3-1-2016

FDIC v. Rippy: Due Care and the Business Judgment Rule in the Fourth Circuit and the Potential Implications for the Banking Industry

Cory A. McKenna

Follow this and additional works at: http://scholarship.law.unc.edu/ncbi

Part of the Banking and Finance Law Commons

Recommended Citation
Available at: http://scholarship.law.unc.edu/ncbi/vol20/iss1/12

This Comments is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Banking Institute by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.
FDIC v. RIPPY: Due Care and the Business Judgment Rule in the Fourth Circuit and the Potential Implications for the Banking Industry

I. INTRODUCTION

In the wake of the 2009 Recession, the banking industry experienced a simultaneous culmination of the second-guessing that accompanies institutional failure and the societal fixation on assigning legal blame. Indeed, it has been said that “the only thing people hate more than losing money is the person who lost it for them.” What the quote lacks in eloquence and novelty, it more than makes up for in veracity. From 2009 to 2015, the Federal Deposit Insurance Corporation (“FDIC”) authorized litigation in connection with 150 failed banks against over 1,200 bank directors and officers (“D&Os”). Since the beginning of 2008, there have been a total of 513 bank failures, meaning that the FDIC has authorized litigation against nearly 30% of failed banks. While the volume of FDIC lawsuits has recently declined, the number of cases still being litigated magnifies the importance of how

2. Author and date unknown.
3. “The [FDIC] preserves and promotes public confidence in the U.S. financial system . . . by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails.” Who is the FDIC?, FDIC, https://www.fdic.gov/about/learn/symbol/, (last visited Jan. 11, 2016).
5. Kevin LaCroix, Meanwhile, Back at the FDIC Failed Bank Litigation Ranch, THE D&O DIARY (July 28, 2015), http://www.dandodiary.com/2015/07/articles/failed-banks/ meanwhile-back-at-the-fdic-failed-bank-litigation-ranch/ [hereinafter LaCroix, FDIC Litigation]. In the same time period, the FDIC has actually filed lawsuits against twenty-one percent of failed banks. Id. The discrepancy between the number of lawsuits authorized and lawsuits filed may well be attributable to a “large backlog” of suits that will be filed, but have not yet been filed. Id. However, not all suits that have been authorized by the FDIC will ultimately be filed. Id.
courts are handling such cases.6

In FDIC ex rel. Cooperative Bank v. Rippy,7 the U.S. Court of Appeals for the Fourth Circuit considered whether a failed bank’s D&Os were protected from claims of ordinary negligence by North Carolina’s business judgment rule (“BJR”).8 Applying its interpretation of North Carolina’s long-recognized, but infrequently applied, BJR,9 the Fourth Circuit concluded that the failed bank’s officers were not entitled to its protection because the FDIC had adduced sufficient evidence to show that the officers had failed to exercise “due care” in their decision-making.10

In reaching its conclusion, the Fourth Circuit applied the BJR in an alarmingly different way than the district court, thereby highlighting the uncertainty and ambiguity still surrounding proper application of the rule.11 Consistent adoption of the Fourth Circuit’s application of the BJR would likely dilute the protection it provides to an extent that would deprive bank D&Os of any meaningful benefit. The lack of North Carolina case law explaining the contours of the BJR further amplifies the persuasive value of the Fourth Circuit’s opinion in Rippy.12

---


8. Id. at 313. Although the Fourth Circuit ultimately considered only whether the BJR protected officers from the FDIC’s ordinary negligence and breach of fiduciary duty claims, this formulation of the question more accurately presents the issue of primary importance.

9. See RUSSELL M. ROBINSON, II, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 14.06, Lexis Advance (database updated Dec. 2015) (“Although the fundamental bases on which the business judgment rule rests have long been established in North Carolina, the rule has been specifically mentioned as such in only a handful of North Carolina appellate decisions.”).


11. Compare id. (holding that the BJR’s initial presumption could be rebutted by evidence suggesting that officers had lacked due care), with FDIC v. Willetts, 48 F. Supp. 3d 844, 849–52 (E.D.N.C. 2014) [hereinafter Willetts II] (holding that the BJR’s initial presumption could only be rebutted by evidence suggesting grossly negligent conduct). See also infra Part IV.A.

12. See ROBINSON, supra note 9 (emphasizing the infrequency of explicit application of the BJR in North Carolina); Salvie v. Med. Ctr. Pharmacy of Concord, Inc., 762 S.E.2d 273 (N.C. Ct. App. 2014) (highlighting that, while North Carolina state courts are not bound by decisions of federal courts, such decisions may possess substantial persuasive value).
Accordingly, the implications of the Fourth Circuit’s decision should be of particular concern to the many banks headquartered in the industry’s arguably most important state.\textsuperscript{13}

This Note examines the Fourth Circuit’s decision, discusses the possible effects on the banking industry in North Carolina, and considers several corollary issues raised by the case. This Note proceeds in five parts. Part II introduces the statutory and common law provisions governing D&O liability in North Carolina.\textsuperscript{14} Part III provides the factual backdrop of \textit{Rippy}, what was argued at the district court level, and how the Fourth Circuit decided the case.\textsuperscript{15} Part IV critically evaluates the Fourth Circuit’s decision, discusses its potential effects, and analyzes the utility of exculpatory provisions in limiting director liability.\textsuperscript{16} Part V concludes by summarizing the major takeaways from \textit{Rippy}.\textsuperscript{17}

\section{Background on Statutory and Common Law Provisions Affecting D&O Liability}

\subsection{Federal Standard of Conduct for Bank D&Os}

Federal banking law provides that “[a] director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care.”\textsuperscript{18} In \textit{Atherton v. F.D.I.C.},\textsuperscript{19} the Supreme Court interpreted this language as only setting the floor for bank D&O liability, rather than categorically barring all ordinary negligence claims.\textsuperscript{20} Accordingly, the Supreme Court established that “state law sets the standard of conduct as long as the state standard . . . is stricter than that of the federal statute.”\textsuperscript{21}
In other words, in states where the standard of care for bank D&Os exposes them to liability for ordinary negligence, that higher standard is applied.\textsuperscript{22}

\textbf{B. North Carolina’s Standard of Conduct for Bank D&Os}

The North Carolina Business Corporation Act ("NCBCA") establishes the standard of conduct for bank D&Os in North Carolina.\textsuperscript{23} Under the NCBCA, D&Os must "discharge [their] duties . . . (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner he reasonably believes to be in the best interests of the corporation."\textsuperscript{24} The adopted statutory provisions effectively codify the three traditional common law duties of good faith, due care, and loyalty.\textsuperscript{25}

\textbf{1. Good Faith}

The duty of good faith is the most generalized duty of D&Os.\textsuperscript{26} While it is expressed as a separate and distinct duty in section 55-8-30(a)(1) of the North Carolina General Statutes, it is generally understood to be a component of the duties of due care and loyalty.\textsuperscript{27} In fact, the North Carolina Business Court has held that there is no duty of good faith separate and apart from the duties of due care and loyalty.\textsuperscript{28} However, other courts nationally, particularly in Delaware, have occasionally cited the duty of good faith as a separate duty that may be breached where

\begin{itemize}
\item \textsuperscript{22} \textit{Id.}
\item \textsuperscript{23} N.C. GEN. STAT. §§ 55-8-30(a), 55-8-42(a) (2013) (establishing identical standards of conduct for both directors and officers); \textit{see also} JOHN M. STRONG, STRONG’S NORTH CAROLINA INDEX § 459 (Thomas J. Czelusta et al. eds., 4th ed. 1989 & Supp. 2015), Westlaw.
\item \textsuperscript{24} § 55-8-30(a), § 55-8-42(a).
\item \textsuperscript{25} ROBINSON, supra note 9, at § 14.01.
\item \textsuperscript{26} Id. at § 14.02.
\item \textsuperscript{27} Id.
\item \textsuperscript{28} State v. Custard, No. 06 CVS 4622, 2010 WL 1035809 (N.C. Super. Mar. 19, 2010) [hereinafter "\textit{Custard II}"] ("The North Carolina courts have not created a separate fiduciary duty of good faith because it is not necessary and would create significant uncertainty under our law."). However, in RREF BB Acquisitions, LLC v. MAS Properties, LLC, No. 13 CVS 193, 2015 WL 3646992 (N.C. Super. June 9, 2015), \textit{aff’d on reconsideration.}, No. 13 CVS 193, 2015 WL 7910510 (N.C. Super. Dec. 3, 2015), the North Carolina Business Court declared that a claim for a breach of duty to negotiate in good faith "may be viable," thereby at least tentatively acknowledging the potential existence of a duty of good faith separate and apart from the duties of due care and loyalty.
\end{itemize}
D&Os demonstrate conduct that constitutes: subjective bad faith, an intentional violation of law, an intentional dereliction of duty, or a conscious disregard of duty.\(^{29}\)

