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 WILLETS, 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 in Case No. 7:11-cv-00165-BO

BRIEF FOR *AMICUS CURIAE* THE CHAMBER OF COMMERCE
OF THE UNITED STATES OF AMERICA URGING AFFIRMANCE.

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, and Local Rule 26.1, the Chamber of Commerce of the United States, *amicus curiae* in this appeal, makes the following disclosures:

The Chamber is a non-profit, tax-exempt organization incorporated in the District of Columbia.

The Chamber has no parent corporation.

No publicly held corporation owns 10% or more of the Chamber's stock.

No publicly held corporation or other publicly held entity has a direct financial interest in the outcome of this litigation.

This case does not arise out of a bankruptcy proceeding.

Signed: /s/ Richard A. Olderman

Date: February 6, 2015

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INTEREST OF THE *AMICUS CURIAE*

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the nation's business community.

The issue presented in this appeal is of great importance to the Chamber and its members because it affects how courts will apply the business judgment rule, a bulwark of protection for corporate officers and directors against hindsight-based assertions of personal liability brought by shareholders and other stakeholders.

All parties have consented to the filing of this brief.[1]

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[1] Pursuant to Rule 29(c)(5), counsel for the *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no person other than the *amicus curiae*, its members, or its counsel made a monetary contribution to its preparation or submission.

SUMMARY OF ARGUMENT

"As generally formulated and applied in corporate litigation," the well-established business judgment rule means "that courts should defer to—should not interfere with—decisions of corporate directors upon matters entrusted to their business judgment except upon a finding of bad faith or gross abuse of their 'business discretion.'" *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1047 (4th Cir. 1985) (citation omitted). The rule focuses on the reasonableness of the process used to reach a decision, not the decision's ultimate outcome; and it reflects the understanding that business executives, rather than judges, are in the best position to determine what transactions best serve their company's interests.

The FDIC, as receiver for failed financial institutions, has the authority to hold bank directors and officers personally liable for bank losses caused by their gross negligence in making loans, unless state law provides a lesser standard of care. *See* 12 U.S.C. § 1821(k). In advancing such claims, the FDIC's practice has been to cherry pick a handful of loans that officers and directors approved, and that with hindsight turned out to be non-performing. Although a given director or officer might approve hundreds of loans in a year's time, the FDIC second-guesses only a few of these loans (generally those with seven or eight-figure losses). The FDIC then sues the individuals personally, seeking damages so high that the *in terrorem* effect of substantial damages, coupled with the burdens and risks of trial, causes most cases to settle even where the allegations of wrongdoing are marginal or groundless.

But routine-lending decisions, made in good faith according to an established process, should not lead to second-guessing by banking agencies and should not put officers and directors in jeopardy of ruinous personal judgments. "North Carolina cases establish that directors are required to exercise only reasonable care and business judgment; they are not guarantors that they will make no mistakes in the management of the corporation and are not personally responsible for mere errors of judgment." Russell M. Robinson, II, *Robinson on North Carolina Corporation Law* § 14.06 n.9 (7th ed. 2002). Accordingly, to provide meaningful protection at a stage where the business judgment rule should matter most, courts generally should grant summary judgment unless plaintiffs can overcome the presumption that the judgments of corporate professionals were reached in good faith based on a rational process.

The protections of the business judgment rule become all the more important in cases like this, where the loan decisions in question were made on the brink of an unforeseen economic disruption that the Second Circuit has described as "the direst financial crisis in modern times." *Starr Int'l Co. Inc. v. Fed. Reserve Bank of N.Y.*, 742 F.3d 37, 42 (2d Cir. 2014). The 2008 financial crisis unleashed a contagion effect that caused historic declines in credit and real estate markets that, in turn, resulted in the default of loans that would have performed in any ordinary economic cycle. From 2000 through 2007, there were 32 bank failures in the United States—all but three of

which occurred before 2005[2]—with total losses estimated at under $1 billion. From 2008 through the present, the number of bank failures skyrocketed to over 500, more than 15 times the rate seen in the preceding seven-year period.[3] Total losses were estimated to exceed $85 billion.[4] It was, in the words of Alan Greenspan, former Chairman of the Federal Reserve, a "once in a century credit tsunami."[5]

