Overcoming the Rippy Effect: Why the North Carolina Business Corporations Act Should Allow Permissive Officer Exculpation

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INTRODUCTION

What if, in the popular board game Monopoly, “Get Out of Jail Free” cards could only be drawn by a predetermined segment of players?\(^1\) Further, what if the opportunity to draw the liberating vouchers was based on an arbitrary distinction\(^2\) that had no bearing on past or future performance? In all likelihood, players who could draw “Get Out of Jail Free” cards would engage in riskier and potentially more rewarding behavior than their opportunity-less counterparts because they might be able to “avoid jail” even after an unfortunate roll of the dice. Eventually, inducing opportunity-less gamers to play at all might prove problematic.

If corporate management can be considered the game—and directors and officers the players—then the Court of Appeals for the Fourth Circuit in *F.D.I.C. ex rel. Cooperative Bank v. Rippy*\(^3\) recently interpreted North Carolina law to dictate that only directors have the chance to draw the little orange cards. In *Rippy*, the court held that while bank directors were not liable for ordinary negligence, sufficient evidence was presented to rebut the presumption that bank officers had acted on an informed basis.\(^4\) The *Rippy* court interpreted the exculpatory provision as allowing exculpation for directors— but not

\(^{1}\) The Parker Brothers game allows players to buy, rent, and sell properties in an effort to bankrupt other players and become the wealthiest player. Parker Bros., *Monopoly Parker Brothers Real Estate Trading Game*, HASBRO.COM (2016), http://www.hasbro.com/common/instruct/monins.pdf [https://perma.cc/H2KV-XZKX]. “Get Out of Jail Free” cards allow players who would otherwise be forced to miss a turn waiting in “jail” to circumvent that obstacle and continue playing without interruption. *Id.*

\(^{2}\) For example, if there were a rule that permitted only players with last names beginning with letters A–H to be eligible for the bonus cards.

\(^{3}\) 799 F.3d 301 (4th Cir. 2015).

\(^{4}\) *Id.* at 313.

\(^{5}\) The *Rippy* court found that exculpation was not available to directors in cases of gross negligence. *Id.* This Recent Development concerns only breaches of care pursuant to ordinary negligence. *See infra* note 85.
officers. Central to the Rippy court’s finding of no liability for directors was their analysis of an exculpatory provision contained in the bank’s bylaws and permitted by the North Carolina Business Corporations Act (“NCBCA”). Although the bank’s directors and officers engaged in the same negligent behavior, only the officers were exposed to liability.

This Recent Development argues that the NCBCA should be amended to allow permissive officer exculpation in corporate charters. Analysis proceeds in four parts. Part I examines the Rippy facts and holding, and explains the genesis and evolution of exculpatory clauses. Part II argues that (1) North Carolina’s management-insulating provisions leave a problematic “gap” in liability coverage for officers, (2) the marginal deterrent effect against officer misbehavior via liability pursuant to non-exculpation is likely outweighed by the costs of enforcing a non-officer exculpating scheme, and (3) the current lack of officer exculpation allows for inequitable and confusing outcomes as between directors and officers. Part III addresses counterarguments, and Part IV concludes by recommending that the NCBCA be revised to allow for officer exculpation.

I. BACKGROUND

A. Facts and Procedural Posture of Rippy

Cooperative Bank (“Cooperative”) opened in 1898 and focused its operations on single-family housing loans for nearly a century. Determined to increase bank assets, Cooperative’s Board of Directors shifted its focus to commercial real estate loans in 2002. Because the FDIC backed Cooperative, the FDIC performed annual reviews of Cooperative’s underwriting and loaning

6. Rippy, 799 F.3d at 313.
7. Id. at 312; see also N.C. GEN. STAT. § 55-2-02 (2015).
8. § 55-2-02.
9. N.C. GEN. STAT. § 55-2-02 outlines permissive exculpation for directors in corporate charters and is a sensible place to position the proposed amendment. See infra notes 29–35 and accompanying text.
10. Rippy, 799 F.3d at 313.
11. Id.
13. The FDIC performed reviews in conjunction with the North Carolina Commission of Banks (“NCCB”). Rippy, 799 F.3d at 307.
practices.14 While these initial reports15 were relatively favorable, each report recommended changes and all of the feedback got progressively worse.16 The final report,17 condemning both Cooperative’s cursory approval of nine large loans to land developers and their rampant use of equity-less “lot loans,”18 gave Cooperative the worst possible score in all but one category.19

Cooperative did not address the issues highlighted in the reports.20 During the Great Recession in 2009, Cooperative closed21 and named the FDIC as receiver.22 The FDIC subsequently sued
Cooperative’s directors\textsuperscript{23} and officers\textsuperscript{24} for negligence, gross negligence, and breach of fiduciary duties.\textsuperscript{25} When the district court granted summary judgment in favor of the defendants,\textsuperscript{26} the FDIC appealed to the Fourth Circuit.\textsuperscript{27}