2. Due Care

The duty of due care requires D&Os to use “the care an ordinarily prudent person in a like position would exercise under similar circumstances.”\(^{30}\) Since the implementation of the NCBCA, North Carolina courts have interpreted the “ordinarily prudent person” language as establishing a standard of ordinary negligence for D&Os rather than gross negligence.\(^{31}\) Over time, the “ordinarily prudent person” standard has evolved to allow for more flexible application dependent on context.\(^{32}\) Consequently, because banks serve a “quasi-public” function by holding the public’s funds for safekeeping, what constitutes the behavior of an “ordinarily prudent person” might be a higher standard in the context of banking than it would be in normal corporations.\(^{33}\) In any case, the duty of care imposes an affirmative duty on D&Os to act with diligence and care in carrying out their respective roles.\(^{34}\) Doing so requires “proper care, attention, and circumspection in the affairs of the corporation”\(^{35}\) and acting on a fully informed basis.\(^{36}\)

---

31. ROBINSON, *supra* note 9, at § 14.03.
32. *Id.; see also* Hauser v. Tate, 85 N.C. 81 (1881) (“To the suggestion that the defendant did not supervise the operations of the bank and knew nothing of its condition, the answer is obvious that he voluntarily assumed a position the obligation of which demands this of him, and persons dealing with the bank may reasonably expect his faithful discharge of that obligation, and if he bestows no attention on the business, it is his own neglect from which others should not suffer.”); Townsend v. Williams, 117 N.C. 330 (1895) (“[Directors] are trustees and liable as such for losses attributable to their bad faith, misconduct or want of care. They are to direct and supervise the trust confided to them and are not mere figureheads.”).
33. Robert F. Finke et al., *FIRREA and Officer and Director Liability*, C880 ALI-ABA 613, 639 (1994), Westlaw; *see also* ROBINSON, *supra* note 9, at § 14.03; Resolution Trust Corp. v. Gregor, 872 F. Supp. 1140, 1150–51 (E.D.N.Y. 1994) (holding that under New York law, bank directors are held to the higher standard of simple negligence and are not entitled to the BJR).
34. ROBINSON, *supra* note 9, at § 14.03.
36. ROBINSON, *supra* note 9, at § 14.03.
3. Loyalty

The duty of loyalty requires D&Os to discharge their duties “[i]n a manner [they] reasonably believe[] to be in the best interests of the corporation.”\(^\text{37}\) The duty of loyalty prohibits D&Os from discharging their duties in such a way that promotes their own self-interests at the expense of the corporation or its shareholders.\(^\text{38}\) Ultimately, the duty of loyalty is the expectation that D&Os will serve the needs of the corporation rather than themselves, which also explains why the duty of loyalty largely comprises the more general duty of good faith.\(^\text{39}\) Because these standards of conduct deal more with how an individual performs his duties rather than the consequences of an individual’s actions, as long as an individual’s behavior comports with the statutory prescriptions, he or she generally cannot be held personally liable for damages.\(^\text{40}\)

C. The Business Judgment Rule in North Carolina

If it cannot be established that a director or officer’s conduct comported with the fiduciary duties described above, then the subsequent determination of liability will be evaluated through the lens of the BJR so long as there is no evidence of bad faith, conflict of interest, or disloyalty.\(^\text{41}\) Because of the limited body of North Carolina case law applying the BJR, North Carolina courts have often relied on the explanation provided in Robinson on North Carolina Corporation Law:

[The business judgment rule] operates primarily as a rule of evidence or judicial review and 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

\(^\text{38}\) ROBINSON, supra note 9, at § 14.04.
\(^\text{39}\) Id.
\(^\text{40}\) §§ 55-8-30(d), 55-8-42(d).
\(^\text{41}\) ROBINSON, supra note 9, at § 14.06; see also State v. Custard, No. 06 CVS 4622, 2010 WL 1035809 at *20–21 (N.C. Super. Mar. 19, 2010) (interpreting North Carolina and Delaware case law to delineate proper application of the BJR); Revised Model Business Corp. Act Official Comment § 8.30(d), at 224 (1984) (noting that where the statutory standard of conduct is established, there is no need to apply the BJR, which should only be applied where evidence suggests that the statutory standard of conduct had not been met).
in the best interest of the corporation, and second, absent
a rebuttal of this initial presumption, a powerful
substantive presumption that a decision by a loyal and
informed board will not be overturned unless it cannot be
attributed to any rational business purpose.42

In effect, the BJR “protects corporate directors from being
judicially second-guessed when they exercise reasonable care and
business judgment.”43

Because due care is the duty that makes ordinary negligence
actionable, but also is presumptively established by the BJR, an
unremitting tension exists between the two.44 The primary question
presented by Rippy can be phrased in two logically equivalent
alternatives: (1) how strong is the initial presumption established by the
BJR, or (2) what degree of a lack of due care must be shown in order to
rebut the initial presumption?45 As discussed below, how a court answers
this question can have a substantial impact on the potential liability of
bank D&Os.46

---

42. ROBINSON, supra note 9, at § 14.06. Furthermore, while the language expressed in
Robinson refers only to “directors,” the scant body of case law applying the BJR in North
Carolina makes it clear that the BJR applies with equal force to officers. See e.g., State ex
Application of the BJR to officers aligns with its underlying purpose of preventing judicial
second-guessing. See infra Part IV.B.i for further discussion of disparate treatment of
directors and officers.

(quot ing HAJMM Co. v. House of Raeford Farms, 94 N.C. App. 1, 10, review on additional
issues allowed, 325 N.C. 271 (1989), and modified, aff’d in part, rev’d in part on other
grounds, 328 N.C. 578 (1991)).

44. See Marcia M. McMurray, An Historical Perspective on the Duty of Care, the Duty
(discussing the interplay between the BJR and the duty of care).

45. See R. Franklin Balotti & James J. Hanks, Jr., Rejudging the Business Judgment
Rule, 48 BUS. LAW. 1337, 1345–46 (1993) (discussing the initial presumption established by
the BJR and the different interpretations of courts regarding what constitutes sufficient
rebuttal evidence).

46. Id. at 1346–48.
III. The Fourth Circuit’s Decision in FDIC ex rel. Co-op. Bank v. Rippy

A. Factual Background

Cooperative Bank (“Cooperative”) opened in Wilmington, North Carolina, in 1898, operating as a thrift until converting to a state-chartered savings bank in 1992. As a result of its status as a state-chartered bank, Cooperative was subject to regulation by both the FDIC and the North Carolina Office of the Commissioner of Banks (“NCCOB”). In 2002, Cooperative became a state commercial banking institution after its board of director’s resolved to increase Cooperative’s assets from $443 million to $1 billion by the year 2005. Pursuant to this goal, Cooperative emphasized a greater focus on commercial real estate lending.

Both the FDIC and NCCOB performed annual reviews of Cooperative, assigning it “CAMELS scores” on a scale of 1-5 (“1” being the highest and “5” being the lowest) in six categories: capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. The FDIC’s 2006 review assigned Cooperative a score of “2” in each category, but noted some deficiencies in Cooperative’s credit administration and underwriting practices, which the FDIC attributed to “oversight weaknesses.” Cooperative’s management ensured that it would take measures to correct the deficiencies identified in the FDIC’s report of examination.

