

Broken Promises: The FDIC's Refusal to Give Former Bank Directors and Officers Pre-Litigation Access to Bank Records

In the aftermath of the “Great Recession” of 2008, the Federal Deposit Insurance Corporation (FDIC) has aggressively investigated and pursued claims against former directors and officers of failed banks as well as other institution-affiliated parties. The ability of directors and officers to defend themselves—and in particular to head off litigation before it even begins—is compromised by the FDIC’s refusal to give them pre-litigation access to bank documents. The FDIC prohibits directors and officers of troubled banks from keeping copies of bank documents in anticipation of litigation or enforcement action against them, and has made it clear that the agency has *exclusive* ownership and access to the failed bank’s financial and supervisory records. Indeed, the FDIC has threatened—and in some cases pursued—enforcement actions against those who violate its guidelines. Lacking the key documents needed to mount a defense at both the investigative stage and in the early stages of litigation, former directors and officers are at a pronounced disadvantage. This article discusses the evolution of the FDIC’s hard-line approach, and then suggests strategies to mitigate the information disadvantage.

RYAN T. SCARBOROUGH AND RICHARD A. OLDERMAN

The Federal Deposit Insurance Corporation (FDIC) derives its authority to pursue claims against directors and officers of a failed bank from the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA),¹ which

authorizes the FDIC, as receiver, to prosecute claims on behalf of a failed bank seeking monetary damages.² Although the FDIC has advised that it “will not bring civil suits against directors and officers

¹ P.L. 101-73, 103 Stat. 183.

² 12 U.S.C. § 1821(k) provides as follows: “A director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by, on behalf of, or at the request or direction of the [FDIC], which

As a partner at Williams & Connolly LLP, Ryan Scarborough has successfully defended financial institutions and their directors and officers against threatened or actual litigation and regulatory enforcement actions. Prior to joining Williams & Connolly LLP, Mr. Scarborough graduated from Duke University in 1994, studied in Japan as a Fulbright Scholar, and earned his law degree from Harvard Law School in 1998, where he was an editor of the Harvard Law Review. Richard Olderman is a veteran appellate attorney and has litigated hundreds of civil and criminal cases in the federal and state courts of appeals as well as the U.S. Supreme Court.

Prior to joining Williams & Connolly LLP as counsel, Mr. Olderman worked at both the Federal Trade Commission and the Justice Department in various roles. Mr. Olderman received his B.A. from the University of Illinois in 1967, his M.A., in English and Comparative Literature, from the Columbia University Graduate Faculties in 1968, and his J.D. from Columbia Law School in 1971, where he was a teaching fellow in antitrust law. The authors may be reached by email at, respectively, rscarborough@wc.com and rolderman@wc.com.

who fulfill their responsibilities, including the duties of loyalty and care, and who make reasonable business judgments on a fully informed basis and after proper deliberation,”³ it has been particularly aggressive in pursuing lawsuits against directors and officers of failed banks in the wake of the “Great Recession” of 2008. To that end, the FDIC has filed over 100 lawsuits against more than 800 directors and officers, alleging negligence, gross negligence, and breach of fiduciary duties in making loans that

money penalties.⁶ Even when cases settle, the FDIC sometimes insists that directors and officers make personal contributions out of their own pockets. According to Cornerstone Research, of 82 settlement agreements involving officers and directors (regardless whether a lawsuit was actually filed), “as many as 38 agreements, or 46 percent, required out-of-pocket payments by directors and officers. Directors and officers agreed to pay at least \$34 million out of pocket in these cases.”⁷

One of the FDIC’s mandates is to maximize the recovery of bank losses and thereby minimize the amount of money the federal Deposit Insurance Fund must pay creditors. Yet, while the FDIC’s recoveries may be admirable from the standpoint of the public fisc, the FDIC’s claims exact an enormous toll on the directors and officers who are caught in the cross-hairs. With few exceptions, the FDIC’s demands threaten financial ruin (typically in the eight-figure range), and almost always come on the heels of substantial financial losses that the directors and officers have already suffered in connection with the failure of their bank. The FDIC’s assertions of gross negligence and breach of fiduciary duties frequently receive prominent coverage in the local community and sometimes render the defendants toxic to other financial institutions. In short, these lawsuits are personally and professionally devastating. Given such severe repercussions, it is imperative that the agency get it right when it chooses which cases to pursue. After all, the FDIC should not pursue marginal cases that lack merit, lest it be perceived as engaging in a government-sanctioned shakedown to generate revenue and discourage qualified individuals from service.

Although the FDIC is required to treat investigations as confidential,⁸ the targets of those investigations

While the FDIC’s recoveries may be admirable from the standpoint of the public fisc, the FDIC’s claims exact an enormous toll on the directors and officers who are caught in the cross-hairs. These lawsuits are personally and professionally devastating.

ultimately failed,⁴ and measures its recoveries in the billions.⁵ It has also brought hundreds of enforcement actions, at significantly higher rates than were seen during the savings and loan (S&L) crisis of the 1980s, against directors, officers, and other institution-affiliated parties seeking to remove and prohibit them from working in banking and/or impose civil

action is prosecuted wholly or partially for the benefit of the [FDIC]—(1) acting as conservator or receiver of such institution.” The standard is “gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law.” However, the Supreme Court has held that the phrase “gross negligence” does not immunize directors and officers from liability for less culpable conduct—such as ordinary negligence. Rather, it “provides only a floor.” States are free to enact more stringent requirements. *Atherton v. FDIC*, 519 U.S. 213, 227–28 (1997).