B. Holdings

The \textit{Rippy} court\textsuperscript{28} held that, while North Carolina law contemplates suits against bank directors and officers sounding in ordinary negligence,\textsuperscript{29} Cooperative’s directors were shielded from liability by an exculpatory provision contained in Cooperative’s articles of incorporation.\textsuperscript{30} Conversely, the \textit{Rippy} court observed simply that “[Cooperative]’s exculpatory provision does not cover [Cooperative’s] officers.”\textsuperscript{31} Because the officers were shielded from liability by the business judgment rule\textsuperscript{32} but not by the articles of

\textsuperscript{23} The nine director-defendants were: Willetts (chief executive officer), Burton (director), King (director), Wright (director), Rippy (director), Fensel (director), Bridger (director), Hundley (director), and Burrell (director). See Complaint at 2–3, FDIC v. Willetts, 48 F. Supp. 3d 844 (E.D.N.C. 2014) (7:11-cv-00165-BO); Lance Duroni, \textit{FDIC Loses $40M Suit Against NC Community Bank Execs}, LAW360 (Sept. 12, 2014, 7:48 PM), http://www.law360.com/articles/576912/fdic-loses-40m-suit-against-nc-community-bank-exec [https://perma.cc/QC6S-D9DE].

\textsuperscript{24} The officers were: Executive Vice-President of Mortgage Lending Bridger and Chief Operating Officer Burrell, who both attended almost all board meetings. Complaint, supra note 23, at 3.

\textsuperscript{25} \textit{Rippy}, 799 F.3d at 308.

\textsuperscript{26} “The Court finds that defendants are entitled to the business judgment rule’s protection as a matter of law and indisputable fact. Therefore the Court enters judgment against plaintiff’s claims for negligence and breach of fiduciary duty.” FDIC v. Willetts, 48 F. Supp. 3d 844, 851 (E.D.N.C. 2014) aff’d in part, vacated in part, rev’d in part sub nom. \textit{Rippy}, 799 F.3d at 301.

\textsuperscript{27} \textit{Rippy}, 799 F.3d at 309–10.

\textsuperscript{28} Throughout this Recent Development, “\textit{Rippy} court” refers to the United States Court of Appeals for the Fourth Circuit and “\textit{Willetts} court” refers to the Eastern District of North Carolina.

\textsuperscript{29} \textit{Rippy}, 799 F.3d at 311.

\textsuperscript{30} “The exculpatory clause protects directors from monetary liability unless the directors ‘knew or believed [that their acts or omissions] were clearly in conflict’ with [Cooperative]’s best interests.” \textit{Id.} at 312–13 (quoting N.C. GEN. STAT. § 55-2-02(b)(3) (2012)).

\textsuperscript{31} \textit{Rippy}, 799 F.3d at 313.

\textsuperscript{32} The business judgment rule is a common law presumption that “in making a business decision the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); see also Constance Frisby Fain, \textit{Corporate Director and Officer Liability}, 18 U. ARK. LITTLE ROCK L.J. 417, 439 (1996) (examining the business judgment rule’s development in conjunction with the duty of care concept); Stephen P. Lamb & Joseph Christensen, \textit{Duty Follows Function: Two Approaches to Curing the Mismatch Between the Fiduciary Duties and Potential Personal Liability of Corporate Officers}, 26 NOTRE DAME J.L. ETHICS & PUB. POL’Y 45, 51 (2012) (“The
incorporation, the *Rippy* court found that the FDIC had presented adequate evidence to rebut the initial presumption that the officer-defendants acted on an informed basis.\(^33\) The officers, the *Rippy* court held, could be personally liable for simple negligence.\(^34\)

Cooperative’s exculpatory provision did not cover officers because it could not cover officers under current North Carolina law.\(^35\) While the nine defendants were accused of essentially the same acts and omissions,\(^36\) the statutory limitations on permissive exculpation in the NCBCA precluded Cooperative’s officers from receiving the same level of protection as their director colleagues.\(^37\)

Hence, *Rippy* effectively highlights the “gap” in liability coverage between directors and officers that can arise in duty of care cases. To better understand why the liability gap should be closed, some background information regarding the origins of director exculpation is required.

**C. Exculpation as a Response to Van Gorkom**

The lack of officer exculpation in North Carolina\(^38\) is best explained as an accident of history and should be conceptualized as a product of *Smith v. Van Gorkom*.\(^39\) In *Van Gorkom*, the chairman of the board and CEO Van Gorkom was faced with a decision to sell the company.\(^40\) After cursory negotiations with a single bidder, Van

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33. *Rippy*, 799 F.3d at 313.
34. *Id.*
37. *See infra* Section II.A.
38. The North Carolina statute is the Model Business Corporations Act provision that follows the Delaware pattern.
40. *Id.* at 865.
Gorkom presented the board with a proposed merger at $55 per share.41 Following a two-hour oral presentation, the board decided to sell the company.42 The Delaware Supreme Court ultimately held that by failing to adequately deliberate about the proposed merger, the directors breached their duty of care.43

In response to this holding and in an attempt to protect directors, the Delaware legislature adopted Rule 102(b)(7),44 which allows for director (but not officer)45 exculpation if a court finds that the director-defendant did not breach the duty of loyalty. Commentators have suggested that 102(b)(7) effectively overruled the effect of Van Gorkom,46 but such assertions give short shrift to the potential47 liability of officers in some duty of care cases.48 While Van Gorkom exposed both officers and directors, 102(b)(7) and its progeny, for reasons discussed below,49 only protects directors. If Van Gorkom, by analogy, entirely removed “Get Out of Jail Free Cards” from the corporate governance game, then Rule 102(b)(7) reintroduced cards that only directors could use. Hence, assertions that director-exculpating provisions wholly erase the effect of Van Gorkom are premature because officers are still partially exposed.50