47. A thrift institution is “[a] financial institution that ordinarily possesses the same depository, credit, financial intermediary, and account transactional functions as a bank, but that is chiefly organized and primarily operates to promote savings and home mortgage lending rather than commercial lending.” FED. DEPOSIT INS. CO., MANAGING THE CRISIS, app. B, at 787 (1998), https://www.fdic.gov/bank/historical/managing/history3-b.pdf.
49. Id. Although the Fourth Circuit referred to the North Carolina Office of the Commissioner of Banks as the “NCCB” in its opinion, the prevailing acronym in North Carolina is “NCCOB,” so that is the form this Note uses. About Us, NCCOB, http://www.nccob.org/Public/AboutUs/AboutMain.aspx, (last visited Jan. 11, 2016).
50. Id.
51. Id.
52. Id. at 307–08; see generally LIessa L. Broome & Jerry W. Markham, Regulation of Bank Financial Service Activities, 571–75, (4th ed. 2011) (providing a background discussion of the CAMELS rating system).
53. Rippy, 799 F.3d at 308.
54. Id.
issued Cooperative identical “2” ratings in each CAMELS category, but observed that Cooperative had been slow to address the previously identified deficiencies. Cooperative again made assurances that it would take steps to correct these issues.

Also in 2007, Cooperative engaged Credit Risk Management (“CRM”) to conduct a review of the bank’s lending practices, ultimately giving the examined loans passing grades while suggesting more frequent updates of credit file documentation. The next year, CRM performed a second external loan review, this time observing severe shortcomings in loan documentation and monitoring along with the use of stale financial information. Consequently, many of the examined loans received failing grades.

In 2008, the FDIC and NCCOB conducted a joint review of Cooperative, issuing it the lowest possible rating of “5” in every category but one. The report criticized Cooperative’s high concentration of commercial real estate loans and management’s inability to correct the previously identified shortcomings. Cooperative closed its doors in June 2009 after failing to comply with the FDIC’s plan for capital restoration contained in its cease and desist order, to which Cooperative had consented. The FDIC concluded that as a result of Cooperative’s failure, the federal deposit insurance fund had suffered $216.1 million in losses.

In August 2011, the FDIC filed a complaint against Cooperative, “alleging that the named officers and directors were negligent, grossly negligent, and had breached their fiduciary duties in their approval of 78 residential lot loans and 8 commercial loans between January 2007 and

55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.* Somewhat ironically, the one category in which Cooperative did not receive a “5” was Sensitivity to Market Risk. It received a “4.” *Id.*
61. *Id.* at 308–09.
62. The NCCOB also consented, took action to close the bank, and appointed the FDIC as receiver. *Id.* at 309. In its capacity as receiver, the FDIC “assumes responsibility for efficiently recovering the maximum amount possible from the disposition of the receivership’s assets and the pursuit of the receivership’s claims.” Receivership Management Program, FDIC (last updated May 19, 2015), https://www.fdic.gov/about/strategic/strategic/receivership.html.
63. *Rippy*, 799 F.3d at 309.
April 2008.”64 The complaint sought damages ranging between $4.4 million and $33 million from each named D&O.65

B. Defendants’ Motion to Dismiss (Willetts I)

In response to the FDIC’s complaint, the named defendants filed a motion to dismiss claiming that North Carolina law does not allow ordinary negligence claims against D&Os, and, regardless, that the BJR shields D&Os from such claims.66 The defendants argued, alternatively, that they were protected from liability because they had relied on the work of other officers and employees as is permitted by North Carolina law, and that the director defendants were protected from liability because of the express elimination of liability provided by an exculpatory clause in Cooperative’s articles of incorporation.67 Lastly, the defendants argued that the FDIC had presented insufficient facts to support a cause of action for gross negligence.68

Evaluating these arguments, Judge Terrence Boyle of the U.S. District Court for the Eastern District of North Carolina first held that North Carolina law does not prohibit claims of ordinary negligence against D&Os.69 As to the protection afforded by the BJR, the district court observed that, “North Carolina law may recognize director liability

64. Id.
65. Id.
67. Id.; N.C. GEN. STAT. §§ 55-8-30(b), 55-8-42(b) expressly provide that:
In discharging his duties a [director or officer] is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by: (1) One or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented; (2) Legal counsel, public accountants, or other persons as to matters the director reasonably believes are within their professional or expert competence . . . [unless] he has actual knowledge concerning the matter in question that makes reliance . . . unwarranted.
68. Willetts I, 882 F. Supp. 2d at 862. Because this Note primarily focuses on the Fourth Circuit’s application of the BJR, the district court and Fourth Circuit’s treatment of the FDIC’s gross negligence claims will be addressed only in the footnote text. See infra text accompanying notes 79, 83, 118.
69. Id. at 863–64. In reaching this conclusion, the district court specifically relied on North Carolina Corp. Comm. v. Harnett Cnty. Trust Co., 192 N.C. 246 (1926) (holding “negligent failure of its officers to perform their duties” to be a valid cause of action) and a comparison of FF Milling Co. v. Sutton, 9 N.C. App. 181,184 (1970) (concluding that directors may be liable for actions taken in bad faith, but not errors in judgment made in good faith) and Anthony v. Jeffress, 172 N.C. 278 (1916) (holding directors to a debatably higher standard because of their duty to maintain knowledge of the corporation’s financial condition).
for simple negligence, to the extent that such negligence falls outside the protection of the business judgment rule.”

Resolving this primary point of law, the district court denied the defendants’ motions to dismiss until further factual development could be made.

C. Defendants’ Motion for Summary Judgment (Willetts II)

Following a lengthy discovery phase, the defendants filed a motion for summary judgment on all claims against them. The defendants maintained that their actions were protected by the BJR, and therefore they could only be held liable for actions constituting gross negligence. In response to this contention, the FDIC asserted that D&Os are only entitled to protection from the BJR if they “(1) acted in good faith; (2) employed rational decision-making processes; (3) availed themselves of ‘all’ materially and ‘reasonably available’ information; and (4) reasonably believed they were acting in the corporation’s best interest.”

Opposing this formulation of the BJR, the defendants contended that such an understanding is fundamentally incompatible with the purpose of the BJR, as an individual satisfying the suggested requirements for its protection could not be liable for negligence, thereby making any additional protection unnecessary. The defendants further attacked the FDIC’s understanding of the BJR as erroneously establishing conduct requirements for its protection instead of establishing an initial presumption that the D&Os “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.” More succinctly, the defendants argued that “[i]t [was the] FDIC’s burden to overcome the presumption, not defendants’ task to

70. Willetts I, 882 F. Supp. 2d at 864 (internal quotation marks omitted). This question offers yet another alternative phrasing of the primary issue in the case.
71. Id.
74. Id. At the time this Note was published the FDIC’s brief opposing summary judgment was under seal by the court and had not yet been released to the public.
75. Id. at 3.
erect it.”\(^77\)

In asserting this to be the proper application of the BJR, the defendants maintained that the FDIC had adduced insufficient evidence of the grossly negligent conduct necessary for it to overcome its burden, and that, as a result, only a showing that “there was \textit{no} rational business purpose for the challenged 87 loan decisions” could preclude protection under the BJR.\(^78\) In support of this argument, the defendants pointed to the absence of evidence suggesting that any D&O had acted in “bad faith,” specifically contending that “[a]s a matter of law, it [would be] impossible for FDIC to establish gross negligence when its own bank examiners graded the challenged practices a CAMELS ‘2’ at the same time they ‘warned’ defendants about ‘weaknesses.’”\(^79\)

After hearing the parties’ arguments, the district court held that the BJR defeated the FDIC’s negligence and breach of fiduciary duty claims.\(^80\) Discussing the proper application of the BJR, the district court adopted the North Carolina Business Court’s annunciation of the rule in \textit{Custard}, which interpreted the evidentiary presumption expressed in \textit{Robinson} as protecting D&Os from personal liability “so long as the court determines that the process employed was either rational or employed in a \textit{good faith} effort to advance the corporate interests.”\(^81\) More explicitly, the district court flat-out declared in reference to the BJR: “This is a gross negligence standard.”\(^82\)

\(^77\). \textit{Id.} (emphasis in original).

\(^78\). \textit{Id.} at 2-3 (emphasis in original). Defendants proceeded to argue that such a showing from the FDIC would be impossible on the basis that “one of Cooperative’s’s principal purposes was to make loans, so there [could be] no opportunity to claim that any of the 87 loans in [the] lawsuit lacked a rational business purpose.” \textit{Id} at 3.

