RECORD NO. 14-2078

In The
United States Court of Appeals
For The Fourth Circuit

FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver for Cooperative Bank,

Plaintiff – Appellant,

v.

RICHARD ALLEN RIPPY; JAMES D. HUNDLEY; FRANCES PETER FENSEL, JR.; HORACE THOMPSON KING, III; FREDERICK WILLETTS, III; DICKSON B. BRIDGER; PAUL G. BURTON; OTTIS RICHARD WRIGHT, JR.; OTTO C. BUDDY BURRELL, JR.,

Defendants – Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA AT WILMINGTON

REDACTED BRIEF OF APPELLEES

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UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
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No. 14-2078 Caption: FDIC v. Richard Rippy, et al.

Pursuant to FRAP 26.1 and Local Rule 26.1,

ALL DEFENDANTS Messrs. Rippy, Hundley, Fensel, King, Willetts, Bridger, Burton, Wright, and Burrell.
(name of party/amicus)

who is appellees, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☐ YES ☑ NO
If yes, identify all parent corporations, including grandparent and great-grandparent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(b))? ☐ YES ☑ NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐ YES ☑ NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐ YES ☑ NO
If yes, identify any trustee and the members of any creditors' committee:

Signature: [signature] Date: October 9, 2014

Counsel for: ALL DEFENDANTS

CERTIFICATE OF SERVICE

****

I certify that on October 9, 2014 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below:

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STATEMENT OF ISSUES

1. Whether the trial court correctly applied North Carolina law to a voluminous record and entered summary judgment where plaintiff submitted insufficient evidence to overcome the Business Judgment Rule's strong presumptions of good faith and rational business processes and purposes?

2. Whether the trial court correctly applied North Carolina's gross negligence standard and entered summary judgment where plaintiff submitted insufficient evidence to demonstrate that defendants acted wantonly or in conscious disregard of the Bank's well-being?

3. Whether summary judgment may be affirmed on alternative grounds asserted below?

STATEMENT OF CASE

This appeal involves a district court's ruling on cross-motions for summary judgment filed by nine defendants-appellees ("defendants") and FDIC as Receiver for Cooperative Bank of Wilmington ("FDIC," "plaintiff," or "Appellant"). FDIC sued these former community bank directors and officers in a derivative capacity, stepping into the shoes of Cooperative Bank of Wilmington ("Cooperative" or "Bank") after the institution was closed in the 2008-09 financial crisis, and alleging that defendants were negligent and grossly negligent in breaching duties to the Bank. While the case nominally involves 87 different commercial and residential

real estate loans, FDIC introduced evidence about only a few loans, and the focus of the parties' cross-motions below was on Cooperative's general loan underwriting and approval processes.

In denying FDIC's negligence and fiduciary claims, the district court applied the Business Judgment Rule which, under North Carolina law, establishes two strong presumptions that plaintiff must overcome. First, absent strong proof of bad faith or disloyalty, corporate officers and directors are presumed to have exercised due care. Second, they are presumed to have acted rationally, and a challenger carries a heavy burden to demonstrate otherwise. Based on a largely undisputed and voluminous record that included loan files, regulator reports, independent audits and minutes from Bank committees and its monthly Board of Director meetings, the district court correctly found that FDIC failed to carry its substantial burden to overcome these presumptions, and that defendants were entitled to judgment as a matter of law. Although FDIC advanced many arguments and suggested inferences, the district court rightly held that the substantial record did not support inferences that defendants acted in bad faith or irrationally in making the challenged loans.

The court below also properly granted defendants' summary judgment on FDIC's gross negligence claim because plaintiff introduced insufficient evidence

to establish that any defendant engaged in wanton conduct or consciously disregarded the Bank's well-being, as required by North Carolina law.

I. STATEMENT OF FACTS

A. Defendants' Successful Operation of Cooperative.

Cooperative, a community bank founded in 1898 in Wilmington, North Carolina, operated as a thrift until 1992, when it converted to a state-chartered savings bank regulated by FDIC. In response to competition from regional and national banks expanding into the Coastal Carolinas, Cooperative again changed its charter in 2002 to a state commercial bank and, as its regulators knew,[1] adopted a plan to grow to a $1 billion bank focusing on commercial real estate ("CRE") lending in the Coastal Carolinas. Thereafter, Cooperative's growth kept pace with the average rate for banks its size. JA-1135-36.

As the Coastal Carolina economy boomed, Cooperative's portfolio of CRE loans grew. Throughout this period, Cooperative received high marks from regulators at FDIC and the North Carolina Office of Commissioner of Banks ("OCOB"). JA-632. FDIC and OCOB thoroughly examined the Bank's

[1] JA-689; JA-602¶¶6-7. "JA" cites refer to the Joint Appendix; "D.E." cites refer to parts of the record below not included in the selectively abridged appendix.

operations[2] and routinely awarded CAMELS ratings of "1" or "2" for asset quality, management capability, sensitivity to market risks, and other factors.[3] CAMELS ratings have an objective, administratively-defined meaning. A composite "2" rating means that the bank presents "no material supervisory concerns" and is "fundamentally sound," considered by regulators to be "stable," "capable of withstanding business fluctuations," and "in substantial compliance with laws and regulations," with risk management practices "satisfactory relative to the institution's size, complexity, and risk profile." JA-776.

1. *Cooperative's long-serving officers and directors were highly qualified.*

Each defendant in this action served Cooperative through years of successful operations. The officer defendants were highly qualified long-time bank employees: Frederick Willetts III, CEO and President of Cooperative until February 2009, joined Cooperative in 1972 and became the third generation of Willetts at the community bank's helm. JA-594¶¶2-3. Otto "Buddy" Burrell

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[2] Bank examiners annually review extensive materials including balance sheets, written policies and procedures, board packets, board minutes, and loan files. *See* FDIC Regulatory Examination Process (cited in Defendants' Memorandum [D.E. 102] at 3, n.2); JA-737-48(21:4-22, 22:20-32:9). Examiners look for violations of laws, including limits on loans to one borrower, or "legal lending limit" violations. JA-725.

[3] "CAMELS" is an acronym for six primary areas of bank operations: **C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk. Ratings are assigned on a 1-to-5 scale, with "1" being the best. JA-630.

began his banking career in 1993, eventually becoming Cooperative's Senior Executive Vice President and COO. JA-597¶2. Dickson Bridger joined Cooperative's mortgage lending department in 1984, rising to Executive Vice President of Mortgage Lending. JA-599¶2. (Willetts, Bridger, and Burrell are "Officers.") The Outside Directors also were experienced Wilmington civic and business leaders.[4]

2. *The CRE loan approval process.*

Cooperative's loan underwriting process generated a voluminous summary judgment record showing that the CRE loans challenged by FDIC were extensively vetted before presentation to the Officers and then to Outside Directors. Cooperative's experienced loan officers researched and prepared highly-detailed credit memoranda for each of the challenged CRE loans. The summary judgment record also includes appraisals as well as a lengthy declaration from former President Willetts (JA-1160-1173¶¶26-55) and from other defendants describing Cooperative's loan processes. JA-604¶11; JA-594-617.

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[4] Dr. James Hundley, a local orthopedic surgeon, joined the Board in 1990 and succeeded Willetts as Chairman in June 2009, JA-601¶¶2-3; Peter Fensel, owner of a Wilmington wholesale distribution business, joined the Board in 1990 and served through Cooperative's closure in 2009, JA-607¶¶2-3; Horace "Tommy" King, longtime operator of a local ironworks, joined the Board in 1990, JA-609¶¶2-3; attorney Richard Wright joined the Board in 1992, JA-612¶¶2-3; Allen Rippy, owner of a Wilmington auto dealership, joined the Board in 1997, JA-615¶¶2-3; Wilmington businessman, Paul Burton joined the Board in 1992 and retired in 2008, D.E.-1-¶3 (Complaint).

After preparing the credit memoranda and analyses, Cooperative's loan officers presented the proposed loans to senior management for approval. JA-1064-1066. Far from an aura of inevitability, proposed loans were often rejected. JA-1162, 1174, 1182; D.E.-103-23 (11-28-2006 Board Minutes reporting six October loan denials).

Some CRE loans (those exceeding 25% of the Bank's legal lending limit) required approval by President Willetts and board members. JA-2383. Although Cooperative's Board of Directors met every month, telephone approvals were sometimes sought for time-sensitive requests. The summary judgment record showed that during these calls, which varied in length, directors were presented information from the credit memoranda. As Burrell explained:

> [T]ypically, there would be me, there would be Mr. Unwin, there would be the loan officer to tell them what the loan was, give them all of the information about it, and that telephone conversation could have been very extensive in time. I mean, it was not a five-minute phone conversation. … [T]hey were given information about it, who the borrower was, what this was about, what they were doing, et cetera, and they were given time each individually or however they wanted to do it to ask any questions.

JA-1067-68(105:14-106:15); *see also* JA-1085-90(47:10-52:7); JA-1076-77(116:2-117:18); JA-604¶11; JA-609-610 ¶4; JA-612-13¶4; JA-615¶4.

At Cooperative's monthly board meeting, loan materials were presented again and directors could ask loan officers additional questions or refine conditions for future loan fund releases. JA-604¶11.

3. *Defendants' decision to expand Cooperative's lot loan program.*

The Coastal Carolinas market has long been a resort and retirement community, and one of Cooperative's traditional products was residential lot financing. In 2006, increasing competition from regional and national banks led Cooperative to offer more flexible terms for lot loans. Cooperative's managers lucidly anticipated that offering lot loan terms similar to competing banks[5] would lead to construction and mortgage loan relationships with the borrowers, who were often out-of-state consumers looking to retire or vacation in the area. JA-1092-93; JA-1098; JA-1105.

Willetts and Bridger discussed the prospect of relaxing lot loan terms with the Bank's ALCO Committee. JA-1092-93. They examined the prevailing market, weighed potential risks and benefits, and decided it was in the Bank's best interests to respond to increased competition in this sphere. *Id.* Bridger advised Cooperative's Board about the special lot loan program. JA-1111, 1114; JA-605¶14. Cooperative's policies called only for Board approval of certain large loans, so Outside Directors did not approve individual lot loans.

Bridger also investigated concerns about whether certain investors were flipping lots in particular developments. He interviewed the title company

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[5] JA-669-70 (Bank of America financing of "95% for qualified applicants. INTEREST ONLY for 5 years" for "high FICO (620+) applicants to avoid a down payment or verification.").

involved and concluded no flipping was occurring. DE-103-31 (6-25-2007 ALCO Minutes, 1-2).