D. The Lack of Officer Exculpation: An Accident of History?

There are at least two reasons why Rule 102(b)(7), and parallel state laws (including North Carolina’s) that have followed the rule51 exclude officers from permissive exculpation: (1) the decision of the

41. Id. at 866–68.
42. Id. at 868–69.
43. Id. at 874.
44. For the purposes of this Recent Development, Rule 102(b)(7) claims are used to generally describe claims based on director exculpation.
45. “The view was that [102(b)(7)] did not . . . extend exculpation to officers, except insofar as an officer was ‘exercis[ing] the authority of a director.’ Moreover, the Delaware Supreme Court all but foreclosed that argument when it noted in Gantler that ‘[a]lthough legislatively possible, there currently is no statutory provision authorizing comparable exculpation of corporate officers.’” Lamb & Christensen, supra note 32, at 58.
46. See, e.g., id. at 56–57.
47. While “[t]he exclusion of officers from exculpation has so far been a sleeping dog, . . . if and when it wakes, . . . it w[ill] be destructive to the rational incentive structures reclaimed and rebuilt after Van Gorkom;” Id. at 47.
49. See infra Section I.D.
50. As one commentator has noted, “the chilly winds of Smith v. Van Gorkom still blow through the boardroom.” Paul Graf, A Realistic Approach to Officer Liability, 66 BUS. LAW. 315, 336 (2011).
51. See supra note 38.
Van Gorkom court to limit its holding to director liability and (2) Delaware’s (pre-2004) pro-officer jurisprudence of personal jurisdiction. Because Van Gorkom imposed liability on directors, it was directors—particularly outside directors—who sought relief. Because most corporate officers at the time were simultaneously serving as directors, “there seemed to be little need for extending protection to officers qua officers.” While the director/officer distinction may not have been crucial in the Van Gorkom analysis, Rippy and other decisions leave little doubt about contemporary courts’ willingness to distinguish between officers and directors in duty of care cases.

A second reason for officer exclusion in Delaware’s (and North Carolina’s) exculpatory statute can be explained by examining the law of personal jurisdiction. Delaware passed a sequestration statute that allowed plaintiffs to sequester stock that directors owned in the subject corporation if directors did not appear in litigation proceedings. Directors challenged this statute in *Shaffer v. Heitner*, where the Court struck it down as violative of the Fourteenth Amendment’s Due Process Clause. To rectify the defects in their sequestration statute, the Delaware legislature passed Section 3114, which provided that persons who accept service as a director are deemed to have consented to Delaware jurisdiction. However, “[a]bsent traditional bases of personal jurisdiction, . . . Delaware courts [still] could not hale officers of Delaware corporations into their courts under Section 3114—officers would be able to cite *Shaffer* as precluding the exercise of such jurisdiction.” In 2004, an

53. An outside director is “[a]ny member of a company’s board of directors who is not an employee or stakeholder in the company.” *Outside Director Definition*, INVESTOPEDIA, http://www.investopedia.com/terms/o/outsidedirector.asp#ixzz3r9YJ1DO [https://perma.cc/VGF4-GWBK].
55. Id.
56. See *supra* notes 29–34 and accompanying text.
60. 61 Del. Laws at 328.
61. Lamb & Christensen, *supra* note 32, at 60.
amendment provided that persons who accept service as an officer of a Delaware corporation after January 1, 2004, are subject to Delaware jurisdiction in the same way as directors.62

The historical reasons for categorically excluding officers from exculpation, while never logically compelling, apply now with less force than ever. First, some modern corporate governance structures routinely require officers to perform directorial functions while remaining non-director officers.63 Hence, while failing to distinguish between officers and directors for the purposes of exculpation eligibility may not have been terribly problematic at the time of Van Gorkom, the contemporary corporate governance structure represented in Rippy undoubtedly highlights the problems inherent in such a failure to so distinguish today. Further, the statutory restraints that limited the ability of plaintiffs to hale officer defendants into court no longer exist.64 While plaintiffs’ historical statutory inability to hale officers into court may have justified officers’ original exclusion from exculpation, the removal of plaintiff limitations means that exculpation for officers is no longer a redundancy. Given these developments and the growing number of states that have amended their laws to allow officer exculpation,65 the lack of permissive officer exculpation generally66—and in North Carolina specifically67—is best explained as a readily amendable accident of history.

II. WHY PERMISSIVE OFFICER EXCULPATION MAKES SENSE

Given the defects of 102(b)(7) and its progeny, this Recent Development argues that the NCBCA should be amended to allow permissive officer exculpation for at least three reasons. First, the lack of officer exculpation leaves a legally significant gap in liability coverage for officers. Second, while the gap between officers and directors is significant, the marginal effect on officer behavior that

63.  See infra Section II.C.
64.  See infra Section II.C.
67 See N.C. GEN. STAT. § 55-2-02(b)(3) (2015) (exculpation allowed only for directors); § 55-8-51 (indemnification available to directors and officers).
potential liability for negligence via non-exculpation may have is likely outweighed by the costs of enforcing the current statutory scheme. Third, the current lack of officer exculpation allows for inequitable and confusing outcomes as between directors and officers.