\(^79\). \textit{Id.} at 6 (emphasis in original). The defendants also maintained the additional arguments proffered at the motion to dismiss stage that Cooperative directors were protected from personal liability by the exculpatory provision in the bank’s articles of incorporation and that all the defendants were further shielded from liability because they were entitled to reasonably rely on other officers and employees in authorizing the questioned loans. \textit{Id.} at 7-8. The defendants further argued that they were entitled to summary judgment on the claims of gross negligence because the FDIC failed to adduce evidence that the defendants’ actions constituted intentional wrongdoing, as they argued is required for a showing of gross negligence. \textit{Id.} at 8–9. This argument was made in response to the FDIC’s contention that gross negligence requires less than wanton and willful conduct, and that, therefore, an individual can be liable for gross negligence even where there is no intentional wrongdoing. \textit{Id.} at 8.


\(^82\). \textit{Willetts II}, 48 F. Supp. 3d at 849–50 (quoting \textit{ROBINSON, supra} note 9, at § 14.06).
Applying this standard, the district court determined that despite the “voluminous records, 15 depositions of party, third party, and expert witnesses including Cooperative’s regulators” the FDIC “fail[ed] to reveal any evidence that suggests any defendant engaged in self-dealing or fraud, or that any defendant was engaged in any other unconscionable conduct that might constitute bad faith.”

Turning then to whether the Cooperative D&Os “employed a rational process in making the challenged loans,” the district court pointed to the multiple satisfactory reviews of Cooperative’s lending practices in determining that “defendants’ processes and practices for the challenged loans were rational and that [the FDIC] . . . failed to rebut the first presumption of the business judgment rule.”

Moving to the second 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,” the district court held that “[t]he record simply [could] not support a finding that the defendants’ business purpose fell so far beyond lucid behavior that it could not even be considered ‘rational.’” The court emphasized the expectation and importance of risk-taking, and held that the defendants did not exhibit “a conscious indifference to risks” that would amount to lacking any rational business purpose and, accordingly, that “the [BJR] applies even if those judgments ultimately turned out to be poor.”

D. On Appeal to the Fourth Circuit

On appeal to the U.S. Court of Appeals for the Fourth Circuit, the FDIC argued that the district court had misapplied the BJR and that it had

83. *Id.* at 850. In noting the absence of evidence supporting self-dealing, fraud, or bad faith, the district court thus concluded that the FDIC had failed to adduce evidence suggesting grossly negligent conduct on the part of Cooperative D&Os. *Id.* Pursuant to this determination and the district court’s conclusion that gross negligence does indeed require intentional wrongdoing, the district court awarded summary judgment to all defendants on the claim of gross negligence. *Id.* at 851–52.

84. *Id.* at 850–51.

85. *Id.* at 851.

86. *Id.* Notably, because summary judgment was awarded to the defendants on the ground that their actions were protected by the BJR, the court did not address the defendants’ alternative arguments. *See id.* at 849–53 (avoiding any mention of the applicability of Cooperative’s exculpatory provision for its directors and whether the defendants were entitled to the proclaimed statutory reliance); *see also supra* text accompanying note 79.
adduced sufficient evidence to make summary judgment improper.\textsuperscript{87}

1. Foundational Differences in the Parties’ Arguments on Appeal

While largely the same arguments were maintained on appeal, the respective positions further developed in both parties’ appellate briefs illustrate some foundational differences in interpretation of the BJR that warrant discussion.\textsuperscript{88} An underlying issue regarding proper application of North Carolina’s BJR is how, if at all, it has been affected by the NCBCA’s statutory-prescribed standards of conduct for D&Os.\textsuperscript{89} The defendants argued that the BJR has always shielded D&Os from claims of ordinary negligence and that the duty of care clause in the statute did not alter the requirement of a showing of gross negligence to defeat the BJR’s initial presumption.\textsuperscript{90} In favor of this position, the defendants relied heavily on the Court of Appeals opinion in \textit{State ex rel. Long v. ILA Corp.},\textsuperscript{91} which noted that the adoption of the NCBCA “does not abrogate the common law of the business judgment rule.”\textsuperscript{92} Accordingly, the ILA court determined, and the defendants argued, that “proper analysis” of a director’s decisions “requires examination of defendant’s actions in light of the statutory protections of N.C. Gen. Stat. § 55-8-30(d) . . . and the business judgment rule, either or both of which could potentially insulate him from liability.”\textsuperscript{93} Thus, the defendants argued that proper evaluation of whether the BJR should apply requires an analysis entirely independent of the prescribed statutory standards of conduct.\textsuperscript{94} To this end, the defendants highlighted what they believed to

\textsuperscript{87}. FDIC \textit{ex rel.} Coop. Bank v. Rippy, 799 F.3d 301, 307 (4th Cir. 2015).
\textsuperscript{88}. \textit{See} Unsealed Principal Brief for Appellant FDIC-Receiver, \textit{Rippy}, 799 F.3d 301 (No. 14-02078); Redacted Brief of Appellees, \textit{Rippy}, 799 F.3d 301 (No. 14-02078).
\textsuperscript{89}. Compare Unsealed Reply Brief for Appellant FDIC-Receiver at 5, \textit{Rippy}, 799 F.3d 301 (No. 14-02078) (“[W]hen the North Carolina Court of Appeals explained that the statute did not abrogate the common law, it did \textit{not} hold, nor could it, that the courts were free after [Section 55-8-30’s] enactment to craft or \textit{extend} the common law to contravene the statute.”) (emphasis in original), with Redacted Brief of Appellees, \textit{supra} note 88, at 30 (“The [r]ule continues to apply with full force and effect even after North Carolina’s codification of a standard of conduct for corporate directors and officers.”).
\textsuperscript{90}. Redacted Brief of Appellees, \textit{supra} note 88, at 32.
\textsuperscript{91}. \textit{State ex rel. Long v. ILA Corp.}, 132 N.C. App. 587 (1999).
\textsuperscript{92}. Redacted Brief of Appellees, \textit{supra} note 88, at 43 (quoting \textit{ILA Corp.}, 132 N.C. App. at 601).
\textsuperscript{93}. \textit{ILA Corp.}, 132 N.C. App. at 601–02.
\textsuperscript{94}. Redacted Brief of Appellees, \textit{supra} note 88, at 44.
be a necessary distinction between an "ordinarily prudent" standard of conduct and a "gross negligence standard of review." Relying on such an observation by the Delaware Chancery court in a shareholder litigation suit, the defendants proffered the argument that "[t]he standard of review is more forgiving of directors and more onerous for . . . plaintiffs" and that such "divergence is warranted for diverse policy reasons typically cited as justifications for the business judgment rule."  

In response, the FDIC argued that the BJR must be applied in a way that accommodates the NCBCA’s statutory duties. Specifically, the FDIC argued that because the “prudent person” language in section 55-8-30(a)(3) establishes a simple negligence standard, D&Os can be held liable for ordinary negligence where their actions fail to satisfy the duty of care element. The FDIC contended that, as a result, automatic invocation of the BJR to preclude liability in all situations where no bad faith exists effectively lowers the standard of conduct for D&Os from ordinary negligence to gross negligence. As further support for this argument, the FDIC emphasized the plain language of section 55-8-30(d) providing that a director or officer will not be subject to liability if "he perform[s] the duties of his office in compliance with [section 55-8-30(a)]." Thus, the FDIC reasoned that the legislature’s codification of the duty of care for D&Os would be meaningless if the BJR shielded D&Os from claims arising from a failure to satisfy that duty.

2. Exculpatory Provisions Will Protect Directors from Liability for Ordinary Negligence

Unlike the district court, the Fourth Circuit’s analysis began by looking at whether Cooperative’s exculpatory provision protected its...
directors from liability for ordinary negligence. The Fourth Circuit observed that, in North Carolina, “a corporation may limit personal liability for a director’s breach of a duty of care so long as the director did not know or believe his or her actions to have been clearly contrary to the corporation’s best interests.” Accordingly, the Fourth Circuit noted that exculpatory provisions only shield directors from liability caused by ordinary negligence, and that they do not also allow for a limitation on the duties of loyalty and good faith, or gross negligence.

