IN THE SUPREME COURT OF GEORGIA

FEDERAL DEPOSIT INSURANCE CORPORATION, as receiver for The Buckhead Community Bank, Appellant, v. R. CHARLES LOUDERMILK, SR., et al., Appellees.	)	CASE NO. S14Q0454 Certified Question from the U.S. District Court for the Northern District of Georgia (Civil Action File No. 1:12-CV-04156-TWT)
FEDERAL DEPOSIT INSURANCE CORPORATION, as receiver for Integrity Bank of Alpharetta, Georgia, Appellant, v. STEVEN M. SKOW, et al., Appellees.	)	CASE NO. S14Q0623 Certified Questions from the U.S. Court of Appeals for the Eleventh Circuit (Eleventh Circuit Appeal No. 12-15878)

BRIEF OF *AMICUS CURIAE*
AMERICAN ASSOCIATION OF BANK DIRECTORS

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

INTEREST OF AMICUS CURIAE 1

BACKGROUND 3

ARGUMENT 4

I. The Purpose of Inserting the "No Liability" Sentence Into § 7-1-490(a) Was to Provide a Broadened Defense to Liability Imposed by Other Provisions, Not to Create Liability 4

A. At Enactment in March 1974, the "No Liability" Sentence Was in a Different Statute. 5

B. Later That Year, the MBCA's Drafters Moved the "No Liability" Language to the MBCA Equivalent of § 7-1-490(a). 7

C. In 1977, Georgia Made the Same Change to § 7-1-490(a). 9

II. The Conduct Standard Applies to Directors and Officers Via Public Supervision and Enforcement. 10

III. Empirical Evidence That a Simple-Negligence Review Standard for Damages Actions is Bad Public Policy: *Van Gorkom*'s Aftermath 12

IV. The Policy Reasons for a Gross-Negligence Standard of Review in Damages Actions. 17

A. Fairness and the Risk of Hindsight Bias 18

1. Hindsight Bias in Assessing Business Decisions 18

2. But What if Using a Gross-Negligence Standard of Review Causes the Conduct Standard to Be Underenforced? 21

TABLE OF CONTENTS
(Cont.)

<u>Page</u>

B. The "Stupefying Disjunction" of That Risk vs. the Prospect of Individual Reward, Part I: The Choice to Serve as a Director. 22

C. The "Stupefying Disjunction," Part II: For Directors Who Do Serve, the "Cliff Effect" Would Deter Socially Valuable Risk Taking. 26

D. These Policies Apply Equally to Bank and Non-Banks. 27

CONCLUSION 29

TABLE OF AUTHORITIES

Page(s)

CASES

Brock Built, LLC v. Blake,
300 Ga. App. 816 (2009) 18

FDIC v. Loudermilk,
2013 WL 6178463 (N.D.Ga. Nov. 25, 2013) 10

FDIC v. Skow,
955 F. Supp. 2d 1357 (N.D. Ga. 2012) 10, 28

Gagliardi v. TriFoods Int'l Inc.,
683 A.2d 1049 (Del. Ch. 1996).................... 24, 27

Gantler v. Stephens,
965 A.2d 695 (Del. 2009) 13

In re Trados Inc. S'holder Litig.,
73 A.3d 17 (Del. Ch. 2013)....................17

Quintal v. Greenstein,
256 N.Y.S. 462 (Sup. Ct.),
aff'd without opinion, 257 N.Y.S. 1034 (1932) 8

S. Cal. Home Builders v. *Young*,
188 P. 586 (Cal. Dist. Ct. App. 1920)....................7

Smith v. Van Gorkom
488 A.2d 858 (Del. 1985) 12-16

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812 F. Supp. 1256 (D.D.C. 1993)....................24

GEORGIA STATUTES AND STATUTORY MATERIAL

Act of Mar. 25, 1974, § 1, 1974 Ga. Laws 705 .... 5-7, 9

Act of Mar. 23, 1977, § 7, 1977 Ga. Laws 730 9

Act of Apr. 7, 1987, § 3, 1987 Ga. Laws 849....................15

Act of Apr. 21, 1987, § 8, 1987 Ga. Laws 1586....................15

Ga. Code of 1933 § 41A-2211....................5, 9

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TABLE OF AUTHORITIES
(Cont.)

Page(s)

O.C.G.A. § 7-1-91 11

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O.C.G.A. § 7-1-494 .... 6, 7, 9

O.G.C.A. § 14-2-171 (1988) 15

O.C.G.A. § 14–2–202 15

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TABLE OF AUTHORITIES
(Cont.)

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Is the Corporate Director's Duty of Care a "Fiduciary" Duty? Does It Matter?,
48 Wake Forest L. Rev. 1027 (2013)......15

E. Norman Veasey, Jesse A. Finkelstein, and C. Stephen Bigler,
Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance,
42 Bus. Law. 399 (Feb. 1987)...... 12, 14, 15

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Medical Malpractice v. The Business Judgment Rule: Differences in Hindsight Bias, 73 Or. L. Rev. 587 (1994)......18

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The Role of Aspiration in Corporate Fiduciary Duties,
54 Wm. & Mary L. Rev. 519 (2012)......21

Melvin Aron Eisenberg,
The Divergence of Standards of Conduct and Standards of Review in Corporate Law,
62 Ford. L. Rev. 437 (1993)...... *Passim*

Roberta Romano,
Corporate Governance in the Aftermath of the Insurance Crisis, 39 Emory L.J. 1155 (1990)......16

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Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law,
56 Bus. Law. 1287 (Aug. 2001)...... 13, 17, 23

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Page(s)

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This brief addresses three issues not covered by any other brief in these cases: (1) the 1977 origin of the "shall have no liability" sentence in O.G.C.A. § 7-1-490(a), which demonstrates that — contrary to the FDIC's position — the sentence's purpose is to broaden protection *against* liability arising from other provisions, not to create liability under § 7-1-490(a); (2) the full extent to which § 7-1-490(a)'s simple-negligence standard of conduct is publicly enforceable, which refutes the FDIC's contention that the standard of conduct would be meaningless if not made a standard of liability in private damages cases; and (3) empirical evidence — an issue we understand the Court inquired about at the *Loudermilk* oral argument — of the negative effects of a simple-negligence standard of liability in damages actions where, as here, there is no allegation of bad faith or conflict of interest. AABD also will draw on the empirical evidence to expand on the public policy reasons for maintaining a gross-negligence standard of review. Lastly, AABD wishes to make clear the strong interest of its members in maintaining that standard.