B. 2006 FDIC Report of Examination.

Plaintiff's claims are founded on FDIC's 2006 Report of Examination ("ROE"). Appellant's Brief at 9-13, 47-48. FDIC thoroughly examined Cooperative's operations (including the Bank's large CRE loan portfolio) and issued a 2006 ROE awarding Cooperative a composite CAMELS 2 rating, grading the Bank as "fundamentally sound" and raising "no material supervisory concerns." JA-717. FDIC's rating included "2s" for Asset Quality and Management, following high marks from prior years. JA-632.

The 2006 ROE recommended improvements for loan underwriting and credit administration, reducing CRE concentrations, and several other items now portrayed as "warnings" by plaintiff. JA-686-702. The record demonstrates that Cooperative's directors and officers responded to the recommendations by hiring additional employees (including Chief Credit Officer Craig Unwin) to strengthen loan processes; enhancing reports to better monitor loans; implementing recommendations in response to 2006 Joint Guidance;[6] and by retaining Credit

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[6] Concentrations in CRE Lending, Sound Risk Management Practices, 71 FR 74580-01 (12-12-2006) ("Guidance"). The Guidance did not impose "recommended limits" on CRE concentrations, but suggested certain CRE thresholds triggering additional monitoring. JA-729. Contemporaneous documents confirm defendants' *bona fide* response to the Guidance. JA-1121; JA-1163¶15; D.E.-103-15 (11-9-2008 Unwin letter to FDIC); D.E.-103-40 (3-24-2006 ALCO Minutes).

Risk Management ("CRM") to independently audit the Bank's portfolio and evaluate process improvements. JA-603¶8; JA-778; JA-783; JA-1116-17; JA-1161¶5; JA-1163¶15.

Several months after delivering its 2006 ROE, FDIC contacted Cooperative for a status report about its response to the exam's recommendations. JA-634. Seemingly satisfied, FDIC then approved Cooperative's application to acquire another Coastal Carolina bank – Bank of Jefferson. JA-656. Before approving Cooperative's acquisition, FDIC favorably assessed the Bank's management because FDIC must "view management as satisfactory" and "capable of managing a larger institution" to approve such acquisitions. JA-604¶10; JA-726-728.[7]

Also in August 2007, FDIC rated Cooperative a "1A" – its best rating – for calculating the Bank's FDIC insurance premiums. JA-1164¶18. FDIC rated Cooperative "1A" even though the 2006 ROE contained criticisms and recommended loan process improvements.

C. 2007 OCOB Report of Examination.

Later in 2007, OCOB examined Cooperative's operations, including its high CRE concentrations and growing lot loan program. JA-761. Among other things,

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[7] OCOB also approved this acquisition, finding that Cooperative was "profitable, well-capitalized, financially sound and satisfactorily managed." JA-664-665. The acquisition would not have been approved if regulators had concerns that Cooperative was operated in anything but a safe and sound manner. JA-753-755.

OCOB assessed [

]. JA-743(27:10-24), JA-752(53:1-23). OCOB assessed [ ]. JA-757(111:19-22). After a multi-week examination, OCOB awarded Cooperative another composite CAMELS "2" rating. JA-760. Most of the challenged CRE loans were necessarily reviewed by OCOB examiners during this 2007 review,[8] [

].

OCOB concluded that Cooperative [

]. JA-761, 765. The 2007 ROE acknowledged [

]. JA-761. OCOB concluded that [

]. JA-765. Just as FDIC did in its 2006 ROE, OCOB's 2007 ROE advised defendants that it found "no material supervisory concerns" – the regulatory, objective definition of a CAMELS "2" rating.

D. CRM Audits Report Cooperative is "Upper Quartile."

Responding to the 2006 ROE recommendations, Cooperative retained CRM to audit its loan portfolio. In April 2007, CRM reported that new credit

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[8] [

].

originations were "well-documented with credit memoranda that adequately articulated the credit decision processes." JA-780. CRM found that Cooperative's processes:

> include analyses of the market dynamics, complete descriptions of the borrowing entities with associated related projects that are in progress, financial analyses of the borrower and guarantor debt service capacities, and depths of management experience. While not yet pervasive in all the files, the analysts are making good progress in utilizing credit underwriting tools that provide detailed cash flow analyses on a global basis. … [I]n consideration of the large growth in loan volume, management has accentuated its credit department with the hiring of an experience[d] credit manager as well as hiring additional credit analysts.

Id. In June 2008, CRM again audited Cooperative's loan portfolio and advised defendants that "the level of detail in the analyses of new credit originations is in the upper quartile for financial institutions the size of Cooperative." JA-785. CRM reported that Cooperative's loan files "generally contained an extensive number of K-1s" used in "global cash flow assessments." *Id.*

E. 2008's Unforeseeable Financial Crisis.

2008 began like prior years, with cautious optimism in the Coastal Carolina economy, particularly in its key vacation, resort, and retirement community sectors. Although signs of recession were appearing, some economists believed that this region would escape or endure only muted effects. The district court cited one North Carolina economist's assessment that: "While Florida, California, Ohio,

Arizona, Nevada, Michigan are already in a recession, North Carolina is not." JA-81. Against this backdrop, OCOB representatives attended Cooperative's February 2008 monthly board meeting to discuss the Bank's CRE concentrations, and advised that the [ ]. JA-1164¶20, 1183-84.

In Fall 2008, Cooperative was hit by what Federal Reserve Chairman Ben Bernanke later described as a "perfect storm." JA-82. No ordinary business cycle, 2008's crisis is widely compared to the Great Depression. Former Fed Chairman Greenspan admitted that "it was beyond the ability of regulators to ever foresee such a sharp decline." JA-82. When the Great Recession swept into the Coastal Carolinas, it caused tremendous losses to banks throughout the region. Banks that were "too big to fail" received substantial government assistance, but many unaided community banks failed as real estate (in which community banks are traditionally focused) crashed. *See* OCOB Remarks ("Areas of the state that experienced the greatest real estate value inflation were hardest hit by the deflationary spiral . . . includ[ing] coastal North Carolina.").[9]

As real estate values plummeted, in September 2008 Cooperative lost $9.1 million after its stock in Fannie Mae and Freddie Mac was devalued overnight when the federal government placed those institutions into conservatorship. JA-

[9] D.E.-102 (Defendants' Memorandum at 13, n.16).

630. This sudden impairment single-handedly dropped Cooperative's capital category from "well capitalized" to "adequately capitalized," triggering FDIC-mandated restrictions on Cooperative's operations and access to capital, straining liquidity. *Id.*

In the midst of this maelstrom, FDIC examiners returned to Cooperative for its 2008 exam. In the 2008 ROE, the community bank that FDIC had consistently rated a CAMELS "2," suddenly received a triple-downgrade CAMELS "5" rating. The same Officers and Outside Directors consistently rated "2" were suddenly rated "5" and Cooperative was closed a few months later, on June 19, 2009, after 110 years of serving the Wilmington community.

F. Challenged CRE Loans.

This case involves FDIC's challenge to the internal process by which Cooperative made nine CRE loans. But on summary judgment below, FDIC introduced evidence about only one – Blue Water Beach – and claimed that underwriting for the remaining CRE loans was similarly afflicted. D.E.-98 (Plaintiff's Memorandum in Support of Summary Judgment at 13-16).[10] But the

[10] FDIC's expert's conclusions are not probative evidence sufficient to defeat a motion for summary judgment. *See Patten v. Nichols*, 274 F.3d 829, 844 (4th Cir. 2001) (experts' characterization of "defendants' action as significant departures from applicable standards of care" was insufficient to survive summary judgment; "[i]nstead the question is whether the evidence provides a factual basis upon which a jury could reasonably find for the party opposing summary judgment.").

record demonstrates fulsome underwriting and analysis behind the Blue Water Beach loan, and includes voluminous documentary evidence about the other challenged CRE loans.

The $10.6 million Blue Water Beach loan was made to pay off an existing loan with SunTrust Bank and to complete site work and lot infrastructure for a lakefront community. This documentation included a twenty-nine page credit memorandum and a 100+ page appraisal. JA-790-818; JA-1189-1295. The memorandum provided an extensive overview of proposed terms and borrower financials. One borrower was a highly-regarded land developer who sold out several other projects in Wilmington and the guarantors [

]. JA-791, 802-818.

This credit memorandum attached an analysis prepared by the Bank's credit administration department, concluding that two guarantors had [

]. JA-807-810. While two other guarantors [

]. JA-810. Cooperative's credit analyst specifically noted guarantor [ ] contingent liabilities with Cooperative and other banks. JA-

808-810, 818. The credit memorandum also included an excerpt from a recent magazine listing this borrower a top Wilmington builder. JA-817.

Plaintiff argues that the Blue Water Beach loan was "ill-conceived" because development was planned for a "former sand mine surrounded by commercial facilities." Appellant's Brief at 24. But the record shows these factors were considered in the appraisal, which reports that the property was "formerly utilized [as] a Sand Mine" and "reclaimed for the residential construction," and that all lots would have access to "an approximately 8.04 acre freshwater lake in the center of the property that is suitable for swimming and an additional lake on the rear boundary of the property that will have small boat access." JA-1210. The appraiser reported nearby industrial facilities and the developer's representation that it would build large berms to eliminate noise and visual pollution. JA-1226.

In January 2009, Cooperative obtained a second appraisal which concluded there was "no indication of adverse effects from the industrial properties" to the potential for "mid to upscale single-family development." JA-1317. This same appraiser was later hired by First Bank in August 2009 (after First Bank acquired Cooperative's assets) and affirmed the property's proximity to industrial areas ***did not*** adversely affect its potential. JA-1416. First Bank hired this appraiser again in late 2010, and he confirmed these conclusions. JA-1506. Although Blue Water Beach's appraised value collapsed, that drop is attributable to economic conditions,

not to any defect in defendants' loan underwriting, the underlying development project's *bona fides*, nor to appraisal methods.

FDIC asserts that all other challenged CRE loans present similar underwriting "failures." But the summary judgment record shows substantial evidence that the remaining challenged CRE loans were appropriately underwritten. For example, the Richmond Hills loan was made to replace an existing SunTrust loan for development of a subdivision, which was 95% complete with all product already under contract to St. Lawrence Homes, a reputable Raleigh, N.C., home-seller. JA-1029. Richmond Hills' [ ]. JA-1030-1031. The 64-page appraisal noted "ample demand for residential lots in Brunswick County." JA-1843. St. Lawrence Homes later pulled out of its contract citing "market conditions." JA-1170¶48.