Applying this standard, the court therefore considered only whether Cooperative’s directors had breached their duty of good faith, as the FDIC had not alleged that they breached their duty of loyalty. In its analysis, the Fourth Circuit noted, “the duty of good faith requires [corporate] directors to avoid self-dealing,” and that “making decisions without adequate information . . . is insufficient.” Accordingly, the Fourth Circuit held that, particularly in light of the bank’s positive CAMELS scores, the FDIC had not presented evidence showing that Cooperative’s directors “knew or believed [that their acts or omissions] were clearly in conflict with the [b]ank’s best interests.” Consequently, the court affirmed the district court’s award of summary judgment to Cooperative directors on the FDIC’s claims of ordinary negligence and breach of fiduciary duties.

3. The Business Judgment Rule can be Rebutted by a Showing of a Lack of Due Care

Because the exculpatory provision in Cooperative’s articles of incorporation protected only directors, the Fourth Circuit examined only officer liability “through the lens of North Carolina’s business judgment rule.” The court stated that while it agreed with the interpretation of
the BJR posited by the defendants and adopted by the district court, it disagreed with the district court’s application of the rule.110 Specifically, whereas the district court held that the BJR’s initial presumption could only be rebutted by a showing that the defendants’ actions amounted to gross negligence, the Fourth Circuit asserted that:

Given the structure of the business judgment rule, the initial presumption [could] be rebutted with evidence showing that the [officers]: (1) did not avail themselves of all material and reasonably available information (i.e., they did not act on an informed basis); (2) acted in bad faith, with a conflict of interest or disloyalty; or (3) did not honestly believe that they were acting in the best interest of the Cooperative.111

The Fourth Circuit determined that the FDIC had presented adequate evidence to rebut the presumption that the officers acted on an informed basis.112 Notably, in reaching its conclusion, the Fourth Circuit relied almost exclusively on the affidavit of the FDIC’s expert witness, Brian Kelley.113 Kelley’s affidavit stated that, in his opinion, “the officers did not act in accordance with generally accepted banking practices.”114 More specifically, Kelley stated that the defendants had “often approved loans over the telephone, without first examining relevant documents” and that “[the defendants] often did not receive the loan documents until after the phone calls, and sometimes not until after the loans had already

---

110. Id. at 310. While the court characterized its analysis as different “application,” the effect of applying the BJR in such a way that allows its initial presumption to be rebutted by evidence that due care was lacking ultimately amounts to a different interpretation of the rule (i.e., what is sufficient to rebut the BJR’s initial presumption of due care). Id.

111. Id. at 313. Importantly, no cases are cited in support of this articulation of how the BJR’s initial presumption can be rebutted. Id. The court appeared to simply make a logical deduction to arrive at this conclusion. See id. (concluding this articulation of the rule to be the proper statement of law without citing to any authority supporting such an understanding, and, instead, premising its articulation on an observation concerning “the structure of the business judgment rule”).

112. Id. at 313–14.

113. Id. The Fourth Circuit described Kelley as an independent banking consultant and former “senior bank executive, lender, and attorney at both regional and large commercial banks.” Id. at 313 (internal quotation marks omitted).

114. Id. at 313.
been funded.” The Fourth Circuit pointed to Kelley’s observation that “[Cooperative’s] review process . . . did not comport with his understanding of officer and director duties . . . [and] that [the defendants] had failed to address warnings and deficiencies in the Bank’s examination reports” as further evidence that the defendants’ duty of care had not been met. While the court acknowledged that Cooperative had been awarded “2” ratings from regulators, it emphasized Kelley’s observations that Cooperative had failed to correct areas of concern identified in the same examination reports. As a result, the Fourth Circuit concluded that the FDIC had presented sufficient evidence to rebut the BJR’s presumption of due care and vacated the district court’s award of summary judgment to officers on the claims of negligence and breach of fiduciary duties.

Looking forward, the only remaining issues to be decided by the district court on remand are whether the officer defendants’ actions constituted a breach of their fiduciary duties, and, relatedly, whether such actions constituted ordinary negligence. How the case is ultimately resolved, however, is subordinate to how the case was decided by the Fourth Circuit. In that respect, the damage may have already been done. The subsequent discussion elaborates on the practical effects of the Fourth Circuit’s application of the BJR, and examines corollary issues that should be considered in light of the decision.

IV. ANALYSIS OF NOTABLE ISSUES DECIDED IN RIPPY

As evinced by the geographical breadth of the amicus briefs submitted on behalf of the defendants, although Rippy is a federal case

115. Id.
116. Id.
117. Id.
118. Id. at 313–14. Similarly, the Fourth Circuit held that Kelley’s affidavit was also sufficient to establish a genuine issue of material fact as to whether the defendants’ reliance on other officials and employees was “reasonable” within the meaning of section 55-8-30(b).
119. Id. at 314. Accordingly, because the FDIC could not present any evidence of intentional wrongdoing by any of the defendants, the Fourth Circuit affirmed the district court’s award of summary judgment on all gross negligence claims. Id. at 315.
applying North Carolina law, it will have significant persuasive value in North Carolina courts as well as federal courts located in states with similar BJRs. Consequently, the Fourth Circuit’s application of the BJR and its treatment of Cooperative’s exculpatory provision should be of considerable interest to the banking industry at large.

A. How the Fourth Circuit Applied the BJR and the Potentially Adverse Implications

The strikingly different analyses of the BJR by the Fourth Circuit and district court highlight the ambiguity surrounding proper application of North Carolina’s BJR, particularly as it relates to the duty of care. While the Fourth Circuit’s discussion of the BJR basically tracked the district court’s explanation, the Fourth Circuit’s application of the rule diverged when it declared that the BJR’s initial presumption could be rebutted by a showing that the defendants “did not avail themselves of all material and reasonably available information (i.e., they did not act on an informed basis).” In contrast to the district court’s holding that the BJR’s initial presumption could only be rebutted by a showing of activity amounting to gross negligence, the Fourth Circuit’s implicit holding that the BJR’s initial presumption could be rebutted by evidence suggesting that due care was not exercised demonstrates how vastly different standards of liability can be derived from different answers to the question of what constitutes adequate rebuttal evidence.

The Fourth Circuit’s determination that the FDIC adduced sufficient evidence to rebut the BJR’s initial presumption—under the particular facts of the case—both accentuates and amplifies the importance of how courts answer this question. Given the fact-

120. See LaCroix, Fourth Circuit, supra note 6 (noting that the Fourth Circuit’s decision “ha[...] been very closely watched”).
121. Id.
122. Compare Willetts II, 48 F. Supp. 3d 844 (E.D.N.C. 2014) (holding that the FDIC had presented insufficient evidence to rebut the initial presumption of the business judgment rule), with Rippy, 799 F.3d at 313–14 (holding that the FDIC had presented sufficient evidence to rebut the initial presumption).
123. Rippy, 799 F.3d at 313.
124. Compare Willetts II, 48 F. Supp. 3d at 849–50 (establishing gross negligence as the standard of liability for D&Os), with Rippy, 799 F.3d at 313 (establishing ordinary negligence as the standard of liability for D&Os).
125. See LaCroix, Fourth Circuit, supra note 6 (discussing the potential issues surrounding the Fourth Circuit’s reliance on the FDIC’s expert’s affidavit).
intensive nature of failed bank litigation, and bank litigation generally, the Fourth Circuit’s nearly exclusive reliance on the FDIC’s expert’s affidavit invites the question of whether similarly critical affidavits, based entirely on opinion, could be sufficient to defeat the BJR in other bank failure cases.\textsuperscript{126} If so, the initial presumption established by the BJR would be made significantly more surmountable, as every bank will have practices that a hired expert can point to as “not [being] in accordance with generally accepted banking practices.”\textsuperscript{127} Consequently, not only does the precedent that the BJR’s initial presumption of due care can be rebutted with a showing of a lack of due care expose D&Os to liability for ordinary negligence, it effectively renders the BJR worthless if the initial presumption can be rebutted by one expert’s opinion that a bank could have operated more soundly.\textsuperscript{128}