³ See FDIC Financial Institution Letter, FIL 87-92 (Dec. 3, 1992).

⁴ See FDIC, Professional Liability Lawsuits (June 13, 2015), available at <https://www.fdic.gov/bank/individual/failed/pls/>. When compared to the FDIC’s response to the S&L crisis in the late 1980s and early 1990s, the FDIC has brought professional liability claims against directors and officers associated with nearly 50 percent more failed institutions (33 percent versus 24 percent) in the aftermath of the Great Recession. See Office of Inspector General, *Enforcement Actions and Professional Liability Claims Against Institution-Affiliated Parties and Individuals Associated with Failed Institutions* (204-SR-B-011, July 25, 2014), at 6, available at <http://oig.federalreserve.gov/reports/board-actions-claims-failed-institutions-jul2014.htm>.

⁵ From 1986 through the present, the FDIC has recovered over \$8 billion from its professional liability lawsuits—i.e., roughly four times what it spent to litigate those cases. Professional Liability Lawsuits, *supra* note 4.

⁶ Since January 2009, the FDIC has brought at least 663 actions seeking removal and prohibition orders in connection with directors, officers, and institution-affiliated parties, and imposed civil money penalties on at least 236 occasions. See FDIC Enforcement Decisions and Orders (June 13, 2015), available at <https://www5.fdic.gov/edo/DataPresentation.html>. According to a joint report issued by the Office of Inspector General for the FDIC, the Board of Governors of the Federal Reserve System, the Consumer Financial Protection Bureau, and the Department of Treasury, federal banking agencies had brought enforcement actions in the wake of the Great Recession at nearly three times the rate that they were brought after the S&L crisis (16 percent versus only 6 percent of failed institutions). See Office of Inspector General, *supra* note 4, at 4.

⁷ Cornerstone Research, *Characteristics of FDIC Lawsuits Against Directors and Officers of Failed Financial Institutions* (2014), at 15, available at <https://www.cornerstone.com/GetAttachment/ab8af5e2-c9f5-4317-86aa-f7dd49be9b36/Characteristics-of-FDIC-Lawsuits-Feb-2014.pdf>.

⁸ 12 C.F.R. § 308.147.

usually know about them. Sometimes the FDIC subpoenas the targets for documents or personal financial information; on other occasions, targets learn from their network of former bank colleagues that the FDIC is conducting interviews. Attorneys in the FDIC's Professional Liability Unit and the Investigations Department within the FDIC's Division of Resolutions and Receiverships investigate each institution failure to determine whether a professional liability claim would be meritorious and cost-effective.⁹ These in-house personnel, sometimes working with outside counsel,¹⁰ perform the investigation and prepare an "Authority to Sue" memorandum for consideration by the FDIC Board of Directors.

The FDIC's enforcement division provides an opportunity to respond to a proposed enforcement action (through issuance of a 15-day notice letter). However, the FDIC's Professional Liability Unit does not offer a parallel opportunity to potential civil defendants. While there is no formal mechanism for a target of the investigation to make his or her case as to why the FDIC should not pursue a professional liability claim, it is possible—indeed, it may be advisable—informally to provide the defense perspective to the FDIC before it decides whether to authorize litigation. Such an approach is functionally equivalent to submitting a response to a "15-Day Letter" from the FDIC's or Office of the Comptroller of the Currency's (OCC's) enforcement division, or making a Wells submission to the Securities and Exchange Commission (SEC).¹¹ The FDIC might not agree with the target's views, but such an exchange of information helps ensure that the FDIC's decision to sue is not based on any factual misconceptions.

Unfortunately, whether done as part of a formal process or an informal one, directors and officers of failed banks are hamstrung in their ability to prepare credible, substantive submissions by their lack of access to bank documents. As explained below, the agency has made it clear that the FDIC has *exclusive* ownership and access to the failed bank's financial and supervisory records, not the former officers and directors, and has

threatened—and in some cases pursued—enforcement actions against those who violate this guidance.¹² The FDIC promises, though, that these records will be made available to directors and officers post-receivership subject to a suitable confidentiality agreement:

Former directors and officers may have a legitimate need to access certain limited confidential financial institution records in order to prepare for, or defend against, litigation that may arise following the placement of a financial institution into receivership. The FDIC is willing to address this need, but any such access must be arranged formally, after the financial institution is taken into receivership, and subject to a suitable confidentiality agreement with the FDIC as receiver, or other acceptable assurance of confidentiality such as a protective order.¹³

The promise to provide access to bank records prior to litigation appears to be a hollow one. Although the FDIC sometimes produces bank records in connection with a pre-litigation mediation (which only occurs after the FDIC has decided to pursue litigation), the FDIC rarely, if ever, provides access to those documents before it makes a decision to pursue litigation. This refusal undermines the ability of directors and officers of failed banks to respond to issues that arise in a post-failure investigation by demonstrating through a written record the care that was exercised in underwriting the loans and the judgments that were made in approving them. By contrast, if directors and officers had access to documents related to the lending function—such as the loan policy, loan committee minutes, and loan packages associated with at-issue loans—then they would be positioned to make a substantive response to the FDIC on the issues that are the subject of investigation.