According to the 37-page credit memorandum for the Mill Creek Holdings CRE facility (JA-910-947), this $8.19 million February 2007 loan was made to complete amenities and infrastructure for 55 residential lots in Phase I-Section 2 of the Mill Creek Cove subdivision in Bolivia, N.C., and to consolidate two prior loans. At the time the loan was approved: (i) 33 subdivision lots were sold and closed, with 12 to close in March 2007; (ii) guarantors were [ ] with combined net worth of [ ] and liquidity of [

]; and (iii) the appraisal reported "high demand" within the neighborhood despite slower projected sales for 2007-2008. The memorandum for a separately-underwritten October 2007 $1.5 million loan explained that it was a business line to cover additional development expenses and acquire additional property at the site for future development. JA-962. The loan paid down [ ] from inception through last renewal in September 2008 (JA-2413), and was current when FDIC closed Cooperative. JA-1172¶55. The summary judgment record on this loan includes a 72-page original appraisal (JA-1891-1962), and 67-page supplemental appraisal. JA-1963-2030.

The credit memoranda relating to the $6.3 million <u>BBN-Mercer</u> loan comprise 90 pages of analysis. JA-819-909. The loan was made to develop 55 other lots in Mill Creek Cove (Phase II-Section 2 and Phase III) and to consolidate two prior loans. The 18-month, interest-only loan had a 30% LTV (of the discounted cash flow value, [ ]). JA-819, 824. The guarantors were the same as Mill Creek's, and presented the same [ ]. JA-819. The September 2007 loan for a 12-month business line was separately underwritten, and the memorandum noted: "All dealings with the company over the past two years have been handled as agreed. The company averages [ ] on deposit with the Bank." JA-856-857. This loan paid down [ ] from inception through the last renewal in September 2008 (JA-2413), and was current

when FDIC closed Cooperative. JA-1172¶55. The summary judgment record includes the 76-page BBN Mercer appraisal. JA-2087-2163.

The $5.57 million <u>Palmetto Pointe</u> CRE loan provided a construction line of credit to acquire fifteen residential lots in a Wilmington subdivision and build single family homes. JA-996. According to its 30-page credit memo, the borrower's owners and guarantors included (i) [

],” (ii) [

] had more than [ ] in assets, (iii) another guarantor had [

] in assets. JA-997-998. The memorandum quoted a local economist's prediction that the area would grow at about 8% in 2007. JA-999. The appraised collateral included five waterfront lots and two water-view lots (JA-1609-1826), which were in “very large demand.” JA-998. One of the collateral homes was acquired in 2011 (at substantial discount) by the acquiring bank's co-manager of Cooperative's loss-share portfolio. JA-2238-2239.

The $2.7 million <u>Crossover Enterprises</u> loan was made to refinance two construction loans and provide cash to invest in another development project. JA-1054. The credit analysis prepared by Cooperative's credit administration department reported that: (i) Crossover Enterprises had [ ] in condominium sales in 2007, (ii) one guarantor had [

] and (iii) the [ ] loan. JA-1564-1566. The credit memorandum also set forth the strengths of the loan, including [ ] and collateral attractively located with successful sales to date. *Id.* The borrowers had a contingent plan to rent units to meet loan payments if sales did not meet projections. JA-1057. The summary judgment record includes an appraisal for each of the three condo model types offered. JA-1693-1723; JA-1724-1826; JA-1596-1608.

The credit memorandum for the $3.7 million RM/PM loan reported that funds would be used by borrowers to purchase interest in a land development company. JA-1033-1053. Borrowers demonstrated more than [ ] in assets, with [ ] in liquidity, and collateral was a first deed of trust on five residential lots valued at [ ]. Borrowers had [ ]. JA-1036. FDIC has never explained how or why First Bank did not fully recover from these [ ] borrowers, and instead entered into a *de minimis* settlement with them, recovering only [ ]. First Bank sold the collateral for $705,000; under the terms of the settlement agreement, it cannot pursue a collection action against the borrowers for the approximately [ ] deficiency. JA-515; JA-2240-2244.

G. Lot Loan Underwriting.

Plaintiff broadly claims that underwriting for the 78 challenged lot loans was deficient, yet FDIC failed to submit detailed evidence supporting its claims.[11] The record reflects evidence for several lot loans that included bank and retirement account statements, certificates of deposit, employment verifications, paystubs, and credit reports. JA-2160; JA-2164-2166; JA-2170-2171. FDIC's own evidence showed that most lot loan borrowers had credit scores over 700 and were verifiably employed. D.E.-103-30 (FDIC "Deficiencies" chart); JA-2424.

II. COURSE OF PROCEEDINGS

FDIC filed its Complaint on August 10, 2011, asserting two counts against defendants. [D.E.-1]. Count I alleged that defendants were negligent and grossly negligent in making the challenged loans. Count II alleged that these loan approvals breached defendants' fiduciary duties to Cooperative.

Defendants filed a 12(b)(6) motion to dismiss on several grounds, [D.E.-18-19], which plaintiff opposed. [D.E.-32]. On April 16, 2012, the district court issued an order [D.E.-38] concluding that because the factual record had not yet been developed and the court had to accept FDIC's allegations and legal theories as true, it was not appropriate to dismiss the Complaint.

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[11] FDIC argues that brokered loans were prohibited under the Bank's loan policy – while ignoring that the loan policy prohibited brokered loans only if the Bank had not received financial information, releases, and verified signatures from the "actual borrower." JA-171-172.

Defendants thereafter filed an Answer and Affirmative Defenses. [D.E.-43]. For two years, the parties developed an extensive discovery record, including thousands of pages of Bank and regulatory records and deposition testimony. At discovery's conclusion, the parties filed cross-motions for summary judgment and *Daubert* motions. Defendants sought judgment on all counts [D.E.-95], arguing that Plaintiff had no evidence sufficient to overcome the Business Judgment Rule ("Rule") or prove that defendants acted with gross negligence in approving the challenged loans. Defendants also sought judgment on grounds that they reasonably relied upon information provided by bank officers, employees, and consultants. The Outside Directors and Willetts asserted protection under the Bank's Articles of Incorporation, as permitted under N.C.G.S. § 55-2-02(b)(3), which provided that directors would not be held personally liable for negligent acts. Defendants also asserted that plaintiff failed to produce evidence that defendants, rather than the Great Recession, caused the alleged losses, and that FDIC could not prove damages. FDIC moved for summary judgment [D.E.-97] on defendants' affirmative defenses that the Great Recession was an intervening event causing the alleged losses, and that FDIC failed to mitigate damages.

On September 11, 2014, the district court granted defendants' motion for summary judgment and denied FDIC's cross-motion. [D.E.-124]. The Court also granted defendants' motion to exclude FDIC's injury and damages expert [D.E.-

95], and denied as moot FDIC's motion to strike an affidavit submitted by defendants' expert. [D.E.-117]. The court held that FDIC failed to proffer any evidence suggesting that any defendant engaged in "self-dealing or fraud" or bad faith. The court held that FDIC failed to submit sufficiently probative evidence to rebut the Business Judgment Rule's presumptions that defendants' "processes and practices for the challenged loans were rational," citing the 2006 and 2007 CAMELS 2 ratings and CRM's audit that the Bank performed "extensive underwriting" with "well documented credit memoranda." The court also found that the challenged decisions were supported by "substantial due diligence" as evidenced by voluminous exhibits. The trial court held that defendants were entitled to the Rule's protection as a matter of law on this record and further held that FDIC presented insufficient evidence to create a genuine dispute that any defendant acted with gross negligence, which the court correctly defined as acting wantonly with conscious disregard of Cooperative's well-being.

SUMMARY OF ARGUMENT

This Court has emphasized that personal liability for corporate officers or directors is an "unusual and extraordinary event." *Steinke v. Beach Bungee*, *Inc.*, 105 F.3d 192, 196 (4th Cir. 1997). FDIC's appeal seeks to relax North Carolina's Business Judgment Rule and expand the state's gross negligence standard to make the unusual commonplace. But once the appropriate standard is embraced and North Carolina's commitment to a strong Business Judgment Rule is acknowledged, summary judgment is inescapable.

Cooperative had a century of successful operations serving the Wilmington community before regulators closed its doors during the nation's financial crisis in June 2009. This case presents no insider abuse by defendants: no self-dealing, fraud, conflict of interest, or other bad faith. Defendants followed loan underwriting and approval processes that generated a voluminous summary judgment record and negated any permissible inferences that defendants utterly failed to have functioning systems, or pursued irrational processes or purposes in making the challenged loans. FDIC has insufficient probative evidence to generate genuine disputes, and is unable to overcome the Business Judgment Rule by picking battles which, if won, still fail to rebut the Rule's strong presumptions. Summary judgment on FDIC's negligence and fiduciary claims was unavoidable on this extensive record.

Summary judgment on gross negligence was also appropriate. North Carolina courts recognize a gross negligence standard that is substantially and qualitatively different from ordinary negligence. Call it willful, wanton, intentional, deliberate, or reckless conduct: gross negligence requires a much more culpable mental state than ordinary negligence. FDIC cannot construct a gross negligence claim by amassing disputed instances of ordinary negligence. Nor does North Carolina's gross negligence standard fall below FIRREA's statutory floor for bank director and officer liability, which adopts state law. North Carolina law is a traditional, black-letter formulation of gross negligence, and therefore not preempted.

Every legal theory that comes into play in this case arrives at the same destination: gross negligence is the standard, and it requires FDIC to meet heightened proof burdens that defendants acted with culpable mental states of bad faith or conscious disregard for Cooperative's interests. The trial court correctly applied North Carolina law and granted summary judgment because a substantial discovery record includes no evidence of defendants' bad faith or conscious disregard for Cooperative's wellbeing. On *de novo* review, this Court should reach the same conclusion.