Demonstrating the importance of the BJR and the significant policy interests implicated by the protection it affords are the fifty-nine amicus briefs offered in support of the defendants in \textit{Rippy} and the arguments contained therein.\textsuperscript{129} As evidenced by \textit{Willetts I}, because of the fact-intensive nature of bank litigation, the BJR is generally insufficient to dispose of such litigation on a motion to dismiss, even where there may not be a strong case against a director or officer defendant.\textsuperscript{130} Therefore, the only viable opportunity D&Os have to dispose of a case before trial is at the summary judgment stage.\textsuperscript{131} If defendants do not prevail at the summary judgment stage, “they face a Hobson’s choice of settling (often at significant personal expense) or litigating (with ruinous amounts of potential liability in the balance).”\textsuperscript{132} With such a degree of potential personal liability at stake, it is unsurprising that, even where claims against D&Os are weak, the vast

\begin{itemize}
\item \textsuperscript{126} \textit{Id.} In the defendant’s Reply Brief they noted language from an unpublished opinion to the effect that not only should the court not substitute its own judgment for that of the board, but that it should not substitute the Plaintiff’s expert opinion for that of the board. Defendants’ Reply in Support of Motion for Summary Judgment, supra note 73, at 6.
\item \textsuperscript{127} \textit{Rippy}, 799 F.3d at 313; see \textit{LaCroix, Fourth Circuit, supra note 6} (expressing that the FDIC will almost always be able to hire experts who will provide similar criticisms to what was presented in \textit{Rippy}).
\item \textsuperscript{128} \textit{LaCroix, Fourth Circuit, supra note 6}.
\item \textsuperscript{129} \textit{Rippy}, 799 F.3d at 301–02.
\item \textsuperscript{130} Brief of Amicus Curiae for the Chamber of Commerce of the United States at 10, \textit{Rippy}, 799 F.3d 301 (No. 14-2078).
\item \textsuperscript{131} \textit{Id.} at 11.
\item \textsuperscript{132} \textit{Id.}
\end{itemize}
majority are settled.\footnote{133. \textit{Id.} at 11–12.} Of the thirty-four FDIC lawsuits that occurred in the wake of the 2008 financial crisis that were resolved by the end of 2014, thirty-three settled, with only one going to trial.\footnote{134. \textit{Id.} at 12.} Thus, weaker application of the BJR at the summary judgment stage coupled with the pressure that D&Os feel to settle to avoid going to trial effectively deprives them of all of its protection.\footnote{135. \textit{Id.} at 13.}

Relatedly, because the BJR seeks to prevent judicial second-guessing, it follows that any softening of the rule is likely to spur additional meritless litigation, the cost of which would presumably be passed on to consumers.\footnote{136. \textit{Brief of Amicus Curiae for the American Bankers Association and State Banking Associations at 9–10, FDIC ex rel. Coop. Bank v. Rippy (2015) (No. 14-2078).}} Such an undesirable effect would also be magnified by the Fourth Circuit’s holding that the FDIC’s expert’s opinion was sufficient to rebut the BJR’s initial presumption.\footnote{137. \textit{See LaCroix, Fourth Circuit, supra note 6} (discussing the ease with which the FDIC can procure similar affidavits thereby lessening the protection available to D&Os under the BJR).} If a hired expert’s opinion is sufficient to rebut the initial presumption at the summary judgment stage, a litigious individual, or group of individuals, are likely to produce a similarly disparaging affidavit in hopes of putting the defendants in a situation where settling is the path of least resistance.\footnote{138. \textit{See id.} (explaining the problems of attributing such weight to expert witness affidavits, particularly in light of their widespread availability); \textit{Brief of Amicus Curiae for the Chamber of Commerce of the United States, supra note 130, at 11–12} (highlighting the incredibly high settlement rate in FDIC lawsuits).} At the very least, such a tempering of the BJR creates significant uncertainty as to the extent of protection it provides D&Os, which may further encourage the settlement of even baseless claims.\footnote{139. \textit{Brief of Amicus Curiae for the Chamber of Commerce of the United States, supra note 130, at 12–13} (emphasizing how uncertainty can be leveraged to force settlement in largely meritless cases).} Undoubtedly, any state whose BJR requires D&Os to vindicate their business judgments through costly litigation will deter qualified and talented D&Os from seeking or taking leadership positions there.\footnote{140. \textit{See 3A FLETCHER Cyc. CORP. § 1037, Westlaw (database updated Sep. 2015) \textquotedblright[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.	extquotedblright).}}
prosperity of its banks and the many sectors of society that rely on their well-being.\textsuperscript{141}

Perhaps more importantly, not only would such a softening of the BJR affect the behavior of those considering D&O opportunities, the actions of those already holding such positions would also be affected.\textsuperscript{142} D&Os fearful of incurring personal liability might avoid taking potentially beneficial risks they might otherwise take but for that fear.\textsuperscript{143}

As was emphasized by the district court, risk-taking is essential to the vitality of banks.\textsuperscript{144} Because banks are so inextricably tied to the communities in which they reside, an influx of risk-averse D&Os might stifle growth in the many communities that rely on their banks to extend credit to those looking to start, fund, or expand business.\textsuperscript{145} Such a barrier to capital could potentially snowball into reduced revenue, fewer job opportunities, and consequently, diminished prosperity in the entire community.\textsuperscript{146} Furthermore, a bank’s failure to serve the fundamental needs of its community could potentially result in a decrease in market share, increased regulatory criticism, and the subsequent possibility of acquisition by larger, more aggressive, and less consumer-friendly banks.\textsuperscript{147} In light of the apparent erosion of D&O protection afforded by the state, banks should look to other avenues of protection to offset the increased exposure of D&Os to personal liability.

\textsuperscript{141} See Brief of Amicus Curiae for the American Bankers Association and State Banking Associations, supra note 136, at 7 (“If corporate value is to be enhanced, the courts must not discourage qualified and capable people from serving as directors and taking risks.”) (internal quotation marks omitted). Cf. Brief of Amicus Curiae for the Chamber of Commerce of the United States, supra note 131, at 19–20 (explaining the inextricable relationship between the welfare of community banks and that of their surrounding communities, specifically in the lending context).

\textsuperscript{142} Id. at 4.

\textsuperscript{143} See Brief of Amicus Curiae for the Chamber of Commerce of the United States, supra note 130 at 18 (“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.’”) (quoting In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 698 (Del. Ch. 2005)).

\textsuperscript{144} Willetts II, 48 F. Supp. 3d 844, 851 (E.D.N.C. 2014) (“[C]orporations are expected to take risks and their directors and officers are entitled to protection from the business judgment rule when those risks turn out poorly.”)

\textsuperscript{145} Brief of Amicus Curiae for the Chamber of Commerce of the United States, supra note 130, at 19.

\textsuperscript{146} See id. (noting the FDIC’s own study on the importance of community banks extending credit to individuals and organizations in their communities).

\textsuperscript{147} Id. at 20.
B. Exculpatory Clauses in North Carolina and the Potential Effects of Limiting Individual Liability

The Fourth Circuit’s affirmance that exculpatory provisions will protect directors from ordinary negligence claims unless they “‘knew or believed [that their acts or omissions] were clearly in conflict’ with the Bank’s best interests” establishes a gross negligence standard that the court implicitly rejected in its application of the BJR.\(^\text{148}\) For something to be clearly in conflict, a director has to act in a manner that amounts to bad faith; “[a]ctions that might have been harmful or decisions that could have been better made” are insufficient.\(^\text{149}\) Therefore, a director protected by an exculpatory clause will be insulated from any harm that results from a decision, even if the director made a decision with less information than an “ordinarily prudent person would have exercised under similar circumstances.”\(^\text{150}\) In effect, exculpatory provisions preclude monetary damages stemming from a breach of the duty of care.\(^\text{151}\) Accordingly, any potential softening of the BJR can be offset for directors by including an exculpatory provision in a bank’s articles of incorporation.\(^\text{152}\)

For bank officers, the Fourth Circuit’s discussion of exculpatory clauses might also provide a glimmer of hope for the future. Interestingly, in its analysis, the Fourth Circuit proclaimed: “The Bank’s exculpatory provision does not cover Bank Officers.”\(^\text{153}\) This seemingly innocuous sentence presents a finding of fact, rather than a conclusion of law, as one would expect if exculpatory clauses were categorically prohibited from protecting officers.\(^\text{154}\) Assuming the Fourth Circuit’s


\(^\text{149}\) Id. at 312–13.

\(^\text{150}\) ROBINSON, supra note 9, at § 18.12; N.C. GEN. STAT. §§ 55-8-30(a)(2), 55-8-42(a)(2) (2015).