THE FDIC'S POWERS AS RECEIVER OF A FAILED BANK

The FDIC has dual roles, serving (1) as regulator acting in the FDIC's Corporate capacity (FDIC-C) and (2) as Receiver for failed banks (FDIC-R). The FDIC-C's role is the traditional supervisory role played by federal bank regulators while the bank is in existence. Once a bank becomes insolvent and the FDIC is appointed as Receiver, the agency "steps into the shoes" of the failed bank, assuming "all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officers

⁹ See Offices of Inspector General, *supra* note 4, at 5.

¹⁰ The litigation is often handled by outside law firms. See Professional Liability Lawsuits, *supra* note 4 ("When pursuing professional liability litigation, the FDIC typically engages outside counsel to assist. Attorneys in the Legal Division manage all legal assignments and litigation, including matters referred to outside counsel, and oversee settlement and litigation strategy.")

¹¹ Rule 5(c) of the SEC's Rules on Informal and Other Procedures, 17 C.F.R. § 202.5(c), provides that SEC staff may advise persons who are targets of preliminary investigations about the nature of the investigation, the violations, and the right to submit a statement in their defense, prior to the staff recommendation to the Commission.

¹² Financial Institution Letter 14-2012 (Mar. 19, 2012).

¹³ SEC Rule 5(c), *supra* note 11.

or directors to the institution with respect to the institution and the assets of the institution.”¹⁴ The FDIC is endowed with exclusive access to the bank’s financial and supervisory records.¹⁵ This access extends not just to the records in the bank’s possession, but also to all supervisory records held by other federal banking agencies, which “may be used by the receiver in any manner the receiver determines to be appropriate.”¹⁶

The FDIC asserts its dominion over bank records from the moment it seizes a troubled bank. As part of a carefully choreographed affair, teams of FDIC personnel led by the FDIC’s Division of Resolutions and Receiverships and augmented by law enforcement simultaneously descend on each branch of a troubled institution at the close of business on the designated Friday. The FDIC seizes control of all hard copy records and databases, making forensic and non-forensic copies of the bank’s email servers, databases,

is longer) to file tort claims.¹⁸ The statute of limitations for the FDIC to bring an enforcement action is five years (measured from the later of the underlying misconduct or its effects on the financial institution).¹⁹ Although some bank failures result in an investigation that begins soon after failure, most investigations take time to get off the ground and do not wrap up until the three-year statute of limitations to bring a professional liability claim looms. The FDIC does not wait long, however, before it makes a demand on directors and officers of the failed bank, as it recognizes that most D&O insurance policies will lapse if a claim is not made within the applicable coverage period. Consequently, the FDIC serves demand letters on the former officers and directors (as well as their insurers), informing them of the agency’s potential charges, shortly after it seizes the bank and long before it has made any substantive progress on an actual investigation.

The FDIC asserts its dominion over bank records from the moment it seizes a troubled bank.

and other electronic files and scanning the bank’s hard copy records into a searchable electronic format.¹⁷ During this lockdown phase, the FDIC goes to great lengths to prevent bank personnel from removing or copying bank records. Key bank personnel are interviewed and are asked to return any bank records that may be in their possession, and nobody is permitted to leave the bank’s premises with bank documents. Locking down the bank’s records serves as a prelude to the next phase, when the FDIC turns its attention to investigating the circumstances surrounding the failure of the bank to assess whether to take any enforcement action against directors, officers, or other institution-affiliated parties, and whether to assert claims as the receiver of the bank to recover some of the bank’s losses.

THE POST-SEIZURE INVESTIGATIVE PROCESS

After the bank’s records have been isolated and secured, the FDIC has either three years from accrual or the limitations period under state law (whichever

Power to Compel Testimony. Before initiating an investigation, attorneys in the FDIC’s Professional Liability Group must obtain authorization from the FDIC’s Board of Directors, General Counsel, or other designee. This Order of Investigation gives the agency nationwide subpoena power as well as the authority to compel testimony.²⁰ Unlike a private plaintiff, the FDIC may depose and issue document subpoenas to bank directors, officers, and employees before filing

¹⁸ See 12 U.S.C. § 1821(d)(2)(A)(i). The date of accrual is the date the cause of action accrues under the applicable law, or the date the FDIC was appointed receiver, whichever is longer. See *id.* Claims alleging fraud or intentional misconduct resulting in unjust enrichment or a substantial loss to the institution, may be brought without regard to the limitations period under state law, if the limitations period for such actions did not expire more than five years before the appointment of the FDIC as conservator or receiver. See *id.*; § 1821(d)(14)(C).

¹⁹ See 28 U.S.C. § 2462 (“Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.”); *Proffitt v. FDIC*, 200 F. 3d 855 (D.C. Cir. 2000) (holding that a Section 8(e) removal and prohibition proceeding has three prongs—misconduct, effect, and culpability—and that the five-year statute of limitations runs from the later of the misconduct or its effects).

