

FDIC Claims Against Directors and Officers of Failed Banks

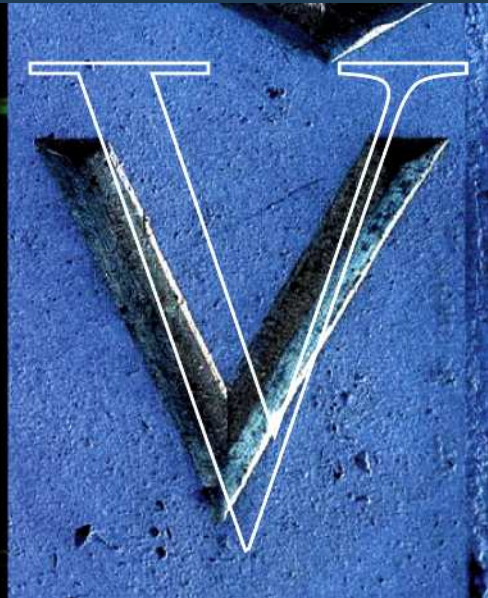
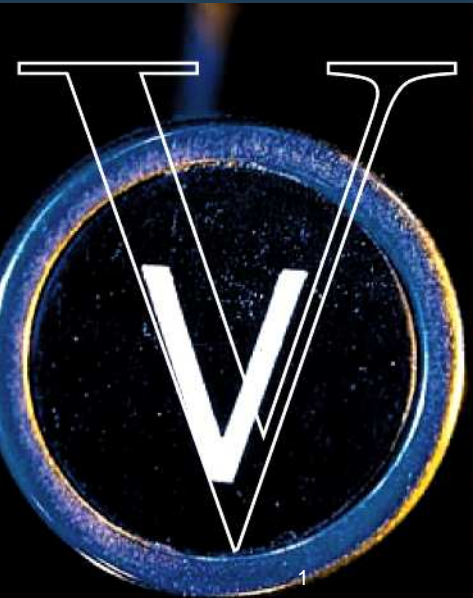
Presented by

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2012 Spring Meeting



Roadmap

- A. Themes From D&O Suits
- B. The Great Recession and Other Defenses
- C. Other Notable Issues Raised in Motions
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Themes from D&O Suits

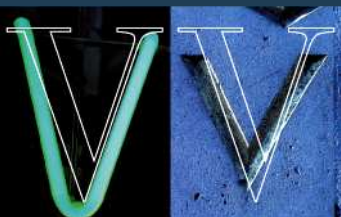
- Common
 - Gross Negligence
 - Negligence
 - Breach of Fiduciary Duty
- Less common
 - Illegal Dividends
 - Corporate Waste
- Most charges arise from allegations of
 - Aggressive growth
 - Too heavily concentrated in real estate lending (particularly acquisition, development, and construction (“ADC”) and commercial real estate (“CRE”))
 - Lax loan underwriting
 - Weak credit administration
 - Regulation O /insider violations
 - “Rubber stamp”/ under-qualified board
 - Failure to heed regulator criticisms



Common Defenses

Overarching theme: the “Great Recession” is to blame for deterioration in assets and even the regulators failed to anticipate the severity of the downturn:

- “Alan Greenspan, the Fed chairman during the two decades leading up to the crash, told the Commission that it was beyond the ability of regulators to ever foresee such a sharp decline. ‘History tells us [regulators] cannot identify the timing of a crisis, or anticipate exactly where it will be located or how large the losses and spillovers will be.’” Financial Crisis Inquiry Commission Report at 3 (Jan. 2011)



The Great Recession (cont.)

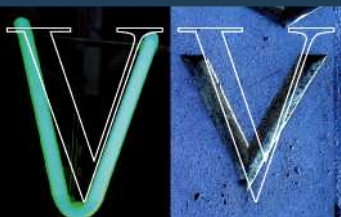
“Charles Prince, the former chairman and chief executive officer of Citigroup Inc., called the collapse in housing prices ‘wholly unanticipated.’”

“Warren Buffett, the chairman and chief executive officer of Berkshire Hathaway Inc., which until 2009 was the largest single shareholder of Moody’s Corporation, told the Commission that ‘very, very few people could appreciate the bubble...’”

“Lloyd Blankfein, the chairman and chief executive officer of Goldman Sachs Group, Inc., likened the financial crisis to a hurricane.”