\(^\text{151}\) ROBINSON, supra note 9, at § 18.12.

\(^\text{152}\) See, e.g., Marc I. Steinberg, The Evisceration of the Duty of Care, 42 Sw. L.J. 919, 920 (1989) (discussing the effect of exculpatory provisions on the duty of care after Van Gorkom). Of further benefit to those covered by exculpatory provisions, North Carolina allows exculpation of liability stemming from “third-party actions as well as direct or derivative corporate actions.” ROBINSON, supra note 9, at § 18.12.

\(^\text{153}\) Rippy, 799 F.3d at 313 (capitalization in original).

\(^\text{154}\) 28 STRONG’S N.C. INDEX 4TH, Trial § 539 (2007) (“‘Findings of fact’ are statements of what happened in space and time. A pronouncement by the trial court which does not require the employment of legal principles will be treated as a ‘finding of fact,’ regardless of how it is denominated in the court’s order.”) (quoting Duvenant v. Duvenant, 142 N.C. App. 169, 173 (2001)).
opinion was written with the care and deliberation one expects to find in a Federal Court of Appeals opinion, it may suggest that the exclusion of officers from protection under Cooperative’s exculpatory provision was simply because they were not covered by the provision in this instance. Thus, the Fourth Circuit seems to leave open, or at least deliberately not address, the question of whether the absence of express authorization of the use of exculpatory provisions by officers in section 55-2-02(b)(3) necessarily equates to a prohibition on such use.

1. Possible Reasons for the Limitation of Exculpatory Provisions to Directors

In light of the Fourth Circuit’s apparent narrowing of the BJR and the corresponding rise in value of exculpatory provisions, the disparity in the law’s treatment of D&Os demands further exploration. As previously discussed, North Carolina law does not currently extend the use of exculpatory clauses to officers. In fact, only five states currently allow exculpatory provisions to protect officers from liability. The reasons for the disparity in the protection available to directors and officers are unclear and likely manifold.

155. See Matter of Wills of Jacobs, 91 N.C. App. 138, 144 (1988) (“Rule 52 of the North Carolina Rules of Civil Procedure requires that the trial court make specific findings of fact and conclusions of law so that the appellate courts may determine whether the trial court has correctly applied the law to the facts.”)
156. See Savage v. Zelent, 777 S.E.2d 801, 804 (N.C. Ct. App. 2015) (expressing the interpretational rule of expressio unius est exclusio alterius – “expression of one thing is the exclusion of the other”).
157. See generally Dennis R. Honabach, Smith v. Van Gorkom: Managerial Liability and Exculpatory Clauses–A Proposal to Fill the Gap of the Missing Officer Protection, 45 WASHBURN L.J. 307 (2006) (providing possible explanations for this disparity in treatment, discussing why it is important, and arguing that the gap needs to be filled).
158. See N.C. GEN. STAT. § 55-2-02(b)(3) (2015) (authorizing use of a “provision limiting or eliminating the personal liability of any director”) (emphasis added).
159. See Honabach, supra note 157, at 318 n.82 (listing Louisiana, Maryland, New Hampshire, New Jersey, Virginia, Nevada, and Utah as the states authorizing officers the use of exculpatory provisions). Since publication, however, Nevada raised its standard of liability to gross negligence, thus foreclosing the need for such a provision. See NEV. REV. STAT. §78.138(7) (2015) (providing that officers will be personally liable for a breach of duty when “[t]he breach of those duties involved intentional misconduct, fraud or a knowing violation of law”). Utah has since shifted the other direction, and no longer allows for exculpation of officers. UTAH CODE ANN. §16-10a-841 (West 2015) (providing, without mention of applicability to officers, that directors may limit personal liability).
160. See Honabach, supra note 157, at 326–28 (detailing the different ways states handle officer liability and the relevant policy considerations).
One historical possibility is that the distinction emerged as a result of the factual background of the Delaware Supreme Court’s decision in Smith v. Van Gorkom,161 in which a group of directors were found personally liable for their failure to exercise due care in recommending a failed merger.162 Prior to Van Gorkom, it was practically inconceivable that directors could be found personally liable for breaching their duty of care.163 In response to the perceived expansion of personal liability for directors, the business-minded Delaware legislature took immediate action to provide additional measures of protection.164 One of these measures included the implementation of a statute authorizing Delaware corporations to protect directors from incurring personal liability for actions taken pursuant to their directorial roles.165 The specific statutory provisions added by Delaware’s General Assembly were crafted by the Corporate Law Section of the Delaware Bar Association.166 Gilchrist Sparks, the Chairman of the Corporation Law Section, specifically noted that the legislation was largely a reaction to the Van Gorkom decision.167 Such being the case, the provisions only intended to compensate for the perceived expansion of directorial liability.168

Although the extent to which exculpatory provisions offered greater protection to directors was subject to much speculation and debate, many states soon followed suit, implementing their own statutes authorizing the exculpation of corporate directors.169 When other states took steps to adopt similar provisions, many of them, including North

161. Honabach, supra note 157, at 328.
162. Smith v. Van Gorkom, 488 A.2d 858, 872–81 (1985) (explaining how directors were found to have breached their duty of care).
163. See Steinberg, supra note 152, at 919–20 (“Shocked at the Delaware court’s ‘chutzpah’ in imposing liability where no self-dealing or other breach of the duty of loyalty existed, corporate fiduciaries and their counsel clamored for action.”).
164. Honabach, supra note 157, at 311–12.
165. Id.
167. See id. at 252 n.63 (stating that directors’ concerns “were heightened by highly publicized lawsuits involving potentially ruinous recoveries”).
168. See Honabach, supra note 157, at 307 (contending that “the explanation for the exclusion of officers is more an accident of history than a product of tight legal analysis”).
169. Id. at 313.
Carolina,\textsuperscript{170} used language that resembled the language in Delaware’s statute.\textsuperscript{171} Consequently, the disparity in protection available to directors and officers may be at least partly attributable to the factual context from which exculpatory provisions emerged.\textsuperscript{172}

However, such a viewpoint seems to necessitate a resounding lack of faith in lawmakers’ abilities to do more than transcribe the statute of another state. To this end, many practical considerations exist that support limiting the use of exculpatory provisions to directors.\textsuperscript{173} Some commentators suggest that different treatment of D&Os may be warranted on the ground that officers have greater accessibility to corporate information and a much higher degree of day-to-day involvement, so they are in a better position to mitigate their own liability.\textsuperscript{174} Citing the premise that liability should be commensurate with an individual’s level of involvement, other commentators point to the general disparity in compensation between directors and officers to justify differing levels of protection.\textsuperscript{175} Such a perspective conceives exculpatory provisions as an additional form of compensation, which can be used to attract the best and brightest directors in the same way that monetary compensation is used to attract the best and brightest officers.\textsuperscript{176}

Whatever the reason for the disparity in protection available to D&Os, exculpatory provisions in North Carolina will be unlikely to protect officers until the General Assembly expressly adjusts the statute to do so, or until North Carolina courts begin interpreting the statute’s express authorization of protection of directors as not precluding application to officers.\textsuperscript{177} However, no North Carolina cases have

\begin{itemize}
\item \textsuperscript{170} Steinberg, \textit{supra} note 152, at 920 n.12.
\item \textsuperscript{171} \textit{Id.} at 920–21.
\item \textsuperscript{172} See Honabach, \textit{supra} note 157, at 328 (offering the possibility that “the reason most exculpatory provisions apply only to a director might well be explained more easily as a historical artifact, a response to Van Gorkom”).
\item \textsuperscript{173} See id. at 327–29 (discussing the robust legal commentary “analyz[ing] both the existing law and its desirability” that has emerged in the wake of Enron and the subsequent corporate responsibility movement).
\item \textsuperscript{175} \textit{Id.} at 219.
\item \textsuperscript{177} See Honabach, \textit{supra} note 157, at 327 (noting that resolution of this issue is first in the hands of the state legislature and then in the hands of the courts).
\end{itemize}
discussed the interpretation of section 55-2-02(b)(3), and those courts applying the provision have unanimously interpreted it as limiting potential liability only for directors.\textsuperscript{178}


