and other significant decisions. *But see Van Gorkom*, 488 A.2d at 876 ("We do not imply that an outside valuation study is essential to support an informed business judgment; nor do we state that fairness opinions by independent investment bankers are required as a matter of law.").

74. PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 4.01(c) cmt. e (AM. LAW INST. 1994); *see, e.g.*, Kavanaugh v. Gould, 119 N.E. 237, 240 (N.Y. 1918) ("What a director must do in exercising reasonable care in the performance of his duties is always dependent upon the facts. Care is a relative term."); Van Schaick v. Aron, 10 N.Y.S.2d 550, 563 (Sup. Ct. 1938) ("Each case is sui generis with respect to the negligence of a director, and the degree of care required necessarily depends on the facts of the particular case.").

negligence is enough for liability,[75] while others suggest that gross negligence is required.[76]

II. DUTY OF CARE LIABILITY IN BANKS

For more than a century, courts, Congress, and administrative agencies have struggled to apply state common law duty of care standards to directors and officers of financial institutions.[77] For much of this time bankers, regulators, courts, and commentators have been preoccupied with the question of whether bank directors and officers should face liability for negligence or gross negligence. This Part traces the development of duty of care standards for bank directors and officers. It shows that the modern bank director and officer duty of care is a strange amalgamation of federal and state law that is far from consistent and clear.

A. Pre-FIRREA

Today, bank director and officer liability is governed primarily by a federal statute, FIRREA.[78] However, to understand the statute it is helpful to understand the banker duty of care laws before 1989. This Section discusses three early developments. First, courts created a common law

75. *See, e.g.*, Doyle v. Union Ins. Co., 277 N.W.2d 36, 44 (Neb. 1979) (concluding that "the approving directors violated their fiduciary duties by negligence in that they failed to inform themselves in any appreciable degree" when approving a transaction); *see also* Brane v. Roth, 590 N.E.2d 587, 592 (Ind. Ct. App. 1992) (noting that the care that an ordinarily prudent person in a like position would use in similar circumstances "is not a gross negligence standard").

76. *See, e.g.*, *Van Gorkom*, 488 A.2d at 873 ("We think the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was an informed one."); Desimone v. Barrows, 924 A.2d 908, 933 (Del. Ch. 2007) (noting that "gross negligence" is the "higher threshold used by our law to analyze due care claims").

When directors and officers fail to comply with their procedural due care obligations, such noncompliance constitutes a breach of the fiduciary duty of care. *See, e.g.*, Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 274–75 (2d Cir. 1986); Plaza Sec. Co. v. Fruehauf Corp., 643 F. Supp. 1535, 1538–39, 1543 (E.D. Mich. 1986); *Doyle*, 277 N.W.2d at 44; *see also* Priddy v. Edelman, 883 F.2d 438, 443 (6th Cir. 1989) (finding that procedural due care was met). Nevertheless, damages are not imposed in many jurisdictions unless the plaintiff can also establish that the breach caused injury. *See supra* note 36. The Delaware courts take a different approach by holding that a breach of the duty of care (procedural due care) rebuts the business judgment rule and shifts the burden to the defendants to demonstrate the entire fairness of the transaction if they wish to avoid liability. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006). In Delaware, therefore, a plaintiff does not have the burden to establish causation of injury. Once a plaintiff establishes a breach of the duty of care (by proving that the board's decision-making process was grossly negligent), the burden shifts to the defendants to establish fairness.

77. *See* Ronald W. Stevens & Bruce H. Nielson, *The Standard of Care for Directors and Officers of Federally Chartered Depository Institutions: It's Gross Negligence Regardless of Whether Section 1821(k) Preempts Federal Common Law*, 13 ANN. REV. BANKING L. 169, 169 (1994) ("[T]he law establishing the standard of care for directors and officers of federally chartered depository institutions has been 'muddled' for an entire century.").

78. 12 U.S.C. § 1821 (2012).

duty of care. Although typically stated as an "ordinary and prudent person" standard, courts and scholars disagree about whether liability under this standard requires a negligence or gross negligence showing. Second, courts formed the business judgment rule. However, again, courts struggled to define the precise contours of the rule and its applicability to bankers. Finally, the federal government created deposit insurance. When banks fail, the federal insurer, the FDIC, now acts as a receiver and brings claims against bank directors and officers. This gives the FDIC, and correspondingly the federal government, a direct interest in the standard of liability for breach of the duty of care by bankers.

Confusion over the standard for bankers' liability can be traced at least as far back as the Supreme Court's 1891 opinion in *Briggs v. Spaulding*.[79] In some ways, the facts of *Briggs* are not much different from the suits against directors and officers that the FDIC brings today. The case arose when the First National Bank of Buffalo failed in 1882.[80] Briggs was appointed by federal regulators to act as a receiver for the bank.[81] He sued both the inside and outside directors, asserting that their mismanagement caused the bank to become insolvent.[82] Briggs complained that one inside director, Lee, had made numerous loans to himself and his family members.[83] Briggs also complained that the bank made several large loans that exceeded statutory restrictions on lending to one borrower.[84] As for the outside directors, Briggs asserted that they "paid no attention to the affairs of the bank" and instead "allowed the executive officers to manage it without supervision."[85] Lee ultimately admitted liability, but outside directors Spaulding and Johnson argued that they should not be held responsible for Lee's mismanagement.[86]

In *Briggs*, the Supreme Court held that "directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figure-heads."[87]

79. 141 U.S. 132 (1891).

80. *Id.* at 134.

81. *Id.*

82. *Id.* at 138–40.

83. *Id.* at 139.

84. *Id.* at 137–38.

85. *Id*. at 137.

86. Two other directors also challenged Briggs's claim of liability. One director, who also served as a vice president of the bank, argued that he should not be held responsible because he had rheumatism and had been unable to participate in the affairs of the bank. *Id.* at 164–65. Another director argued that he was ineligible to be a director because he had sold his stock in the bank. *Id.* at 152–53. Both the trial court and the Supreme Court concluded that these directors were not responsible. *See id.* at 165.

87. *Id*. at 165.

This "ordinary care and prudence" language seems to adopt a simple or ordinary negligence standard.[88]

However, the Court in several places used the term "gross" to describe inappropriate director conduct. For example, in explaining why the outside directors were not responsible, the Court wrote:

> They are entitled under the law to commit the banking business, as defined, to their duly-authorized officers, but this does not absolve them from the duty of reasonable supervision, nor ought they to be permitted to be shielded from liability because of want of knowledge of wrong-doing, if that ignorance is the result of *gross inattention*, but in this case we do not think these defendants fairly liable . . . .[89]

Thus, in the intervening years, some have argued that *Briggs* can be reasonably read as applying a gross negligence standard for banker duty of care liability.[90]

Whatever *Briggs*'s actual holding, it provided "the first truly modern articulation of a tort-based duty of care for bank directors."[91] While *Briggs* itself considered only the duty of national bank directors, its language soon turned up in cases establishing the standard of liability for state bank directors.[92] Because *Briggs* was ambiguous, the courts' application of the

88. Hwa-Jin Kim, *Financial Regulation and Supervision in Corporate Governance of Banks*, 41 J. CORP. L. 707, 717 (2016) ("*Briggs v. Spaulding* established a standard of simple negligence for directors of federally chartered and insured banks . . . ." (footnote omitted)); Jonathan R. Macey & Maureen O'Hara, *Solving the Corporate Governance Problems of Banks: A Proposal*, 120 BANKING L.J. 326, 334 (2003) ("*Briggs* established 'a federal common law standard of simple negligence for directors of federally chartered and federally insured depository institutions.'"); David B. Fischer, Comment, *Bank Director Liability Under FIRREA: A New Defense for Directors and Officers of Insolvent Depository Institutions—or a Tighter Noose?*, 39 UCLA L. REV. 1703, 1763 (1992) (describing *Briggs* as stating an "'ordinary negligence' standard").

89. *Briggs*, 141 U.S. at 165–66 (emphasis added).

90. Stevens & Nielson, *supra* note 77, at 186 ("In short, while the courts have formulated 'ordinary care' as the standard of conduct to which directors and officers of federally chartered thrifts and banks are held under federal common law, in practice, they have applied a gross negligence standard of liability."); Fischer, *supra* note 88, at 1713 ("Applying what amounted to a gross negligence threshold, the [*Briggs*] Court absolved the defendants." (footnote omitted)); Marcia M. McMurray, Note, *An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule*, 40 VAND. L. REV. 605, 622 n.109 (1987) (stating that the *Briggs* court held "bank directors to a gross negligence standard").

91. Patricia A. McCoy, *A Political Economy of the Business Judgment Rule in Banking: Implication for Corporate Law*, 47 CASE W. RES. L. REV. 1, 36 (1996).