“Regulators echoed a similar refrain. Ben Bernanke, the chairman of the Federal Reserve Board since 2006, told the Commission a ‘perfect storm’ had occurred that regulators could not have anticipated...”

(FCIC Report at 3)

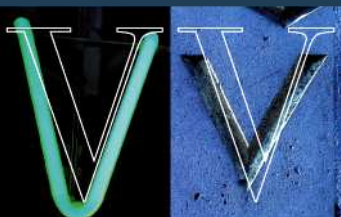


Additional Defenses and Rulings

- Standard of Care (gross negligence v. ordinary negligence)
 - Application of state law under *Atherton v. FDIC*, 519 U.S. 213 (1997) (gross negligence “floor”) (see “Duty of Care” discussion, below).
 - See, e.g., Pending Motions to Dismiss filed in *FDIC as Receiver of Integrity Bank of Alpharetta, GA v. Skow* (N.D. Ga.); *FDIC as Receiver of Haven Trust Bank v. Briscoe* (N.D. Ga.); *FDIC as Receiver of Cooperative Bank v. Willetts* (E.D.N.C.).
- Business Judgment Rule
 - FDIC generally contends this defense is not properly raised in a FRCP 12(b)(6) motion.
 - *FDIC as Receiver of IndyMac Bank, F.S.B. v. Perry* (C.D. Cal. Dec. 13, 2011) (holding that BJR does not apply to officers; motion pending to certify question to California Supreme Court).
 - *FDIC as Receiver of Heritage Community Bank v. Saphir* (N.D. Ill. Sept. 1, 2011) (declining to rule on BJR at 12(b)(6) stage), *but see FDIC as Receiver for Wheatland Bank v. Spangler* (N.D. Ill. Dec. 22, 2011) (“while in essence it is a defense, under Illinois law, it does not appear to be an affirmative defense that cannot be raised in response to a motion to dismiss.”). See also *Mukamal v. Bakes (In re Far & Wide Corp.)*, 378 F. App’x 890 (11th Cir. 2010); *Anderson v. Dobson*, 627 F. Supp. 2d 619 (W.D.N.C. 2007); *National Credit Union Admin. v. Siravo*, No. 10-1597 (C.D. Cal. July 7, 2011) (unpublished).

Additional Defenses and Rulings (cont.)

- Duplicate Breach of Fiduciary Duty/Negligence Counts
 - *FDIC as Receiver of Heritage Community Bank v. Saphir* (N.D. Ill. Sept. 1, 2011) (“The FDIC’s complaint does not include any indication that the negligence and breach of fiduciary duty claims are alternative theories. Accordingly, the negligence claims. . . are dismissed as duplicative of the breach of fiduciary duty claims.”)
- Reliance by Directors on Officers
 - See generally *In re Walt Disney Co. Derivative Action*, 907 A.2d 693, 770 (Del. Ch. 2005) (holding that directors will not be liable for negligence when they reasonably rely on information, opinions, reports, or statements within the expertise of an expert selected with reasonable care, as long as the information is not so deficient as to give reason to question).
 - Directors cannot, however, abdicate all of their supervisory responsibility by allowing themselves to be dominated by management and act as rubber stamps. Even outside directors must become more involved with the institution when warning signals arise. See *Atherton v. Anderson*, 86 F.2d 518 (6th Cir. 1936); *Rankin v. Cooper*, 149 F. 1010 (W.D. Ark. 1907).



Additional Defenses and Rulings (cont.)

- **Exculpatory Clauses in Bank Articles of Incorporation**
- **Failure to mitigate**
- **Waiver/Ratification**
- **Intervening causes/ “Intervening Economic Downturn”**
- **Violation of Constitutional Due Process and Equal Protection** for filing suit against officers and directors of community banks but ignoring similar alleged conduct in “too big to fail” institutions. *See FDIC as Receiver of Heritage Community Bank v. Saphir* (Nathan Answer, 12/30/11).