While the availability and use of exculpatory provisions for directors became essentially ubiquitous following \textit{Van Gorkom}, the extent of their use should not be taken to imply that they do not present their own problems.\textsuperscript{179} The widespread adoption of exculpatory provisions, much like any limitation on D&O liability, has been criticized as providing directors with an invincibility cloak under which they can act with impunity.\textsuperscript{180} The deterrent effect intended by the legislature’s prescription of standards of conduct for directors is substantially weakened by removing the ultimate check on individual actions: self-interest.\textsuperscript{181} With potential adverse consequences removed from the picture, the caution that emanates from fear of liability may be similarly vacated.\textsuperscript{182} Because the legislature prohibited certain conduct precisely because of its potentially detrimental effect on the relevant interests at stake, those expansive interests are threatened where the prescribed standard of conduct can be so easily contravened.\textsuperscript{183}

More specifically, as precisely demonstrated by \textit{Rippy}, exculpatory provisions effectively serve to protect directors from liability stemming from a breach of their duty of care.\textsuperscript{184} Because a primary aspect of the duty of care is the requirement that directors act on an informed

\begin{itemize}
\item \textsuperscript{178} See \textit{Robinson}, \textit{supra} note 9, at § 18.12 (discussing exculpatory clauses in North Carolina generally, and specifically noting that they may only be used to protect directors from potential liability).
\item \textsuperscript{180} \textit{Id.} at 114–16.
\item \textsuperscript{181} \textit{Id.} at 114.
\item \textsuperscript{182} \textit{Id.}
\item \textsuperscript{183} See FDIC ex rel. Coop. Bank v. Rippy, 799 F.3d 301, 312 (4th Cir. 2015) (explaining how exculpatory clauses can protect directors from liability arising from conduct that fails to meet the prescribed statutory standards); see also Steinberg, \textit{supra} note 152, at 928–29 (explaining the potential effect of exculpatory provisions on Delaware’s duty of care).
\item \textsuperscript{184} Steinberg, \textit{supra} note 152, at 919–20.
\end{itemize}
basis, limiting protection of a director’s duty of care may translate into better business decisions, ultimately benefitting the entire corporation. Commentators have suggested that where directors are immune to liability from their duty of care and thus face less pressure to act with the deliberation and circumspection required by it, they are more likely to violate other duties. A decreased obligation to exercise care and deliberation in decision-making may engender a mentality that might not serve the best interests of the corporation as a whole, while still not being contrary to the corporation’s best interests. Such behavior may begin as benign shortcuts, but without the threat of possible repercussions, it may devolve into increasingly unsound and high-risk practices putting the welfare of the entire corporation in jeopardy. Furthermore, the additional protection offered by exculpatory provisions weakens the viability of litigation as a means of redressing violations of prescribed standards of conduct. Thus, by rendering an important check on behavior less effective, the ability of shareholders and other third parties to maintain an even playing field may be threatened.

A 1989 study by Michael Bradley and Cindy Schipani provides empirical support for the conceptual argument that limiting the potential personal liability of directors may adversely affect the corporation as a whole. The study, performed in Delaware during the post-Van Gorkom surge in the use of exculpatory provisions, indicated that the mere existence of exculpatory provisions as a mechanism for limiting director liability negatively impacted shareholders of Delaware corporations.

186. Id.
187. Cf. id. at 115 (discussing how greater pressure on a director or officer to ensure that they are informed in their decision-making may foster better business practices across the board, which will, in-turn, benefit the company as a whole).
188. See id. (“The idea is that the procedural good of informing oneself is not simply an intrinsic good, but is instrumental in achieving other desirable ends such as being aware of conflicts and making substantive decisions that are more likely to be of the greatest benefit to shareholders.”).
189. See Kuykendall, supra note 176, at 469–70 (“Exculpation statutes, simply by enactment, eliminate large segments of the financial liability of directors in public corporations. In doing so, they create a dissonance between substantive corporate law, which remains intact despite the removal of financial accountability, and the remedial substructure.”).
190. Id.
191. Drury, supra note 179, at 118.
192. Id.; See also Michael Bradley & Cindy A. Schipani, The Relevance of the Duty of Care Standard in Corporate Governance, 75 IOWA L. REV. 1, 47–70 (1989) (discussing the
The study observed a significant decrease in the value of Delaware corporations following the availability of exculpatory provisions. The natural inference was that the market viewed potential individual liability as an effective restraint on directorial action, and more broadly, that personal liability functions as an important tool in promoting sound corporate governance practices. Accordingly, while exculpatory provisions may be necessary to attract the most desirable directors possible, their use should be considered in light of some of the countervailing problems they present.

V. CONCLUSION

While it might be hyperbolic to say that the Fourth Circuit’s holding in Rippy drastically alters the landscape of D&O liability in the banking industry, it should be disconcerting to many that the Fourth Circuit applied the BJR with the weakest force it possibly could have given the existing body of case law. Particularly, given the fact-intensive nature of bank litigation, the Fourth Circuit’s holding that a lack of due care is sufficient to rebut the BJR dilutes the protection it provides to an extent that renders it unhelpful at best. As a consequence of being unable to dispose of such onerous litigation at the summary judgment stage, the banking industry in North Carolina will likely experience harmful, derivative effects that will make serving community needs that much more difficult.

Until it can be ascertained whether the Fourth Circuit’s application of the BJR in North Carolina will serve as a new guiding light results of an empirical study on the immediate effect of exculpatory provisions on the value of Delaware corporations following Van Gorkom).

193. Drury, supra note 179, at 118; Bradley & Schipani, supra note 192, at 60–64 (comparing the abnormal returns and cumulative abnormal returns in the twenty-one trading days prior to the Van Gorkom decision and the twenty-two trading days after the Van-Gorkom decision).

194. Id.; Bradley & Schipani, supra note 192, at 61 (finding this conclusion to be “consistent with the view that the new regime established by section 102(b)(7) allows corporate managers greater latitude in managing their firms, which in turn increases the agency costs of the corporate form and reduces the value of the equity claims of these firms”).


196. See supra text accompanying notes 132–38.

197. See supra text accompanying notes 139–50 (discussing how the Fourth Circuit’s application of the BJR, if applied consistently, would encourage frivolous litigation, make it difficult to attract and retain quality D&Os, and decrease the availability of credit in communities that rely on their local banks.)
for the courts, the apparent waning of the protection afforded by the BJR will conversely magnify the value of the numerous other avenues of protection banks can provide their D&Os. \(^{198}\) In view of the apparent erosion of the protection offered by the BJR, banks should reexamine their articles of incorporation to determine whether additional mechanisms of protection would serve their best interest. As discussed, this might include the adoption of exculpatory provisions, which, if used to the fullest extent of their legal force, will protect bank directors from personal liability arising from any conduct that does not amount to gross negligence. \(^{199}\) Regardless of the specific means of protection, banks should be aware of the potentially adverse effects that limiting individual liability may have on the organization as a whole. \(^{200}\)

Rather than take the “wait and see approach,” banks should take immediate action to put their D&Os in positions they feel will enable them to make decisions that will most effectively serve the interests of the bank. \(^{200-201}\) As one of America’s foremost innovators once observed, “[w]hen one door closes, another opens; but we often look so long and so regretfully upon the closed door that we do not see the one which has opened for us.” \(^{201-202}\) The banking industry would do well not to forget this advice anytime soon.

**Cory A. McKenna**

---

198. See Honabach, *supra* note 157, at 307 (discussing the demand for increased director protection following a court decision perceived as expanding potential liability).

199. See *supra* Part IV.B. (discussing the practical effect of exculpatory provisions on director conduct as raising the standard of liability to gross negligence and identifying additional consequences to consider before implementation). Other measures banks can take to limit both D&O liability include indemnification of a director of officer for reasonable costs incurred during the litigation process upon a vote of the board, ROBINSON, *supra* note 9, at § 18.04, and purchasing liability insurance to protect D&Os for personal liability up to a certain amount. ROBINSON, *supra* note 9, at § 18.10. For a more thorough discussion of ways to limit D&O liability, see Seth Van Aalten, D&O Insurance in the Age of Enron: Protecting Officers and Directors in Corporate Bankruptcies, 22 ANN. REV. BANKING L. 457 (2003).

200. See *supra* Part IV.B.ii.


202. Alexander Graham Bell (date unknown).