A. North Carolina’s Business Corporations Act Leaves a Problematic “Gap” in Liability Coverage for Officers

North Carolina’s Business Corporations Act insulates directors from liability to a greater extent than it insulates officers. Directors may be exculpated68 and indemnified,69 while officers may only70 be indemnified.71 While both exculpation and indemnification are management-insulating devices, the differences between exculpation and indemnification are more than semantic. Exculpation is superior to indemnification as a protective shield because (1) exculpation is effective regardless of the defendant company’s solvency,72 (2) indemnification covers only “reasonable expenses” incurred in the case of a settlement,73 and (3) exculpated defendants accused of ordinary negligence may be able to move for dismissal at the motion-to-dismiss stage of litigation.74

First, exculpation is superior to indemnification because, unlike indemnification agreements, the efficacy of exculpatory clauses is not dependent on company solvency.75 As others have noted, the

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68. N.C. GEN. STAT. § 55-2-02 (2015) (“The articles of incorporation may set forth any provision that under this Chapter is required or permitted to be set forth in the bylaws, and may also set forth: . . . 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. No such provision shall be effective with respect to (i) acts or omissions that the director at the time of such breach knew or believed were clearly in conflict with the best interests of the corporation.”) (emphasis added).
69. § 55-8-51.
70. Insurance, while available to officers, does not cover suits brought against officers by the corporation. See infra note 155.
71. § 55-8-42(e).
72. See infra notes 75–78 and accompanying text.
73. See infra notes 79–80 and accompanying text.
74. See infra notes 81–84 and accompanying text.
75. J. Phil Carlton & M. Guy Brooks, Corporate Director and Officer Indemnification: Alternative Methods for Funding, 24 WAKE FOREST L. REV. 53, 58 (1989); see also Ronald E. Mallen & David W. Evans, Surviving the Directors’ and Officers’ Liability Crisis: Insurance and the Alternatives, 12 DEL. J. CORP. L. 439, 466 (1987) (“The failing of any indemnification agreement is that even if such an agreement is valid, its significance depends upon the financial stability of the corporation. For the established, financially solid corporation indemnification agreements afford meaningful and reliable protection for directors and officers. For the newly formed or thinly capitalized company, the protection of the indemnity agreement may be illusory. Many
deficiency of indemnification is that the “offer [to indemnify] is only as good as the ability and willingness of the corporation to pay.” 76
When corporations become insolvent, as Cooperative did, 77 corporate officers seeking to enforce indemnity claims necessarily compete with other creditors. 78 No such problem exists for exculpated defendants.

Second, exculpation is superior to indemnification because in North Carolina, indemnified (but not exculpated) defendants must pay the “unreasonable” costs incurred in any litigation proceedings that do not end in a final adjudication. 79 Unlike only indemnified defendants, exculpated persons may avoid litigation of the messy “reasonableness” question and receive protection from all costs related to the litigation and settlement of the matter. 80

Third, exculpatory clauses may provide defendants with tactical litigation advantages which indemnification does not. If exculpated, directors accused of duty of care breaches may successfully move for dismissal without expending the resources necessary for a trial. 81

While the paucity of non-Delaware case law regarding director exculpation makes North Carolina’s future adjudication of 102(b)(7) claims less than certain, 82 Delaware’s allowance of exculpated director-defendants to move for dismissal at the outset of cases suggests that North Carolina courts may follow suit. 83 Absent exculpation, officers are denied the tactical litigation advantages

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76. Carlton & Brooks, supra note 75, at 58.
77. See supra note 21.
78. Carlton & Brooks, supra note 75, at 58.
79. N.C. GEN. STAT. § 55-8-51(e) (2015) (“Indemnification permitted under this section in connection with a proceeding by or in the right of the corporation that is concluded without a final adjudication on the issue of liability is limited to reasonable expenses incurred in connection with the proceeding.”) (emphasis added).
80. See id.
82. For example, state courts in Illinois and Texas, while dismissing suits against exculpated director-defendants, have not expressly relied on exculpatory clauses to do so. See Shaper v. Bryan, 864 N.E.2d 876, 879 (Ill. App. Ct. 2007) (basing dismissal on the plaintiffs’ failure to allege facts sufficient to rebut presumption of business judgment rule); Eloway v. Pate, 238 S.W.3d 882, 896 (Tex. Ct. App. 2007) (holding that the plaintiff failed to produce evidence of defendants’ gross negligence).
exculpatory clauses may provide and must further litigate duty of care claims.84

B. Excluding Officers from Exculpation Is More Costly Than It Is Worth

Because the costs of statutorily precluding officers from permissive exculpation likely outweigh the benefits that potential liability for negligence has on officer behavior, permissive officer exculpation should be allowed. Further, because the enforcement of an officer’s duty of care85 ultimately comes via litigation,86 a system using litigation as a check on behavior is justified only if it accomplishes deterrence, compensation, or punishment.87 While it is probable that exposure to potential liability deters some officers from negligent behavior, the important question, as Professor Honabach88 notes, is whether the “marginal benefit of improved decision-making [is] greater than the sum of the cost of increased caution in decision-making and the cost of actual litigation necessary to make the threat of litigation credible.”89 This Recent Development asserts that those two costs—decision-making caution and actual litigation—make the preclusion of officers from permissive exculpation more expensive than it is worth.

