Going the Distance: Application of the Business Judgment Rule

By Janel Dressen

With the number of failed financial institutions increasing in the last decade, bank officers and directors have seen a commensurate increase in claims asserted against them by the Federal Deposit Insurance Corporation (FDIC). According to the FDIC's website, the FDIC brought claims against directors and officers (D&O) in 24percent of the bank failures between 1985 and 1992. From Jan. 1, 2009 through Oct. 23, 2015, the FDIC authorized suits in connection with 150 failed institutions against 1,207 individuals for D&O liability. This includes 108 filed D&O lawsuits (70 of which have fully settled, and one of which resulted in a favorable jury verdict) naming 826 former directors and officers. *Id.*

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The Federal Deposit Insurance Act, as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), allows directors and officers of banks to be held personally liable for gross negligence, unless the state imposes a lesser standard of care, such as simple negligence. 12 U.S.C. § 1821(k); *Atherton v. F.D.I.C.*, 519 U.S. 213, 227 (1997). At least one Minnesota United States Federal District Court has concluded that Minnesota provides for a lower standard of care, that of an "ordinarily prudent person in a like position." *F.D.I.C. v. Milbauer et al.*, No. 15CV434 PAM/JJK, 2015 WL 4255944 (D. Minn. July 14, 2015), citing Minn. Stat. §§ 302A.251, 302A.361.

Bank directors are allowed to exercise business judgment without incurring legal liability. In virtually every case commenced by the FDIC, the D&Os argue that the business judgment rule insulates them from liability. As a practical matter, however, very few bank D&Os have been successful in asserting this defense in the short term and must be prepared to go the distance before this "defense" is successfully applied.

In ongoing cases across the country commenced by the FDIC, many motions to dismiss FDIC complaints have involved the question of whether the business judgment rule may be raised to defeat claims of simple negligence. Minnesota United States Federal District Court Judge Paul Magnuson recently considered this issue in the *Milbauer* case, supra. In *Milbauer*, the court reached two conclusions when considering application of the business judgment rule on a motion to dismiss. First, the court concluded that "application of the business judgment rule is a question of fact that cannot be determined on a motion to dismiss." *Id.* at *4. Second, the court concluded that the FDIC pled against the business judgment rule "defense" by alleging that the D&Os "acted in bad faith and contrary to reasonable decision-making." *Id.* No fur-

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ther allegations were required to defeat the motion to dismiss. *See also FDIC v. Spangler*, No. 10-CV-4288, at 18-20 (N.D. Ill. Dec. 22, 2011) (denying dismissal on basis of business judgment rule where FDIC adequately pled lack of due care).

For other courts, whether the business judgment rule may be raised at the motion to dismiss stage depends on whether the rule is considered an affirmative defense. These courts cite precedent holding that affirmative defenses are not the proper basis for a motion to dismiss. *See, e.g.*, *Doe v. GTE Corp.*, 347 F.3d 655, 657 (7th Cir. 2003) ("Affirmative defenses do not justify dismissal under Rule 12(b)(6) . . . ."); *see also FDIC v. Hawker*, No. 12-0127, at 12 (N.D. Cal. June 7, 2012); *FDIC v. Willetts*, No. 7:11-CV-165-BO, at 6 (E.D.N.C. Apr. 16, 2012); *FDIC v. Saphir*, No. 10-CV-07009, at 7 (N.D. Ill. Sept. 1, 2011).

Other courts have dismissed an FDIC complaint by invoking precedent approving dismissal where a complaint's allegations, on their face, show that an affirmative defense bars recovery. *See FDIC v. Briscoe,* 1:11-CV-02303, at 4-6 (N.D. Ga. Aug. 14, 2012); *FDIC v. Skow*, No. 1:11-CV-0111, at 14-19 (N.D. Ga. Feb. 27, 2012) ("[T]he allegations of the complaint indicate the existence of the business judgment rule affirmative defense so that is proper to rule on" it in the context of a motion to dismiss). Some Minnesota courts have followed this logic, at least for affirmative defenses involving statutes of limitation and *res judicata*. *See Pederson v. Am. Lutheran Church*, 404 N.W.2d 887, 889 (Minn. Ct. App. 1987) ("[D]ismissal was proper . . . only if it clearly and unequivocally appears from the face of the complaint that the statute of limitations has run and only if the complaint contains no facts to toll that running."); *Ellis v. Hanson*, No. A11-101, 2011 WL 5829104, at *2 (Minn. Ct. App. Nov. 21, 2011) ("The affirmative defense of *res judicata* may, in appropriate circumstances, be resolved on a motion to dismiss pursuant to rule 12.02(e).") This logic was not applied by the *Milbauer* court when reviewing the business judgment rule.

While *Milbauer* is not binding precedent, it is likely to be considered persuasive authority in Minnesota that would operate to preclude bank officers and directors from successfully asserting the business judgment rule to bar a complaint out of the gate. Consequently, bank officers and directors should be prepared to litigate the application of the business judgment rule well into their case with prepared and experienced litigation counsel by their side.