²⁰ See 12 U.S.C. § 1821(d)(2) (authorizing the issuing of subpoenas when the FDIC is acting “as conservator, receiver, or exclusive manager and for purposes of carrying out any power, authority, or duty with respect to an insured depository institution (including determining any claim against the institution and determining and realizing upon any asset of any person in the course of collecting money due the institution.”). See also 12 C.F.R. § 308.146 (Powers of person conducting investigation); see *id.* § 308.146 (delineating the FDIC’s subpoena power).

¹⁴ See 12 U.S.C. § 1821(d)(2)(A)(i).

¹⁵ See 12 U.S.C. § 1821(d)(2)(A)(ii) (the powers and privileges granted by Congress include “title to the books, records and assets” of the failed financial institution).

¹⁶ See 12 U.S.C. § 1821(o).

¹⁷ 12 U.S.C. § 1821(d)(14)(B).

a lawsuit. The only statutory limit on the FDIC's subpoena power is that it be issued "for purposes of carrying out any power, authority, or duty with respect to an insured depository institution."²¹ This sweeping power includes the authority to subpoena the personal financial records of former directors and officers, so long as the general statutory requirements for the issuance of administrative subpoenas are satisfied, as part of its assessment of the overall cost-effectiveness of pursuing litigation.²² Such subpoenas are colloquially referred to as "deep pocket subpoenas," and are seen as solely intended to enable the agency to decide whether a given director or officer is worth suing—a power private litigants lack absent a court order predicated on stringent factual determinations.

Preliminary Investigation. The investigative process begins with the FDIC's Professional Liability Group and an investigations team from the Division of Resolutions and Receiverships, which conduct a pre-lawsuit investigation of the failed bank to determine whether the FDIC should assert professional liability claims against the bank's officers and directors. When deciding whether to authorize suit, the FDIC weighs the following factors:

- Whether directors or officers may be liable as a result of any actions or failures to act that may have affected the bank;
- Whether pursuit of the action would be cost effective considering the extent of the potential defendants' ability to pay a judgment;
- Whether the FDIC should seek to set aside any transfers or obligations incurred by the bank before its failure; and
- Whether the FDIC should seek to attach any assets.

The threshold for bringing a professional liability claim is generally lower than that required to bring an enforcement action, which requires proof of scienter.²³

In reviewing documents from the failed bank, and interviewing cooperative former employees of the bank, the FDIC looks for evidence of self-dealing, violations of the bank's internal policies, or failure to establish, monitor, or follow underwriting guidelines or examiner recommendations.

²¹ 12 U.S.C. § 1821(d)(2)(I)(i).

²² During the 1990s, courts ruled that the personal financial information of former directors and officers could be subpoenaed when the FDIC needed the information to evaluate the merits of claims. See *FDIC v. Garner*, 126 F.3d 1138 (9th Cir.1997); *Gimbel v. FDIC*, 77 F.3d 593 (2d Cir. 1995).

²³ See *Offices of Inspector General*, supra note 4, at 5.

Once the investigation team completes its work, members of the FDIC's Professional Liability Unit prepare an "Authority to Sue" memo setting forth their recommendation to pursue litigation and the facts supporting their recommendation. The FDIC Board of Directors must approve the request. Directors, officers, and other targets are not formally offered an opportunity to respond to the one-sided presentation from the FDIC's investigative team.

THE FDIC'S APPROACH TO LITIGATION

When the FDIC Board of Directors authorizes suit on a professional liability claim, the agency acts as the equivalent of a private litigant seeking to prove its

These lawsuits have nothing to do with the reasons why the bank failed even though the failure of the bank permeates the entire case. The FDIC seeks to limit the scope of the case to the underwriting and approval of individual loans while ignoring the economic tumult that occurred in more recent years.

case through the adversary process. If sufficient time remains before the expiration of the applicable statute of limitations, the FDIC may notify the targeted individuals that they may settle the claims or be sued. If time is running short, then the FDIC will simply file its complaint and commence litigation. Relying on boilerplate allegations of wrongdoing that are frequently recycled from complaint to complaint, the agency demands tens of millions of dollars in damages from defendants in their personal capacities, arguing that they (or their insurance carriers) must cover the bank's losses on those loans.²⁴

Contrary to what one might think, these lawsuits have nothing to do with the reasons why the bank failed even though the failure of the bank permeates the entire case. Although there are exceptions, the FDIC in each complaint typically takes the same approach when it sets forth its narrative of the case: It focuses on a handful of loans that failed to perform; identifies exceptions or risk factors associated with the at-issue borrowers, guarantors, and/or collateral; and—with the full benefit of hindsight—questions the

²⁴ For all director and officer lawsuits filed by the agency through 2013, the average damages claim was \$49 million, and the median claim was \$22 million. See *Cornerstone Research*, supra note 7, at 11.

wisdom of those loans by claiming that the directors and officers who underwrote and approved the loans were negligent, grossly negligent, and breached their fiduciary duties. By pleading its case in this way, the FDIC seeks to limit the scope of the case to the underwriting and approval of individual loans while ignoring the economic tumult that occurred in more recent years.