Because many powerful deterrents of negligent officer behavior already exist,90 measuring the exact impact that potential liability (via non-exculpation) for negligent acts has on officer behavior is difficult. Despite the continued prevalence of corporate officer negligence in the presence of non-litigation based deterrents, few doubt that such deterrents nevertheless exist and influence officer behavior.91 When

84. See generally Kapnick & Rosen, supra note 81 (describing how exculpatory clauses can be used to defend against breach of duty claims).
85. The relevant officer behavior regards breaches of care, not loyalty. Exculpating officers for breaches of loyalty would violate public policy and create obviously perverse incentives for officers to self-deal or otherwise be disloyal. This Recent Development does not advocate for exculpation—permissive or otherwise—in such cases.
86. Honabach, supra note 54, at 332.
87. Id.
88. Professor Honabach is a leading scholar on director and author liability and a joint author of West’s D&O Liability Handbook. See supra note 66.
89. Honabach, supra note 54, at 334.
90. Id. at 332. Such deterrents include: loss of reputation, loss of employment, desire to conform to cultural norms, and a desire to comport with ethical standards. In publicly traded companies, significant disclosures mandated by the SEC likely further deter negligent officer behavior. See generally Matthew R. King et. al., Securities Fraud, 46 AM. CRIM. L. REV. 1027, 1028–29 (2009) (discussing SEC disclosure requirements).
91. Honabach, supra note 54, at 332–33.
considering the existing and cost-free deterrents already in place,\textsuperscript{92} the additional value of holding officers liable for ordinary negligence seems marginal at best.\textsuperscript{93}

Even if holding officers liable by withholding exculpation adds significant deterrence-based value, its benefits are still likely outweighed by its costs because some risk-taking will be shifted to directors.\textsuperscript{94} Statutory schemes where directors but not officers can be exculpated “simply encourage officers to place more decisions in the hands of the board, and to take fewer, and less risky, initiatives on their own, so as to avoid liability.”\textsuperscript{95} This makes delegation from the board to officers challenging and makes board service more time-intensive and costly to corporations.\textsuperscript{96} It also may encourage officers, when they do make discretionary decisions, to be overly cautious in their decision making to the detriment of the corporation.\textsuperscript{97}

\textit{Rippy} highlights the costly shift in risk-taking, from officers to directors, sometimes engendered by schemes exculpating only directors.\textsuperscript{98} In \textit{Rippy}, the two non-director officers were the vice president of mortgage lending and the chief operating officer—positions requiring technical expertise and financial acumen. Conversely, six director-defendants, according to the complaint,\textsuperscript{100} had no such expertise yet still participated in the loan approval process.\textsuperscript{101} Would the decision-making process and structure have

\begin{itemize}
  \item \textsuperscript{92} See supra note 90.
  \item \textsuperscript{93} This Recent Development is not examining the effect of non-exculpation on officer behavior in a vacuum. Hence, the relevant inquiry concerns the marginal effect that non-exculpation has on officer behavior within the context of the current statutory scheme. Crucially, the current officer protections (i.e. D&O insurance, indemnity, and the business judgment rule) reduce the value of non-exculpation as a deterrent because each of those protections overlap to some extent with the protections exculpation provides. In other words, adding permissive exculpation to the protections already available to officers will likely have little effect on their behavior. Paradoxically, the more officers are already protected, the more it makes sense (from a cost-benefit paradigm) to allow permissive exculpation. While the benefits of withholding exculpation (in the current statutory scheme) are small, the high costs of withholding exculpation (and seeking to impose liability) stay the same.
  \item \textsuperscript{94} Hamermesh & Sparks, supra note 32, at 875. (“[A] default rule that would place officers at substantially greater risk of care-based liability than the risk faced by directors \textit{would} impinge upon the board’s managerial prerogative[].”)
  \item \textsuperscript{95} Id.
  \item \textsuperscript{96} Id.
  \item \textsuperscript{97} Honabach, supra note 54, at 333. Of course, a lack of exculpation will not always encourage cautious behavior.
  \item \textsuperscript{98} FDIC \textit{ex rel.} Coop. Bank v. Rippy, 799 F.3d 301, 313 (4th Cir. 2015).
  \item \textsuperscript{99} Complaint, supra note 23, at 3.
  \item \textsuperscript{100} Id. at 2–3.
  \item \textsuperscript{101} \textit{Rippy}, 799 F.3d at 313.
\end{itemize}
looked differently if the non-director officers were exculpated? While the answer to this question is difficult to ascertain, it seems likely that a reason for the non-director officers’ unwillingness to lead the loan-approval process may have been their lack of liability protection relative to the directors.