Without meaningful business judgment protections against liability for decisions that only with the benefit of hindsight now seem dubious, individuals will be less willing to risk potentially ruinous financial liability by serving as officers and directors. As a result, financial institutions, as well as other corporations, will find it harder to attract and retain the most-qualified individuals to serve as officers and directors. Further, those who agree to serve might become unduly risk averse, which has its own set of societal costs measured by lost economic opportunities. One of the important purposes of the business judgment rule is to "allow[] directors to be risk takers without being made subject to the hindsight of judicial second guessing." Robinson, II, *supra,* § 14.06, at 14–16 through 14–17. Assaults on the business judgment rule's protections necessarily temper entrepreneurial risk-taking by officers

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[2] "FDIC Failures & Assistance Transactions," *available at* https://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30.

[3] *See id.*

[4] *See id.*

[5] Statement of Alan Greenspan, *The Financial Crisis and the Role of Regulators*, Hearing Before the House Committee on Oversight and Government Reform (Oct. 23, 2008).

and directors. In the banking context, less risk-taking translates into denials of credit to local borrowers who wish to start, fund, or run businesses that create jobs in our communities. For corporations of every kind, to succeed in an intensely competitive business environment management must be willing to take reasonable risks that enable them to pursue new markets, create new products, and execute new strategies. Subjecting corporate decision makers to liability for decisions made in good faith according to a rational decision making process, deters them from taking steps necessary to advance business operations and shareholder wealth.

It is easy to second-guess decisions in hindsight. Directors and officers who make decisions in good-faith, according to a rational process should not have to go to trial to vindicate their judgments.

ARGUMENT

I. THE BUSINESS JUDGMENT RULE PROTECTS DECISIONS MADE USING A RATIONAL PROCESS AND PERFORMED IN GOOD FAITH.

A. The Business Judgment Rule in North Carolina

Directors and officers of failed institutions who are alleged to have acted negligently or in breach of their fiduciary duties may in most jurisdictions invoke the defense of the business judgment rule, a presumption that their decisions were made in good faith.[6] The rule had its origins in the common law, in bank director cases.[7]

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[6] Federal law imposes a heightened liability standard on the FDIC as receiver of a bank's assets. The Financial Institutions Reform, Recovery, and Enforcement Act of

In North Carolina, the rule "creates, first, an initial evidentiary presumption that in making a decision the directors 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, and second, absent rebuttal of the initial presumption, a powerful substantive presumption that a decision by a loyal and informed board will not be overturned by a court unless it cannot be attributed to any rational business purpose." Robinson, II, *Robinson on North Carolina Corporation Law*, § 14.06, at 14–16 through 14–17.[8]

1989 ("FIRREA"), 12 U.S.C. 1821(k), established "gross negligence" as a national minimum standard for officer and director liability. However, the Supreme Court has held that the phrase "gross negligence" does not immunize directors and officers from liability for less culpable conduct—such as ordinary negligence. Rather, it "provides only a floor." States are free to enact more stringent requirements. *Atherton v. FDIC*, 519 U.S. 213, 227–28 (1997). In North Carolina, the business judgment rule may be overcome only by a showing of gross negligence. *See State v. Custard*, No. 06-CVS-4622, 2010 WL 1035809, at *20-21 (N.C. Super. Ct. Mar. 19, 2010). Gross negligence requires "willful and wanton conduct." *Yancey v. Lea*, 550 S.E.2d 155, 157–58 (N.C. 2001).

[7] *See Percy v. Millaudon*, 8 Mart. (n.s.) 68, 1829 WL 1592 (La. 1829) (bank director not liable if he exercised ordinary care); *Godbold v. Branch Bank*, 11 Ala. 191, 199, 1847 WL 159, at *6 (Ala. 1847) (holding bank director liable for any error in decision-making would be "manifestly wrong" and observing that "[t]he inevitable tendency of such a rule, would be hostile to the end proposed by it, as no man of ordinary prudence would accept a trust surrounded by such perils.").