92. *See id*. at 35 ("Strictly speaking, the common-law duty in *Briggs* derived from an analogy to the National Banking Act and was tailored to national banks. Soon, however, *Briggs* began to be adopted outside of the national bank context. By the turn of the century, state and federal courts were applying the duty of care announced in *Briggs* to state and national bank directors alike.").

standard varied. Some cases seemed to apply a simple negligence standard, while others embraced gross negligence.[93]

Judicial concerns that an ordinary care standard would reduce "entrepreneurial spirit" led to another development in the banking duty of care setting: the adoption of the business judgment rule.[94] Indeed, the cases often identified as the first to recognize the business judgment rule in the United States involved claims against the directors of failed banks.[95] As explained in Part I.B.1, the basic premise of the business judgment rule is that, absent irrationality, directors and officers are not held liable for mistakes in judgment. Thus, the business judgment rule can temper the potentially stringent duty to act with ordinary care and prudence.

As with the duty of care, the precise contours of the business judgment rule varied somewhat from jurisdiction to jurisdiction, and even from case to case. Many cases followed the development of the business judgment rule in the corporate context by requiring at least a showing of gross negligence before liability would be imposed for breach of the duty of care.[96] Others suggested that even in the presence of the business judgment rule, bankers should be held to a higher standard than non-bank directors

93. *Compare* Stone v. Rottman, 82 S.W. 76, 82 (Mo. 1904) ("The degree of care directors are bound to exercise cannot be better stated than in the opinion of Chief Justice Fuller in the leading case of Briggs v. Spaulding . . . ."), *and* Lippitt v. Ashley, 94 A. 995, 1006–07 (Conn. 1915) (citing *Briggs* and stating that the legal duty for savings bank directors is that of "ordinary care and prudence"), *with* Swentzel v. Penn Bank, 23 A. 405, 408 (Pa. 1892) ("The recent case of Briggs . . . goes a long distance in its *dicta*, if not in the actual decision, to relieve bank directors, and especially the directors of national banks, from all liability for anything but acts of malfeasance."), *and* Wash. Bancorporation v. Said, 812 F. Supp. 1256, 1266 (D.D.C. 1993) (stating that in *Briggs* "it is evident that the Court was not applying the heightened standard of care simple negligence envisions").

94. McCoy, *supra* note 91, at 7 ("Concerned that entrepreneurial spirit might be dampened as a result [of the ordinary and prudent person duty of care], courts grafted the business judgment rule onto the duty of care.").

95. Percy v. Millaudon, 8 Mart. (n.s.) 68 (La. 1829); Godbold v. Branch Bank, 11 Ala. 191 (1847); *see also* Joel B. Harris & Charles T. Caliendo, *Who Says the Business Judgment Rule Does Not Apply to Directors of New York Banks?*, 118 BANKING L.J. 493, 516 n.36 (2001) ("[T]he cases most often cited by commentators as the first American statements of the business judgment rule are banking cases decided in Louisiana and Alabama in 1829 and 1847, respectively."); Ryan Scarborough & Richard Olderman, *Why Does the FDIC Sue Bank Officers? Exploring the Boundaries of the Business Judgment Rule in the Wake of the Great Recession*, 20 FORDHAM J. CORP. & FIN. L. 367, 373 (2015) ("The business judgment rule originated in the common law, and first appeared in the United States in *Percy v. Millaudon*, an 1829 decision of the Louisiana Supreme Court."); Stevens & Nielson, *supra* note 77, at 191 ("The business judgment rule traces its origins to a 1829 banking case.").

96. *See, e.g.*, *Percy*, 8 Mart. (n.s.) at 78 (explaining that bank directors and officers are only liable for an error that "is of so gross a kind that a man of common sense, and ordinary attention, would not have fallen into it"); *Godbold*, 11 Ala. at 200 ("[B]ank directors are not responsible for errors of judgment, unless the error be of the grossest kind."); Muller v. Planters' Bank & Trust Co., 275 S.W. 750, 752 (Ark. 1925) (holding that directors were not liable for defaulted loans because the "mere exercise of poor judgment is not sufficient to form a basis of liability"); *see also* Case Note, *Banks and Banking—Responsibility of Directors of Insolvent Bank to Depositors*, 38 YALE L.J. 1142, 1143 (1929) ("By the majority rule, where deposits are made in a solvent bank which become insolvent through a director's negligence (as with corporations in general), the director is not responsible to the depositor.").

and officers.[97] Finally, some courts rejected the idea of the business judgment rule in banking altogether.[98]

The third important development in the banking duty of care setting was the statutory creation of federal deposit insurance in response to the Great Depression. Prior to federal deposit insurance, bank deposits were either uninsured or insured by financially unstable state insurance systems.[99] This meant that when a bank failed, depositors might lose whatever money was stored in the bank. In 1933, Congress created the FDIC to provide insurance for banks.[100] A year later, Congress authorized a similar fund for thrift institutions.[101]

In addition to providing insurance, federal insurers were authorized to act as receivers for failed financial institutions.[102] Before federal deposit insurance, the chartering entity, whether federal or state, appointed a receiver for a failed bank. The receiver could then sue on behalf of depositors. After the creation of federal deposit insurance, "federal bank agencies . . . replaced shareholders, depositors, and state court receivers as the dominant plaintiff in bank director liability litigation."[103] With federal insurers acting as receivers, the receivers have greater motivation to pursue directors and officers. Rather than just collecting damages for depositors, receiver recoveries can be returned to the deposit insurance fund. Thus, the federal insurers have their own financial interest in the outcome of the cases, and they pursue their claims in federal court rather than in state court.[104]

Congress's creation of deposit insurance had the potential to bring uniformity to the claims against directors and officers of failed banks.[105] By consolidating receivership powers in only a few agencies, Congress lessened the chance that different receivers would adopt varying theories of

97. Litwin v. Allen, 25 N.Y.S.2d 667, 678 (Sup. Ct. 1940) ("Undoubtedly, a director of a bank is held to stricter accountability than the director of an ordinary business corporation.").

98. *See, e.g.*, Greenfield Sav. Bank v. Abercrombie, 97 N.E. 897 (Mass. 1912) (explaining that the business judgment rule does not apply to unpaid directors of a savings bank who negligently made real estate loans that were not properly secured).

99. *See generally* THOMAS BRUCE ROBB, THE GUARANTY OF BANK DEPOSITS (1921) (describing state deposit insurance in Oklahoma, Kansas, Nebraska, Texas, South Dakota, Mississippi, Washington, and North Dakota).

100. Banking Act of 1933, Pub. L. No. 73-66, § 8, 48 Stat. 162, 168.

101. National Housing Act, Pub. L. No. 73-479, §§ 402–403, 48 Stat. 1246, 1256–58 (1934) (creating the Federal Savings and Loan Insurance Corporation).

102. Banking Act of 1933, Pub. L. No. 73-66, § 8, 48 Stat. 162, 174–75; National Housing Act, Pub. L. No. 73-479, § 406, 48 Stat. 1246, 1259–60 (1934).

103. McCoy, *supra* note 91, at 53.

104. *Id.*

105. *See id.* (noting that "de facto authority for defining the scope of the business judgment rule has decisively shifted from state courts and bankers to federal bank regulators").

the duty of care and the business judgment rule.[106] The receivers' unified voices could have more influence on the development of bank director and officer liability standards.[107]

B. FIRREA

After the Great Depression, the next period of scrutiny for bankers was the savings and loan crisis of the 1980s.[108] As financial institutions failed, federal receivers became increasingly more aggressive in pursuing directors and officers. Critics charged that "the FDIC had even begun seeking damages for comparatively minor errors that they characterized as ordinary and simple negligence when individual fact patterns were not egregious enough to sustain claims for gross negligence or willful misconduct."[109]

At the same time, some states were rethinking corporate responsibilities generally. A wave of mergers and acquisitions in the 1980s led to a rash of stockholder suits against corporate directors and officers.[110] By the mid-1980s, director and officer insurance pools were in crisis: "premiums skyrocketed, deductibles increased, and coverage was reduced."[111] Recognizing a problem, some states passed legislation that "eliminated or substantially reduced the liability of directors and officers of financial institutions and other corporations for decisions made in good faith and in the absence of gross negligence, willful misconduct, or the like."[112] This frustrated the federal government's efforts to recoup losses to the insurance funds by suing bank directors and officers.[113]

106. *Cf.* Jon Canfield, *The Evolution of a More Stringent Business Judgment Rule in Banking: The Minimization of Director Deference*, 6 U.C. DAVIS BUS. L.J. 17 (2006) (arguing that "the FDIC . . . has played a major role in weakening the business judgment rule and reducing the amount of deference courts afford to bank directors").

107. Professor Patricia McCoy argues that the advent of federal deposit insurance made courts more likely to impose liability upon bank directors and officers. *See* McCoy, *supra* note 91, at 42–43 ("[C]ourts proved decidedly more inclined to impose liability when the federal fisc was at stake than when the victims were individual depositors.").

108. *Id*. at 43, 47–48.