Other Notable Issues Raised in Motions

- Spoliation
 - *FDIC as Receiver of IndyMac Bank, F.S.B. v. Van Dellen* (C.D. Cal.) (motion for sanctions alleges: “the bitter irony is that the Government’s gross negligence in discharging its document retention obligations leaves the Defendants unable to defend themselves against the negligence charges the Government has levied against them”).
- Motion to Stay pending resolution of suit alleging improper closure by regulators
 - *FDIC as Receiver of Columbian Bank & Trust Co. v. McCaffree* (D. Kan.) (Motion for stay denied Dec. 15, 2011).
- Insurance defense
 - *FDIC as Receiver of Silverton Bank v. Bryan* (N.D. Ga.) (insurers have argued that they are not obligated to provide coverage under “insured vs. insured” and/or regulatory exclusions).
 - *FDIC as Receiver of First National Bank of Nevada v. Dorris* (D. Az.) (FDIC and defendants settled; FDIC has filed suit against insurer ““to recover more than \$40 million from the defendants for their wrongful breach of the insurance policy and their acts of bad faith in connection therewith”).
- Trial structure
 - *FDIC as Receiver of IndyMac Bank, F.S.B. v. Van Dellen* (C.D. Cal.) (defense proposal to break the trial down into “phases” and, during the first phase, narrowing the number of loans at issue from 66 to 5).

D&O Litigation: Where Things Stand Today

- We expect more lawsuits to be filed in the coming years as the FDIC completes its investigations and negotiations are unsuccessful.
- “As of January 18, 2012, the FDIC has authorized suits in connection with 44 failed institutions against 391 individuals for D&O liability with damage claims of at least \$7.7 billion.” 18 suits against D&O defendants were authorized in January 2012 alone. See <http://www.fdic.gov/bank/individual/failed/pls/> (updated monthly).



Settlements

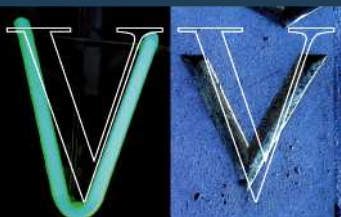
- *FDIC as Receiver of Corn Belt Bank and Trust Company v. Stark* (C.D. Ill.)
 - Reported to have settled \$10.4 million suit for \$700,000 (Reuters, June 17, 2011).
- *FDIC as Receiver for Washington Mutual Bank v. Killinger* (W.D. Wash.)
 - Reported to have reached agreement to settle \$900 million suit for \$64 million (Associated Press, Dec. 13, 2011).
 - Dec. 27, 2011 Stipulation and Order to Extend Time to Perfect Settlement by 60 days.
- *FDIC as Receiver of First National Bank of Nevada v. Dorris* (D. Az.)
 - Final Judgment Order filed Oct. 13, 2011.
 - Two defendants agreed to enter into settlement of \$20 million each (plus post-judgment interest), and assign their rights under insurance policies to FDIC.
 - “In consideration for these assignments” the FDIC “agreed not to take any action of any kind to assign, document, record, register as a lien, or collect against the Defendants, the Stipulated Judgments” and further agreed to dismiss suit with prejudice.
 - FDIC subsequently filed suit against insurer to recover \$40 million (suit pending).



D&O Litigation: Duty of Care

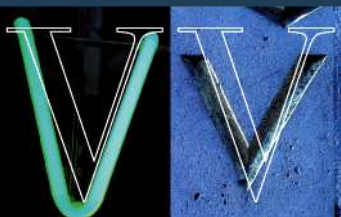
- 12 U.S.C. §1821(k):

“A director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by, on behalf of, or at the request or direction of the Corporation, which action is prosecuted wholly or partially for the benefit of the Corporation . . . 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. Nothing in this paragraph shall impair or affect any right of the Corporation under other applicable law.”



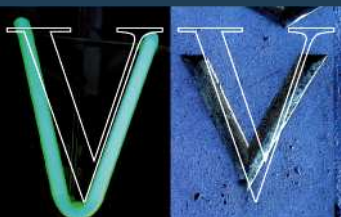
D&O Litigation: Duty of Care (cont.)

- Courts were split as to what law was authoritative: federal common law, state common law, or §1821(k).
- Issue was settled in the 1997 Supreme Court case *Atherton v. FDIC*. 519 U.S. 213.
- Outcome: FDIC may pursue simple negligence claims if state law permits.



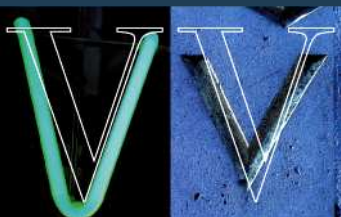
D&O Litigation: Duty of Care (cont.)