One outgrowth of this approach manifests itself in the FDIC's calculated refusal to acknowledge the severity and magnitude of the Great Recession or the catastrophic effect it had on real estate values in many parts of the country. As the FDIC contends, bankers know that the economy goes through cycles and what happened in 2008 and thereafter was nothing more than an economic cycle. Indeed, the FDIC often claims that defendants were on notice of the looming economic collapse by virtue of market reconnaissance that suggested softening in real estate markets, even though such signs were a far cry from presaging the Great Recession. Such extreme positions prompted at least one federal court to characterize the FDIC's approach as "absurd," and to observe:

In sum, the FDIC claims that defendants were not only more prescient than the nation's most trusted bank regulators and economists, but that they disregarded their own foresight of the coming crisis in favor of making risky loans. Such an assertion is wholly implausible. The surrounding facts, and public statements of economists and leaders such as Henry Paulson and Ben Bernanke belie FDIC's position here. It appears that the only factor between defendants being sued for millions of dollars and receiving millions of dollars in assistance from the government is that [their bank] was not considered to be "too big to fail."²⁵

This is not to criticize the FDIC or to suggest that every case it brings lacks merit. Rather, it reveals a fundamental truth about our adversary system: Once litigation commences, both sides spend enormous resources and adopt competing narratives designed to win the case.

For those not accustomed to litigation—mainly the directors and officers of community banks who find themselves targeted as defendants in these cases—the brass-knuckle nature of litigation can exact a terrible toll financially, psychologically, and even physically. The magnitude of damages threatens financial ruin on all but the most financially secure of defendants and the very fact that a former bank director or officer has been named as a defendant frequently disqualifies him

or her from being hired by another financial institution or the federal government, or, for that matter, from obtaining a mortgage or other loan. Defendants are forced to relive the past when they would rather move on with their lives, and occasionally the psychological toll is so great that it actual leads to physical or mental breakdowns.

In light of these personal impacts, the FDIC should go to great lengths to avoid borderline claims and to ensure that it only brings meritorious claims where there truly has been gross negligence or breach of fiduciary duty. It should not pursue cases where directors or officers followed a reasonable decision making process and made good-faith approval decisions on loans that only failed after our country experienced what former Chairman of the Federal Reserve Alan Greenspan has described as a "once in a century credit tsunami."²⁶ It is only by going the extra mile in evaluating potential claims that the FDIC can honor its commitment that "[b]ank directors are allowed to exercise business judgment without incurring legal liability."²⁷

As every good defense lawyer knows, the best case to defend is the one that never gets brought in the first place. Rather than trying to win a case on a dispositive motion or at trial, directors and officers are far better off if they can persuade the FDIC not to bring a lawsuit in the first place. For directors and officers of failed banks who face substantial monetary, reputational, and other risks, the only way to influence the FDIC Board of Directors' decision on whether to sue is to present evidence—either informally or by sworn testimony—to FDIC staff lawyers before any recommendation is submitted to the FDIC Board of Directors. The best—indeed, the only—way to do that is to respond to the potential claims that the FDIC's investigative team has developed with specific evidence demonstrating the underwriting that was performed, the process that was followed to approve each loan, and the reason(s) why the loans failed to perform. But, lacking access to the bank records documenting their actions, which typically date back many years before the bank failed, former directors and officers may be unable to ward off an ill-conceived or unjustified FDIC lawsuit. Their efforts to persuade the FDIC are limited to their recollection of complex events that may have occurred many years before. Memories fade, and without full

²⁵ *FDIC v. Willetts*, 48 F. Supp. 3d 844 (E.D.N.C. Sept. 11, 2014).

²⁶ *The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. on Oversight and Government Reform*, 110th Cong. 2d Sess. 11 (2008) (statement of Alan Greenspan, Chairman, Federal Reserve), available at <https://house.resource.org/110/org.c-span.281958-1.pdf>.

²⁷ See *Professional Liability Lawsuits*, supra note 4.

access to relevant bank records, directors and officers will be significantly disadvantaged in their efforts to convince the FDIC Board of Directors that it should not authorize a lawsuit.

The evidence that directors and officers of failed banks need comes directly from the bank's own files. It is invariably found in the bank's loan policies, its loan files, and its board and committee minutes. The reasonableness of the processes followed and decisions made is frequently corroborated by FDIC or state reports of examination, as well as internal or external loan reviews and audit reports. These materials are invariably key defense documents, establishing that the defendants acted in good faith and with a rational loan review process, the touchstones for invocation of the traditional business judgment rule.²⁸ Kept under the proverbial lock and key by the FDIC, these documents represent the exact type of evidence that individual directors and officers cannot access when they need it most.