[8] North Carolina applies the rule to officers and directors. *See Robinson, II, supra,* § 14.96 ("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 . . . ." (citations and internal quotation marks omitted)). In some States, the rule only applies to directors. *See, e.g.*, *FDIC v. Perry*, No. CV 11-5561-

When applying the rule, courts in North Carolina (and many other States, led by well-established Delaware jurisprudence),[9] consider the reasonableness of the process used to reach a decision, not the decision's ultimate outcome. *See Maurer v. Maurer*, No. 13 CVS 4421, 2013 WL 4647703, at *6 (N.C. Super. Ct. Aug. 23, 2013) ("the business judgment rule is 'process oriented' rather than a simple exercise of an after the fact 'objective' evaluation") (citation omitted); *State v. Custard*, 2010 WL 1035809, at *21 (no liability for a decision that the fact-finder believes to be "wrong," stupid," or "egregious" "so long as the . . . [decision-making process] . . . was either rational or [was] employed . . . in good faith") (emphasis omitted) (quoting *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996)); *Stewart v. BF*

ODW, 2012 WL 589569 (C.D. Cal. Feb. 21, 2012). In other States, the application of the rule to officers is unclear. Both the American Law Institute and the ABA Committee on Corporate Laws endorse applying the Business Judgment Rule to officers and directors. *See* ABA Comm. on Corporate Laws, Changes in the Model Business Corporation Act Pertaining to the Standards of Conduct for Officer; Inspection Rights and Notices—Final Adoption, 54 Bus. Law 1229, 1231 (1999) ("[T]he business judgment rule will normally apply to decisions within an officer's discretionary authority."); American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 4.01 cmt. a (1994) ("Sound public policy points in the direction of holding officers to the same duty of care and business judgment standards as directors.").

[9] "North Carolina courts have frequently looked to the well-developed case law of corporate governance in Delaware for guidance." *State v. Custard*, 2010 WL 1035809, at *18 (N.C. Super. Ct. Mar. 19, 2010); *see also Ehrenhaus v. Baker*, No. 08 CVS 22632, 2008 WL 5124899, at *9, n.19 (N.C. Super. Dec. 5, 2008) ("North Carolina courts frequently look to Delaware for guidance on questions of corporate governance because of the special expertise and body of case law developed in the Delaware Chancery Court and the Delaware Supreme Court.").

Boathouse Holdco, LLC, No. 8119-VCP, 2013 WL 5210220, at *10 (Del. Ch. Aug. 30, 2013) ("Due care in the decision-making process is process due care only") (emphasis and internal quotation marks omitted); *FDIC v. Loudermilk*, 761 S.E.2d 332, 338 (Ga. 2014) (business judgment rule "generally precludes claims against officers and directors for their business decisions that sound in ordinary negligence, except to the extent that those decisions are shown to have been made without deliberation, without the requisite diligence to ascertain and assess the facts and circumstances upon which the decisions are based, or in bad faith"). *See also Kahn v. M& F Worldwide Corp.*, 88 A.3d 635, 654 (Del. 2014) (rule does not apply only where it can be credibly argued that no rational person would have made the decision); *Brehm v. Eisner*, 746 A.2d 244, 264 & n.66 (Del. 2000) ("Irrationality is the outer limit of the business judgment rule") (footnote omitted).

The rule reflects the understanding that business executives, rather than judges, are in the best position to determine what transactions best serve their company's interests. *Wachovia Capital Partners, LLC v. Frank Harvey Inv. Family Ltd. P'ship*, No. 05 CVS 20568, 2007 WL 2570838, at *4 (N.C. Super. Ct. Mar. 5, 2007) ("The business judgment rule recognizes that business decisions are best left in the hands of informed and experienced boards of directors and managers. Courts, although expert at interpreting and applying the law, 'are ill equipped to engage in post hoc substantive review of business decisions.'") (quoting *In re Walt Disney Co. Derivative Litig.*, 907A.2d 693, 746 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006)). *See*

also In re MFW S'holders Litig., 67 A.3d 496, 526 (Del. Ch. 2013) ("[I]t has long been thought beneficial to investors for courts, which are not experts in business, to defer to the disinterested decisions of directors, who are expert, and stockholders, whose money is at stake."), *aff'd*, 88 A.3d 635 (Del. 2014).