- *Atherton v. FDIC*
 - “There is no federal common law that would create a general standard of care applicable to these cases.” 519 U.S. at 226.
 - “The statute’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.” 519 U.S. at 227.



D&O Litigation: Duty of Care (cont.)

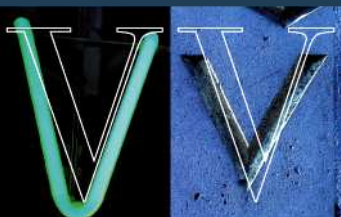
- Prior to *Atherton*, many states had statutes that severely limited the liability for bank directors, and some extended to officers. States feared that if liability was not limited, the threat of litigation would deter qualified individuals from being willing to serve on bank boards.
- Most states have now adopted the **Business Judgment Rule**, which is typically based on the gross negligence standard.
 - *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)
 - *FDIC v. Castetter*, 184 F.3d 1040 (9th Cir. 1999) (discussing California law).



D&O Litigation: Duty of Care (cont.)

- Business Judgment Rule – Director/Officer must:
 - Act in good faith;
 - Be uninterested in the subject of the judgment;
 - Be appropriately informed as to the subject matter involved; and
 - Rationally believe that the judgment is in the best interests of the company.

Aronson, 473 A.2d at 812.
- Specific state standard may vary slightly

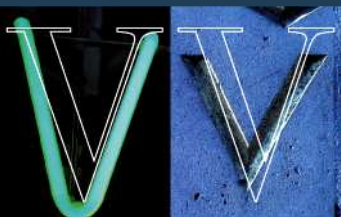


D&O Litigation: FDIC Guidance

- **1992 FDIC Statement of Policy**, regarding duties of bank directors and officers and the procedures and nature of suits by the FDIC against directors and officers (included with handouts):

Procedures to bring suit

1. Requires authorization by FDIC Board of Directors, who perform a “rigorous review” of the factual circumstances
2. Allow officers and directors to respond to proposed charges and discuss settlement
3. Lawsuit must be cost-effective

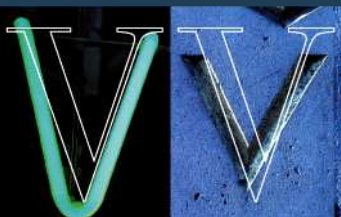


D&O Litigation: FDIC Guidance (cont.)

Importantly, the FDIC's "Statement Concerning the Responsibilities of Bank Directors and Officers," states:

“The 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.”

-FDIC Financial Institution Letter, FIL-87-92 (Dec. 3, 1992)

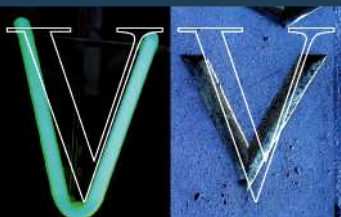


D&O Litigation: FDIC Guidance (cont.)

Three principal categories for FDIC D&O suits:

1. Dishonest conduct or approved/condoned abusive transactions with insiders
2. Responsibility for failure of institution to adhere to applicable laws, regulations, internal policies, supervisory agreements or other safety or soundness violations
3. Failure to establish or monitor adherence to proper underwriting policies or knowledge or reason to know of improper underwriting policies

Claims Letter: The FDIC's decision on when to send a claims letter is typically guided by the expiration date of a D&O insurance policy or an applicable statute of limitations. The claims letter preserves the FDIC's rights, and an investigation will continue after that point while the FDIC determines whether to file suit.



FDIC Statement Regarding Suits Against Inside Directors/Outside Directors:

“One factor considered in determining whether to bring an action against a director is the **distinction between inside and outside directors**. An inside director is generally an officer of the institution, or a member of a control group. An inside director generally has greater knowledge of and direct day to day responsibility for the management of the institution.

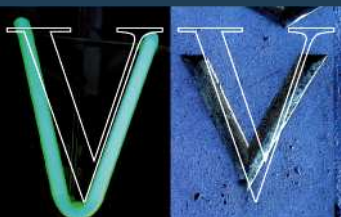
By contrast, an outside director usually has no connection to the bank other than his directorship and, perhaps, is a small or nominal shareholder. Outside directors generally do not participate in the conduct of the day to day business operations of the institution.

The most common suits brought against outside directors 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. In the latter instance, if the directors fail to take steps to implement corrective measures, and the problem continued, the directors may be held liable for losses incurred after the warnings were given.”

