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FDIC v. Loudermilk, et al.—Georgia's Business Judgment Rule (and Its Limitations)

On July 11, 2014, the Georgia Supreme Court issued its highly-anticipated decision in *FDIC v. Loudermilk*,[1] addressing squarely the extent to which Georgia's business judgment rule shields bank directors and officers from ordinary negligence claims. Although there is a lot to unravel in Justice Blackwell's 34-page opinion, a few things are clear:

- ***First,*** the business judgment rule is alive and well in Georgia for bank and non-bank directors and officers, although the scope of the rule's protection is not as robust as some prior Georgia Court of Appeals cases had suggested.

- ***Second***, it is now more important than ever for Georgia directors and officers to carefully consider and document the process by which business decisions are reached.

- ***Third***, Georgia's business judgment rule appears to be less protective than the comparable rule in Delaware.

Background

In the wake of the Great Recession, the FDIC has prosecuted nearly 100 lawsuits against directors and officers of failed banks, alleging (among other things) that those directors and officers negligently performed their duties in approving various bank loans. Georgia leads the nation in bank failures and thus has been an important FDIC litigation battleground. In recent years, several federal district courts, applying Georgia law, have held that bank directors are entitled to have the FDIC's negligence claims against them dismissed under the business judgment rule.[2] In the *Loudermilk* case, however, the district judge questioned whether those decisions were consistent with statutory law and applied with equal force to ***bank*** directors and officers.[3] The federal court certified the question to the Georgia Supreme Court.[4]

The Court's Opinion

In a unanimous opinion, Justice Blackwell confirmed that the business judgment rule is a "settled part of our common law in Georgia" and that it applies to bank directors and officers to the same extent as it applies to non-bank directors and officers.[5] As the Court explained, the rule in Georgia, as in other jurisdictions, acts as a presumption in favor of officers and directors and "generally precludes claims against officers and directors for their business decisions that sound in ordinary negligence."[6] The Court further rejected the FDIC's argument that Georgia's Banking Code and Corporate Code "supersede[]" the common law business judgment rule and that "if a bank officer or director fails to exercise ordinary care, he is liable, period."[7]

But the Court's opinion was not a complete victory for directors and officers. The opinion opens the door for directors and officers to face liability for some types of negligence claims—namely, those alleging an inadequacy in the process by which the decision was reached.[8] That is, while the business judgment rule insulates directors and officers from claims of negligence concerning the wisdom of their judgment, the Court explained, it does not foreclose negligence claims alleging that their decision was made without deliberation or without assessing the facts upon which the decision was based.[9]

The Court's substance/process distinction is not entirely surprising. A series of Georgia cases suggested that, while courts should not second-guess well-intended business decisions that turn out badly, a director cannot abdicate his or her responsibilities to reach business decisions in an informed and deliberative manner and expect to be protected by the business judgment rule.[10] Other states have made similar distinctions.[11]

While the Court found support for this process/substance distinction in a handful of decisions, drawing the line between negligence in a board's deliberative process and in the substance of the board's decision can be difficult. Notably, in reaching this conclusion, the Court overruled two recent Georgia Court of Appeals decisions holding that the business judgment rule bars ***all*** ordinary negligence claims as a matter of law.[12] Thus, prior to the Court's opinion in *Loudermilk*, Georgia law appeared to mirror the law in Delaware, where "[i]n order to prevent second-guessing on what might be close questions concerning the appropriateness of the process by which a business decision was made," courts had routinely required the plaintiff to show that there was "gross negligence" in the process of reaching the decision.[13] Going forward, in an effort to survive dismissal, plaintiffs will surely frame challenges to board decisions as challenges to the deliberative process so to fit within *Loudermilk*. The Court's opinion paves the way for at least some such negligence claims and may make it less likely for directors to obtain a quick dismissal at the pleading stage. Left unresolved are such questions as the amount of factual support a plaintiff must plead to raise a plausible negligent process claim.

The Road Ahead

In light of the Court's landmark ruling, it is now more important than ever for Georgia directors to carefully consider and document the process by which a decision is reached. Directors should closely review all material information prior to making decisions and should involve corporate counsel in drafting meeting minutes so as to ensure clear documentation of the deliberation process.