INTEREST OF *AMICUS CURIAE*

AABD is a non-profit organization that represents the interests of bank and savings institution ("bank") directors throughout the Nation. Founded in 1989, AABD is the only trade group in the United States devoted solely to bank directors and their information, education, and advocacy needs.

The issue before this Court — whether bank directors may be held financially liable for good faith, disinterested conduct based on a hindsight determination of mere ordinary negligence — is vitally important to AABD's membership. In response to the significant increase since the Great Recession in the number of investigations and related lawsuits by the FDIC against bank directors, AABD has established a Bank Director Liability Resource Center to serve as a clearinghouse for developments in these areas. In addition, AABD has published a book describing the standard of liability in each U.S. jurisdiction.[1]

The FDIC's attempt to make simple-negligence determinations in hindsight the basis of financial liability is an affront to independent directors of community banks, who make up the vast majority of AABD's membership. These directors usually are paid small fees and are often not professional bankers. Nevertheless, they are exposed to ruinous liability when a bank fails because of a national crisis not of their making. They are most often the small business men and women of small town America — realtors, doctors, pharmacists, teachers, and leaders of their community who mainly serve to support the availability of credit in their locality.

Most of the banks that failed in the Great Recession (including those in Georgia) were community banks and, as a result, many of the FDIC's lawsuits are

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[1] AABD, BANK DIRECTOR STANDARDS OF CARE AND PROTECTIONS: A FIFTY-STATE SURVEY (David Baris ed., 2013).

filed against community bank directors. Those directors, unlike directors of larger institutions, often still approve individual loans at the board or board-committee level. And it is those approvals now being challenged, based on many months of hindsight review by numerous highly trained FDIC examiners and attorneys of every piece of paper about the loans, whereas busy directors are required by business necessity to process loan applications expeditiously while attending to hundreds of other legal requirements.[2] Directors, moreover, are not legally required to approve individual, non-insider loans. Directors who do are simply seeking to provide the bank with the benefit of an additional level of oversight.

AABD asks this Court to hold, consistent with the well-settled business judgment rule, that a hindsight determination of mere simple negligence cannot trigger damages liability for the outcome of good-faith decisions unaffected by self-interest.

BACKGROUND

The FDIC's position on the certified questions is not based on any allegation of disloyalty, self-interested conduct, or actions taken other than in good faith.[3]

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[2] *See* David Baris & Robert Hopkins, BANK DIRECTOR REGULATORY BURDEN REPORT (2012) (cataloguing legal requirements applicable to bank directors).

[3] Appellant's Br. 2-3, 9, *FDIC v. Loudermilk*, No. S14Q0454 ("FDIC's *Loudermilk* Br."); Appellant's Br. 1, 3-4, 9, *FDIC v. Skow*, No. S14Q0623 ("FDIC's *Skow Br.*").

The cases, therefore, solely involve the duty of care. Nonetheless, the damages sought are substantial: "at least $21.8 million" from the *Loudermilk* defendants and "in excess of $70 million" from the *Skow* defendants, in each case on a joint-and-several basis.[4]

ARGUMENT

I. The Purpose of Inserting the "No Liability" Sentence Into § 7-1-490(a) Was to Provide a Broadened Defense to Liability Imposed by Other Provisions, Not to Create Liability.

On the subject of statutory construction, AABD agrees with the persuasive arguments by Defendants — not repeated here — that § 7-1-490(a) does not impose liability for violating its simple-negligence standard of conduct, based on both (i) its plain language;[5] and (ii) official comments, authored *after enactment* of § 7-1-490(a), to the MODEL BUSINESS CORPORATION ACT ("MBCA") provision that § 7-1-490(a) tracks.[6] Here, we present legislative evidence *at enactment* of § 7-1-490(a).

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[4] *Loudermilk*, *supra*, First Amended Compl., R-Doc. 10 at 71; *Skow*, *supra*, Complaint, R-Doc. 1 at 54.

[5] Appellees' Br. 26-27 & n.14, *Loudermilk*, *supra*; Appellees' Br. 8-11, *Skow*, *supra*.

[6] Appellees' Br. 20-21, *Loudermilk*, *supra*; Appellees' Br. 12-13, *Skow*, *supra*; Appellees' Supp'l Br. 6-9, *Loudermilk*, *supra*. Defendants also point out that the MBCA comments appear without significant change as official comments to Georgia's corporate analogue to § 7-1-490(a).

The FDIC's position in these cases relies heavily on § 7-1-490(a)'s third sentence (the "No Liability" sentence), which provides that: "A director or officer who so performs his duties shall have no liability by reason of being or having been a director or officer of the bank or trust company." The FDIC takes the sentence to mean that it *creates* liability in damages for any conduct short of the standard in § 7-1-490(a)'s first sentence.[7] The legislative history proves the FDIC wrong.

Section 7-1-490(a), as enacted in 1974, contained nothing like the "No Liability" sentence. Instead, the legislature inserted it by an amendment three years later. And as explained below, the amendment's purpose was not to *impose liability*, but rather to *provide a broadened defense to liability imposed by statutes other than § 7-1-490(a)*. That is why, for instance, the "No Liability" sentence does not say "no liability *under this section*," but rather "no liability *by reason of being or having been a director or officer of the bank or trust company*."