109. Fischer, *supra* note 90, at 1708–09 (emphasis omitted).

110. Christopher Lam, Note, Resolution Trust Corp. v. Cityfed Financial Corp.*: The State Law and Federal Common Law Distinction*, 41 VILL. L. REV. 1035, 1040 (1996).

111. Roberta Romano, *What Went Wrong with Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L 1, 1 (1989).

112. Stevens & Nielson, *supra* note 77, at 194; *id.* at 194–208 (citing Florida, Indiana, Kansas, Louisiana, Nebraska, Ohio, Oklahoma, South Dakota, Texas, Utah, Virginia, and Wisconsin as having adopted gross negligence or willful misconduct statutes); Ronald W. Stevens, *FDIC Lawsuits Against Former Directors and Officers of Banks that Have Failed Since 2008: Is This Déjà Vu All Over Again?*, 97 Banking Rep. (BNA) No. 16, at 762 (Nov. 1, 2011) ("During the period between 1986 and 1994, approximately 12 states, many of which suffered relatively large numbers of bank failures and suits by the FDIC and RTC, adopted statutes (some of which explicitly targeted those suits) that insulated bank [directors and officers] from liability in the absence of conduct that rose at least to the level of gross

With this tumultuous backdrop, Congress passed FIRREA. Among other things, FIRREA set a common rule for banker duty of care liability in all insured financial institutions:

> A director or officer of an insured depository institution may be held personally liable for monetary damages in any [federal receiver-initiated] civil action . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law.[114]

However, FIRREA also incorporated a savings clause: "Nothing in this paragraph shall impair or affect any right of the [receiver] under other applicable law."[115]

Following the passage of FIRREA, bankers and others complained that the standard of liability for breach of the duty of care was unclear.[116] First, what impact did FIRREA have on *Briggs*? Did FIRREA effectively overrule *Briggs*? Or did *Briggs*'s "ordinary care" standard survive under FIRREA's "other applicable law" savings clause?[117] Second, what impact did FIRREA have on duty of care claims under state law? When such claims asserted negligence, were they preempted by FIRREA's gross negligence standard, or were they preserved by the statute's savings clause?[118] Third, what about the business judgment rule? Did it survive or was it swept up in FIRREA?[119]

---

negligence, and in some cases sought to permit liability only upon a finding of willful or reckless misconduct.").

113. Macey & O'Hara, *supra* note 88, at 336 ("Some states adopted legislation that imposed liability only for willful or wanton conduct or intentional conduct. This had the effect of limiting the opportunity for the federal government to recover some of its loss due to the widespread failure of financial institutions.").

114. 12 U.S.C. § 1821(k) (2012).

115. *Id*.

116. Fed. Deposit Ins. Corp., Financial Institution Letter 87-92: New FDIC Guidelines Issued to Clarify the Responsibilities of Bank Directors and Officers, 1992 WL 714954 (Dec. 17, 1992) [hereinafter FDIC Financial Institution Letter]; *see* Eric G. Zajac, Comment, *FIRREA and Federal Common Law: The Extent to Which They Preempt State Law Regarding the Duties and Standard of Liability Imposed upon Financial Institution Directors*, 37 VILL. L. REV. 1461, 1466 (1992) ("The proper definition and scope of the 'duty of care' remain unclear under § 1821(k)."); Cindy A. Schipani, *Should Bank Directors Fear FIRREA: The FDIC's Enforcement of the Financial Institutions Reform Recovery and Enforcement Act*, 17 J. CORP. L. 739, 743 (1992) (noting that the director and officer liability language in FIRREA "is not a model of legislative clarity").

117. *See* Peter A. Lowy, *The Director Liability Provision of the Financial Institutions Reform, Recovery and Enforcement Act: What Does It Do?* 16 ANN. REV. BANKING L. 355, 370–77 (1997).

118. *See id.* at 364–70.

119. *See* Michael P. Battin, Note, *Bank Director Liability Under FIRREA*, 63 FORDHAM L. REV. 2347, 2388 (1995) (arguing that "[t]he lack of consensus on the definition of the business judgment rule

C. FDIC Guidelines

In 1992, the FDIC responded to concerns about FIRREA with a financial institution letter containing "guidelines . . . to clarify the responsibilities of bank directors and officers."[120] The guidelines explain that "[s]imilar to the responsibilities owed by directors and officers of all business corporations, [bank director and officer] duties include the dut[y] of . . . care."[121]

Under the 1992 guidelines, directors are responsible for "establishing business strategies and policies" and "selecting, monitoring, and evaluating competent management."[122] In contrast, "[o]fficers are responsible for running the day to day operations of the institution in compliance with applicable laws, rules, regulations and the principles of safety and soundness."[123] The FDIC recognized that some directors, the "inside" directors, will also be officers or employees of the financial institutions. The guidelines clarify that such inside directors will be held to a more exacting standard because they have "greater knowledge of and direct day to day responsibility for the management of the institution."[124] On the other hand, the guidelines indicate that the FDIC will generally only pursue outside directors (those directors who are not responsible for the day-to-day operations of the bank) for breach of the duty of care in situations that "either involve insider abuse or situations where the directors failed to heed warnings from regulators, accountants, attorneys or others that there was a significant problem in the bank which required correction."[125] Some commentators interpreted this language to mean that outside directors will not be liable for breach of the duty of care unless a gross negligence showing is made.[126]

The guidelines further suggest that both directors and officers are protected by the business judgment rule.[127] As the FDIC explained: "The

demonstrates that courts should not apply the business judgment rule to actions brought under" FIRREA).

120. FDIC Financial Institution Letter, *supra* note 116, at *1.

121. *Id.* at *2.

122. *Id.*

123. *Id.*

124. *Id.* at *3.

125. *Id.*

126. *See* William F. Kroener, III, *The Professional Liability Programs at the FDIC and the RTC: Some Myths Past, the Experience Presented*, 19 ANN. REV. BANKING L. 227, 232 (2000) ("[I]n the controversial area of director liability, FDIC policy applies a threshold review standard of gross negligence.").

127. Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175, 186 (1995) ("[T]he banking agencies' enforcement guidelines support the application of the business judgment rule." (citing FDIC Financial Institution Letter, *supra* note 116)); Paul L. Lee, *Risk Management and the Role of the Board*

FDIC will not bring civil suits against directors and officers who fulfill their responsibilities, including the duties of loyalty and care, and who make reasonable business judgments on a fully informed basis and after proper deliberation."[128]

Finally, the FDIC explained in the guidelines that it "brings suits only where they are believed to be sound on the merits and likely to be cost effective."[129] Before the FDIC can bring a suit against a director or officer, the suit must be approved "by the FDIC Board of Directors or designee."[130]

Almost immediately, bankers noticed that the guidelines did not discuss whether the FDIC would sue directors and officers under any standard other than FIRREA's gross negligence standard.[131] Indeed, the guidelines do not mention the word negligence at all—not even when discussing the FDIC's higher threshold for suing outside directors. Even the statement in the guidelines on business judgments is peculiar by referring to business judgments that are "reasonable."[132] The word "reasonable" is more commonly associated with an ordinary negligence standard of liability than with a gross negligence or irrationality standard that would be more protective of the substantive decisions of bankers.

---

of Directors: Regulatory Expectations and Shareholder Actions, 125 BANKING L.J. 679, 687 (2008) (noting that the guidance "appears to recognize the business judgment rule as adopted by case law in many states").

128. FDIC Financial Institution Letter, *supra* note 116, at *2.

129. *Id.*

130. *Id.* In the guidelines, the FDIC also explained the following:

Most suits involve evidence falling into at least one of the following categories:

- Cases where the director or officer engaged in dishonest conduct or approved or condoned abusive transactions with insiders.
- Cases where a director or officer was responsible for the failure of an institution to adhere to applicable laws and regulations, its own policies or an agreement with a supervisory authority, or where the director or officer otherwise participated in a safety or soundness violation.
- Cases where directors failed to establish proper underwriting policies and to monitor adherence thereto, or approved loans that they knew or had reason to know were improperly underwritten, or, in the case of outside directors, where the board failed to heed warnings from regulators or professional advisors, or where officers either failed to adhere to such policies or otherwise engaged in improper extensions of credit.

Id. at *3.

131. *See* Ronald R. Glancz, *FDIC D&O Guidelines on Personal Liability Don't Go Far Enough*, BANKING POL'Y REP., Feb. 1993, at 1, 6 ("Directors could live with these guidelines if the FDIC acknowledged that the standard of care, as set forth in FIRREA, is that of 'gross negligence,' as directors have argued in the courts, so far unsuccessfully.").