ARGUMENT

I. STANDARD OF REVIEW

This Court reviews the district court's summary judgment *de novo*, viewing facts and drawing all reasonable inferences in the most favorable light allowed to the non-moving party. *Glynn v. EDO Corp*., 710 F.3d 209, 213 (4th Cir. 2013). Summary judgment is proper "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). To show a genuine issue of material fact, the non-moving party must submit specific facts going beyond "mere existence of a scintilla of evidence." *Anderson v. Liberty Lobby, Inc*., 477 U.S. 242, 252, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). FDIC must present sufficient evidence such that reasonable jurors could find for plaintiff under the substantive law's standards. *Sylvia Development Corp. v. Calvert Cty*., 48 F.3d 810, 817-818 (4th Cir. 1995) ("Whether an inference is reasonable cannot be decided in a vacuum; it must be considered 'in light of the competing inferences' to the contrary.")[12] Where parties "do not disagree as to the material facts of the case," and contest only "application of the law to the facts," a court may grant summary judgment. *Berry v. Atlantic Coast Line R. Co*., 273 F.2d 572, 582-583 (4th Cir. 1960).

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[12] For example, FDIC argues that defendants "ignored" regulator warnings and that Cooperative's Board of Directors never met as a "deliberative body." These are lawyer arguments contradicted by record facts and not permissible inferences.

FDIC's brief is infected with undisciplined notions that a non-movant on summary judgment enjoys free reign to suggest adverse inferences. Appellant's Brief at 5, 31, 33, 46-47 (court must "view all facts" and "draw all inferences" in its favor). That standard is more apt on a motion to dismiss, but on summary judgment, permissible inferences are often limited by the record and substantive law at issue.

When strong presumptions and heightened standards of proof must be overcome, a plaintiff cannot avoid summary judgment by generating disputes that fail to meet governing standards, or by arguing facts consistent with lawful conduct. *See*, *e.g.*, *Anderson*, 477 U.S. at 249, 252-54 (summary judgment implicates substantive standard at trial); *Matsushita Elec. Indus. Co.*, *Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 597 (1986) (where antitrust cases erect presumption of lawful independent conduct, plaintiff must proffer evidence tending to exclude inferences of lawful conduct and cannot defeat summary judgment with evidence "as consistent with permissible competition as with illegal conspiracy.")

Although the district court did not subject FDIC's claims to a heightened standard of proof, given the "strong presumptions" of good faith and rationality that define North Carolina's Business Judgment Rule, these claims appear to require "clear and convincing" evidence under relevant case authorities. *See Ehrenhaus v. Baker*, No. 08-CVS-22632, 2008 WL5124899, at *10-11 (N.C.

Super. Dec. 5, 2008), *aff'd*, 717 S.E.2d 9, 30 (N.C. App. 2011) (*citing First Union Corp. v. SunTrust Banks, Inc.*, No. 01-CVS-10075, 2001 WL1885686, at *20-21 (N.C. Super. Aug. 10, 2001)); *State v. Custard*, No. 06 CVS 4622, 2010 WL1035809 at *21 (N.C. Super. Mar. 19, 2010) ("*Custard II*"). In many instances where a plaintiff alleges bad faith or invokes a heightened duty of care, the law typically imposes a reciprocally higher burden of proof. *See AMP Inc. v. Allied Signal Inc.*, No. 98-4405, 1998 WL778348, at *8 (E.D. Pa. Oct. 8, 1998) (claim that corporate directors acted in bad faith subjected to "clear and convincing" standard); *Dias v. Purches*, No. 7199VCG, 2012 WL4503174, at *3 (Del. Ch. Oct. 1, 2012) ("[P]arties claiming bad faith must meet the stringent evidentiary burden of producing clear evidence of bad faith conduct.").

FDIC needed strong probative evidence to overcome the Business Judgment Rule's presumptions and avoid summary judgment below, and was not at liberty to generate disputes with merely colorable evidence that left the issues in equipoise.

II. BUSINESS JUDGMENT RULE DEFEATS NEGLIGENCE AND FIDUCIARY CLAIMS AS NO EVIDENCE OF BAD FAITH AND NO GENUINE DISPUTE ABOUT IRRATIONAL PROCESSES EXISTS

FDIC sued Cooperative's officers and directors for Negligence (Count I) and Breach of Fiduciary Duty (Count II). Complaint at ¶¶50-62. FDIC's claims are what a leading Delaware case described as the "most difficult theory in corporation law upon which a plaintiff might hope to win a judgment," namely: charging

directors and officers "with responsibility for corporate losses for an alleged breach of care, where there is no conflict of interest or no facts suggesting suspect motivation." *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) ("*Caremark*"). Plaintiff failed to come forward with substantial proof to overcome the Business Judgment Rule's strong presumptions of good faith and rationality. The district court correctly applied the law and granted defendants summary judgment.

FDIC concedes it is not before this Court as a regulator entitled to *Chevron* deference. Rather, plaintiff is suing in a derivative capacity with a substantial burden to overcome the Rule's strong presumptions. FDIC reads these strong presumptions out of the Rule, treating them as mere elements or "jump balls" that prevent summary judgment whenever a plaintiff presents some evidence. In FDIC's hands, the Business Judgment Rule is a hollow exercise: the doctrine only protects against strict liability, and its presumptions are easily surmounted by evidence that the challenged corporate decisions and processes are debatable. But in North Carolina and other states following Delaware law,[13] the Rule has rigor and

[13] The trial court appropriately relied on North Carolina and Delaware decisions interpreting the Business Judgment Rule. JA-76. North Carolina courts regularly look to Delaware courts for guidance on corporate law matters. *See Custard II*, 2010 WL1035809 at *18; *see generally*, *Meiselman v. Meiselman*, 307 S.E. 551 (N.C. 1983); *Smith v. N.C. Motor Speedway, Inc.*, 1997 NCBC 5 (N.C. Super. Nov. 12, 1997), *aff'd*, 516 S.E.2d 921 (N.C. App. 1999), *review denied*, 534 S.E.2d 596 (N.C. 1999).

substantive application. The robust Rule in North Carolina and Delaware contrasts with states like Georgia, which recently adopted what its Supreme Court called a "more modest business judgment rule" inviting derivative litigation about negligent director and officer decision-making. *FDIC v. Loudermilk*, 761 S.E.2d 332 (Ga. 2014); Appellant's Brief at 38 (urging adoption of *Loudermilk* standard).

A defendant satisfying FDIC's version of the Rule would eliminate all basis for finding negligence in the first place, and hardly needs recourse to the Rule. In FDIC's hands, the Rule would operate to protect only against strict liability while nurturing disputes about whether corporate decision-makers exhausted "all" sources of information. As applied by North Carolina and Delaware courts, the Rule operates with greater precision: only conflicts of interest constitute bad faith, and only an utter failure of corporate processes overcomes the due care and material information presumption. FDIC also misperceives the Rule's "rationality" presumptions, as if litigants may argue about whether challenged processes were prudent or reasonable. Those disputes are immaterial under North Carolina's Business Judgment Rule: the standard is mere "rationality." *See infra* at 31-41.

North Carolina courts apply these protections recognizing that "business decisions are best left in the hands of informed and experienced boards of directors and managers," *Wachovia Capital Partners, LLC v. Frank Harvey Inv. Family Ltd.*

P'ship, No. 05 CVS 20568, 2007 WL2570838, at *4 (N.C. Super. Mar. 5, 2007), and should not be judged by hindsight. The Business Judgment Rule thus establishes a judicial standard of review protecting directors and officers from claims of ordinary negligence and fiduciary breaches. The Rule continues to apply with full force and effect even after North Carolina's codification of a standard of conduct for corporate directors and officers. *See State ex rel. Long v. ILA Corp.*, 513 S.E.2d 812, 820-21 (N.C. App. 1999) ("section 55-8-30(d) does not abrogate the common law of the business judgment rule.").[14]

Under North Carolina's Business Judgment Rule, corporate officers and directors may not be held personally liable even though "a judge or jury considering the matter after the fact, believes a decision substantively wrong or degrees of wrong extending through 'stupid,' to 'egregious' or 'irrational', . . . so long as the court determines that the process employed was either rational or employed in a good faith effort to advance corporate interests." *Custard II*, 2010 WL1035809, at *21, quoting *Caremark*, 698 A.2d at 967-68. The presumptive validity of a business judgment is rebutted only in "rare cases" where the challenged decision is "so far beyond the bounds of reasonable judgment" that it

[14] FDIC argues that because North Carolina's legislature enacted a statutory duty of ordinary care for corporate officers and directors, the Rule cannot operate. Appellant's Brief at 33-41. Yet, the North Carolina General Assembly expressly preserved the Rule when enacting the statutory standard of care for corporate officers and directors. *See infra at* 41-45.

seems "inexplicable on any ground other than bad faith." *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1246 (Del. 1999).

Here, the district court found that the record showed plaintiff could not make the required showing under the circumstances, and properly granted defendants' summary judgment motion.

A. FDIC Miscalculates the Rule's Sequential Presumptions.

In North Carolina, the Rule involves two steps. The starting point is "an initial evidentiary presumption that in making a decision the directors [and officers] acted with due care (i.e., on an informed basis) and in good faith in the honest belief that their action was in the best interest of the corporation.'" *Custard II*, 2010 WL1035809, at *20-21, *quoting* Russell M. Robinson II, *Robinson on North Carolina Corporation Law* § 14.06, at 281 (5th ed.1995). Absent rebuttal of the first presumption, the Rule establishes a second "powerful substantive presumption that a decision by a loyal and informed board [and officers] will not be overturned by a court unless it cannot be attributed to any rational business purpose." *Ehrenhaus*, 717 S.E.2d at 25.

1. *FDIC Cannot Surmount the Rule's First Presumption.*

Under North Carolina law, there is a "strong presumption" that corporate directors and officers exercised due care in good faith. *Ehrenhaus*, 717 S.E.2d at

30. It is plaintiff's burden to overcome the presumption, not defendant's task to establish it. In *Custard II*, the North Carolina Business Court held:

> Absent proof of bad faith, conflict of interest, or disloyalty, the business decisions of officers and directors will not be second-guessed if they are "the product of a rational process," and the officers and directors "availed themselves of all material and reasonably available information" and honestly believed they were acting in the best interest of the corporation.

2010 WL1035809, at *21, *quoting In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 124 (Del. Ch. 2009). The Rule's first presumption "is predicated on concepts of gross negligence," and does not invite disputes that fall short of gross negligence. *Id.*

To overcome the Rule's first presumption, plaintiff must show defendants failed to act in good faith and in the honest belief that loans were made in the best interest of the company or on an informed basis. *Technik v. WinWholesale*, No. 10 CVS 15709, 2012 WL160068, *5 (N.C. Super. Jan. 13, 2012). This presumption does not invite disputes about whether every last bit of available information was reviewed for particular decisions, but is surmounted only by evidence of gross negligence: only something like an "utter failure to attempt to assure a reasonable information and reporting system exists" can defeat the Rule's first presumption of due care. *Caremark*, 698 A.2d at 967, 971.