A. At Enactment in March 1974, the "No Liability" Sentence Was in a Different Statute.

What is now § 7-1-490(a) dates to March 1974, when it appeared as the first two sentences of then-newly enacted § 41A-2211 of the 1933 Code.[8] It contained

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7 FDIC *Loudermilk* Br. 8-10; FDIC *Skow* Br. 10-11.

8 Act of Mar. 25, 1974, § 1, 1974 Ga. Laws 705, 862, *codified at* 1933 Code § 41A-2211 [hereinafter, "§ 7-1-490(a) (Mar. 1974)"].

no reference to liability. The provision's first sentence, describing the standard of conduct, has not changed since. The second and only other sentence was an earlier but narrower version of today's; then as now, it gave directors the right to "rely" on certain information, but did not indicate whether reliance was a defense to liability (the "Right-to-Rely" sentence).[9]

At the time, the "no liability" language that three years later would become § 7-1-490(a)'s third sentence appeared in an entirely different provision, the 1933 Code version of today's § 7-1-494, entitled "Liability of Directors in Certain Cases."[10] There, the "no liability" language served the purpose of providing a defense to what otherwise would have been strict liability under for assenting to an excessive distribution to shareholders. Specifically, whereas § 7-1-494(a) provided that directors who "vote for or assent to" such a payment "shall be jointly and severally liable" for the excess, § 7-1-494(c) provided a defense: "(c) A director *shall not be liable* under subsection (a) of this section if he relied and acted in good faith upon" any of the same types of information described in the Right-to-Rely

9 *Id.* A third sentence of § 7-1-490(a) (Mar. 1974), codified today as Subsection (b) of § 7-1-490, concerns delegation to correspondent banks and has no relevance here.

10 Act of Mar. 25, 1974, § 1, 1974 Ga. Laws 705, 865-67, *codified at* 1933 Code § 41A-2215 [hereinafter, "§ 7-1-494 (Mar. 1974)"].

sentence of § 7-1-490(a).[11] Section 7-1-494 was based on, and identical in all relevant respects to, MBCA § 48 (1969).[12]

Three years later, the Georgia legislature would insert the "no liability" language from § 7-1-494(c) into § 7-1-490(a) and, simultaneously, broaden the right to rely. It took both steps in imitation of an intervening change to the MBCA, described below, which illuminates the legislature's purpose.

B. Later That Year, the MBCA's Drafters Moved the "No Liability" Language to the MBCA Equivalent of § 7-1-490(a).

Six months after Georgia enacted the provisions discussed above, the MBCA's drafters split the MBCA's version of § 7-1-494(c) (*i.e.*, MBCA § 48, ¶ 3) into two sentences, one describing a broadened list of information on which directors could rely, and a second containing the "no liability" language. Split in that manner, the two sentences were moved to the MBCA's version of § 7-1-

[11] § 7-1-494 (Mar. 1974) (emphasis added). This purpose of the no liability language in § 7-1-494(c) (Mar. 1974) is confirmed by commentary to the MBCA provision on which it was based, MBCA § 48 (1969). The commentary explained that unlike § 7-1-494 (Mar. 1974), "earlier statutes" prohibiting excessive shareholder distributions "did not expressly confer upon directors a defense for acting in good faith and the courts generally refused to engraft such a defense upon the statute." MBCA § 48 cmt. One such court, for example, upheld the exclusion of "evidence that" directors, in assenting to dividend payments, "had acted in good faith and relied upon financial statements" and other information, "where there was no statutory provision protecting directors who acted in good faith." *Id.* § 48 casenotes (summarizing *S. Cal. Home Builders* v. *Young*, 188 P. 586 (Cal. Dist. Ct. App. 1920)). That is why MBCA § 48, ¶ 3 — and statutes based on it, such as § 7-1-494(c) (Mar. 1974) — "expressly provide[] for a good faith defense to relieve directors of liability." MBCA § 48 cmt. (emphasis added).

[12] § 7-1-494 (Mar. 1974) (emphasis added).

490(a) (*i.e.*, MBCA § 35, ¶ 2), right after a sentence describing the simple-negligence standard of conduct (which was new to the MBCA).[13] Those three sentences — *i.e.*, the whole of MBCA § 35, ¶ 2 — are substantively identical to § 7-1-490(a) today (except that the latter applies to officers as well as directors).

In addition to broadening the types of information on which directors could rely, the purpose of the change to the MBCA was to "broaden" the "the range of situations (presently limited in § 48 to dividends [and other] distributions to stockholders) in which directors will have available to them, by force of statute, the right to rely on others."[14] Placing the "no liability" sentence behind both the standard-of-conduct sentence and the "right-to-rely" sentence in § 35, ¶ 2 also provided directors with the general defense of due care, regardless of whether they also relied on the specified types of information or not.[15]

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13 MBCA §§ 35, ¶ 2 and 48 (1969) (amended Sep. 1974), *reprinted in* American Bar Association, *Report of Committee on Corporate Laws: Changes in the Model Business Corporation Act*, 30 Bus. Law. 501, 502 (Jan. 1975) [hereinafter, "*Committee Report*"].

14 *Committee Report*, 30 Bus. Law. at 504.

15 As commentary to MBCA § 48 (1969) had explained, caselaw construing statutes like it that provided no statutory defense had, in addition to rejecting the defense of reliance on specific types of information as noted above, rejected the general defense of "due care." MBCA § 48 casenotes (1969) (describing *Quintal v. Greenstein*, 256 N.Y.S. 462 (Sup. Ct.), *aff'd without opinion*, 257 N.Y.S. 1034 (1932)).