The rule also encourages reasonable risk-taking by reassuring officers and directors that they are not guarantors of business outcomes. *See, e.g.*, *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 205 (Del. Ch. 2006) (The rule "provid[es] directors with sufficient insulation so that they can seek to create wealth through the good faith pursuit of business strategies that involve a risk of failure"), *aff'd*, 931 A.2d 438 (Del. 2007) (Table). These protections are critical to recruiting and retaining qualified individuals, whether in the context of regulated financial institutions, or more broadly in offices and boardrooms across corporate America.

B. Adoption of the FDIC's Approach Would Frustrate the Protections of the Business Judgment Rule for Bank Officers and Directors.

The salutary purposes of the rule are frequently thwarted by the FDIC in bank director and officer litigation. Such litigation, which invariably focuses on relatively few loans, viewed with hindsight, and relies on boilerplate allegations of wrongdoing that are recycled from complaint to complaint, seeks millions of dollars of damages from defendants in their personal capacities. Over a five-year period (2009–2014) since the 2008 financial crisis staggered the global economy, the FDIC has authorized more than 100 lawsuits against nearly 800 directors and officers of failed financial

institutions. *See* FDIC, Professional Liability Lawsuits, https://www.fdic.gov/bank/individual/failed/pls/ (last visited Feb. 4, 2015). For all director and officer lawsuits filed by the agency through 2013, the average damages claim was $49 million, and the median claim was $22 million. *See* Cornerstone Research, *Characteristics of FDIC Lawsuits against Directors and Officers of Failed Financial Institutions* (2014) at 11. In this particular lawsuit, the FDIC seeks to recover more than $34 million overall without counting pre-judgment interest. It premises liability on the decision of individual directors and officers who voted to approve each particular loan. The agency seeks judgment against Rippy for $20 million; against Willetts for $33.274 million; against Burton for $9.4 million; against Hundley for $4.48 million; against King for $12.38 million; against Wright for $11.01 million; against Fensel for $21.436 million; against Bridger for $14.45 million; and against Burrell for $18.64 million.

Notwithstanding the Supreme Court's rulings in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009), many courts faced with failed bank litigation have held that the business judgment rule is too fact-intensive to be disposed of on a motion to dismiss. *See, e.g.*, *FDIC v. Baldini*, 983 F. Supp. 2d 772, 783 (S.D. W.Va. 2013) (citing "overwhelming authority" that the rule "is highly fact dependent and, therefore, inappropriate for consideration on a motion to dismiss"); *Court Appointed Receiver of Lancer Offshore, Inc. v. Citco Grp. Ltd.*, No. 05-6008-Civ., 2008 WL 926509, at *5 (S.D. Fla. Mar. 31, 2008) ("[T]he Court considers it unwise to

evaluate conduct and determine whether or not it is protected by the business judgment rule at the motion to dismiss stage."). *But see FDIC v. Blackwell*, No. 1:11-cv-03423-PWS, 2012 WL 3230490 (N.D. Ga. Aug. 3, 2012) (granting motion to dismiss claims of ordinary negligence and breach of fiduciary duty where the entitlement to the protections of the rule were clear under the Georgia statute). Moreover, few courts are willing to certify business judgment rule issues for interlocutory appeal under 28 U.S.C. § 1292(b).[10]

Accordingly, absent unusual circumstances, directors and officers in failed bank litigation have only one real chance to dispose of a case before trial: summary judgment. If Defendants do not prevail on summary judgment, they face a Hobson's choice of settling (often at significant personal expense)[11] or litigating (with ruinous amounts of potential liability in the balance). Not surprisingly, the great majority of

[10] In this case, for example, following the denial of the motion to dismiss, the District Court denied Defendants' motion to certify what Defendants characterized as a controlling question of law. *See FDIC v. Willetts*, 882 F. Supp. 2d 859, 867-68 (E.D.N.C. 2012).