132. FDIC Financial Institution Letter, *supra* note 116, at *1–2.

D. Atherton v. FDIC

While the FDIC's guidelines were ambiguous, its position in litigation against bank directors and officers was not. The FDIC vigorously pursued interpretations of FIRREA that would provide it with the greatest chance of recovery. For example, the FDIC argued that *Briggs* adopted a common law simple negligence standard that was not overruled by FIRREA.[133] The FDIC also argued that FIRREA did not preempt state law negligence standards.[134] In short, the FDIC believed that regardless of FIRREA's gross negligence language, it could sue bank directors and officers for simple negligence under both federal and state law. The FDIC's embrace of the negligence standard was so strong it left little room for the business judgment rule.[135]

Of course, bank directors and officers disagreed with the FDIC's interpretation of FIRREA. They believed that FIRREA created a gross negligence standard of liability for all duty of care claims brought by the FDIC.[136] And with that, the stage was set for a conflict that would ultimately be addressed by the Supreme Court of the United States.[137] In the 1997 decision of *Atherton v. FDIC*, the Court held that the FDIC must prove gross negligence in a duty of care action seeking to recover money from directors and officers of failed banks—unless state law allowed liability to be imposed upon a simple negligence showing.[138]

The *Atherton* case began when federal regulators closed City Federal Savings Bank. The Resolution Trust Corporation, the thrift receiver whose

133. *See* FDIC v. Gonzalez-Gorrondona, 833 F. Supp. 1545, 1550 (S.D. Fla. 1993); FDIC v. Mintz, 816 F. Supp. 1541, 1542 (S.D. Fla. 1993).

134. *See* FDIC v. McSweeney, 976 F.2d 532, 536–37 (9th Cir. 1992); FDIC v. Canfield, 967 F.2d 443, 445–46 (10th Cir. 1992) (en banc).

135. *See* Schooner, *supra* note 127, at 186 (noting that although the FDIC's guidelines clearly embraced the business judgment rule for both officers and directors, the guidelines seemed "incongruous when juxtaposed with the FDIC . . . position[] in . . . receivership cases arguing in favor of applying a simple negligence standard").

136. *See McSweeney*, 976 F.2d at 536; *Canfield*, 967 F.2d at 445.

137. Circuit courts were split on the question of *Briggs*'s survival as federal common law. *Compare* Resolution Trust Corp. v. Gallagher, 10 F.3d 416 (7th Cir. 1993), Resolution Trust Corp. v. Miramon, 22 F.3d 1357 (5th Cir. 1994), FDIC v. Bates, 42 F.3d 369 (6th Cir. 1994), *and* Resolution Trust Corp. v. Frates, 52 F.3d 295 (10th Cir. 1995) (holding that there was no federal common law negligence claim), *with* Resolution Trust Corp v. CityFed Fin. Corp., 57 F.3d 1231 (3d Cir. 1995) (holding that federal common law negligence claims under *Briggs* survived FIRREA), *vacated sub nom.* Atherton v. FDIC, 519 U.S. 213 (1997).

Circuit courts were also split on the question of whether state law negligence claims were preempted by FIRREA. *Compare* Resolution Trust Corp. v. Chapman, 29 F.3d 1120 (7th Cir. 1994), *and McSweeney*, 976 F.2d 532, *and Canfield*, 967 F.2d 443 (holding that state law negligence claims could only reach state-chartered bank directors and officers), *with* FDIC v. Stahl, 89 F.3d 1510 (11th Cir. 1996) (holding that state law negligence claims were not preempted by FIRREA).

138. 519 U.S. 213 (1997).

responsibilities were later transferred to the FDIC,[139] sued City Federal's directors and officers. The receiver alleged that "the defendants failed to discharge their duties and obligations properly as directors and officers of City Federal in connection with their consideration, approval and subsequent oversight of several large acquisition, development and construction loans."[140] The question ultimately before the Supreme Court was the appropriate standard of liability for the bank's directors and officers.[141]

The Supreme Court first held that there was no federal common law cause of action against bank directors and officers for simple negligence.[142] In the years after the *Briggs* decision, the Court had clarified in *Erie Railroad Co. v. Tompkins* that "[t]here is no federal general common law."[143] Under *Erie* and its progeny, federal courts can only develop federal common law when there is "a significant conflict between some federal policy or interest and the use of state law."[144] The *Atherton* Court concluded that there was no significant conflict between federal policy and state law when considering the standard of liability for bank directors and officers.[145] The Court rejected the receiver's argument that federal common law was justified because it would create a uniform standard of liability for directors and officers of national banks. Banks, the Court reasoned, had long been chartered and regulated by both federal and state law.[146] Thus, the Court concluded that "[t]here is no federal common law that would create a general standard of care applicable to this case."[147]

Next, the Court held that FIRREA's gross negligence standard does not preempt state laws that make directors and officers liable for less culpable conduct (i.e., ordinary negligence).[148] The Court's reasoning was rooted largely in the language of FIRREA's savings clause: "[n]othing in this paragraph shall impair or affect any right of the [receiver] under other applicable law."[149] According to the Court, "[t]hat language, read naturally,

139. Financial Institutions Reform, Recovery, and Enforcement Act 1989, Pub. L. No. 101-73, § 501, 103 Stat. 183, 363–94 (creating the Resolution Trust Corporation); Federal Deposit Insurance Reform Act of 2005, Pub. L. No. 109-171, § 2102, 120 Stat. 4, 9 (merging the RTC-administered Savings Association Insurance Fund with the FDIC-administered Bank Insurance Fund).

140. *CityFed Fin. Corp.*, 57 F.3d at 1236–37.

141. *Atherton*, 519 U.S. at 215.

142. *Id.* at 218, 226.

143. 304 U.S. 64, 78 (1938).

144. Wallis v. Pan Am. Petroleum Corp., 384 U.S. 63, 68 (1966).

145. *Atherton*, 519 U.S. at 219–26.

146. *Id.* at 220.

147. *Id.* at 226.

148. *Id*. at 227

149. 12 U.S.C. § 1821(k) (2012).

suggests an interpretation broad enough to save rights provided by other state, or federal, law."[150]

In sum, *Atherton* concluded that FIRREA's "'gross negligence' standard provides only a floor—a guarantee that officers and directors must meet at least a gross negligence standard. It does not stand in the way of a stricter standard that the laws of some States provide."[151]

Some saw *Atherton* as a "victory for directors and officers" of banks.[152] This optimism was based on the belief that few states had laws imposing director or officer liability for simple negligence. As *American Banker* explained: "For the [FDIC] to charge officers or directors with simple negligence . . . the bank must be in a state that expressly allows such suits. A 1994 study found that only four states allow simple negligence suits."[153]

Others were more hesitant to claim that *Atherton* was a win for bank directors and officers.[154] The FDIC's first post-*Atherton* statements emphasized that it would continue to rely on the simple negligence standard.[155] In addition, some bankers worried that *Atherton* left open the door for the FDIC or other federal regulators to administratively adopt a simple negligence standard of liability for all directors and officers.[156]

Perhaps the FDIC was worried that the rumors of administrative changes to the duty of care would prompt Congress to re-examine FIRREA.[157] Perhaps the FDIC was worried that, after *Atherton*, people would be discouraged from serving on bank boards.[158] Whatever the reason, the FDIC's later statements on *Atherton* were more measured.

The FDIC left its 1992 guidelines in effect without amendment. The FDIC also repeatedly assured bankers that *Atherton* would not change the

150. *Atherton*, 519 U.S. at 228.

151. *Id*. at 227.

152. Jaret Seiberg, *Docket: Loophole Could Permit Simple-Negligence Suits*, AM. BANKER, Feb. 12, 1997, at 3.

153. *Id.*; *see also* Stevens & Nielson, *supra* note 77, at 194–208 (citing Georgia, Massachusetts, Mississippi, and Tennessee as the four states that allowed director and officer suits for simple negligence).

154. *Failed Bank's Directors Can Be Liable, Court Says; But Justices Reject FDIC's Bid to Get More Power for Regulators*, BALT. SUN, Jan. 15, 1997, at 1C ("The decision is a 'mixed bag,' said Michael F. Crotty, deputy general counsel for the American Bankers Association. It will have no impact on states that already permit lawsuits under the tough simple-negligence rule, but will clarify the law in states that make it harder for the government to sue, Crotty said.").

155. Jaret Seiberg, *Court Makes It Harder to Find Failed Banks' Officials Liable*, AM. BANKER, Jan. 15, 1997, at 2 ("FDIC General Counsel William F. Kroener said the agency will continue to bring negligence suits. 'It provides us with a clear standard and as a result will reduce our litigation costs,' Mr. Kroener said.").

156. *See Seiberg*, *supra* note 152, at 3.

157. *Id.* (The simple negligence issue will wind up on Capitol Hill if regulators try to adopt the standard by regulation Ronald R. Glancz, a partner at the Venable law firm in Washington, D.C. said.).

158. Ricki Helfer, Chairman, Fed. Deposit Ins. Corp., Remarks at the Assembly for Bank Directors (May 2, 1997), https://www.fdic.gov/news/news/speeches/archives/1997/sp2may97.html.

agency's practices, particularly with respect to outside directors. Then-FDIC Chairman Ricki Helfer explained that "gross negligence is precisely the standard the FDIC always applies in determining whether to sue outside directors for breaching their duty of care."[159] The FDIC's 1997 Annual Report emphasized that it would "continue to follow its long-standing practice of bringing claims against outside directors where investigation shows them to have been grossly negligent or worse."[160] The FDIC's silence on the standard of liability for officers and inside directors presumably left open the door that they might be sued for ordinary negligence.