C. In 1977, Georgia Made the Same Change to § 7-1-490(a).

Today's version of § 7-1-490(a) reached its final form in 1977, when the Georgia legislature modified it in imitation of the changes three years earlier to its MBCA analogue, § 35, ¶ 2. Specifically, the legislature replaced the second sentence of § 7-1-490(a) (Mar. 1974) — the "Right-to-Rely" sentence — with the broader "Right-to-Rely" sentence from § 35, ¶ 2. And it added a new, third sentence — the "No Liability" sentence — also from § 35, ¶ 2.[16]

Perhaps for belts-and-suspenders reasons, the legislature did not also delete Subsection (c) of § 7-1-494, leaving its "no liability" and "right-to-rely" language intact through today. That choice does not make the defense in § 7-1-490(a) surplusage, however, even as the defense applies to § 7-1-494. The defense in § 7-1-490(a) to excessive-dividends liability is broader, in two ways: (1) it provides a more extensive list of the types of information on which reliance is permitted; and (ii) it provides a general defense based on the director's exercise of due care, regardless of what types of information might have been relied on. And, of course, it applies to other provisions whose plain text, like that of § 7-1-494, also impose liability.[17]

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[16] Act of Mar. 23, 1977, § 7, 1977 Ga. Laws 730, 734-36, *codified at* 1933 Code § 41A-2211.

[17] *See, e.g.*, 7-1-398 ("shall be jointly and severally liable").

II. The Conduct Standard Applies to Directors and Officers Via Public Supervision and Enforcement.

Section 7-1-490(a) makes simple negligence the standard of *conduct* for bank directors. But as the district court in *Skow* explained, following a long line of precedent regarding the duty of care, there is a difference between "the standard of conduct expected of directors" and "the business judgment rule, which is the standard of *review* that determines whether directors will be held liable" in damages for a decision that turned out badly.[18] Indeed, as explained by the chief reporter for the American Law Institute's PRINCIPLES OF CORPORATE GOVERNANCE, the standards of conduct and liability, or review, for directors and officers "pervasively diverge."[19] The wide acceptance of this divergence is illustrated by the *Loudermilk* district court's acknowledgment that until its certification of the issue to this Court, Georgia's federal courts had "uniformly applied the business judgment rule to protect bank officers and directors" from simple-negligence claims.[20]

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18 *FDIC v. Skow*, 955 F. Supp. 2d 1357, 1366 (N.D. Ga. 2012).

19 Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 Ford. L. Rev. 437, 438 (1993). The two standards diverge in other areas of the law as well, such as the law of constitutional torts, as the Defendants-Appellants ("Defendants") in *Skow* explain. (Appellees' Br. 17-18, *FDIC v. Skow*, No. S14Q0623.)

20 *FDIC v. Loudermilk*, 2013 WL 6178463, at *4 (N.D. Ga. Nov. 25, 2013).

The FDIC is wrong to assert that if this Court confirms there is a divergence, § 7-1-490(a)'s simple-negligence standard of conduct "could never be enforced."[21] The Georgia legislature, in fact, has provided for potent enforcement of the simple-negligence standard against bank directors and officers, but chose to vest the power to enforce that standard in a state agency, rather than private plaintiffs — a choice consistent with all the policy reasons detailed in Part IV, below. (The FDIC suing as a receiver is for all relevant purposes a private plaintiff.[22]) That legislative choice should be respected.

Specifically, the Georgia Department of Banking and Finance ("DBF") may sue a director or officer to enforce § 7-1-490(a)'s conduct standard "by injunction or otherwise."[23] The Georgia DBF also may issue a cease-and-desist order when "it shall appear to the department" that the conduct standard has been violated by a director or officer.[24] Failure to comply with the order carries a penalty of up to $1,000 per day.[25] In addition, a Georgia-chartered bank's federal supervisor (either

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21 FDIC's *Loudermilk* Br. at 10; see FDIC's *Skow* Br. at 18-20.

22 *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 85-89 (1994).

23 O.G.C.A. § 7-1-93 (permitting the DBF to "bring an appropriate civil action to enforce any provision of this chapter").

24 *Id.* § 7-1-91(d), (h) (authorizing cease-and-desist orders based on a "violat[ion]" of "any law of this state").

25 *Id.* § 7-1-91(f), (h).

the Federal Reserve or FDIC) may commence cease-and-desist proceedings against directors or officers for violating any "law," including § 7-1-490(a).[26]

Accordingly, there is no reason to disregard the business judgment rule and make § 7-1-490(a)'s standard of conduct a standard of private damages liability, because that conduct standard is enforceable through several other mechanisms. Indeed, even for private plaintiffs, the standard of conduct may "have vitality in [actions not seeking] personal monetary damages against directors," such as private "injunction and rescission cases" as well as director-removal suits.[27]

III. Empirical Evidence That a Simple-Negligence Review Standard for Damages Actions is Bad Public Policy: *Van Gorkom*'s Aftermath.

Although we will describe in the next section the public policy bases for a standard of review in damages actions that is more lenient than the standard of conduct, we understand that the Court inquired at the *Loudermilk* oral argument whether there is empirical evidence to support those policy arguments. In AABD's view, the best empirical evidence is the well-documented fallout in Georgia and

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[26] 12 U.S.C. § 1818(b). Because the banks in both of these cases were state-regulated and not members of the Federal Reserve System, their federal supervisor was the FDIC.

[27] E. Norman Veasey, Jesse A. Finkelstein, and C. Stephen Bigler, *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 Bus. Law. 399, 403 (Feb. 1987) [hereinafter, "Veasey et al., *Three-Legged Stool*"]. The standard of review for private suits seeking relief other than damages is not before this Court, so AABD does not address the unique considerations relevant that question.

elsewhere from one of the more (in)famous of all corporate-law decisions: the Delaware Supreme Court's 1985 ruling in *Smith v. Van Gorkom*.[28] The fallout not only supports the policy rationales, but led state legislatures to embrace them as well — in particular, rationales regarding (i) the need to encourage directors to serve and (ii) the need to ensure that those who do serve are not steered toward detrimental risk-averse behavior.