Directors of Georgia corporations—particularly corporations with a significant number of shareholders—should also consider a charter amendment pursuant to section 202(b)(4) of the Corporate Code. That provision allows a company to insulate its directors from shareholder litigation seeking personal monetary liability so long as the director's conduct did not rise to the level of intentional misconduct or a knowing violation of the law. Unfortunately, this strategy provides little comfort for bank directors defending against the FDIC. The analogous

provision of Georgia's Banking Code applies only to shareholder actions.[14] Since the FDIC is suing as receiver of the failed bank, the provision does not apply.

At bottom, given the lingering ambiguity in the Court's decision and the apparent distinction between the rule announced in *Loudermilk* and that applicable to directors of Delaware corporations, directors and officers may be forced to look to the legislature to provide the business judgment protection necessary to avoid the sort of strike suits and non-meritorious complaints often levied at officers and directors.

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[1] *FDIC v. Loudermilk*, No. S14Q0454, --- S.E.2d ---, 2014 WL 3396655 (Ga. July 11, 2014).

[2] *FDIC v. Skow*, No. 1:11-cv-111, 2012 WL 8503168 (N.D. Ga. Feb. 27, 2012) (Jones, J.), *reconsideration denied,* 955 F. Supp. 2d 1357 (N.D. Ga. Aug. 14, 2012), *interlocutory appeal docketed*, No. 12-15878-E (11th Cir. Nov. 26, 2012), *aff'd in part*, 741 F.3d 1342 (11th Cir. 2013); *FDIC v. Briscoe*, Order, No. 1:11-cv-2303 (N.D. Ga. Aug. 14, 2012) (Jones, J.); *FDIC v. Whitley*, Order, No. 2:12-cv-170 (N.D. Ga. Dec. 10, 2012) (O'Kelley, J.); *FDIC v. Miller*, Order, No. 2:12-cv- 00042 (N.D. Ga. Dec. 26, 2012) (Story, J.).

[3] *F.D.I.C. v. Loudermilk*, 984 F. Supp. 2d 1354, 1355 (N.D. Ga. 2013) (Thrash, J.).

[4] The Eleventh Circuit certified a similar question to the Georgia Supreme Court in *FDIC v. Skow*, 741 F.3d 1342 (11th Cir. 2013). The Georgia Supreme Court heard oral argument in the *Skow* case on May 19, 2014 but has not yet issued a separate opinion in that case. King & Spalding represents some of the bank director defendants in the *Skow* case.

[5] *Loudermilk*, 2014 WL 3396655, at *5.

[6] *Id.*

[7] *Id.* at **6-7.

[8] As explained more fully below, corporations with an exculpation provision pursuant to section 202(b)(4) of the Corporate Code may—notwithstanding the Court's decision—insulate directors from monetary liability so long as the directors' conduct does not rise to the level of intentional misconduct or a knowing violation of the law. Unfortunately, however, the analogous provision of the Banking Code does not enable banks to provide the same protection against claims brought by the FDIC. *See infra.*

[9] *Id.* at *9.

[10] *See, e.g.*, *McEwen v. Kelly*, 140 Ga. 720, 723 (1913); *Woodward v. Stewart*, 149 Ga. 620, 628 (1919); *Shannon v. Mobley*, 166 Ga. 430 (1928).

[11] *See, e.g., FDIC v. Jamison*, No. CV-12-1508-PHX-SMM, 2013 WL 1335606, at *6 (D. Ariz. Mar. 29, 2013) (finding that, under Arizona law, a complaint sufficiently pled facts that, if true, show that the defendants failed to reasonably inform themselves prior to making certain business decisions and, therefore, the defendants could not shield themselves under the business judgment rule).

[12] *See Flexible Prods. Co. v. Ervast*, 284 Ga. App. 178, 182 (2007) (holding the rule "forecloses liability in officers and directors for ordinary negligence in discharging their duties"); *Brock Built, LLC v. Blake*, 300 Ga. App. 816 (2009) (holding that "[a]llegations amounting to mere negligence, carelessness, or 'lackadaisical performance' are insufficient as a matter of law [to overcome the business judgment rule]").

[13] *Solash v. Telex Corp.*, Nos. Civ. A. 9518, 9525, 9528, 1988 WL 3587, at *8 (Del. Ch. Jan. 19, 1999); *see also Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000) ("[T]he directors' process is actionable only if grossly negligent.").

[14] *See* O.C.G.A. § 7-1-493(e).