FDIC failed to come forward with evidence that bad faith tainted defendants' challenged loan approvals. FDIC misstates North Carolina law and

advances a dangerously loose definition of "bad faith," suggesting that it is satisfied by evidence that defendants "ignored" regulator warnings, employed "unsound" processes, departed from internal loan policies, and the like. Appellant's Brief at 30-31. But under North Carolina law, "bad faith" means insider abuse, self-dealing, and improper motives ***only***. The Rule's good-faith presumption does not invite debate about whether negligent, though untainted, conduct was "in the corporation's best interests." *See* Alan Woodlief, Jr., N.C. Law of Damages, § 14:4 (5th ed.) ("The requirement of good faith seeks to prevent directors and officers from diverting corporate opportunities or otherwise profiting from a conflict of interest detrimental to the corporation."); *ILA Corp.*, 513 S.E.2d at 822 (declining to apply Rule to "leading participant in a plan to benefit himself and his interests" at corporation's expense); *In re Brokers*, *Inc.*, 363 B.R. 458, 474 (Bankr. M.D.N.C. 2007) (declining to apply Rule where defendant "had a direct financial interest" in challenged transactions).

As a matter of law, FDIC's litany of sub-optimal underwriting practices cannot constitute "bad faith" that overcomes the Rule's initial presumption. The record shows no policy or loan decision undertaken in bad faith and there can be no genuine dispute on this issue: defendants were untainted by insider abuse, self-dealing, or fraud, nor were any afflicted with a conflict of interest, suspect motive, or unconscionable conduct constituting bad faith. Each defendant attested to his

honestly-held belief that he acted in Cooperative's best interests at all times. JA-594-615. This evidence remained unrebutted below.

Nor does the substantial record permit a genuine dispute about gross negligence infecting defendants' duty of care. The Rule is pointless if, as FDIC argues, a challenged decision is made "on an informed basis" only when defendant shows that she reviewed "all" materials and exercised ordinarily prudent care. No case authorities support FDIC's novel application of the Rule, while North Carolina and Delaware cases refute that interpretation: only a gross negligence standard applies. *See supra* at 32.

As receiver to Cooperative, FDIC wants to litigate derivative claims about whether these processes were "meaningful" enough. A vast body of business and regulatory records and related depositions show that substantial due diligence informed Cooperative's loan decisions. Whatever recommendations Cooperative's regulators and independent auditors made for improving loan processes, these same examiners and auditors – acting in the ordinary course and promoting a heightened standard of prudent banking practices – rated these same processes a CAMELS 2 ("no material supervisory concerns") and in the "upper quartile" during the relevant period. JA-785. On this highly detailed record, no genuine dispute can arise that these same processes evidence an "utter failure" to even try

to have functioning underwriting and loan approval systems at Cooperative. FDIC's suggested inferences to the contrary are impermissible on this record.

2. *FDIC Cannot Surmount the Rule's Second Presumption.*

Having failed to disprove application of the "good faith and due care" presumption, FDIC also failed to overcome the Rule's more-demanding second presumption that defendants acted with a rational purpose and processes. Below and on this appeal, FDIC refuses to grasp what the rationality standard provides. "Courts do not measure, weigh or quantify directors' judgments. We do not even decide if they are reasonable in this context. . . . Irrationality is the outer limit of the business judgment rule." *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. Ch. 2000).

As *Ehrenhaus* held, only "clear and convincing evidence" can rebut the Rule's rationality presumption. 2008 WL5124899, at *10-11. To employ a higher standard, as urged by FDIC, impermissibly exposes officers and directors to "substantive second-guessing by ill-equipped judges or juries, which would, in the long run, be injurious to investor interests." *In re Citigroup*, 964 A.2d at 122.

FDIC's claims are based on recommendations for improving loan processes and practices that regulators gave Cooperative in its 2006 ROE. FDIC's theory is that defendants irrationally "ignored" the recommendations. But the same bank exam forming the basis of FDIC's theory graded existing processes a CAMELS "2," *i.e.*, "satisfactory" and not requiring material changes. JA-717. Whatever

recommendations independent auditors made for improving loan processes, these same auditors ranked these same processes as "upper quartile." JA-785. One might argue in an academic setting whether the tone and substance of the regulator's recommendations, taken out of context, suggest that Cooperative's loan processes were less than prudent or "meaningful." But on this record and reading the 2006 ROE as a whole, which includes a formal CAMELS 2 grade, there can be no genuine dispute about whether the challenged processes were at least rational – and that is the end of the Rule's inquiry.

FDIC purports to dispute the rationality of defendants' loan processes and purposes, but does so by confusing "rationality" with higher standards of "reasonableness" and even "prudence." FDIC muddles the standard by repeatedly claiming defendants failed to follow "prudent lending standards" in making the challenged loans. "Prudent" conduct is care of the highest order: "circumspect," "judicious," or "cautious." *Black's Law Dictionary* (9th ed. 2009). "Prudence" is the standard FDIC promotes as a bank regulator issuing CAMELS ratings to examined banks, but is ***not*** the standard applicable to a derivative receiver trying to surmount the Business Judgment Rule. The Rule's rationality standard is far lower: a "rather permissive" standard as opposed to the reasonableness standard misperceived by FDIC. *In re Dollar Thrifty Shareholder Litig.*, 14 A.3d 573, 598 n.181 (Del. Ch. 2010); *In re Trados Inc. Shareholder Litig.*, 73 A.3d 17, 43 (Del.

Ch. 2013) (irrational decision is "so blatantly imprudent that it is inexplicable, in the sense that no well-motivated and minimally informed person could have made it."); *In re Openlane*, *Inc.*, C.A. No. 6849-VCN, 2011 WL4599662, at *5 (Del. Ch. Sept. 30, 2011) (noting that reasonableness standard is "significantly more stringent than the rationality review that characterizes the business judgment rule.")

In any event, FDIC's effort to convert the Rule's "rationality" standard into a more demanding "prudence" or "reasonableness" test is fatally flawed. The standard FDIC advocates is not North Carolina law. Its approach would reverse the Rule's burden of proof and require corporate directors and officers to prove that the corporation's practices and procedures meet the higher standard. But the Rule works in the opposite manner, by requiring this derivative plaintiff to carry a heavy burden of proving that the defendants' approach fell below a mere rationality standard.

As a matter of law on this substantive record, the *process* that defendants used to make the challenged loans cannot fall below a highly-deferential "rationality" standard. Litigants may try to argue inferences to avoid summary judgment, but a CAMELS 2 rating has a defined, objective meaning under applicable regulations: "no material supervisory concerns." JA-776. By regulatory definition, this CAMELS 2 score means that the deficiencies noted in

Cooperative's loan processes were not material to safety and soundness, and prevents any reasonable inference that Cooperative's loan processes were not even rational.

On appeal, FDIC makes the newly-minted (and wholly unsupported) factual claim that regulators bargained with Cooperative for these high CAMELS marks in exchange for promises to improve. Appellant's Brief at 13. This unsupported argument fails because Cooperative again received a CAMELS 2 rating in its 2007 ROE, which evaluated the Bank's response to the 2006 recommendations, and FDIC reviews state examiner findings to ensure that CAMELS ratings are appropriate. JA-2375.[15]

In sum and on this extensive record, a CAMELS 2 rating addressed to the same challenged loan processes during the relevant time period forecloses a genuine dispute about whether the challenged processes were merely "rational."

The second "rationality" presumption of North Carolina's Business Judgment Rule required FDIC to demonstrate that defendants' loan decisions had no "rational business purpose." This burden is extraordinarily high in any case

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[15] Neither FDIC nor OCOB would award a composite 2 CAMELS rating if Cooperative's loan processes were not even rational. CAMELS ratings drive a number of regulator decisions including enforcement actions. ROE's are FDIC's "primary evidentiary exhibit[s]" in agency enforcement proceedings, thus they should be "factually and statistically correct, [and] free of inconsistencies. …" FDIC Risk Management Manual, Formal Administrative Actions, § 15.1, ¶8, www.fdic.gov/regulations/safety/manual/section15-1.pdf.

where the first presumption survives, and FDIC had no hope of meeting it on this record, as the district court properly found. *Ehrenhaus*, 717 S.E.2d at 30 (Rule is likely insurmountable when plaintiff must prove that challenged conduct cannot be attributed to any rational business purpose where actions were taken in tumultuous market conditions). Cooperative's pursuit of CRE and lot loans furthered a lucid goal to grow at the rate of its peers to stay competitive. JA-602¶6. The business purpose of the challenged loans aligned with Cooperative's business activities: commercial lending in the Wilmington area. FDIC wants wide latitude to second-guess the wisdom of the underlying developments, but each was undertaken by area developers and builders in the *bona fide* pursuit of completing the projects. A properly instructed jury could not find that defendants' business purpose in making these loans fell so far beyond lucid behavior that it was not even "rational."

Though there were risks involved in making the CRE and lot loans at issue, community banks must take risks to survive increasing competition, and directors and officers who act in good faith are entitled to Business Judgment Rule protection. The *Custard II* court recognized that

> [i]n order for the corporation to increase in value . . . it must take risks. If we discourage the directors who must make those risk decisions from being bold and creative by imposing a standard of review that is too onerous and creates too great a possibility of unacceptable liability, we defeat one of the very purposes for which corporations exist.

2010 WL1035809 at *16; *see also* JA-756 (regulators expect a bank to take appropriate risks). The *Custard II* court held that, where directors and officers did not display "a conscious indifference" to risks, and where no evidence suggests that they "did not honestly believe that their decisions were in the Company's best interest," then the Rule applies even if their "judgments ultimately turned out to be wrong from a business standpoint." 2010 WL1035809 at *22-23.[16]

In sum, many key undisputable facts provide compelling support for the district court's grant of summary judgment to defendants on the ground that FDIC failed to overcome the Rule's strong presumptions. Because no reasonable jury could conclude otherwise, plaintiff is "not entitled to any remedy." *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 747 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006). On this record, defendants are entitled to the Rule's protection.