In *Van Gorkom*, the court by a 3-2 margin held that directors were liable on duty-of-care grounds for "gross negligence." That alone would have been unremarkable, *but the facts reported by the court were widely viewed as evidencing no more than simple negligence*.[29]

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[28] 488 A.2d 858 (Del. 1985), *superseded by statute*, 8 Del. Code § 102(b)(7), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

[29] *See, e.g.*, William T. Allen, Jack B. Jacobs, & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1299 (Aug. 2001) [hereinafter, "Allen, Jacobs & Strine, Jr., *Function Over Form*"] ("although purporting to apply the gross negligence standard of review, [the court] in reality applied an ordinary negligence standard"); Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 Wake Forest L. Rev. 1131, 1142-43 (2006) ("most practitioners, like the lower court, would have predicted that the facts in *Van Gorkom* would not constitute gross negligence under Delaware's duty of care standard").

The three authors of *Function Over Form* are each highly experienced, respected Delaware corporate jurists: William T. Allen was Delaware's Chancellor from 1985-97; Jack B. Jacobs has been a Justice of the Delaware Supreme Court since 2003, having previously served as a Vice Chancellor for 17 years; and Leo E. Strine Jr. is now the Chief Justice of the Delaware Supreme Court, having previously served as Chancellor and a Vice Chancellor for 15 years.

"*Van Gorkom* exploded a bomb," according to an account later in the same year.[30] Quite apart from the reaction of the corporate bar, which "generally view[ed] the decision as atrocious," *Van Gorkom* seriously disrupted the market on which corporate service depends: the market for directors and officers liability insurance.[31] Nine months after the decision, an observer reported that "[p]remium rates for directors' and officers' insurance ha[d] soared within the past six months."[32]

After another year, a future Chief Justice of the Delaware Supreme Court wrote that

> many D&O insurers have withdrawn from the market completely or have dramatically altered their policies to decrease the availability and scope of coverage and/or increase the premiums and the amounts deductible under existing policies. *The result has been the ultimate irony in corporate governance — outside directors refusing to serve*.[33]

Delaware's legislature — and, as discussed below, Georgia's and most other states' — responded swiftly to *Van Gorkom* "to put together the best practical

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30 Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 Bus. Law. 1, 1 (Nov. 1985).

31 *Id.* at 1.

32 *Id.* at 6. The market for that insurance had been in some distress prior to *Van Gorkom*, but as this quote indicates, the case made matters substantially worse.

33 Veasey, et al., *Three-Legged Stool*, 42 Bus. Law. at 400-01 (emphasis added) (footnote omitted). This article appeared in February 1987. Norman Veasey would serve as Chief Justice for 12 years (1992-2004).

solution … to what has been characterized as the 'D&O Crisis' and its attendant problem of director resignation."[34] Specifically, the year after *Van Gorkom*, the Delaware legislature changed that state's code to give shareholders the option of "eliminating or limiting the personal liability of a director" for monetary damages in duty-of-care cases by amending their corporation's articles of incorporation.[35] Georgia followed suit nine months later.[36]

The new Delaware statute "has been broadly (and accurately) understood from the beginning as a direct response to the turmoil created by the *Van Gorkom* decision, permitting Delaware corporations to revert to the status quo ante one by one — which most have in fact done."[37] The legislative history describes the statute as responding specifically to the twin problems of (i) recruitment of, and (ii) overly risk-averse behavior by, directors arising from *Van Gorkom*'s disruption of the insurance market — issues we address in the policy section below at IV.B and IV.C:

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[34] *Id.*

[35] 8 Del. Code Ann. § 102(b)(7).

[36] For non-bank corporations, *see* Act of Apr. 7, 1987, § 3, 1987 Ga. Laws 849, 855-56 (codified then as O.G.C.A. § 14-2-171(b)(3) (1988), now in O.C.G.A. § 14–2–202(b)(4)). For banks, *see* Act of Apr. 21, 1987, § 8, 1987 Ga. Laws 1586, 1592-93 (codified as O.C.G.A. § 7-1-493(e)).

[37] Christopher M. Bruner, *Is the Corporate Director's Duty of Care a "Fiduciary" Duty? Does It Matter?*, 48 Wake Forest L. Rev. 1027, 1030-31 (2013).

> [The new statute, and a more minor amendment that enhanced directors' indemnification rights] represent a legislative response to recent changes in the market for directors' liability insurance … [, which] have threatened the quality and stability of the governance of Delaware corporations because directors [i] *have become unwilling, in many instances, to serve* without the protection which such insurance provides and, [ii] in other instances, *may be deterred by the unavailability of insurance from making entrepreneurial decisions*.[38]

The official comment to the new Georgia statute told the same story:

> This provision was adopted in response to uncertainties concerning director personal liability arising from judicial decisions in other states (primarily *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)), and to reduced availability of, coverage under, and increasing cost of, directors' and officers' liability insurance. The amendment was derived from [the Delaware statute].[39]

Georgia and Delaware were not alone. "Within two years" of the Delaware legislature's action, "forty-one states had amended their corporation statutes to reduce directors' liability exposure" to damages from duty-of-care suits.[40] Moreover, shareholders overwhelmingly voted to eliminate their directors' exposure to such suits where shareholder action was necessary.[41]

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[38] Chapter 289, Laws of 1986: § 102, Contents of Certificate of Incorporation, Comment (Del. 1986) (emphasis added), *reprinted in* R. Franklin Balotti & Jesse A. Finkelstein, DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS I-12 (3d ed. Supp. 2005).

[39] O.G.C.A. § 14-2-171 cmt. (1988).

[40] Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 Emory L.J. 1155, 1160 (1990).

[41] *Id.* at 1161.

IV. The Policy Reasons for a Gross-Negligence Standard of Review in Damages Actions.

"The reasons" for the "pervasive divergence" between standards of conduct and liability in duty-of-care cases "are rooted in policy interests."[42] Indeed, the FDIC itself implicitly acknowledges the wisdom of the policy arguments described below, at least for outside directors: the agency has had a "long-standing internal policy of pursuing only 'outside' director claims for which the facts show that the culpable conduct rises to the level of gross negligence or worse."[43] The same reasons why that is the right basis for internal decision-making also weigh in favor of making gross negligence the standard applicable to the FDIC before neutral arbiters in court.