Another cost of withholding officer exculpation is the literal cost of enforcement. Because corporate litigation is so expensive, there is good reason to believe that, at least in some cases, shareholders would want to prevent liability litigation directed at corporate officers. Notably, even when officers are found liable for ordinary negligence and are compelled to render monetary damages, merely shifting money from negligent officers to angry shareholders does not add value to the company. Because officers must at times be sued to make the lack of officer exculpation even a marginally effective deterrent and because such litigation is painfully expensive, the “benefit” of precluding officers from exculpation likely is outweighed by its pecuniary cost.

*Rippy* illustrates the marginal value of holding officers liable for ordinary negligence in duty of care cases. In *Rippy*, the non-director officers committed potentially negligent acts even though they were not exculpated. The exculpated directors committed the same acts. The fact that the non-exculpated officers acted in the same manner as their exculpated director colleagues suggests that potential officer liability via non-exculpation played a relatively small role in shaping officer behavior regarding individual loan decisions.
tenuous connection between the deterrent effect of potential liability pursuant to non-exculpation and actual officer behavior makes the exclusion of officers from permissive exculpation hard to justify from a cost-benefit standpoint. While the benefits of officer non-exculpation are probably marginal and often unclear, the cost of attempting to impose liability on officers in non-exculpation schemes has not been ambiguous.\textsuperscript{113}

C. The Current Lack of Officer Exculpation Allows for Inequitable and Confusing Outcomes as between Directors and Officers

Because officers and directors have the same duties of care and fiduciary duties, allowing permissive officer exculpation will engender fairer outcomes and less confusing jurisprudence. Directors have a duty to act in good faith and with ordinary care.\textsuperscript{114} As the \textit{Rippy} court noted,\textsuperscript{115} officers\textsuperscript{116} are held to an identical standard.\textsuperscript{117} Directors and officers also have the same fiduciary duties.\textsuperscript{118} Further, in some cases,
officers and directors are responsible for the same tasks. Because the duty of care and fiduciary duties imposed on directors and officers are the same, it follows that permissible statutory protections for each group should likewise be congruous.

The Rippy facts are especially illustrative of the inequities inherent in holding officers and directors to the same standards but affording them different levels of protection. In Rippy, there were nine defendants—one director/officer, six directors, and two officers. Both the district and appellate courts generally examined the defendants’ actions in the aggregate without distinguishing between officer and director behavior.

In FDIC v. Willetts, the Eastern District of North Carolina repeatedly referred to and analyzed the defendants as a group; specifically, the court referred to “the decisions of defendants” when discussing the business judgment rule. The court further considered “whether defendants employed” a rational process in making loans and later examined whether the challenged “actions of the defendants” could be attributed to a rational business purpose. In eventually ruling in favor of the defendants, the Willetts court did not discuss any differences between director and officer behavior.

The Court of Appeals for the Fourth Circuit similarly failed to distinguish between directors and officers when examining conduct. The Rippy court observed that “Bank management promised to address the issues” highlighted in the CAMELS reports. The Rippy court also noted that the joint report alleged that “Cooperative’s

119. Ironically, while the jurisprudential impact of Van Gorkom concerned directors, much of the actual criticized behavior was arguably behavior normally attributed to officers. Lamb & Christensen, supra note 32, at 56 n.51.
120. See supra notes 114–118.
121. See supra notes 23–24.
122. See infra notes 123–130 and accompanying text.
123. 48 F. Supp. 3d 844 (E.D.N.C. 2014).
124. Willetts, 48 F. Supp. 3d at 850 (emphasis added).
125. Id. (emphasis added).
126. Id. at 851 (emphasis added).
127. Id. A reason for the Willetts court’s lack of differentiation between director and officer behavior likely stemmed from their interpretation of the business judgment rule—an interpretation the Rippy court explicitly rejected. Id.
128. As previously noted, the Rippy court distinguished between officers and directors for the purposes of exculpation eligibility. FDIC ex rel. Coop. Bank v. Rippy, 799 F.3d 301, 313 (4th Cir. 2015) (“[Cooperative]’s exculpatory provision does not cover Bank officers.”). See supra note 31 and accompanying text.
management” had ignored previously raised concerns. The Rippy court’s analysis deserves a nuanced examination.

First, the Rippy court found that directors and officers could be sued for ordinary negligence. Next, they applied the exculpatory provision, which pertained only to the directors. Because the exculpatory provision did not apply to officers, the Rippy court then examined officer behavior in the context of the business judgment rule. The court did not readily distinguish between officer and director behavior in their discussion of the business judgment rule—the director behavior was simply considered irrelevant pursuant to the exculpatory provision. However, the expert FDIC witness, used by the plaintiff to rebut the initial presumption that the defendants acted with due care, testified that “the review process was inconsistent with practices at other banking institutions, and did not comport with his understanding of officer and director duties.” Hence, the behavior that removed the officer-defendants from the protection of the business judgment rule would likely have had the same inculpatory effect on the directors in the absence of an exculpatory clause. Cooperative’s directors were not protected because they acted differently or knew less than the officers; they were protected via statute.