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[16] Summary judgment outcomes comport with this Circuit's treatment of the Rule under a variety of settings. *See Froelich v. Senior Campus Living LLC*, 355 F.3d 802, 810 (4th Cir. 2004) (Maryland's Rule defers to board decisions unless tainted by fraud, bad faith, or gross negligence); *Kreischer v. Kerrison Dry Goods Co.*, 172 F.3d 863, 1999 WL30836, *4 (4th Cir. 1999) (South Carolina's Rule not superseded by statute establishing duty of care, and "bad faith, dishonesty or incompetence" to disturb board decision). Courts within other Circuits have ruled similarly. *FDIC v. Castetter*, 184 F.3d 1040, 1045-1046 (9th Cir. 1999) (upholding summary judgment against FDIC claims of negligence, applying Business Judgment Rule protections); *Roselink Investors*, *LLC v. Shenkman*, 386 F.Supp.2d 209, 221 (S.D.N.Y. 2004) (applying Delaware Rule, finding that "bad faith" required "conscious doing of a wrong because of dishonest purpose or moral ambiguity" and "contemplates a state of mind affirmatively operating with furtive design or ill will."); *Washington Bancorporation v. Said*, 812 F.Supp. 1256, 1268-1270 (D.D.C. 1993) (granting judgment to former bank officers and directors against FDIC).

B. Under the Statutory Standard of Conduct, North Carolina Courts Still Apply the Rule's Gross Negligence Standard of Review.

FDIC argues that the foregoing is unavailing because the Business Judgment Rule was neutered by passage of a North Carolina statute imposing a duty of ordinary care on corporate officers and directors. *See* N.C.G.S. §§ 55-8-30, 55-8-42 (adopting "ordinarily prudent person" duty of care for corporate officers and directors) (the "Statute").[17] Plaintiff's argument is abetted by its misperception that North Carolina courts have failed to define the Rule's contours, which enables FDIC to look elsewhere – notably, not Delaware – for the proposition that North Carolina's statutory standard must trump the Rule and impose ordinary negligence liability here. But, North Carolina courts apply the Rule consistent with the trial court's construction, and the North Carolina legislature recognized that the Rule's standard of review applies when the Statute's standard of conduct cannot be met.

As early as 1896, the North Carolina Supreme Court held that "directors are liable for gross neglect of their duties, and mismanagement (though not for errors of judgment made in good faith), as well as for fraud and deceit." *Caldwell v. Bates*, 24 S.E. 481, 482 (N.C. 1896); *see also Besseliew v. Brown*, 97 S.E. 743, 744

[17] FDIC did not raise this argument in its summary judgment papers below. It is therefore waived. *See Liberty Univ., Inc. v. Lew*, 773 F.3d 72, 103 (4th Cir. 2013).

(N.C. 1919) (directors are not "responsible for mere errors of judgment" but bank directors might be liable for gross negligence).[18]

North Carolina's intermediate appellate court has contributed to the state's well-developed Business Judgment Rule, and these decisions are entitled to deference. *C.F. Trust*, *Inc. v. First Flight Ltd. P'Ship*, 306 F.3d 126, 137 (4th Cir. 2002) ("when an intermediate appellate state court rests its considered judgment upon the rule of law which it announces, that is a datum for ascertaining state law which is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise.").

[18] FDIC cites *Lillian Knitting Mills Co. v. Earle*, 74 S.E.2d 351, 355 (N.C. 1953) and implies that bank directors should be held to a heightened standard of care. Appellant's Brief at 36-37. *Lillian Knitting* does not go that far, but references a specific provision of then-existing law allowing personal liability when a bank director or officer induced a depositor to "place money in the bank solely by false representations of solvency" in certain circumstances. *Id.* This provision has no bearing on the Business Judgment Rule analysis confronting this Court. And, in *Custard II*, the North Carolina Business Court did ***not*** hold bank directors and officers to a heightened standard. The court speculated in *dicta* – based on a treatise which also misplaced reliance on *Lillian Knitting* – that a bank director "might" be held to a higher standard of care. *See Custard II*, 2010 WL1035809, at *19 *citing Robinson on N.C. Corp. Law*, § 14.03[a] (7th ed. 2009).

In 1999, *after* the Statute's enactment, North Carolina's Court of Appeals recognized the Rule's continuing vitality:

> [W]e note that the Business Corporation Act provides, "A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section." N.C.Gen.Stat. §55-8-30(d) (1990) (amended 1993). As with other portions of the Business Corporation Act, this section is not meant to abrogate the common law. [citing cases] Therefore, ***section 55-8-30(d) does not abrogate the common law of the business judgment rule***. Accordingly, proper analysis requires examination of defendant's actions in light of the statutory protections of N.C.Gen.Stat. §55-8-30(d) … and the business judgment rule, either or both of which could potentially insulate him from liability.

ILA Corp., 513 S.E.2d at 821-822 (emphasis added) (because defendant engaged in self-dealing and not "mere errors in judgment," the Rule's initial presumption was defeated). *See U.S. v. Camp*, 566 Fed. Appx. 226, 230 (4th Cir. 2014) (citing *ILA Corp*. and stating "the business judgment rule, however, does not protect against an individual's purposeful and fraudulent misconduct, but rather protects mere errors in judgment").

Contrary to FDIC's argument, the North Carolina Supreme Court has held that statutes do not override common law principles unless the legislature clearly expresses that intent. *Stone v. N.C. Dept. of Labor*, 495 S.E.2d 711, 715 (N.C. 1998); *Amos v. Oakdale Knitting Co*., 416 S.E.2d 166, 172 (N.C. 1992). The Statute's Official Comments expressly provide that it did ***not*** abrogate the Rule: "[S]ection 8.30 does not try to codify the business judgment rule or to delineate the

differences, if any, between that rule and the standards of director conduct set forth in this section." Official Comments, N.C.G.S. § 55-8-30.[19] The Official Comments emphasize that: "application of the business judgment rule need only be considered if compliance with the standard of conduct set forth in … Section 8.30 [and Section 8.42] is not established." *Id.* at Comment 4. The Rule applies where compliance with the Statute remains in doubt. This commentary is entitled to "substantial weight" when ascertaining legislative intent. *Parsons v. Jefferson-Pilot Corp.*, 426 S.E.2d 685, 689 (N.C. 1993); *Jones v. Whimper*, 736 S.E.2d 170, 171-72 (N.C. 2013).

While the Statute establishes an "ordinarily prudent" standard of *conduct* (which FDIC and the trial court interpret as an ordinary negligence standard) the Rule establishes a gross negligence standard of *review*. *Ehrenhaus*, 717 S.E.2d at 30 ("The business judgment rule is a standard of review courts use to determine whether directors have met the statutory standard of conduct"); *In re Trados Inc.*

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[19] FDIC cites extensively to *Loudermilk*, *supra*, where the Georgia Supreme Court adopted a "more modest business judgment rule" than the prevailing Delaware version. The *Loudermilk* court held that Georgia's legislature imposed a statutory standard of ordinary negligence for bankers, with the intention of "embody[ing]" Georgia's business judgment rule in the statute. 761 S.E.2d at 341. The same cannot be said here: North Carolina's legislature expressly rejects a reading of the Statute as codifying the Rule, and the two offer ***separate*** protections. *Cf. FDIC v. Skow*, 763 S.E.2d 879 (Ga. 2014) (following *Loudermilk*); *FDIC v. Stahl*, 89 F.3d 1510, 1516-1517 (11th Cir. 1996) (interpreting Florida's pre-1987 statute governing director conduct as precluding gross negligence standard of review under Florida's business judgment rule).

Shareholder Litig., 73 A.3d at 36 ("[T]he standard of review is more forgiving of directors and more onerous for stockholder plaintiffs than the standard of conduct. This divergence is warranted for diverse policy reasons typically cited as justifications for the business judgment rule").[20]

III. NO EVIDENCE SUPPORTS GROSS NEGLIGENCE

Relying on current North Carolina precedents emphasizing the qualitative difference between ordinary negligence and gross negligence, the district court correctly applied that law to a substantial record containing no evidence of wanton conduct done with conscious disregard for Cooperative's rights. On appeal, FDIC claims the trial court erred. But FDIC's approach takes an expansive view of gross negligence, piling on accusations of ordinary negligence until it builds a veritable heap of negligence that it calls "gross." Plaintiff's approach blurs the governing

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[20] FDIC cites *N.C. Corp. Comm. v. Harnett Cnty. Trust Co.*, 134 S.E. 656 (N.C. 1926) and *Gordon v. Pendleton*, 162 S.E. 546 (N.C. 1932) for the proposition that North Carolina always held directors and officers liable for negligence to their corporate employers. Appellant's Brief at 36, n.97. These citations seem difficult to reconcile with the remainder of FDIC's brief, which grudgingly acknowledges that some form of business judgment rule operates in North Carolina. These authorities also acknowledge that directors and officers are *not* liable for "mere errors of judgment." FDIC also cites *RTC v. Bernard*, No. 94-CV-475, 1995 WL 17164886 (M.D.N.C. Aug. 8, 1995), where, on a motion to dismiss, the trial court expressed frustration with the parties' attempts to reconcile the Statute and Rule, and pondered whether North Carolina "may" recognize director liability for simple negligence "to the extent such negligence falls outside the protection of the business judgment rule." *Id.* at *12. Like the trial court below, the *Bernard* court was unwilling to dispense with the receiver's claims on a motion to dismiss, preferring to revisit the issues on a full discovery record.

standards and argues that defendants "were grossly negligent when they ignored warnings, prudent banking practices, and legal limits, and made the Loss Loans anyway." Appellant's Brief at 50.

The district court properly found that the record did not support a reasonable inference that defendants "ignored" warnings, and ignoring a heightened prudence standard does not collapse into gross negligence in any event. There are wide gulfs between prudent ("circumspect" and "cautious"), negligent ("inadvertent"), and grossly negligent ("wanton" and "conscious" disregard) mindsets. FDIC fails to grasp that these standards reflect different mental states, and a plaintiff cannot satisfy North Carolina's gross negligence standard by accumulating instances of ordinary negligence.

A. The Trial Court Applied the Correct North Carolina Gross Negligence Standard.

The North Carolina Supreme Court recently distinguished ordinary and gross negligence as separate causes of action with substantial differences. "The difference between ordinary negligence and gross negligence is substantial," whereby "negligence, a failure to use due care… connotes inadvertence," and gross negligence "connotes intentional wrongdoing." *Yancey v. Lea*, 550 S.E.2d 155, 158 (N.C. 2001); *see also Horne v. Owens-Corning Fiberglas Corp.*, 4 F.3d 276, 284-285 (4th Cir. 1993) (outside context of the Wrongful Death Act and bailment, North Carolina courts equate gross negligence with willful and wanton conduct).