EVOLUTION OF THE FDIC'S CURRENT POLICY DENYING ACCESS TO DOCUMENTS

The FDIC has not always taken such a hard-line approach to restricting access. It showed a somewhat greater willingness to provide directors and officers of failed banks meaningful pre-litigation access to bank documents during the S&L crisis of the 1980s and 1990s, although even then there were complaints about undue restrictions. As an attorney who litigated S&L cases at that time has observed: "In that period it was not uncommon that D&O's during their tenures received and retained copies of their bank's loan policies and procedures, loan committee minutes and related loan packages, minutes of board of directors meetings and audit committee meetings and related materials, internal audit reports, regulatory examinations and correspondence and other documents that might relate to transactions that resulted insignificant losses."²⁹ Indeed, "in exchange for the willingness of

²⁸ The business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). It can be regarded as a standard of liability, an abstention doctrine, or an immunity. See, e.g., Lori McMillan, "The Business Judgment Rule as an Immunity Doctrine," 4 Wm. & Mary Bus. L. Rev. 521(2013). The rule had its origin in common law bank director cases. See *Perry v. Millaudon*, 8 Mart. (n.s.) 68, 1829 WL 1592 (La.1829); *Godbold v. Branch Bank*, 11 Ala. 191, 199, 1847 WL 159 (Ala. 1847). See also *Briggs v. Spaulding*, 141 U.S. 132 (1891).

²⁹ See Ronald W. Stevens, "FDIC Lawsuits Against Former Directors and Officers of Banks That Have Failed Since 2008: Is This Déjà vu All Over Again?" *BNA's Banking Report*, 97 BBR 762 (Nov. 1, 2011) at p. 11.

former D&Os voluntarily to cooperate with the FDIC or RTC, those agencies often provided the prospective defendants' counsel with access to the relevant bank documents when they had not kept copies."³⁰

A New, Harder Line. This more permissive attitude morphed into a hard-line, aggressive approach—often

Memories fade, and without full access to relevant bank records, directors and officers will be significantly disadvantaged in their efforts to convince the FDIC Board of Directors that it should not authorize a lawsuit.

involving not only directors and officers but also their counsel—in the wake of the Great Recession, as evidenced by the FDIC's litigation position in three lawsuits:

- In *FDIC v. Bryan Cave, LLP*,³¹ the FDIC, acting as receiver for Georgia's Hillcrest Bank, not only sued former officers and directors of Hillcrest Bank for alleged negligence, gross negligence, and breaches of fiduciary duty, but also brought a separate action against the law firm that had advised the bank prior to its seizure. The FDIC alleged that bank officers and directors retained Bryan Cave as counsel and provided the law firm with copies of the bank's books and records to aid in their defense. The FDIC claimed that the directors and officers violated federal laws, internal bank policies, and in some cases written agreements by copying the documents and providing those copies to counsel. The FDIC ultimately dismissed its case after a settlement. The terms of the settlement were not made public.
- In *McKenna Long & Aldridge LLP v. FDIC*,³² the FDIC asserted a similar claim against another law firm, claiming that the firm violated various statutes, including the Computer Fraud and Abuse Act,³³ and had breached its fiduciary duties, by possessing documents from clients who were former officers of failed banks. The law firm filed a declaratory judgment action, seeking a ruling that its possession of the documents was lawful. The parties ultimately settled on terms that were not disclosed.

³⁰ *Id.*

³¹ No. 10-cv-03666 (N.D. Ga., complaint filed 11/09/10, dismissed with prejudice, 08/18/11).

³² No. 10-cv-3779 (N.D. Ga., complaint filed 11/17/10, dismissed with prejudice 04/12/11).

³³ 18 U.S.C. § 1030(a)(2).

- In *FDIC v. Liberty Finance Group*,³⁴ directors and officers of a troubled bank copied loan files prior to the bank's seizure and transferred the documents to its holding company. The holding company ultimately agreed to return the files, on the condition that the FDIC file a declaratory judgment action to determine its ownership rights. This case also settled; and as in *Bryan Cave* and *McKenna*, the terms of the settlement were not made public.

As a result of this litigation, the American Association of Bank Directors (AABD), in a 2010 letter, argued that the FDIC's position on document access was wrong, and detrimental, and that directors should be permitted access to bank documents that were essential to their defense.³⁵ The FDIC's then General Counsel, Michael Krimminger, replied to the AABD letter, rejecting the Association's position and asserting that, "[p]ursuant to 12 U.S.C. § 1821(d)(2)(A), the FDIC as receiver obtains the exclusive rights and benefits associated with the failed institution's documents and records. These rights and benefits give the FDIC the unrestricted and sole right to possess and use the books and records of the failed institution."³⁶ He also remarked that "[t]his is not a new policy or change in policy but simply a necessary response to conduct that compromises the confidentiality of bank records and customer information."³⁷

Official Guidance Issued. In 2012, the FDIC officially published this policy in a letter disseminated to all financial institutions.³⁸ Entitled "Guidelines Regarding the Copying and Removal of Confidential Financial Institution Information," the letter advised banks that "FDIC reports of examination and other supervisory documentation do not belong to the financial institution, but remain the property of the FDIC."³⁹

³⁴ No. 2010-cv-06280 (D. Or., complaint filed 8/27/10, dismissed with prejudice 02/23/11).

³⁵ Letter from David Baris, Executive Director, AABD, to Sheila C. Bair, Chairman, FDIC, (Dec. 22, 2010), available at <http://aabd.org/fdic-should-stop-interfering-with-bank-directors-rights-to-defend-themselves/>.