E. Today

By the time *Atherton* was decided, economic conditions had improved and FDIC suits against directors and officers of failed banks were on the wane.[161] The 2008 financial crisis was the first opportunity for the courts and the FDIC to apply *Atherton* in a significant number of disputes.[162] Recent cases show that the FDIC pursues legal theories of liability that maximize its chances of recovery—just as it did in the period immediately following the enactment of FIRREA. In particular, the FDIC often brings ordinary negligence claims, even when the claims seem to contradict its 1992 guidelines. This focus on state law rather than FIRREA's gross negligence standard means that banker liability varies significantly from state to state.

In one of the FDIC's first financial crisis cases, the agency sued three former officers of failed IndyMac, alleging that they "were negligent and breached their fiduciary duties in approving certain [loans to homebuilders]."[163] The officers argued that they were protected from

159. *Id.*

160. 1997 FDIC ANN. REP. 31; *see also* 1 FDIC, MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 275 (1998) [hereinafter FDIC, MANAGING THE CRISIS] (stating that the *Atherton* decision "is consistent with the FDIC's long-standing internal policy of pursuing only 'outside' director claims for which the facts show that the culpable conduct rises to the level of gross negligence or worse").

161. *See* Schooner, *supra* note 127, at 177–78 (noting in 1995 that "[a]s the number of bank failures continues to decrease, we should witness a corresponding drop in the number of actions brought against bank directors by the FDIC and RTC as receivers" (footnote omitted)); *see also* Joe Alder, *FDIC Burden of Proof Looms Large in Failed-Bank Suits*, AM. BANKER, Mar. 9, 2012, 2012 WLNR 5056020 ("'Shortly after FIRREA the industry improved tremendously. So we went for years without a significant number of bank failures,' said Sanford 'Sandy' Brown, a partner at Bracewell & Giuliani in Dallas."); *see also In Mixed Ruling, High Court Revises Decades of D&O Caselaw*, ABA BANKING J., Feb. 1, 1997, at 7 (noting that *Atherton* "could be especially helpful for the relative handful of directors still making their way through the federal courts as a result of FDIC or Resolution Trust Corp. actions").

162. Alder, *supra* note 161.

163. FDIC v. Van Dellen, No. CV 10-4915-DSF (SHx), 2012 WL 4815159, at *1 (C.D. Cal. Oct. 5, 2012).

negligence claims by the business judgment rule, but the FDIC responded that, under California law, the business judgment rule only protected directors.[164] The California court agreed with the FDIC's position.[165] A jury ultimately found the officers negligent and awarded the FDIC $168 million in damages.[166] Federal district courts in Florida and Wisconsin have also held that the business judgment rule does not protect bank officers.[167]

The FDIC soon took the argument one step further, asserting that the business judgment rule does not apply to bank directors as well. In *FDIC v. Loudermilk*, the FDIC brought negligence claims against directors and officers of a failed Georgia bank "alleging that they were negligent with respect to the making of loans."[168] The bankers defended by arguing that they were protected from negligence claims by Georgia's business judgment rule.[169] The FDIC asserted that "a business judgment rule is no part of the common law in Georgia, and even if it were, it does not apply to *bank* officers and directors, insofar as the statutory law in Georgia explicitly requires bank officers and directors to exercise ordinary diligence and care."[170] The United States District Court for the Northern District of Georgia certified the question of the applicability of the business judgment rule to the Georgia Supreme Court.[171]

The Georgia Supreme Court's opinion embraced a traditional understanding of the business judgment rule. The court held that the rule "precludes claims against officers and directors for their business decisions that sound in ordinary negligence" unless there was some procedural problem with the decision-making process.[172] The court also concluded that

164. *See id.* at *6–7. The FDIC has repeatedly argued that the business judgment rule does not apply to officers. *See* FDIC v. Beere, No. 14-C-0575, 2015 WL 5667119, at *6 (E.D. Wis. Sept. 25, 2015); FDIC v. Castro, No. 13-80596-CV-MIDDLEBROOKS/BRANNON, 2014 WL 11241691, at *6 (S.D. Fla. Mar. 31, 2014); FDIC v. Dodson, No. 4:13-cv-416-MW-CAS, 2014 WL 11511068, at *2 (N.D. Fla. Feb. 27, 2014); FDIC v. Baldini, 983 F. Supp. 2d 772, 779–83 (S.D. W. Va. 2013); FDIC v. Faigin, No. CV 12-03448 DDP (CWx), 2013 WL 3389490, at *5 (C.D. Cal. July 8, 2013); FDIC v. Florescue, No. 8:12-cv-2547-T-30TBM, 2013 WL 2477246, at *4 (M.D. Fla. June 10, 2013); FDIC v. Brudnicki, No. 5:12-cv-398-RS-GRJ, 2013 WL 2145720, at *1–2 (N.D. Fla. May 15, 2013); FDIC v. Hawker, No. CV F 12-0127 LJO DLB, 2012 WL 2068773, at *1 (E.D. Cal. June 7, 2012); FDIC v. Perry, No. CV 11-5561-ODW (MRWx), 2012 WL 589569, at *2 (C.D. Cal. Feb. 21 2012).

165. *Van Dellen*, 2012 WL 4815159, at *6–7, *14.

166. Jeff Horwitz, *FDIC Prevails in Suit Blaming IndyMac Execs for Construction Losses*, AM. BANKER, Dec. 11, 2012, 2012 WLNR 26264631.

167. *Beere*, 2015 WL 5667119, at *6–8; *Castro*, 2014 WL 11241691, at *6; *Florescue*, 2013 WL 2477246, at *4–6; *Brudnicki*, 2013 WL 2145720, at *2–3.

168. FDIC v. Loudermilk, 761 S.E.2d 332, 334 (Ga. 2014).

169. *Id*.

170. *Id*. The FDIC has made similar arguments in other cases. *See* FDIC v. Townsend, No. 3:13-cv-05055-RBL, 2015 WL 5734833, at *4 (W.D. Wash. Sept. 30, 2015).

171. *See Loudermilk*, 761 S.E.2d at 334.

172. *Id*. at 338. As the court explained:

> [T]he business judgment rule is a settled part of our common law in Georgia, and it generally precludes claims against officers and directors for their business decisions that

the rule was not superseded by a state statute providing that bank directors and officers must "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 positions."[173] According to the court, "the statutory reference to ordinary 'diligence, care, and skill' is most reasonably understood to refer to the care required with respect to the process by which a decision is made."[174] Consistent with the statute, therefore, the business judgment rule can protect directors and officers from liability for making negligent substantive decisions, so long as they use an appropriate process when the decisions are made.[175]

These and similar cases show that even though FIRREA sets a gross negligence standard,[176] the FDIC often pursues duty of care liability under state law that allegedly requires only a showing of negligence.[177] This strategy is consistent with the Supreme Court's decision in *Atherton*, which clarified that the FDIC may use state law if it imposes liability on bank directors and officers for conduct less egregious than gross negligence.[178] This aggressive strategy is likely designed to maximize the FDIC's chances of collecting damages that can be returned to its insurance fund.

III. CONTEXT MATTERS

As Part I explained, context matters when discussing the duty of care under state corporate law. And as Part II explained, FIRREA and *Atherton* enable the FDIC to rely on state duty of care standards in suits against

> sound in ordinary negligence, except to the extent that those decisions are shown to have been made without deliberation, without the requisite diligence to ascertain and assess the facts and circumstances upon which the decisions are based, or in bad faith. Put another way, the business judgment rule at common law forecloses claims against officers and directors that sound in ordinary negligence when the alleged negligence concerns only the wisdom of their judgment, but it does not absolutely foreclose such claims to the extent that a business decision did not involve 'judgment' because it was made in a way that did not comport with the duty to exercise good faith and ordinary care.

Id.

173. *Id*. at 339 (quoting GA. CODE ANN. § 7–1–490(a)).

174. *Id*. at 341–42.

175. The court stated:

> [T]he statutory reference to ordinary 'diligence, care, and skill' is most reasonably understood to refer to the care required with respect to the process by which a decision is made, most notably the diligence due to ascertain the relevant facts. So understood, the implication of liability 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.

Id.

176. 12 U.S.C. § 1821(k) (2012).

177. In its examination manual, the FDIC asserts that all bank directors and officers are liable for "negligence which is the proximate cause of loss to the bank." FED. DEPOSIT INS. CORP., RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES § 4.1, at 5 (2004).