A closer examination of the defendants’ behavior in Rippy further highlights the confusion that can arise when directors, but not officers, are exculpated. In Rippy, defendant Frederick Willetts was both president and chairman of the Board. That is, he was both an officer and a director. Such role duality can be problematic when assessing the applicability of exculpatory clauses. As one commentator has noted, “[an exculpatory] statute that applies only to directors creates the possibility that directors who are also officers may face personal liability for their actions as officers, but not as

130. Id. (emphasis added).
131. Id. at 311.
132. See supra note 30.
133. Rippy, 799 F.3d at 313.
134. This Recent Development does not argue that the Rippy court’s interpretation of § 55-2-02 of the North Carolina General Statutes was per se faulty and should have been otherwise conducted; the Rippy court did not meaningfully distinguish between officer and director behavior because the current statutory scheme does not require such an analysis. Allowing permissive exculpation for directors and officers would require courts to look separately at both groups’ behavior to determine whether either or both groups could legitimately receive exculpation.
135. Rippy, 799 F.3d at 313 (emphasis added).
137. Id.
directors. This would mean that only outside directors, as a practical matter, would benefit from the statutory limitation on liability.” 138 By allowing exculpation for directors but not officers, state legislatures—in cases dealing with director and officer liability—leave questions regarding exculpation eligibility unanswered. Such messy, and potentially litigious, 140 questions could be avoided in a statutory scheme allowing officer exculpation.

III. COUNTERARGUMENTS

A. “Officers and Directors Are Not the Same and Should Be Treated Differently”

In the Monopoly game analogy, the distinction made between players was arbitrary. 141 Some commentators have suggested that, for the purposes of imposing liability, directors and officers are different in salient ways and should therefore receive different levels of protection. 142 They essentially contend that officers’ proximity to decision-making (relative to directors) justifies placing on them a different (non-arbitrary) standard for exculpation eligibility. 143 Further, the argument goes, viewing officer-director liability in the principal-agent paradigm (with officers as agents) provides a meaningful differentiation between the two groups and a coherent structure with which to evaluate conduct. 144


139. Several questions remain unanswered: Was Willetts acting as a director or an officer when he approved eight out of the nine commercial real estate loans in question? Should he be exculpated for some acts but not others? How should courts decide? Is directorship dispositive and therefore wholly exculpatory? See Complaint, supra note 23, at 2.

140. See In re Capital One Derivative S’holder Litig., 979 F. Supp. 2d 682, 691 (E.D. Va. 2013) (“[Defendant-officer/CEO] cannot be liable for breaches of the duty of care when he acts as a director. It follows that to state a claim against [defendant officer–CEO] for breach of the duty of care where, as here, there are no allegations of bad faith, intentional misconduct, or knowing violation of the law, plaintiffs must plead facts plausibly alleging that he acted solely in his capacity as an officer, thereby removing his actions from protection under the exculpatory clause.”).

141. See supra note 2 and accompanying text.


143. Id. (“Recalling the agency law status of corporate officers . . . clarifies immensely why courts can and should scrutinize officer conduct more closely than they now review director performance—i.e., the fiduciary duties of agents are more demanding than those of directors, and officers rightly face a greater risk of personal liability for misconduct.”).

144. See id. at 1602.
It is true that, in some cases, officer and director functions are sufficiently different to justify imposing disparate standards for liability. This is especially true in corporations with boards containing a significant proportion of outside directors. In such cases, information asymmetry or effective CEO control over the board may justify allowing permissive exculpation for directors but not officers. However, that officer and director roles are sufficiently different in some corporations to impose different standards for liability does not imply that such differences universally exist. As Cooperative’s management structure illustrates, some corporations intermingle classic director duties with quintessential officer responsibilities and vice versa. When this occurs, corporations should have the opportunity to impose the same liability standard on officers as they do on directors via permissive exculpation. That single

145. Such cases include companies where outside directors comprise a significant portion of the board. Because “[b]eing an outside director is a part-time job[,]” outside directors have less time to review the information they have. Troy A. Paredes, Too Much Pay, Too Much Deference: Behavioral Corporate Finance, CEOs, and Corporate Governance, 32 FLA. ST. U. L. REV. 673, 724–25 (2005). Outside directors also have limited access personnel who might help them vet important issues and must otherwise depend on the CEO and other high-ranking officers to supply crucial information. Id. at 725.

146. Id.

147. See, e.g., McPadden v. Sidhu, 964 A.2d 1262, 1273–76 (Del. Ch. 2008) (holding that directors who placed non-director CEO in charge of the acquisition process were not liable for negligence, while CEO with conflict of interest was liable for breach of care and loyalty).

148. SEC Commissioner Cynthia Glassman stated that the “closed nomination process dominated by powerful CEOs, and the entrenchment of directors, . . . [leads] to an unhealthy coziness in some instances between ostensibly independent directors and the executives whose performance they [are] supposed to oversee.” Cynthia A. Glassman, Comm’r, Sec. & Exch. Comm’n, Issues Surrounding the SEC’s Shareholder Access Proposal (Mar. 8, 2004). See Johnson & Millon, supra note 142, at 1613–14 (arguing that the “overly ‘cozy’ relationship between boards of directors and senior officers . . . may result in a corporate culture in which directors do not regard officers as persons owing high fiduciary duties to the corporation”).