³⁶ Letter from Michael Krimminger, Acting General Counsel, FDIC, to David Baris, Executive Director, AABD (Jan. 25, 2011), available at <http://aabd.org/fdic-responds-to-aabd-request-to-allow-bank-directors-access-to-bank-records-for-defense-against-lawsuits/>.

³⁷ *Id.*

³⁸ FDIC FIL-14-2012 (Mar. 19, 2012). See <https://www.fdic.gov/news/news/financial/2012/fil12014a.html>. Notably, the FDIC stated its policy in a Financial Institution Letter, and declined to invoke the notice-and-comment rulemaking procedures of the Administrative Procedure Act.

³⁹ *Id.*

It went on to explain that directors and officers may use bank documents while carrying out their official duties; but once the FDIC closes the bank and takes over as receiver, bank documents vest exclusively with the agency. According to this Guidance, directors and officers have no right to collect records "for their own personal use in anticipation of or following the failure of a financial institution."⁴⁰ As the agency explained, only the FDIC has an "unrestricted right" to possess and use the books, records, and assets of the failed institution.⁴¹ "Personal possession of bank and supervisory materials by a former director or officer, under the circumstances described here, is inconsistent with this unrestricted right."⁴²

The FDIC struck an aggressive tone, informing bank directors, officers, and counsel that it would aggressively police this guidance:

This is a reminder to directors and officers that this activity is a breach of their fiduciary duty to the institution and an unsafe and unsound banking practice, which may also violate applicable laws and regulations and contravene the financial institution's information security program. Attorneys who represent an insured depository institution are also reminded that their fiduciary duty, both legally and ethically, obligates them to act in the best interests of the institution. The FDIC will investigate any matter that appears to violate confidentiality and pursue enforcement actions, as appropriate.⁴³

It further warned that "removing financial institution and supervisory records (originals or copies, in any media format) for personal use . . . can violate Gramm-Leach-Bliley and Federal Deposit Insurance Acts, among other laws and regulations, and constitute a breach of fiduciary duty and unsafe and unsound banking practices."⁴⁴

A Promise Unfulfilled. In apparent acknowledgment of the rights of former bank directors and officers, though, the FDIC expressed its willingness, subject to certain safeguards to ensure confidentiality, to provide meaningful pre-litigation access to bank records:

Former directors and officers may have a legitimate need to access certain limited confidential financial institution records in order to prepare for, or defend against, litigation that may arise following the

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

placement of a financial institution into receivership. The FDIC is willing to address this need, but any such access must be arranged formally, after the financial institution is taken into receivership, and subject to a suitable confidentiality agreement with the FDIC as receiver, or other acceptable assurance of confidentiality such as a protective order.⁴⁵

This letter echoed the same position articulated by the FDIC's General Counsel in his 2011 letter to the AABD:

[W]e . . . recognize that directors and officers may have individual interests in accessing bank records after failure but prior to the institution of legal or administrative action. We have been and remain willing to accommodate these interests where appropriate, provided that any information furnished to the interested party is made subject to the terms of a suitable confidentiality agreement or protective order. However, directors, officers, and counsel engaging in what amounts to "self-help discovery" is not permitted and frustrates these procedures and practices.⁴⁶

Unfortunately, the FDIC has broken its promise. Pre-litigation requests for key bank records have been ignored; and having canvassed bank D&O counsel handling numerous receivership demands and lawsuits, there are no anecdotal reports of the FDIC actually providing any bank documents prior to authorizing suit. Directors and officers of failed banks are left to little more than their recollections and any bank documents they happen to have.

THE FDIC'S REFUSAL TO PROVIDE MEANINGFUL PRE-LITIGATION ACCESS TO BANK DOCUMENTS

The FDIC's guidance letter restricting the copying or removal of bank records is premised on the need to maintain confidentiality of bank records and borrower information, and to ensure that the agency has access to all bank records as it investigates the reasons for the bank's failure. This rationale fades, though, after the bank is seized and its records are locked down. At that point, the balance shifts in favor of disclosure and the arguments against giving directors and officers controlled access lose their force. Providing confidential access to certain records of a failed bank at a pre-litigation stage does not compromise borrower confidentiality or undermine the regulatory process in any way. It does enable potential targets of FDIC lawsuits to respond to allegations made by the FDIC

⁴⁵ Id.

⁴⁶ Letter from Michael Krimminger, Acting General Counsel, FDIC, to David Baris, Executive Director, AABD, supra note 36.

investigative team, and perhaps head off ill-advised suits. Were the FDIC to adopt such an approach, it would strengthen the practical impact of the business judgment rule by giving directors and officers a meaningful way to demonstrate the judgments they made, and indirectly encourage other qualified individuals to serve as bank directors and officers.

Many of the concerns surrounding bank and borrower information articulated in the FDIC's guidance letter become far less pressing post-seizure. For example, any suggestion that the FDIC would be deprived of crucial information if documents were removed from the bank prior to seizure no longer applies in a post-seizure world. Giving directors and officers access to bank records does not deprive the FDIC of any information, since only copies would be shared. Moreover, proper handling of the documents can be negotiated as part of the terms of a suitable confidentiality arrangement. Sharing such information under controlled circumstances would not violate any federal statute. To the contrary, many state statutes and decisions specifically provide such access.⁴⁷ And the FDIC routinely discloses bank records in other circumstances when it suits its purposes. For example, the agency gives potential bidders for failed bank assets unfettered access to bank documents before a bank is seized, subject to execution of a confidentiality agreement protecting the documents.⁴⁸ Likewise, the FDIC shares confidential bank information with the Inspectors General of the FDIC, Treasury, and the Board of Governors of the Federal Reserve System as part of their material loss review investigations. It is clear that these records are not sacrosanct.