178. Atherton v. FDIC, 519 U.S. 213, 227 (1997).

bankers. Thus, context-specific state corporate law is also important in the banking setting. This Part explores the implications of context analysis for banking duty of care claims. It explains that just as duty of care actions in corporate law arise in different contexts, so too do duty of care actions in the banking setting. Under state law, the standard of liability can vary depending upon the context; thus, it is inaccurate to frame the banker liability debate in any particular jurisdiction as a binary choice between negligence and gross negligence. Given this reality, the application of FIRREA and *Atherton* to duty of care claims in the banking setting becomes more complicated than commentators have previously appreciated. Finally, context analysis partly explains why the FDIC's 1992 guidelines are inconsistent with its litigation practices. We recommend that the FDIC adjust its guidelines and practices so that they are consistent with each other.

A. Claims in Context

Context matters in duty of care cases because, even within a state, courts may review claims arising in different contexts under different standards. For example, courts often review claims arising in the oversight context more rigorously than they would review claims that the directors or officers made a poor substantive decision. Similarly, courts may review claims about deficiencies in the decision-making process more rigorously than claims that the decision itself was substantively deficient. If banking duty of care claims also arise in a variety of contexts, and the FDIC brings those claims under state law, context may change the level of review in banking cases too. Thus, as an initial matter, it is useful to establish that claims against bank directors and officers arise in the same contexts as non-bank duty of care claims.

In corporate law, duty of care claims arise in either the oversight context or the decision-making context. The same is true in banking. The early banking duty of care decision of *Briggs* is an example of an oversight case.[179] There the receiver alleged that the outside directors "paid no attention to the affairs of the bank" and "allowed the executive officers to manage it without supervision."[180] More recently, in the wake of the 2008 financial crisis, the FDIC has brought cases containing allegations focused on the oversight context. For example, the FDIC sued the directors and officers of R-G Premier Bank of Puerto Rico after it failed in 2010.[181] In that case, the FDIC alleged that the directors and officers hired a loan

179. Briggs v. Spaulding, 141 U.S. 132 (1891).
180. *Id*. at 137.
181. Complaint, FDIC v. Galan-Alvarez, No. 3:12-cv-1029-CCC (D.P.R. Jan. 18, 2012).

officer and "gave him virtually absolute control over the Bank's commercial lending."[182] The FDIC also alleged that "[f]or years, the Directors and Officers ignored numerous warnings from multiple sources about serious problems in the Bank's management, and freed [the loan officer] to recklessly pursue explosive commercial loan growth."[183]

Other claims against bank directors and officers arise in the decision-making context. Bank directors and officers make many different decisions, but the ones most often scrutinized are decisions to extend credit.[184]

Sometimes claims in the decision-making context focus on the substance of the directors and officers' decisions. For example, the FDIC sued the directors and officers of failed Patriot Bank Minnesota for approving three multimillion dollar loans "all of which were intended to be—but were not—short term loans for purposes of financing a speculative land-flip."[185] According to the complaint, the plan had been for the borrower to purchase tracts of land and then to resell them to two large residential developers.[186] The FDIC faulted the directors for approving the loans even though the directors were aware of several risks, including that "government approvals necessary to complete the land flip had not yet been secured," "[t]he land serving as collateral did not yet possess preliminary plat approval," and "[t]he primary source of repayment for the [loans] was the sale of the collateral underlying the loan[s]."[187]

In other instances, claims in the decision-making context focus primarily on the process that the directors and officers used to reach their decision. For example, after Integrity Bank in Georgia failed, the FDIC sued inside and outside directors of the bank's loan committee for making loans "on the basis of grossly inadequate or inaccurate information regarding the finances of the borrower, the value of the collateral, and/or the sources of repayment."[188] In another case, the FDIC alleged that the

182. *Id.* at 3.

183. *Id.*; *see also* FDIC v. Baldini, 983 F. Supp. 2d 772, 774–75 (S.D. W. Va. 2013) (alleging that bank officers failed "to properly supervise and manage" the bank's relationship with a third-party mortgage broker).

184. *See* Adele Nicholas, *Regulatory Rampage: FDIC Suits Against Directors and Officer of Failed Financial Institutions are on the Rise*, INSIDE COUNS. (July 1, 2013), http://www.insidecounsel.com/2013/07/01/fdic-suits-against-directors-and-officers-of-faile?page=2&slreturn=1489174876 ("'Most of the cases follow the same pleading pattern, alleging negligent lending by directors and officers who were caught up in the frenzy of the time and in their eagerness to grow lost sight of the proper lending practices,' says Randy Lehner, a partner at Ulmer & Berne, who has represented the FDIC in several such cases.").

185. Complaint at 15, FDIC v. Milbauer, 119 F. Supp. 3d 939 (D. Minn. 2015) (No. 15cv434 (PAM/JJK)).

186. *Id.* at 15–17.

187. *Id.* at 20, 22.

188. Complaint at 50, FDIC v. Skow, No. 1:11-CV-0111-SCJ, 2012 WL 8503168 (N.D. Ga. Feb. 27, 2012), *aff'd in part, vacated in part, and remanded*, 769 F.3d 1306 (11th Cir. 2014).

underwriting of $4.25 million in loans was inadequate because directors and officers:

- "Accepted estimated value of collateral stock and then failed to perfect lien on collateral";
- "Failed to validate legitimacy of borrowing entity, as no corporate documents were provided and no research was performed"; and
- "Approved despite undated financial statements."[189]

In sum, the FDIC brings claims against bank directors and officers for deficiencies in both oversight and decision-making—the same types of claims that are commonly asserted in the corporate setting.

B. Beyond Negligence Versus Gross Negligence

Although duty of care claims against bankers arise in different contexts, this nuance is sometimes overlooked as bankers, policy makers, courts, and commentators grapple with "the standard" for banker liability.

As Part II shows, for more than a century, the standard for banker liability has often been viewed as a dichotomous choice: ordinary negligence or gross negligence. The Supreme Court's 1891 *Briggs* opinion set off decades of discussion about whether it created a negligence or gross negligence standard.[190] Congress's passage of FIRREA did little to change the crux of the debate. The legislation itself first contained a simple negligence standard before being amended to read gross negligence.[191] Following the passage of FIRREA, the question was whether the statute set a uniform gross negligence standard or whether the FDIC could use other law to bring negligence claims.[192] *Atherton* clarified that state negligence claims survived post-FIRREA,[193] but only seemed to reemphasize an ordinary negligence versus gross negligence distinction. Academics and others still talk about "the standard" for bank director and officer liability under each state's law in broad negligence or gross negligence terms.[194]

189. Complaint at 11–13, FDIC v. Blackwell, No. 1:11-CV-03423-RWS, 2012 WL 3230490 (N.D. Ga. Aug. 3, 2012), *vacated in part*, 2014 WL 8754679 (N.D. Ga. Aug. 19, 2014).

190. *See supra* notes 88, 90, 93 and accompanying text.

191. *See* S. 774, 101st Cong., § 214(n)(1) (1989); FDIC v. Canfield, 763 F. Supp. 533, 538 (D. Utah 1991) (discussing S. 744, § 214(n)), *rev'd en banc*, 967 F.2d 443 (10th Cir. 1992).

192. *See supra* notes 133–137 and accompanying text.

193. Atherton v. FDIC, 519 U.S. 213 (1997).

194. *See, e.g.*, Amy Deen Westbrook, *Does Banking Law Have Something to Teach Corporations Law About Directors' Duties?*, 55 WASHBURN L.J. 397, 413 (2016) ("The current round of litigation differs from prior FDIC efforts to recover bank losses from delinquent directors in a key way: The FDIC now routinely alleges not just gross negligence, but simple negligence and breach of fiduciary duty."); Craig McCrohon & Aaron H. Stanton, *FDIC Seeking to Recoup Failed Bank Losses*

A context-specific analysis shows that thinking of the standard of liability as negligence or gross negligence in a particular jurisdiction can be a misleading oversimplification. Some states review oversight and procedural decision-making claims under an ordinary negligence standard, but review substantive decision-making claims for gross negligence.[195] In other words, a court would hold bank directors and officers liable for a negligent loan underwriting process, but would evaluate the merits of the decision to make the loan only under a gross negligence standard.

Delaware corporate law adds another facet to this analysis. Under Delaware law, oversight claims are reviewed for gross negligence, procedural decision-making claims are reviewed for gross negligence, and substantive decision-making claims are reviewed for a lack of rationality.[196] If banking cases were to follow corporate law, therefore, substantive decision-making claims would be reviewed for irrationality—a standard of liability that seems to require more culpability than gross negligence.[197] Delaware may require a level of culpability higher than gross negligence for some oversight claims as well. In the *Caremark* case, the Delaware Court of Chancery held that directors must "attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists."[198] The court explained that "only . . . an utter failure to attempt to assure a reasonable information and reporting

from Bank Directors, BUS. L. TODAY, Feb./Mar. 2011, at 1 (evaluating whether certain states allow simple negligence claims); Christoffer Koch & Ken Okamura, *Why Does the FDIC Sue?* 8 (Fed. Res. Bank of Dall., Working Paper No. 1601, 2016), https://www.dallasfed.org/assets/documents/research/papers/2016/wp1601.pdf (coding states as having either a simple negligence standard or a gross negligence standard).