149. See Paredes, supra note 145, at 725.

150. This Recent Development concedes that officer exculpation may not be appropriate in corporations where director and officer roles and responsibilities are sufficiently distinguishable and separate. See supra note 117.

151. See supra notes 99–101 and accompanying text.

152. Whether courts should be able to intervene in cases where the articles of incorporation are insufficiently tailored to a corporation’s management structure is beyond the scope of this Recent Development. However, given the deference traditionally afforded corporations regarding business decisions, it seems likely that courts should generally allow even poorly tailored articles to remain in effect. See generally Susanna M. Kim, The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute, 60 WASH. & LEE L. REV. 111, 138–40 (2003) (discussing judicial intervention and rewriting of corporations’ articles of incorporation in deadlock situations). Because
persons working in relatively smaller companies continue to share
director and officer titles further underscores the importance of
allowing corporations the kind of bylaw flexibility permissive officer
exculpation provides.

B. “Officers Already Have Adequate Protection from Liability”

Another argument against officer exculpation is that the
protections already afforded them adequately insulate them from
liability. While indemnity, director and officer (“D&O”) insurance,153
and the business judgment rule undoubtedly protect officers, such
protections may be inadequate when officer and director behavior are
indistinguishable from each other. As has been shown, indemnification is inferior to exculpation as a liability shield.154 D&O
insurance can mitigate officer exposure, but is inferior to exculpation
in many of the same ways that indemnification is.155 Finally, the
business judgment rule provides some common law protection for
decisions made in good faith.156 However, as Rippy illustrates, just
because officer conduct is evaluated in light of the business judgment
rule does not preclude liability in cases of ordinary negligence.157
Because the current available officer protections—though not
inconsequential—are inferior to the protections available via
exculpation,158 shareholders should have the option of providing the

153. D&O insurance can in some cases cover liability where indemnification cannot. See Lamb & Christensen, supra note 32, at 70.
154. See supra Section II.A.
155. Namely, D&O insurance does not provide the tactical litigation advantages which exculpation does and requires insured defendants to seek, and in some cases negotiate
with, insurers to settle the claims made against them. D&O insurance is also not available
in cases where the corporation brings suit against management. Hamermesh & Sparks,
 supra note 32, at 871 & n.42 (“[D]irector and officer liability insurance policies uniformly
include an ‘insured v. insured’ exclusion, denying coverage where the corporation itself
initiates the claim against the officer.”).
156. See supra note 32.
158. While there are significant differences in protection between exculpation and
existing officer liability shields, it may not be reasonable to assume that officers’
familiarity (or lack thereof) with these differences will effectuate a meaningful difference
in their behavior. Hence, while exculpation is clearly superior to existing officer
protections, it is likely that allowing officer exculpation would not significantly further
deter negligent officer behavior. See supra note 93. Hence, that the high degree of overlap
between exculpation and other available protections makes non-exculpation a marginally
less valuable deterrent of negligent behavior does not necessarily beg the conclusion that
the differences between exculpation and other protections are legally insignificant. Id.
highest protection to officers when the management structure of their corporation renders director and officer functions indistinguishable.

CONCLUSION

When officers and directors have the same information, functions, standard of care, and fiduciary duties, they should be afforded the same protections. Nominal nonconformity alone does not justify imposing disparate standards for liability. Unfortunately, the NCBCA, as it is currently codified and understood, allows for disparate exculpation eligibility treatment based on just such titular technicalities.159

While the actual differences between officers and directors in some cases are largely technical, the differences between the protections afforded them are material and significant.160 Rippy represents these problematic differences in liability protection.161 Further, while the gap between officers and directors is significant, the marginal effect on officer behavior that potential liability for negligence via non-exculpation may have is likely outweighed by the costs of enforcing the current statutory scheme.162 In addition to being costly, the current lack of officer exculpation allows for inequitable and confusing outcomes as between directors and officers.163

While this Recent Development argues for the expansion of officer protections, it does so only in a narrow set of circumstances. Exculpation—for officers and directors—should only be available for non-grossly negligent breaches of care.164 Self-dealing, fraudulent, embezzling, or reckless officers would receive no respite under the proposed change.165 Further, the proposed amendment calls for allowance of permissive officer exculpation. Shareholders—those most sensitive to any potential negative effects of exculpation—would be the arbiters of this important corporate governance question. While it is difficult to predict in what circumstances shareholders would opt for officer exculpation, this Recent Development suggests

159. Rippy, 799 F.3d at 313.
160. See supra Section II.A.
161. See supra notes 35–37 and accompanying text.
162. See supra Section II.B.
163. See supra Section II.C.
164. See supra note 85.
165. See supra note 85.
that such exculpation is appropriate when officer and director duties and functions are significantly intermingled.\textsuperscript{166}

The economic, theoretical, and policy justifications for allowing director exculpation apply, at least in some cases, to officers. For those reasons, North Carolina should follow the example of states\textsuperscript{167} that have recognized this by amending the NCBCA to allow permissive officer exculpation.

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\textsuperscript{166} See FDIC ex rel. Coop. Bank v. Rippy, 799 F.3d 301, 313 (4th Cir. 2015); Complaint, supra note 23, at 2–3.
\textsuperscript{167} See supra note 65.

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