- FDIC Financial Institution Letter, FIL-87-92 (emphasis added).

D&O Litigation

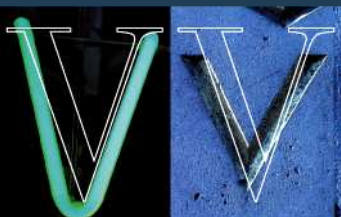
- Prejudgment Attachments
 - The FDIC as receiver or conservator may seek injunctive relief through “asset freezes” without showing that injury, loss, or damage is irreparable and immediate, as normally required by Federal Rule 65.
12 U.S.C. § 1821(d)(19)
 - The other requirements for injunctive relief (likelihood of success on the merits, balance of harms favors plaintiff, no harm to public interest) still must be met.
12 U.S.C. § 1821(d)(18)



D&O Litigation: Document Retention/Production Issues

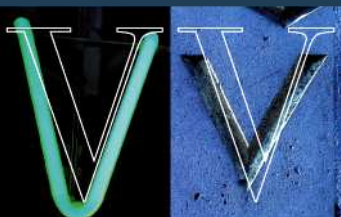
FDIC General Counsel Letter of January 25, 2011

- FDIC policies remain the same:
 - Documents belong to the bank/FDIC as Receiver
 - No “self-help discovery” by Directors and Officers
 - FDIC is willing to work with Directors and Officers to provide information subject to confidentiality/protective order
 - Requests considered on case-by-case basis
- The cases against Bryan Cave LLP and McKenna Long & Aldridge LLP have been settled.
- The FDIC is expected to issue a financial institutions letter providing further guidance in the near future.



D&O Litigation: Document Retention/Production Issues

- Directors contend that they have a right to keep board packages and other documents that they saw during the course of their board service.
- They are willing to sign confidentiality agreements.
- Need possession of the board documents in order to defend third-party suits.



Suits filed as of Feb. 7, 2012

1. *FDIC as Receiver of IndyMac Bank, F.S.B. v. Van Dellen, et al.*, Case No. 10-cv-04915 (U.S. District Court for the Central District of California, Filed Jul. 2, 2010).
2. *FDIC as Receiver of Heritage Community Bank v. Saphir, et al.*, Case No. 10-cv-07009 (U.S. District Court for the Northern District of Illinois, Filed Nov. 1, 2010).
3. *FDIC as Receiver of 1st Centennial Bank v. Appleton, et al.*, Case No. 11-cv-00476 (U.S. District Court for the Central District of California, Filed Jan. 14, 2011).
4. *FDIC as Receiver of Integrity Bank of Alpharetta, GA v. Skow, et al.*, Case No. 11-cv-0111 (U.S. District Court for the Northern District of Georgia, Filed Jan. 14, 2011).
5. *FDIC as Receiver of Corn Belt Bank and Trust Company v. Stark, et al.*, Case No. 11-cv-03060 (U.S. District Court for the Central District of Illinois, Filed Mar. 1, 2011).
6. *FDIC as Receiver for Washington Mutual Bank v. Killinger, et al.*, Case No. 11-cv-000459 (U.S. District Court for the Western District of Washington, Filed Mar. 16, 2011).
7. *FDIC as Receiver for Wheatland Bank v. Spangler, et al.*, Case No. 10-cv-4288 (U.S. District Court for the Northern District of Illinois, Filed May 5, 2011).
8. *FDIC as Receiver of IndyMac Bank, F.S.B. v. Perry*, Case No. 11-cv-5561 (U.S. District Court for the Central District of California, Filed Jul. 6, 2011).
9. *FDIC as Receiver of Haven Trust Bank v. Briscoe*, Case No. 11-cv-02303 (U.S. District Court for the Northern District of Georgia, Filed Jul. 14, 2011).
10. *FDIC as Receiver of Michigan Heritage Bank v. Cuttle*, Case No. 11-cv-13442 (U.S. District Court for the Eastern District of Michigan, Filed Aug. 8, 2011).



Suits filed as of Feb. 7, 2012 (cont.)