In summary, those reasons are: fairness, and two considerations arising from the indisputable disjunction, when a director makes decisions, between (i) his risk of liability if the decision turns out badly and (ii) his individual reward if the decision turns out favorably.

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42 Allen, Jacobs & Strine, Jr., *Function Over Form*, 56 Bus. Law. at 1295-96; *see In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 36 (Del. Ch. 2013) (The "divergence [between the standards of conduct and liability] is warranted for diverse policy reasons typically cited as justifications for the business judgment rule.").

43 FDIC, THE FDIC AND RTC EXPERIENCE: MANAGING THE CRISIS 275 (1998).

A. Fairness and the Risk of Hindsight Bias

It is often said, as the Georgia Court of Appeals conveyed when it correctly rejected a simple-negligence standard of review as inconsistent with the business judgment rule, that the rule is justified because officers and directors "are, in most cases, more qualified to make business decisions than are judges."[44] But stated so broadly, the rationale would apply as much to the standard of review for claims seeking prospective relief (such as one to stop a merger), and in fact it applies more strongly where, as here, the lawsuit is backward-looking.

1. Hindsight Bias in Assessing Business Decisions

Because the legal system is not perfect, any backward-looking assessment is subject to "hindsight bias." Indeed, there "is empirical evidence that persons who know the outcome of a decision tend to exaggerate the extent to which that outcome 'could have been correctly predicted beforehand.'"[45] That is why, in securities actions for instance, courts frequently caution against viewing the facts

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44 *Brock Built, LLC v. Blake*, 300 Ga. App. 816, 823 (2009).

45 William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy*, 96 Nw. U. L. Rev. 449, 454-55 (2002) [hereinafter, "Allen, Jacobs & Strine, Jr., *Realigning the Standard of Review*"] (quoting Hal R. Arkes & Cindy A. Schipani, *Medical Malpractice v. The Business Judgment Rule: Differences in Hindsight Bias*, 73 Or. L. Rev. 587,588 (1994)).

in "the blazing light of hindsight."[46] Moreover, the sheer vagueness of any negligence standard — simple or gross — "create[s] a risk" arising from the inevitability of legal error that "that legitimate conduct will be found to violate it."[47]

But these dangers of an unfair result are particularly acute in the case of business decisions, such as the decision to extend a loan. The reason has been explained by many others, but we quote here Professor Eisenberg, the corporate-law scholar selected by the American Law Institute to be the chief reporter for its PRINCIPLES OF CORPORATE GOVERNANCE:

> In paradigm negligence cases involving relatively simple decisions, such as automobile accidents, there is often little difference between decisions that turn out badly and bad decisions. In such cases, typically only one reasonable decision could have been made under a given set of circumstances, and decisions that turn out badly therefore almost inevitably turn out to have been bad decisions.[48]

Thus, in the case of most torts, there is no unfairness in conflating the standard of conduct (simple negligence) with the standard of review (whether the

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[46] *E.g.*, *Dolphin and Bradbury, Inc. v. SEC*, 512 F.3d 634, 642 n.9 (D.C. Cir. 2008).

[47] Richard A. Posner, ECONOMIC ANALYSIS OF LAW 748 (8th ed. 2011) (describing the trade-offs between precise rules of conduct versus vague standards); *see also id.* at 749-50.

[48] Eisenberg, 62 Ford. L. Rev. at 443; *see also* Allen, Jacobs & Strine, Jr., *Realigning the Standard of Review*, 96 Nw. U. L. Rev. at 454.

defendant was negligent). But as Professor Eisenberg has articulated, torts involving business decisions are different, because most "reasonable" business choices can nonetheless "turn out badly":

> … [i]n the case of business decisions it may often be difficult for factfinders to distinguish between bad decisions and proper [or at least non-negligent] decisions that turn out badly. Business judgments are necessarily made on the basis of incomplete information and in the face of obvious risks, so that typically a range of decisions is reasonable. A decision maker faced with uncertainty must make a judgment concerning the relevant probability distribution and must act on that judgment. If the decision maker makes a reasonable assessment of the probability distribution, and the outcome falls on the unlucky tail, the decision maker has not made a bad decision, because in any normal probability distribution some outcomes will inevitably fall on the unlucky tail.[49]

Under these circumstances, when in hindsight it is clear that the negative risk materialized, the *ex ante* decision was not necessarily "bad" (or "tortious," to be more precise). But if simple negligence were the standard of review, "factfinders might too often erroneously treat decisions that turned out badly as bad decisions, and unfairly hold directors and officers liable for such decisions."[50]

It is well worth adding that even within the realm of business decisions, this problematic tendency of factfinders is especially applicable to the conduct most

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[49] Eisenberg, 62 Ford. L. Rev. at 444; *see also* Allen, Jacobs & Strine, Jr., *Realigning the Standard of Review*, 96 Nw. U. L. Rev. at 454.

[50] Eisenberg, 62 Ford. L. Rev. at 444; *see also* Allen, Jacobs & Strine, Jr., *Realigning the Standard of Review*, 96 Nw. U. L. Rev. at 454.

often at issue in FDIC lawsuits, like those here: the decision to make a loan.[51] *Every* decision to extend credit — whether a reasonable decision or not — can turn out badly. A gross-negligence standard of review addresses the problem of hindsight bias in evaluating business decisions by giving directors a larger "zone of protection to avoid an unfair imposition of liability."[52]

2. But What if Using a Gross-Negligence Standard of Review Causes the Conduct Standard to Be Underenforced?

To the extent a more forgiving standard of review in private damages cases leads to any level of underenforcement of the standard of conduct — despite the public remedies noted above — it should be remembered that "no law is perfectly enforced."[53] Maximum "enforcement is prohibitively expensive" and can also, as discussed in Section IV.C below, deter actors from making socially valuable decisions.[54]

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51 Research by AABD demonstrates that most FDIC suits against directors often do in fact challenge the approval of individual loans. *See* David Baris & Jared Kelly, FDIC DIRECTOR SUITS: LESSONS LEARNED (2012)

52 Allen, Jacobs & Strine, Jr., *Realigning the Standard of Review*, 96 Nw. U. L. Rev. at 454-55; *see also* Eisenberg, 62 Ford. L. Rev. at 449 (A "gross-negligence standard of review" addresses this [unfairness] problem by "leaving a play in the joints in determining whether the relevant standard of conduct" *really* was violated.).