[11] When cases settle, officers and directors frequently must make out-of-pocket payments. According to Cornerstone Research, of 82 settlement agreements involving officers and directors (regardless whether a lawsuit was actually filed), "as many as 38 agreements, or 46 percent, required out-of-pocket payments by directors and officers. Directors and officers agreed to pay at least $34 million out of pocket in these cases." Cornerstone Research, *Characteristics of FDIC Lawsuits against Directors and Officers of Failed Financial Institutions* at 15 (2014). Although directors do receive fees for their work, there is an enormous discrepancy between the amount they are paid and the potential liability they face from FDIC lawsuits.

cases, even cases with marginal or wholly insubstantial claims, settle. Of the hundred-plus D&O lawsuits filed by the FDIC since the 2008 financial crisis, thirty-four had been resolved by the end of 2014: thirty-three settlements and only one trial (involving a verdict in favor of the FDIC involving the failure of IndyMac Bank, one of the country's largest savings and loan associations prior to its failure on July 11, 2008). *See* FDIC, Professional Liability Lawsuits, https://www.fdic.gov/bank/individual/ failed/pls/ (last visited Feb. 4, 2015). Even when cases go to trial, vindicating business judgments can be an extremely long and costly process fraught with uncertainty.[12]

In this regard, failed bank litigation is similar to class action securities fraud lawsuits, where both Congress and the Supreme Court criticized (and acted to

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[12] In *FDIC v. Castetter*, 184 F.3d 1040 (9th Cir. 1999), for example, the FDIC alleged that former bank directors were negligent and liable for losses in the bank's loan portfolio. The case went to trial. Following a jury verdict in favor of the FDIC, the trial court granted the defendants' motion for judgment as a matter of law or, in the alternative, a new trial. The Ninth Circuit reversed the order granting judgment as a matter of law, but affirmed the grant of a new trial. On remand, the trial court ruled in defendants' favor on summary judgment, and the FDIC again appealed. The Ninth Circuit then determined that the California business judgment rule insulated the directors from liability. Holding that the directors had relied on the advice of experts regarding the bank's financial condition, the Ninth Circuit criticized the FDIC for "largely ad hominem attacks on the directors' capabilities, their decisions, and their inability to reverse negative earnings trends." *Id.* at 1045–46 (internal quotation marks omitted). The court observed that the FDIC was primarily attacking the directors' decisions themselves and that the business judgment rule should "protect well-meaning directors who are misinformed, misguided, and honestly mistaken." *Id.* at 1046.

eliminate) blackmail settlements induced by a small probability of an immense judgment. In the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4, et seq. ("PSLRA"), Congress created several procedural barriers to securities fraud actions, including a heightened pleading requirement, to prevent *in terrorem* settlements.[13] Moreover, in a series of securities decisions, both before and after the PSLRA, the Supreme Court recognized and condemned the practice of suing for the value of settlement. *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163 (2008) (rejecting the expansion of securities fraud causes of action where it would "allow plaintiffs with weak claims to extort settlements from innocent companies"); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313(2007); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975). The magnitude of damages coupled with the costs of litigation in bank director and officer suits continues to drive settlement, causing defendants to forfeit the protections of the business judgment rule before they have any meaningful opportunity to avail themselves of its shield.

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[13] *See* S. Rep. No. 104-98, at 6 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 685 ("The dynamics of private securities litigation create powerful incentives to settle . . . . Many such actions are brought on the basis of their settlement value. The settlement value to defendants turns more on the expected costs of defense than the merits of the underlying claim[s]."). *See also* H.R. Rep. No. 104-369, at 37 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 736 ("The cost of discovery often forces innocent parties to settle frivolous securities class actions.").

II. BUSINESS JUDGMENT RULE ISSUES SHOULD BE RESOLVED ON SUMMARY JUDGMENT, WITHOUT THE COSTS OF TRIAL.

To provide meaningful protection to these individuals within the intended scope of the business judgment rule, courts should dismiss, or grant summary judgment, on ordinary negligence and breach of fiduciary duty claims where the business judgments of corporate professionals were based on a rational process performed in good faith. That is particularly the case where, as here, regulators contemporaneously examined that process and found it to be satisfactory.[14] Courts should reject the FDIC's invitation to second-guess the substance of the actual loan decisions at issue, or the fact that the bank failed. As then-Vice Chancellor Strine of the Delaware Court of Chancery observed in *Trenwick America Litigation Trust v. Ernst & Young*, 906 A.2d 168, 193 (Del. Ch. 2006): "[B]usiness failure is an ever-present risk. The business judgment rule exists precisely to ensure that directors and managers acting in good faith may pursue risky strategies that seem to promise great profit. If the mere fact that a strategy turned out poorly is in itself sufficient to create an inference that the directors who approved it breached their fiduciary duties, the

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[14] One commentator has observed that "[t]he business-judgment rule applicable to directors and officers goes much further than the honest-error-of-judgment rule of general tort law. . . . Under the business judgment rule, there is no liability even though a decision is unreasonable." Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. Pitt. L. Rev. 945, 963 (1990).

business judgment rule will have been denuded of much of its utility." 906 A.2d at 193.