195. *See supra* notes 37, 75 and accompanying text; FDIC v. Loudermilk, 761 S.E.2d 332, 334 (Ga. 2014) (holding that bank directors must exercise ordinary diligence, care, and skill in the decision-making process, but the substance of their decision would only be reviewed for gross negligence).

196. *See supra* notes 38, 43, 76 and accompanying text.

197. *See* Brett H. McDonnell, *Committing to Doing Good and Doing Well: Fiduciary Duty in Benefit Corporations*, 20 FORDHAM J. CORP. & FIN. L. 19, 38 (2014) ("Defendants are protected from claims that a decision was a bad deal for the corporation as long as they could rationally believe that it was a good deal. This is essentially the waste standard, which sets a very low bar for defendants to justify their decisions . . . ."); E. Norman Veasey & Julie M.S. Seitz, *The Business Judgment Rule in the Revised Model Act, the* Trans Union *Case, and the ALI Project—A Strange Porridge*, 63 TEX. L. REV. 1483, 1486–87 (1985) (distinguishing rationality from gross negligence and noting that under a rationality standard "judges should find personal liability only in cases where no person of ordinary business judgment would find the board's decision to be rational or an arguably valid exercise of discretion"); *id.* at 1486 ("Gross negligence should not be the touchstone of judicial review of *substantive* business decisions; rather, judicial review of substantive decisions should be limited to the search for an 'abuse of discretion'—which equates to the lack of a rational business purpose." (footnote omitted)).

Not everyone agrees that irrationality requires more culpability than gross negligence. *See infra* note 208 and accompanying text.

198. *In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996); *see also supra* note 38 (discussing *Caremark*).

system exi[s]ts" would amount to a lack of good faith.[199] It further noted that so-called *Caremark* claims are "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[200] This *Caremark* "bad faith" standard may require more egregious conduct for liability than gross negligence.[201]

Of course, if a state required conduct more egregious than gross negligence for banker liability, it may run afoul of FIRREA and *Atherton*. This possibility will be discussed in the next Section. For now, our point is merely that in states with well-developed corporate law, the law varies the standard for imposing duty of care liability on directors and officers depending on the context of the claim. Because FIRREA allows the FDIC to bring claims against bankers under state law, this variance also affects banking duty of care claims. As a result, it is misleading to characterize a jurisdiction's standard of liability for breach of the duty of care as negligence or gross negligence regardless of the nature of the claim.

C. FIRREA and Context Analysis

Because states may vary the standard of liability depending on the nature of the claim, the question then becomes the extent to which FIRREA limits the application of state law. As *Atherton* explains, FIRREA's "'gross negligence' standard provides only a floor—a guarantee that officers and directors must meet at least a gross negligence standard. It does not stand in the way of a stricter standard that the laws of some States provide."[202] In situations where the state law applies a negligence standard, therefore, *Atherton* clearly allows the FDIC to pursue negligence claims.

However, when state law chooses a liability standard that is not expressed in negligence or gross negligence terms, FIRREA's application is less clear. Consider, for example, Delaware's standard of irrationality for substantive decisions or its standard of bad faith for *Caremark* claims.[203] Are these standards preempted by FIRREA, or do they survive? We see two possible approaches.

The first approach concludes that irrationality and/or bad faith are standards of liability that are more forgiving of defendants than gross negligence.[204] They are, therefore, preempted. After all, *Atherton* clearly

199. *Caremark*, 698 A.2d at 971.

200. *Id.* at 967.

201. *See* Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006); *infra* note 210 and accompanying text. It should be noted, however, that Delaware now characterizes *Caremark* actions as duty of loyalty claims rather than duty of care claims. *See supra* note 38; *infra* notes 210–211 and accompanying text.

202. Atherton v. FDIC, 519 U.S. 213, 227 (1997).

203. *See supra* notes 197–199 and accompanying text.

204. *See supra* note 197 and accompanying text.

holds that gross negligence is the floor for bank director and officer conduct.[205] (That is, *Atherton* holds that the standard of liability can be no more forgiving than gross negligence.)[206] Under this approach, the substantive decisions of bank directors and officers would be reviewed under FIRREA's gross negligence standard rather than an irrationality standard. Similarly, *Caremark* lack of oversight claims would be reviewed for gross negligence rather than bad faith. Thus, bank directors and officers would be held to a less forgiving standard of liability than non-bank managers in Delaware and states with similar law.

An alternative approach preserves Delaware's irrationality standard by construing it as a definition of gross negligence under state law. FIRREA provides that bank directors and officers may be held liable "for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, *as such terms are defined and determined under applicable State law*."[207] Thus, the FDIC and courts must look to state law to define gross negligence. At least some commentators believe that Delaware views gross negligence as akin to its irrationality standard under the business judgment rule.[208] Thus, in Delaware, in order to determine whether a substantive decision was grossly negligent, courts may need to ask whether the decision was irrational. In effect, if one believes that Delaware law defines gross negligence as the lack of a rational basis, an irrationality standard can be applied consistently with the language of FIRREA.[209]

A different argument applies to *Caremark's* bad faith standard, but it may reach the same result of avoiding any preemptive effect of FIRREA. Most commentators conclude that liability under *Caremark's* bad faith standard requires more egregious conduct than gross negligence.[210]

205. *Atherton*, 519 U.S. at 227.

206. *See id*.

207. 12 U.S.C. § 1821(k) (2012) (emphasis added).

208. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of* Van Gorkom *and Its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449, 457 (2002) ("[T]he gross negligence standard applicable in due care cases is, functionally speaking, a proxy for the rationality standard of the business judgment rule."); *see also id.* at 453 ("The selection of a gross negligence standard to govern due care cases may be viewed as synonymous with, and as a practical way to articulate a judicially useful metric to apply, the rationality test embodied in the business judgment rule."); *id.* at 454 (noting that "[s]ound justifications exist for employing a rationality-level gross negligence standard to evaluate claims that directors breached their duty of care").

209. As mentioned, however, there is disagreement among Delaware commentators as to whether Delaware law would view gross negligence and irrationality as synonymous. *Compare supra* note 208 and accompanying text, *with supra* note 197 and accompanying text.

210. *See, e.g.*, Samuel W. Buell, *Good Faith and Law Evasion*, 58 UCLA L. REV. 611, 649 (2011) (explaining that for *Caremark* claims "liability will be imposed only for 'systematic and sustained failure to address compliance,' not for negligence or even gross negligence"); Nancy R.

However, the subsequent Delaware Supreme Court case of *Stone v. Ritter* held that *Caremark*-type actions are properly conceptualized as duty of loyalty claims rather than as oversight claims under the duty of care.[211] Because FIRREA's gross negligence standard is applicable only to duty of care claims,[212] *Caremark* actions in Delaware presumably proceed as duty of loyalty claims without preemption by FIRREA. In other words, state law is the sole source of law for FDIC claims against bankers based upon a breach of the duty of loyalty. For such claims, the states have latitude to define the standard of liability as they wish.[213]

Regardless of how one construes FIRREA's preemptive effect, it seems clear that a recognition that context matters in determining banker standards of liability complicates the application of FIRREA and *Atherton*. Commentators who believed that *Atherton* would resolve most questions about FIRREA's impact on state law claims[214] may have been overly optimistic.

D. FDIC Guidelines and Practices

As discussed, the standard of liability for breach of the duty of care can vary by context within a state. We have also explained that the standard of liability can vary between states—even for claims within the same context. For example, with respect to claims involving the decision-making process, one state may apply a negligence standard while another requires a gross negligence showing.[215] In other instances, a state might simply choose an idiosyncratic approach, such as California's decision not to extend the

Mansfield et al., *The Shocking Impact of Corporate Scandal on Directors' and Officers' Liability*, 20 U. MIAMI BUS. L. REV. 211, 220 n.38 (2012) (stating that "gross negligence without more is not a showing of bad faith"); *cf. In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 64–65 (Del. 2006) ("[W]e address the issue of whether gross negligence . . . without more, can also constitute bad faith. The answer is clearly no.").

211. *See supra* note 38.

212. 12 U.S.C. § 1821(k) (stating that bank directors and officers can be held liable for "gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence)").

213. We are not aware of any cases raising the issue of whether Delaware's rationality or good faith standards survive FIRREA. No Delaware banks failed during the 2008 financial crisis. *See Failed Bank List*, *supra* note 1. Thus, the FDIC has not recently brought any cases against bank directors and officers in Delaware. *See Professional Liability Lawsuits*, *supra* note 6.

214. *See, e.g.*, *Developments in Banking Law: 1997*, 17 ANN. REV. BANKING L. 2, 39–41 (1998) (stating that *Atherton* "clarif[ied] once and for all the standard of care required in cases involving directors and officers of federally chartered banks," and noting the basic choice between gross negligence and simple negligence); Tiffany Z. Stuart, Note, *Corporate Officer and Director Liability:* Atherton v. Federal Deposit Insurance Corporation: *A Final Resolution of the Issues Surrounding Section 1821(K) of FIRREA*, 52 OKLA. L. REV. 251 (1999).