11. *FDIC as Receiver of Columbian Bank & Trust Co. v. McCaffree*, Case No. 11-cv-2447 (U.S. District Court for the District of Kansas, Filed Aug. 9, 2011).
12. *FDIC as Receiver of Cooperative Bank v. Willetts*, Case No. 11-cv-00165 (U.S. District Court for the Eastern District of North Carolina, Filed Aug. 10, 2011).
13. *FDIC as Receiver of Silverton Bank v. Bryan*, Case No. 11-cv-02790 (U.S. District Court for the Northern District of Georgia, Filed Aug. 22, 2011).
14. *FDIC as Receiver of First National Bank of Nevada v. Dorris*, Case No. 11-cv-01652 (U.S. District Court for the District of Arizona, Filed Aug. 23, 2011).
15. *FDIC as Receiver for Alpha Bank & Trust v. Blackwell*, Case No. 11-cv-3423 (U.S. District Court for the Northern District of Georgia, Filed Oct. 7, 2011).
16. *FDIC as Receiver for Mutual Bank v. Mahajan*, Case No. 11-cv-7590 (U.S. District Court for the Northern District of Illinois, Filed Oct. 25, 2011).
17. *FDIC as Receiver for Westsound Bank v. Johnson*, Case No. 3:11-cv-05953 (U.S. District Court for the Western District of Washington, Filed Nov. 18, 2011).
18. *FDIC as Receiver for the Bank of Asheville v. Greenwood*, Case No. 1:11 cv 00337 (U.S. District Court for the Western District of North Carolina, Filed Dec. 29, 2011.)
19. *FDIC as Receiver for R-G Premier Bank of Puerto Rico v. Galán-Alvarez*, Case No. 3:12-cv-01029-JAG (U.S. District Court for the District of Puerto Rico Filed Jan. 18, 2012).
20. *W Holding Co. Inc. v. Chartis Ins. Co.* (U.S. District Court for the District of Puerto Rico, Filed Jan. 20, 2012) (FDIC as Intervenor).
21. *FDIC as Receiver for County Bank v. Hawker*, Case No. 1:12-cv-00127-LJO-DLB (U.S. District Court for the Eastern District of California, Filed Jan. 27, 2012).



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Ron Glancz is the Chair of Venable's Financial Services Group.

Mr. Glancz represents financial institutions of virtually every type -- banks, savings associations, bank and thrift holding companies, insurance companies, securities firms, and credit unions -- and represents companies and investors seeking to become or acquire a bank. He also represents directors and officers of financial institutions. Mr. Glancz represented the U.S. Department of the Treasury in connection with the Capital Purchase Program.

He focuses on bank and thrift regulation, supervision and enforcement, mergers and acquisitions, new financial products and services, corporate governance, FDIC issues, and Bank Secrecy Act compliance.

Mr. Glancz is recognized for leadership in banking law by both The Best Lawyers in America and Chambers USA: America's Leading Lawyers for Business.

He served as assistant general counsel and acting deputy general counsel of the Federal Deposit Insurance Corporation, where he also served on the U.S. Attorney General's Bank Fraud Enforcement Working Group.

Mr. Glancz was director of the Litigation Division, Office of the Comptroller of the Currency. He was an assistant director, Civil Division, Department of Justice, where he represented the Federal Reserve, OCC, and FDIC in many of the leading banking cases.

HONORS

- Recognized in the 2009-2011 editions of *Chambers USA*, (Band 1), Financial Services Regulation: Banking (Regulatory Enforcement & Investigations), National
- Recognized in the 2008 edition of *Chambers USA*, (Band 2), Financial Services Regulation: Banking (Regulatory Enforcement & Investigations), National
- Recognized in the 2007 edition of *Chambers USA*, (Band 2), Financial Services Regulation: Banking (Regulatory Enforcement & Investigations), National
- Recognized in the 2006 edition of *Chambers USA*, (Band 2), Financial Services Regulation: Banking (Regulatory Enforcement & Investigations), National
- Listed in *The Best Lawyers in America*, Banking Law, (Woodward/White, Inc.)
- Recognized in 2009 by *Washingtonian* magazine as one of "Washington's Top Lawyers"
- Selected for inclusion in *District of Columbia Super Lawyers* (2008 - 2010)
- Listed in *Who's Who in America*
- AV® Peer-Review Rated by Martindale-Hubbell
- Frank Simpson II Award from American Bar Association's Banking Law Committee

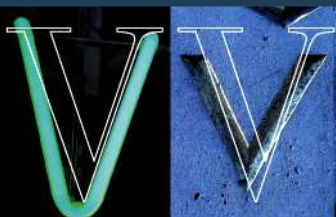
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