Applying the business judgment rule to dismiss a complaint before trial is particularly important where, as here, the underlying decisions were made on the cusp of an historic economic catastrophe, the full extent of which was impossible to predict.[15] In testimony given to the House of Representatives in 2011, Sheila C. Bair, Chairperson of the FDIC, observed that the financial crisis that hit "in the fall of 2008" was "the worst financial crisis since the 1930s," and that "few at the time foresaw the extent of the emerging threat to our financial stability." *FDIC Oversight: Examining and Evaluating the Role of the Regulator During the Financial Crisis and Today, Before the H. Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services*, 112th Cong. 46, 48, (2011) (Statement of Sheila C. Bair, Chairman, FDIC). Alan Greenspan conceded that "virtually every economist and policymaker of note [was] . . . blind to the coming calamity and "experts, including me, fail[ed] to see it approaching[.]" *See* Alan Greenspan, Never Saw It Coming: Why the Financial Crisis Took Economists By Surprise, *Foreign Affairs*, (Nov/Dec 2013) at 2. The closest historical precedent was the Great Depression.

Banks lend based on presumptions about the local, regional, and national

[15] The FDIC's Complaint in this case charged Defendants with negligence, gross negligence, and breaches of fiduciary duty with respect to 86 loans made between January 5, 2007 and April 10, 2008.

economies, including the presumption that the economy will cycle up and down but will stay within an historical range. They expect that some small percentage of loans will not pay off, no matter how reasonable the underlying business judgment, and thus they establish an Allowance for Loan and Lease Losses to account for that fact. The 2008 financial crisis, however, proved those presumptions wrong. Both the economy and real estate prices plunged much faster and far deeper than the industry or its regulators predicted, resulting in a far higher percentage of what would have been performing loans in any ordinary economic cycle defaulting.

In this case, the trial court recognized this economic reality and properly invoked the protections of the business judgment rule to dispose of the case at the summary judgment stage. The court resisted the temptation to second-guess the decisions: "Although the decisions of defendants to engage in various forms of lending and to make the particular loans challenged in the complaint, and the wisdom of such decisions raise interesting discussion points in hindsight, the business judgment rule precludes this court from delving into whether or not the decisions were 'good' and limits the court's involvement to a determination of whether the decisions were made in 'good faith' or were founded on a 'rational business purpose.'" Joint Appendix ("JA") 0077.

But the position advanced by the FDIC on appeal is shortsighted and, if adopted, could make our banking system less resilient. If directors and officers must go to trial to vindicate business judgments reached in good faith through a rational

decision making process deemed to be satisfactory by examiners at the time, the most qualified individuals will be discouraged from serving as directors or officers. *See* 3A *Fletcher*, *Cyclopedia of the Law of Corporations* § 1037(West 2014) ("[B]usiness is inherently risky and the quality of a business decision cannot always be judged by the immediate results; therefore personal liability for a decision that produces bad results would make it difficult to secure the services of able and experienced corporate directors."). That is why it is critically important for trial courts to apply the business judgment rule at a pre-trial stage in a way that insulates directors and officers from hindsight-based criticisms after a risk materializes. As one commentator observed, "[T]here is a substantial risk that suing shareholders and reviewing judges will be unable to distinguish between competent and negligent management because bad outcomes often will be regarded, ex post, as having been foreseeable and, therefore, preventable ex ante. If liability results from bad outcomes, without regard to the ex-ante quality of the decision or the decision-making process, however, managers will be discouraged from taking risks." *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 Vand. L. Rev. 83, 114–15 (2004) (footnote omitted).