Indeed, the North Carolina Supreme Court has traditionally defined gross negligence as "wanton conduct done with conscious or reckless disregard for the rights and safety of others." *Yancey*, 550 S.E.2d at 157; *Abney v. Coe*, 493 F.3d 412, 421 n.2 (4th Cir. 2007) (in North Carolina, gross negligence is defined as "wanton conduct done with conscious or reckless disregard for the rights and safety of others."); *Horne*, 4 F.3d at 284, *quoting Hinson v. Dawson*, 92 S.E.2d 393, 396 (N.C. 1956) ("an analysis of [Supreme Court of North Carolina] decisions impels the conclusion that this Court, in references to gross negligence, has used the term in the sense of wanton conduct.").[21]

Conduct is "wanton" when done in conscious or intentional disregard of the rights and safety of others. *Yancey*, 550 S.E.2d at 157-58; *Bauberger v. Haynes*, 632 F.3d 100, 107 (4th Cir. 2011) ("Under North Carolina law, wantonness describes intentional wrongdoing, conduct undertaken in conscious and intentional disregard of and indifference to the rights and safety of others."). Quite unlike

[21] FDIC's argument for reversal hinges on what it claims is a significant difference between the terms "reckless disregard" and "conscious disregard," while those terms are essentially synonyms. *See U.S. v. Peterson*, 629 F.3d 432, 437 (4th Cir. 2011) ("recklessness" means acting with a conscious disregard of risk,); *Kebe v. Brown*, 91 Fed. Appx. 823, 826 n.2, (4th Cir. 2004) ("An act is reckless if improperly done in conscious disregard of its known probable consequences."); *Black's Law Dictionary* 506 (9th ed. 2009) ("reckless disregard" is "conscious indifference to the consequences of an act"). Even the cases cited by FDIC adopt a definition of gross negligence that requires a deliberate mindset. *Parish v. Hill*, 513 S.E.2d 547, 551 (N.C. 1999) (gross negligence is "wanton conduct done with conscious or reckless disregard for the rights and safety of others.").

FDIC's novel reformulation, the difference between ordinary and gross negligence is ***not*** "in degree or magnitude of inadvertence or carelessness, but rather is intentional wrongdoing or deliberate misconduct affecting the safety of others. An act or conduct rises to gross negligence" when "done purposely and with knowledge" that it is a breach of duty: "a *conscious* disregard for the safety of others." *Yancey*, 550 S.E.2d at 158. "An act or conduct moves beyond the realm of negligence when the *injury or damage* itself is intentional." *Id.*

Gross negligence is not a pile of allegations about conduct "so negligent" it becomes gross: it is a mindset that is substantially different from mere inadvertence. The district court followed this long-standing definition of gross negligence and granted summary judgment.

FDIC stakes its gross negligence claim on a withdrawn decision of the North Carolina Supreme Court dealing with the standard for first responders: *Jones v. City of Durham (Jones I)*, 622 S.E.2d 596, 597 (N.C. 2005) *opinion withdrawn and superseded on reh'g*, 638 S.E.2d 202 (N.C. 2006). Although the decision was withdrawn, FDIC still argues that "*Jones* correctly states North Carolina law." Appellant's Brief at 51. Inexplicably, plaintiff builds its entire gross negligence case on this withdrawn decision, never citing the *Yancey* and *Hinson* precedents – nor this Court's own *Abney* and *Horne* precedents – which flatly contradict FDIC's argument. As recognized by the district court, the *Jones I* opinion is not

dispositive because it was expressly withdrawn.[22] Since then, the North Carolina Supreme Court has done nothing to reinforce *Jones I*'s withdrawn reasoning, and no other North Carolina court has ventured to apply it. But there are many post-*Jones* North Carolina opinions that continue applying traditional gross negligence: "wanton conduct done with conscious or reckless disregard for the rights and safety of others." *See*, *e.g.*, *Greene v. City of Greenville*, 736 S.E.2d 833, 835 (N.C.App. 2013) *review denied*, 747 S.E.2d 249 (N.C. 2013).

The North Carolina federal bench, post-*Jones*, acknowledged that gross negligence requires wanton, intentional, or deliberate misconduct with knowledge or conscious disregard that such act is a breach of duty. *Boykin Anchor Co.*, *Inc. v. AT & T Corp.*, 825 F.Supp.2d 706, 712 n.6 (E.D.N.C. 2011) (under North Carolina law, "gross negligence has the same basic elements as negligence, but requires either intentional wrongdoing or deliberate misconduct affecting the safety of others, such as when the act is done purposely and with knowledge that such act is a breach of duty to others"); *Synovus Bank v. Coleman*, 887 F.Supp.2d 659, 672

[22] Even if it were still on the books, *Jones* would be inapposite. The case dealt with a statute regulating police high-speed chases (N.C.G.S. § 20-145), providing that "gross negligence occurs when an officer consciously or recklessly disregards an unreasonably high probability of injury to the public despite the absence of significant countervailing law enforcement benefits." *Jones v. City of Durham*, 608 S.E.2d 387 (N.C.App. 2005) (dissent), adopted by *Jones v. City of Durham (Jones II)*, 638 S.E.2d 202 (N.C. 2006). That statutory definition has no application here. The *Jones I* court also based its withdrawn reasoning on North Carolina's punitive damages statute, which likewise is irrelevant here. *Jones I*, 622 S.E.2d at 600.

(W.D.N.C. 2012) ("An act or conduct rises to the level of gross negligence when the act is done purposely and with knowledge that such act is a breach of duty to others, i.e., a conscious disregard of the safety of others.").

The district court properly applied North Carolina's long-standing definition of gross negligence.

B. The Record Contains No Material Facts Supporting a Genuine Dispute About Gross Negligence.

FDIC fights so hard to loosen North Carolina's gross negligence standard because it has no evidence to support this claim. Instead, the summary judgment briefs evidence a series of running skirmishes about this bit of underwriting versus that guarantor factoid, weighing this sentence from a bank exam against that CAMELS score from the same exam, this regulatory approval to acquire a competing bank versus that sentence from an independent auditor's report. FDIC's "negligence stew" presents issues ranging from the regrettable to the picayune, but none are capable of standing alone to satisfy a gross negligence standard.

The trial court reviewed a substantial summary judgment record comprised of "voluminous records, 15 depositions of party, third party, and expert witnesses including Cooperative's regulators at the FDIC," and concluded that FDIC had not shown that "any of the defendants engaged in wanton conduct or consciously disregarded Cooperative's well-being." JA-77, 80. This ruling is manifestly correct. Consider FDIC's own description of its case: "D&Os heedlessly

approved loans without obtaining hard equity or meaningful and timely financial information, they performed no global cash-flow analyses, or other meaningful analyses of the borrowers' and guarantors' ability to repay, and they failed to require independent analyses of property appraisals." Appellant's Brief at 54. FDIC wants a jury to decide whether equity backing the challenged loans was sufficient, whether financial information collected and relied upon in Cooperative's loan processes was "meaningful" and "timely" or thorough enough to be called "global" (as independent auditor CRM deemed it), and whether Cooperative's analysis of borrower repayment abilities was "meaningful," or whether independent property appraisals were subject to appropriate review.[23]

FDIC's search for "meaningfulness" is intended to insulate its claims from meaningful scrutiny on summary judgment. But the quality of these disputes fails to satisfy a gross negligence standard.

Even if FDIC's loose reading of "reckless indifference" applied, it would not change the outcome. Because the trial court held that defendants acted in good faith, they could not simultaneously act with reckless indifference to Cooperative's

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[23] *See also* Appellant's Brief at 1-2 (issues include whether defendants "ignored" regulatory warnings, failed to obtain "meaningful" financial information, failed to perform "meaningful" credit-risk analysis, failed to obtain "all" reasonably-available material information, and failed to "act in the best interests of the bank"). These highly qualified and attenuated issues belie any concerns about gross negligence: they describe a debate about whether bank processes were prudent or, at worst, negligent.

rights. *Kolstad v. American Dental Ass'n*, 527 U.S. 526, 544 (U.S. 1999) ("Where an employer has undertaken such good faith efforts at Title VII compliance, it demonstrates that it never acted in reckless disregard of federally protected rights."); *Dellastatious v. Williams*, 242 F.3d 191, 194 (4th Cir. 2012) ("To determine whether the good-faith affirmative defense has been satisfied under section 20(a), defendants must show that they did not act recklessly."). And an inference of "reckless indifference" is not permissible given the trial court's finding that defendants' loan processes were rational and supported by "substantial due diligence." JA-77-78.

C. FIRREA Does Not Preempt North Carolina's Gross Negligence Standard.

FDIC argues that the trial court's adoption of North Carolina's gross negligence standard is somehow preempted by FIRREA, 12 U.S.C. § 1821(k), which sets a gross negligence floor under which state standards for bank director and officer liability may not fall. Appellant's Brief at 52-53. FDIC never raised this argument below, and it is therefore waived. *Liberty Univ., Inc.*, 733 F.3d at 103. In any event, it fails.

Under FIRREA, as clarified by *Atherton v. FDIC*, 519 U.S. 213 (1997), a bank director or officer may be personally liable for gross negligence, and state law sets the applicable standard so long as it is not more lenient than FIRREA's gross negligence floor. 12 U.S.C. § 1821(k). The *Atherton* Court did not thereby

establish a federal common law gross negligence standard, nor did it hold that FIRREA supplants state-law standards of care, but the decision does direct courts to continue applying state law gross negligence standards. *Atherton*, 519 U.S. at 226-27.[24] *Atherton* was not presented with (and did not decide) the issue of whether a state law's definition of gross negligence requiring "wanton conduct" and a "conscious disregard" is somehow preempted by § 1821(k), and FDIC cannot support a preemption argument here.[25]

FDIC's argument is a *cul-de-sac* because plaintiff has no evidence to meet any acceptable definition of gross negligence, and by no means does FIRREA or *Atherton* eliminate a culpable mental state from North Carolina's definition of gross negligence. North Carolina's definition of gross negligence does not fall below FIRREA's floor, and the standard in *Yancey*, *Hinson*, *Abney*, and *Horne* was not enunciated to cut bank directors a break, so *Atherton's* concerns are not even implicated. This Court should apply North Carolina's long-established gross

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[24] *Atherton* notes with approval an Indiana statute providing that directors are not liable unless their conduct constitutes at least "willful misconduct or recklessness." *Id*. at 220 (emphasizing that "Nation's banking system has thrived despite disparities in matters of corporate governance" and citing "the divergent state-law governance standards applicable to banks chartered in different states").