53 Julian Velasco, *The Role of Aspiration in Corporate Fiduciary Duties*, 54 Wm. & Mary L. Rev. 519, 581 (2012).

54 *Id.*

For those reasons, a great number of laws are in fact *deliberately* underenforced. The most obvious example is the choice not to provide for private causes of action, which otherwise would generate more enforcement than government action alone. In the case of duty-of-care breaches, a standard of review more forgiving than the standard of conduct serves precisely the same purpose that precluding *all* private actions does in many other cases.

Regarding the costs and benefits of underenforcement, there is also the fact that "unlike most types of negligence cases, negligent decisions by directors or officers characteristically involve neither personal injury nor economic damages that are catastrophic to an individual."[55] As a result, the "law may justifiably be less willing to take the risk of erroneously imposing liability in such cases."[56]

B. The "Stupefying Disjunction" of That Risk vs. the Prospect of Individual Reward, Part I: The Choice to Serve as a Director.

Because of the danger of unfairness when punishing directors and officers financially on the basis of hindsight, it is widely recognized that a standard less rigid than simple negligence is needed to, in the words of the Delaware Supreme Court, "make[] board service by qualified persons more likely."[57] Otherwise, "the

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55 Eisenberg, 62 Ford. L. Rev. at 444.

56 *Id.*

57 *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 372 (Del. 2006); Allen, Jacobs & Strine, Jr., *Realigning the Standard of Review*, 96 Nw. U.

(continued …)

risk of liability for assuming a given corporate role" would dwarf "the incentives for assuming the role."[58]

Indeed, the FDIC itself recognizes that "[b]anks need to be able to attract and to retain experienced and conscientious directors and officers."[59] The FDIC asserted that point in its landmark 1992 policy statement, still in effect, describing its program for suing directors and officers; presumably then, even the agency would acknowledge that its program, if too aggressive, would threaten banks' "ab[ility] to attract and retain" competent individuals.

Chancellor Allen, in a notable opinion, aptly used the term "stupefying" to describe the disjunction that would exist between risk and reward for directors under a simple-negligence standard. As he explained, if directors:

(… continued)

L. Rev. at 449 ("If law-trained judges [or juries] are permitted to make after-the-fact judgments that businesspersons have made 'unreasonable' or 'negligent' business decisions for which they must respond in monetary damages, [then] [h]ighly qualified directors may also avoid service if they face liability risks that are disproportionate to the benefits of service.").

58 Eisenberg, 62 Ford. L. Rev. at 438; *see also* Allen, Jacobs & Strine, Jr., *Function Over Form*, 56 Bus. Law. at 1296 ("[G]iven the limited investment in publicly held firms that typical corporate directors are able or willing to make, any risk of liability would likely dwarf the incentives for assuming the role."); Bruner, *supra* note 29, 41 Wake Forest L. Rev. at 1132 ("Directors bear the downside costs of potential personal liability, but only see a very small portion of any upside flowing from the risks they direct the business to take.").

59 FDIC, *Statement Concerning the Responsibilities of Bank Directors and Officers* (1992), *at* http://www.fdic.gov/regulations/laws/rules/5000-3300.html.

> were to be found liable for a corporate loss from a risky project on the ground that the investment was too risky (foolishly risky! stupidly risky! egregiously risky!-you supply the adverb), their liability would be joint and several for the whole loss (with I suppose a right of contribution). Given the scale of operation of modern public corporations, this stupefying disjunction between risk and reward for corporate directors threatens undesirable effects.[60]

The disjunction is precisely why the Georgia DBF "is concerned" that an ordinary-negligence liability standard would cause "the resignation of many skilled directors and officers and the inability to attract skilled directors and officers."[61] Indeed, the disjunction exists even now, due in part to the FDIC's approach to cases like the ones before this Court. In a survey released by AABD two months ago, 24% of responding banks reported that fear of personal liability was a reason why either a director had resigned, a person offered a directorship had refused to serve, and/or a director had refused to serve on (or had resigned from) the board's loan committee.[62]

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60 *Gagliardi v. TriFoods Int'l Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996).

61 Ga. DBF Br. 4, *FDIC v. Skow*, No. S14Q0623. The Georgia DBF also filed a substantively identical amicus brief in *Loudermilk*. For brevity, we cite only to the version it filed in *Skow*.

62 AABD, *AABD Survey Results - Measuring Bank director Fear of Personal Liability* at 1 (Apr. 9, 2014), http://aabd.org/aabd-survey-results-measuring-bank-director-fear-personal-liability-good-news/; *see also Washington Bancorporation v. Said*, 812 F. Supp. 1256, 1267-68 (D.D.C. 1993) (noting, in lawsuit by FDIC against officers and directors: "Courts recognize that even disinterested, well-intentioned, informed directors can make decisions that, in hindsight, were improvident. To impose liability on directors for these good-faith business decisions, however, would effectively destroy the corporate system in this country,

(continued …)

The disjunction between individual risk versus reward is well-illustrated by the dollar figures in the two cases before this Court. In *Skow*, for example, the FDIC seeks joint-and-several damages "in an amount in excess of $70 million."[63] Even ignoring joint-and-several liability, the claimed damages amount to nearly $9 million for each of the eight defendants. The $9 million figure contrasts sharply with what bank directors may expect in compensation. The median compensation of board members of banks with between $1 billion and $5 billion in assets, for example, is about $40,819; for banks between $500 million and $1 billion in size, it is about $26,646.[64]

Moreover, the bulk of AABD's members — outside directors of community banks — serve not for the money but in order to aid their communities by ensuring that deserving small business and other consumers have adequate access to credit. It will not take much to convince a director that the risk of liability exceeds the rewards.