Eroding the protections of the business judgment rule not only discourages participation by qualified individuals, it also discourages risk-taking, which is the life-blood of a corporation. As the Second Circuit has observed, "because potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions." *Joy v.*

North, 692 F.2d 880, 886 (2d Cir. 1982). Hindsight review of business decisions destroys "[t]he entire advantage of the risk-taking, innovative, wealth-creating engine that is the . . . corporation . . . with disastrous results for shareholders and society alike." *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 698 (Del. Ch. 2005); *see also* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care With Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem,* 96 Nw. U. L. Rev. 449, 455 (2002) ("Because the expected value of a risky business decision may be greater than that of a less risky decision, directors may be acting in the best interest of the shareholders when they choose the riskier alternative."); *id.* at 450 ("By intruding on the protected space that the business judgment rule accords such decisions, courts create disincentives for businesses to engage in the risk-taking that is fundamental to a capitalist economy.").[16]

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[16] *See also Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 205 (Del. Ch. 2006) (observing that the business judgment rule "provid[es] directors with sufficient insulation so that they can seek to create wealth through the good faith pursuit of business strategies that involve a risk of failure"), *aff'd*, 931 A.2d 438 (Del. 2007) (Table); *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996) ("[The business judgment rule] protects shareholder investment interests against the uneconomic consequences that the presence of [judicial] second-guessing risk would have on director action and shareholder wealth in a number of ways.") (emphasis omitted). *Cf.* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit incorporate Law: A Theoretical and Empirical Analysis*, 71 Cornell L. Rev. 261, 285 (1986) (" Public corporations are structured to transfer most business risk to security holders who have access to capital markets and thus have a comparative advantage in bearing risk. The threat of litigation if a particular decision turns out poorly, however, has the effect of transferring the risk from security holders to managers who are far less efficient risk bearers.").

The defendants in this case were local residents who served as officers and directors of a community bank. When such individuals act too conservatively, and decline to take reasonable risks or extend credit to creditworthy borrowers, the shareholders and customers they serve suffer as well. Less risk-taking leads to denials of credit to local residents who wish to start, fund or expand businesses that create jobs for other local residents, which in turn leads to reduced profits. This is particularly true of community banks such as Cooperative. As the FDIC has recognized, community banks "focus on providing traditional banking services in their local communities. They obtain most of their core deposits locally and make many of their loans to local businesses." *See FDIC Community Banking Study* https://www.fdic.gov/regulations/resources/cbi/study.html (last visited Feb. 5, 2015). As the FDIC's own study makes clear:

> This relationship approach to lending is particularly important to small businesses that rely on community banks for loans and other services. Small businesses, particularly small start-up companies, may be unable to satisfy the requirements of the more structured approach to underwriting that larger banks use. The relationship lending approach used by community banks is often the only avenue small businesses have to obtain loans and access other financial services.

Id.[17]

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[17] The FDIC Report additionally notes that "[c]ommunity banks can develop close relationships with customers because they tend to be smaller in size and only conduct business locally." FDIC Community Bank Study, at 1-1. And that community banks "may weigh the competing interests of shareholders, customers, employees and the

When directors and officers can be second-guessed without meaningful protection, the natural reaction is to restrict borrowing to only the most creditworthy individuals. This has an enormous social and economic cost to the communities the banks serve. That strategy would have caused conservative banks to lose market share and share value, endure regulatory criticism, and run the risk of being acquired by more aggressive and thus more profitable banks. The same cautionary rule applies, of course, to all corporations. Where the business judgment rule is not properly applied by the courts, directors and officers become risk-adverse and the corporation, its shareholders, and the economy suffers.

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local community differently from a larger institution with stronger ties to the capital markets." *Id.*

CONCLUSION

For the foregoing reasons, the Court should affirm the grant of summary judgment in favor of the individual defendants.

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CERTIFICATE OF COMPLIANCE WITH RULE 32(A)(7)(b)

This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a) because it contains 5,405 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type-style requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2007 in 14-point Garamond.

/s/ Richard A. Olderman

Date: February 6, 2015

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of February 2015, the foregoing Brief of the Amicus Curiae Chamber of Commerce of the United States of America was electronically filed through the Court's CM/ECF system. Notice of this filing will be sent by email to all parties by operation of the Court's electronic filing system.

I additionally caused eight true and correct printed copies of the brief to be filed with the Clerk of the Court by Fed Ex delivery directed to the following address:

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