[25] *FDIC v. Giannoulias*, 918 F.Supp.2d 768 (N.D. Ill. 2013) (Appellant's Brief at 53) is inapposite. *Giannoulias* addressed whether gross negligence in Illinois meant "very great negligence" or "recklessness." The concepts of "wanton conduct" or "conscious disregard" were not presented.

negligence definition, and reject FDIC's untenable federal common law standard that requires no distinguishing mental state beyond ordinary negligence. That is not the law under FIRREA or North Carolina precedents.

IV. JUDGMENT MAY BE AFFIRMED ON ALTERNATIVE GROUNDS

This Court may affirm the trial court's judgment on alternate grounds, if such grounds are apparent from the record. *Ellis v. La.-Pac. Corp.*, 699 F.3d 778, 786-87 (4th Cir. 2012) *citing MM ex rel. DM v. School Dist. Of Greenville Cnty.*, 303 F.3d 523, 536 (4th Cir. 2002). Defendants presented four additional arguments below, on which this Court may affirm.

A. Defendants Properly Relied on Reports Under N.C.G.S. §§ 55-8-30(b) and 55-8-42(b).

The voluminous record demonstrates that defendants made the challenged loans in reliance on reports, opinions, appraisals, financial data and other information developed and provided by Cooperative's experienced loan officers and credit administrators. N.C.G.S. § 55-8-30(b) provides that "[i]n discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by: (1) One or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented." *See* § 55-8-42(b) (offering same protection to officers). The Commentary states that reliance on written materials is appropriate if the director or officer read

them – ***or if the materials were "orally presented"*** – or took other steps to become "generally familiar" with a report's contents. *Id.* at Official Comment 2 (emphasis added).

Application of §§ 55-8-30(b) and 55-8-42(b) is appropriate on summary judgment because defendants' reliance on loan officer and credit administration reports shows that they reviewed available information in good faith and had a rational business process – thereby securing the Business Judgment Rule's protections. In *Custard II*, the court applied this reliance statute on summary judgment because there was "no evidence before the Court to suggest that the Custards' belief that Mr. Haigh and Mr. Allen were reliable and competent in these matters was unreasonable." 2010 WL1035809, at *27.

The trial court's substantial summary judgment record evidenced Cooperative's loan approval process whereby loan officers, with the assistance of credit administrators, conducted substantial due diligence for each prospective loan and synthesized their own assessments of this data into a credit memorandum presented to the Officers. JA-1064-65(65:18-66:19); JA-1076-77(116:2-117:18); *see supra* at 5-7. The Outside Directors relied upon Cooperative's experienced management to assess proposed loans based upon reports prepared by loan officers and credit administrators. JA-604-05¶12. FDIC seeks wide latitude to debate whether selected aspects of these reports were "meaningful," even though this

process was routinely ranked a CAMELS 2 by regulators and described as "upper quartile" by an independent auditor. JA-785. Debating the "meaningfulness" of these reports puts the cart before the horse: FDIC has no evidence that defendants' reliance on the bank employees was unwarranted. There is no evidence that any Cooperative employee was compiling misleading information or feathering his own nest, or that defendants had reason to doubt the reliability of personnel who had served the Bank for years. And as the Official Commentary to N.C.G.S. § 55-8-30(b) makes plain, defendants were ***not*** required to read all materials themselves: the statute entitles defendants to rely on oral presentations of these voluminous materials. Because FDIC offered no proof to counter the undisputed documentary and testimonial evidence showing that the CRE loans underwent a multi-step approval process and that each of the challenged loans was extensively underwritten, all defendants are entitled to rely on Section 55-8-30 and 55-8-42 to defeat FDIC's claims on summary judgment.

B. Cooperative's Articles Eliminated Director Negligence Claims.

The North Carolina Business Corporation Act provides that a corporation's Articles of Incorporation may include a provision:

> limiting or eliminating the personal liability of any director arising out of an action whether by or in the right of the corporation or otherwise for monetary damages for breach of any duty as a director.

N.C.G.S. § 55-2-02(b)(3). Thus, "shareholders may limit or eliminate all director liability other than liability for receipt of a financial benefit to which the director is not entitled, intentional infliction of harm, harm to the corporation resulting from intentional violation of criminal law, and liability . . . for unlawful distributions." American Bar Association, *Model Business Corporation Act*, xxv (2005). Exculpatory provisions appropriately recognize that "[d]irectors should be afforded reasonable predictability; they are entitled to know whether a contemplated course of action will result in personal liability for money damages." *Id.* at Official Comment to § 2.02.

Article Nine of Cooperative's Articles of Incorporation implement this statutory provision in an "Exculpatory Clause" providing that directors "shall not be personally liable to the Corporation or its shareholders for monetary damages for breach of any fiduciary duty as a director." JA-683. Consistent with the Business Judgment Rule, FIRREA, and *Atherton*, Article Nine states that the Exculpatory Clause does not apply to gross negligence.

Cooperative's exculpatory provision must apply unless FDIC shows that at the time the challenged loans were approved, the approving director knew or believed that the acts were ***clearly*** in conflict with the best interests of Cooperative. *FDIC v. Willetts*, 882 F.Supp.2d 859, 865 (E.D.N.C. 2012). Importantly, the standard is not "should have known," nor a duty of inquiry. FDIC had to prove

actual knowledge or belief that the challenged loans conflicted with the best interests of Cooperative. A director acts "in conflict with the best interests" of the corporation, only if he has breached his duties of loyalty and good faith. *Green v. Condra*, No. 08 CVS 6575, 2009 WL2488930, at *7 (N.C. Super. Aug. 14, 2009) ("section 55-2-02(b)(3) permits the shareholders of a corporation to limit or eliminate a breach of the duty of care as the basis of a claim for money damages. It does not allow shareholders to . . . limit or eliminate liability for breaches of the directors' duties of loyalty or good faith.").

FDIC has no evidence on this point, not even circumstantial evidence suggests that any defendant breached a duty of loyalty or engaged in self-dealing or other insider abuse. FDIC seeks no inferences for bad faith, but simply argues – without citing evidence – that it "adduced summary judgment evidence from which a juror could conclude that the directors did not act in good faith and acted without adequate information." Appellant's Brief at 55. Sections 55-8-30(b) and 55-8-42(b) validate the way these defendants approved loans after considering information compiled and presented by Cooperative's loan officers and credit administrators. No gross negligence arises from these facts, and Cooperative's exculpatory clause shields the Outside Directors from anything less.

The Court may affirm judgment, in part, on grounds that Cooperative's exculpatory clause shields the Outside Directors (and Willetts in his capacity as a director) from liability for ordinary negligence.

C. FDIC Failed to Prove Proximately-Caused Losses.

FDIC failed to produce evidence that defendants, rather than the Great Recession, proximately caused the loan defaults pled. FDIC claims that defendants' laxity in making, supervising, and administering these loans proximately caused the bank's losses. Complaint at ¶¶53-55. What FDIC pled as a bald conclusion at the outset has no probative support in response to summary judgment. In response to defendants' motion below, and FDIC's own motion for judgment on this defense, plaintiff could not establish how any given loan approval or act of credit administration proximately led to any loan defaults in its 87-loan damage case.

Instead of proximate cause, FDIC argues a loose "but-for" causation: the loan losses would have been avoided if they'd never been approved in the first place. Proximate cause demands more: an inquiry about what caused nonpayment of the subject loans and whether that cause was foreseeable when defendants approved them. Federal Reserve Chairman Ben Bernanke and many others in authority confirm that the size, scope, and duration of 2008's Great Recession was ***not*** foreseeable – not to FDIC and not to Cooperative's Officers and Outside

Directors, nor to the borrowers at issue. Cooperative's track record, including ordinary-course-of-business examinations by FDIC and OCOB, demonstrate the sound operation of this community bank for decades before the Crash. The Great Recession caused a free-fall in real estate values and a collapse in the nation's credit markets, which doomed the borrowers' underlying construction projects and caused the loan failures at issue.

D. FDIC Cannot Prove Damages With Reasonable Certainty.

When defendants moved for summary judgment in May 2014, it had been almost three years since FDIC filed its complaint and yet it still could not state its damages. The Court granted defendants' *Daubert* motion challenging FDIC's injury and damages expert, which was not appealed. The result: FDIC has no damages case to present at trial if this Court reverses summary judgment.

FDIC's speculation about continually expanding and contracting loss figures for the challenged loans could not survive defendants' summary judgment motion below because "[i]t is a well-established principle of law that proof of damages must be made with reasonable certainty." *Southeast Coastal Dev. Fund, LLC v. Cruse*, 5:08-CV-45-F, 2010 WL147910 at *3 (E.D.N.C. Jan. 13, 2010). The burden is on FDIC to prove its losses with reasonable certainty and its failure to do so after litigating this case for almost three years is detrimental to its recovery of any alleged losses. *Lord of Shalford v. Shelley's Jewelry, Inc.*, 127 F.Supp.2d 779,

788 (W.D.N.C. 2000), *aff'd*, 18 Fed. Appx. 147 (4th Cir. 2001); *see also USA Trouser*, *S.A. de C.V. v. Int'l Legwear Grp.*, *Inc.*, 1:11-CV-00244-MR-DLH, 2014 WL1230507, at *6 (W.D.N.C. Mar. 25, 2014) (denying request for consequential damages because, while plaintiff showed a monetary loss resulting from defendant's conduct, it "failed to prove its consequential damages 'with sufficient certainty and specificity' to permit recovery of such damages here.").

CONCLUSION

For the foregoing reasons, plaintiff's appeal should be dismissed and the trial court's summary judgment order should be affirmed with applicable costs awarded to defendants.

REQUEST FOR ORAL ARGUMENT

Due to the complexity of the issues presented, Appellees request oral argument.

Respectfully submitted,

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Dated: January 30, 2015

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CERTIFICATE OF FILING AND SERVICE

I hereby certify that on this 30th day of January, 2015, I caused this Redacted Brief of Appellees to be filed electronically with the Clerk of the Court using the CM/ECF System, which will send notice of such filing to the following registered CM/ECF users:

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I further certify that on this 30th day of January, 2015, I caused the required copies of the Redacted Brief of Appellees to be hand filed with the Clerk of the Court.

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