215. *Compare* note 201 (discussing Delaware law), *with* note 197 (discussing the approach of other states).

business judgment rule to corporate officers.[216] Because FIRREA and *Atherton* allow the FDIC to rely on state law, these jurisdictional differences result in non-uniform standards of liability for duty of care claims against bankers.

In a sense, the non-uniformity of liability standards for bank directors and officers seems so obvious that it is hardly worth mentioning. Before the Supreme Court decided *Atherton*, those who interpreted FIRREA as creating a nationwide gross negligence standard often pointed out that using state law would create inconsistent standards of liability for bankers.[217]

We raise the issue of non-uniformity among states because, for many years, the FDIC's statements have suggested a single nationwide standard. Indeed, the FDIC's 1992 guidelines (which remain in effect today) do not acknowledge the agency's heavy reliance on state law in bringing duty of care claims against bankers.[218] As mentioned, the guidelines explain that the FDIC will sue outside directors only in situations that "either involve insider abuse or situations where the directors failed to heed warnings from regulators, accountants, attorneys or others that there was a significant problem in the bank which required correction."[219] Commentators have interpreted this language to mean that outside directors will not be liable for breach of the duty of care unless a gross negligence showing is made, and FDIC statements seem to agree.[220] The guidelines also state that "[t]he

216. *See supra* note 163–167 and accompanying text; *see also* Selcke v. Bove, 629 N.E.2d 747, 750 (Ill. App. Ct. 1994) (calling the argument that "the business judgment rule applies only to the conduct of corporate directors and not to the conduct of corporate officers . . . clearly contrary to the substantial body of corporate case law"); STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 286 (2002) (concluding that because "[m]ost of the theoretical justifications for the business judgment rule extend from the boardroom to corporate officers," "the better view is that officers are eligible for the protections of the business judgment rule"); Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865, 865 (2005) ("We continue to believe that the policy rationales underlying the development and application of the business judgment rule to corporate directors similarly justify application of the rule to non-director officers, at least with respect to their exercise of discretionary delegated authority."). *But see* Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 440 (2005) (arguing "that the business judgment rule—a cornerstone concept in corporate law—does not and should not be extended to corporate officers in the same broad manner in which it is applied to directors").

217. *See, e.g.*, FDIC v. Canfield, 967 F.2d 443, 451–52 (10th Cir. 1992) (en banc) (Brorby, J., dissenting) (noting that interpreting FIRREA to allow state law claims would "breed inconsistent application of a pivotal national banking statute by causing directors' and officers' personal liability to turn not on the gravity of the alleged misconduct, but rather, on the state situs of the federally insured bank").

218. FDIC Financial Institution Letter, *supra* note 116.

219. *Id*.

220. *See supra* note 131 and accompanying text; *see also* FED. DEPOSIT INS. CORP., MANAGING THE CRISIS, *supra* note 160, at 275 (stating that the *Atherton* decision "is consistent with the FDIC's long-standing internal policy of pursuing only 'outside' director claims for which the facts show that the culpable conduct rises to the level of gross negligence or worse"); Jaret Seiberg, *Regulators Say*

FDIC will not bring civil suits against directors and officers who fulfill their responsibilities, including the duties of loyalty and care, and who make reasonable business judgments on a fully informed basis and after proper deliberation."[221] Commentators have viewed this language as evidence of the FDIC's belief that bank directors and officers are entitled to the protection of the business judgment rule.[222]

Although the FDIC's guidelines presume a uniform standard of liability—at least with respect to holding outside directors to a gross negligence standard and allowing the business judgment rule to apply—its litigation practices are inconsistent with its guidelines. For example, as illustrated in *Loudermilk*, the FDIC often brings negligence claims against outside directors and frequently argues that the business judgment rule is inapplicable to bankers.[223] While it is indisputable that the FDIC can use favorable state law under FIRREA and *Atherton*,[224] bank directors and officers should be able to rely on the FDIC's policy statements. As of now, the guidelines do not indicate that (1) the standard of liability for breach of the duty of care can vary depending upon the context of the claim; (2) the FDIC will pursue an ordinary negligence standard if the state law permits it

---

Directors, Officers Could be Liable if Year-2000 Bug Bit Bank, AM. BANKER, Sept. 29, 1998, at 2 (quoting Sandy Comentez, FDIC counsel, who explained that the FDIC can sue inside directors under state simple negligence rules, but must sue outside directors for gross negligence); Helfer, *supra* note 158 ("[G]ross negligence is precisely the standard the FDIC always applies in determining whether to sue outside directors for breaching their duty of care.").

221. FDIC Financial Institution Letter, *supra* note 116.

222. Glancz, *supra* note 131, at 5 ("There is some good in the FDIC guidelines. The FDIC gives explicit recognition to the business judgment rule."); Lee, *supra* note 127, at 687 (noting that the guidelines "appear[] to recognize the business judgment rule as adopted by case law in many states"); Schooner, *supra* note 127, at 186 ("[T]he banking agencies' enforcement guidelines support the application of the business judgment rule."); *see also* Scarborough & Olderman, *supra* note 95, at 371 ("[T]he FDIC acknowledges on its website that directors are entitled to business judgment protections . . . .").

The only policy-type hint that the FDIC may be rethinking the applicability of the business judgment rule is its current webpage describing "Professional Liability Lawsuits." It states that "[b]ank directors are allowed to exercise business judgment, and under the business judgment rule, they generally will not be subject to liability . . . ." *Professional Liability Lawsuits*, *supra* note 6. Previous versions of the webpage used less equivocal language: "[b]ank directors are allowed to exercise business judgment without incurring legal liability." *See* Scarborough & Olderman, *supra* note 95, at 371 (alteration in original) (citing the 2014 version of the FDIC webpage).

The FDIC webpage does not discuss whether officers are entitled to the protection of the business judgment rule. Nevertheless, the webpage reiterates that "the FDIC follows the policies adopted by the FDIC Board in 1992," and those policies mention both directors and officers. *Id*.; FDIC Financial Institution Letter, *supra* note 116.

223. *See supra* notes 168–177 and accompanying text. The FDIC's 1997 Annual Report provides one possible explanation for why the FDIC's litigation strategy deviates from its Guidance and other public statements. The Report explains: "[W]here applicable state law provides an ordinary care standard, the FDIC still will sue outside directors believed to be guilty of gross negligence but will allege only what is required under the law." 1997 FDIC ANN. REP. 31. This seems a large caveat to have buried in a nearly two-decade-old annual report.

224. *See supra* notes 149–151 and accompanying text.

(even against outside directors); and (3) the FDIC may take the position that the business judgment rule is inapplicable to bank directors and officers.

Recently the FDIC has acknowledged that state law plays an important role in banking duty of care cases. Its webpage states: "Professionals may be sued for, among other things, simple negligence [or] gross negligence . . . . With respect to claims against directors and officers, the Supreme Court has held that the FDIC may pursue simple negligence claims if state law permits (*Atherton v. FDIC*)."[225] In addition, the FDIC Chairman has also recently explained that the agency carefully scrutinizes state law when determining whether a suit against directors and officers is likely to be successful.[226] Nevertheless, the FDIC's webpage still reiterates that "the FDIC follows the policies adopted by the FDIC Board in 1992."[227]

The FDIC should review and update its 1992 guidelines. The guidelines should accurately communicate the standards of liability under which the FDIC may sue for breach of the duty of care. Until this is accomplished, the FDIC should generally decline to bring cases under theories that are inconsistent with the existing guidelines and the FDIC's repeated statements.

CONCLUSION

Under state corporate law, the standard of liability for breach of the duty of care can vary depending upon the context and the particular claim within that context. Under FIRREA and *Atherton*, this state law is also relevant to duty of care claims against directors and officers of banks. Thus, context matters in the banking setting as well. Because the standard of liability can vary depending upon the context, it is misleading to suggest that the banker liability debate in a particular jurisdiction reduces to a simple choice between negligence and gross negligence. Instead, as we have explained, duty of care liability is often more nuanced, and the application of FIRREA and *Atherton* to duty of care claims in the banking setting is correspondingly more complex. The FDIC should revise its guidelines to help bankers understand this complexity and to allow them to accurately gauge their risk of exposure under the FDIC's current litigation practices.

225. *Professional Liability Lawsuits*, *supra* note 6.

226. Martin J. Gruenberg, Chairman, Fed. Deposit Ins. Corp., Remarks at Meeting of American Association of Bank Directors in Washington, D.C. (May 12, 2015), https://www.fdic.gov/news/news/speeches/spmay1315.html ("Potential claims are evaluated based on the legal standards established by applicable state law, including the business judgment rule, and are pursued only if they are meritorious and expected to be cost-effective.").

227. *Professional Liability Lawsuits*, *supra* note 6.