(… continued)

for no individuals would serve as officers and directors.") AABD sent its survey questionnaire to more than 2,000 randomly selected banks and savings institutions. Eighty institutions responded.

[63] Complaint, R-Doc. 1 at 54, *Skow*, *supra*.

[64] McLagan, *Today's Compensation Environment – 2012* 12 (11th ed. Nov. 2012) at 12, http://aabd.org/wp-content/uploads/2014/05/12-10-30-McLagan-White-Paper-final.pdf . This figure is based on an analysis of compensation data reported in proxy statements from 678 publicly traded banking institutions for the fiscal year 2011. *Id.* at 4.

C. The "Stupefying Disjunction," Part II: For Directors Who Do Serve, the "Cliff Effect" Would Deter Socially Valuable Risk Taking.

The market for investment capital is competitive, and investors always can earn a risk-free rate of return by holding federal securities. Thus, a bank cannot attract capital to function unless it seeks to provide investors with more than that risk-free rate of return, *i.e.*, unless it seeks to earn some level of profit that can be shared with investors. And as the phrase "risk-free" rate of return would imply, in order to earn more than that rate the bank must take risks.[65]

But when a liability standard is as vague as negligence — again, simple or gross — those subject to it will not merely avoid stepping over the line it seeks to draw. Instead, given the greater probability of legal error when assessing compliance with vague standards, they will steer well clear of that line.[66] This phenomenon is sometimes called the "cliff effect." Here, where the risk of error is exacerbated by hindsight bias in making backward-looking judgments of business decisions (*see* Section IV.A, above), the cliff effect is even more pronounced.

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65 And apart from the requirement to pursue the goal of earning a profit, banks must accept additional risk because they are required by the federal Community Reinvestment Act to "meet[] the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of" the bank. 12 U.S.C. § 2903.

66 Posner, ECONOMIC ANALYSIS OF LAW 749 (explaining that because of the risk of legal error, a relatively vague law necessarily "deter[s] some legitimate activities," and referring to *id.* at 299 (applying sanctions to non-intentional conduct "and *a fortiori* to unavoidable conduct" creates "incentives to steer clear of lawful activity in order to avoid the risk of erroneous" punishment)).

A standard of review more forgiving than simple negligence is therefore necessary to avoid unduly deterring the acceptance of some degree of risk.[67] As Chief Justice Veasey put the matter, "to equate the analyses in common negligence cases with those involving corporate decision-making overlooks the different values society assigns to the behavior under review."[68] While there is "no discernible basis, in common negligence cases, to encourage [a pedestrian] to risk crossing the street," for example, courts "have traditionally favored freedom in corporate decision-making in response to society's encouragement of risk-taking enterprises."[69]

D. These Policies Apply Equally to Bank and Non-Banks.

The FDIC argues at length that banks are "different" from corporations in ways that, somehow, would call for the use of different liability standards. That view, based mostly on dicta from cases 75 or more years old, is "unjustified and

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67 Allen, Jacobs & Strine, Jr., *Realigning the Standard of Review*, 96 Nw. U. L. Rev. at 454 ("If a high-risk decision leads to a good outcome, only the corporation (but not the directors) would benefit, whereas a bad outcome could cause the directors to be held liable for the corporation's entire loss.").

68 E. Norman Veasey & William E. Manning, *Codified Standard-Safe Harbor or Unchartered Reef?*, 35 Bus. Law. 919, 931-32 (Apr. 1980).

69 *Id*. Professor Eisenberg also has provided a nice example of how the cliff effect's over-deterrence of risky decisions under a simple-negligence standard would be harmful. *See* Eisenberg, 62 Ford. L. Rev. at 445; *see also Gagliardi*, 683 A.2d at 1052 ("But directors will tend to deviate from this rational acceptance of corporate risk *if*, in authorizing the corporation to undertake a risky investment, the directors must assume some degree of personal risk relating to *ex post facto* claims of derivative liability for any resulting corporate loss.").

anachronistic today."[70] The modern view is that "[n]o sensible distinction can be drawn solely on the basis of the label 'financial' as opposed to 'industrial' corporation."[71] In any event, the question that matters is whether the *Georgia legislature* specified divergent standards for banks versus non-banks, and it did not.[72]

The "banks-are-different" argument, moreover, is inconsistent with the agency's landmark 1992 Policy Statement, still in effect, regarding its professional liability program. The purpose of the Policy Statement was to assure the banking community in the wake of the S&L crisis that the program would be based on widely familiar, corporate-law principles of director-and-officer liability.[73] The "banks-are-different" argument also is inconsistent with the agency's internal policy, noted above, of suing outside directors only for gross negligence.

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[70] American Law Institute, PRINCIPLES OF CORPORATE GOVERNANCE § 4.01, Reporter's Note ¶ 18 (1994).

[71] *Id.*

[72] *See, e.g.*, *Skow*, 955 F. Supp. 2d at 1360 n.6 (describing the bank- and corporate-director liability statutes as "essentially identical").

[73] FDIC, *Statement Concerning the Responsibilities of Bank Directors and Officers* (1992), *at* http://www.fdic.gov/regulations/laws/rules/5000-3300.html ("Similar to the responsibilities owed by directors and officers of all business corporations, these [bank-director] duties include the duties of loyalty and care.").

CONCLUSION

For the reasons described above as well as those in the briefs of Defendants, this Court should answer the certified questions by confirming that where only good faith, disinterested conduct by directors and officers is at issue, a private plaintiff may not recover damages under § 7-1-490(a) without proving gross negligence, as required by the business judgment rule.

Respectfully submitted this 7th day of June, 2014.

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