PRACTICAL STRATEGIES TO MITIGATE THE INFORMATION DISADVANTAGE

As the wave of Great Recession receivership litigation crests, it is apparent that the FDIC exploits its information advantage to obtain a litigation advantage against potential defendants. Although the agency will occasionally provide a limited set of loan file records to defendants as part of a pre-litigation mediation, this

⁴⁷ See, e.g., Kan. Stat. Ann. § 17-6510(d) (providing statutory right of inspection by any director of corporation records so long as not for an improper purpose); State ex rel. Oliver v. Soc'y for the Preservation of the Book of Common Prayer, 693 S.W. 2d 340, 343 (Tenn. 1985) (director has right of access, even after removal, if he or she "has been or may reasonably be charged with some act or failure to act during his incumbency for which he might be held personally responsible.").

⁴⁸ FDIC, Marketing Process, available at https://www.fdic.gov/buying/franchisemarketing/marketing_process.html ("The interested bidders are . . . granted full access to the information regarding the institution and the terms offered on the secure website.").

occurs only after the FDIC authorizes suit. In short, the FDIC's pre-litigation actions in effect, if not by design, keep potential targets of litigation from gaining a more even footing. That approach is not limited to the pre-litigation phase; it frequently carries over into the FDIC's litigation approach to restricting discovery.

Pre-Litigation. On the front end before litigation is authorized, former directors and officers have limited options. To the extent they happen to possess bank records as part of the ordinary performance of their

(although at that point it is of course too late to dissuade the FDIC from pursuing litigation). Before the complaint is filed, defendants can condition their willingness to participate in pre-suit mediation on gaining access to certain categories of documents. But at that point, no matter how strong the defense arguments, the FDIC is implacable. The only question is how much it will cost to settle, not whether the FDIC should file suit in the first place.

After litigation has commenced, the court's scheduling order will govern document production. Using the discovery tools provided by the Federal Rules of Civil Procedure should not be difficult, but the FDIC's production of bank records may drag out if defense counsel does not keep this issue on the front burner. The FDIC's unwillingness to make bank documents available to the defense prior to litigation increases the importance of defense counsel being able to quickly obtain those documents through discovery and develop their defenses to the FDIC's allegations.

The FDIC-R may also oppose defense efforts to obtain bank examination workpapers from the FDIC-C. The FDIC routinely takes the position that bank examination workpapers are irrelevant, arguing that they have nothing to do with the individual loans that are the subject of the lawsuit. This refusal carries over to the FDIC's document production as well. Although the FDIC has a statutory right to access bank records held by other federal regulatory agencies, it usually refuses to exercise that power absent court order. Indeed, the FDIC-R regularly (1) claims that it cannot produce documents that are in the possession of the FDIC-C, even though the FDIC-C is sometimes represented by the same counsel representing the FDIC in its position as receiver; (2) asserts lawyer-client, work product, and deliberative process bank examination privileges, often inappropriately; and (3) contends that banking records are exempt from disclosure because they "are contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of the FDIC."⁴⁹ But courts have compelled the FDIC to produce documents held by other banking agencies,⁵⁰ and it is usually just a matter of time and dogged effort to get these records.

⁴⁹ 12 C.F.R. Part 309.

⁵⁰ See *FDIC v. Berling*, No. 14-CV-00137-CMA-MJW, 2015 WL 3777408 (D. Colo. June 16, 2015) (granting motion to compel production of examiner work papers); *FDIC v. Dosland*, 2014 WL 1347118, at *5 (N. D. Iowa, Apr. 4, 2014) ("By this order, FDIC-R will be compelled to produce responsive OTS documents, whether they are currently in the possession of FDIC-R or OCC. The inter-agency procedures under which FDIC-R obtains materials from OCC pursuant to Section 1821(o) are not this court's concern. I assume this will not be the first opportunity for FDIC-R to enforce its statutory right to receive documents from OCC.").

The FDIC routinely takes the position that bank examination workpapers are irrelevant, arguing that they have nothing to do with the individual loans that are the subject of the lawsuit. This refusal carries over to the FDIC's document production as well.

bank duties, they will not run afoul of the mandates announced in the FDIC's 2012 financial institution letter so long as they maintain the confidentiality of these materials. Of course, the ordinary performance of bank duties lies in the eyes of the beholder; what former bank directors or officers perceive as being held in the ordinary course may be viewed very differently by an aggressive regulator. Needless to say, this course is fraught with peril, and unlikely to provide access to all of the documents that turn out to be the focus of an FDIC investigation.

Another option is to try to take the FDIC up on its promise to provide pre-litigation access to documents under controlled circumstances. Because nobody wants to attract unnecessary regulatory scrutiny, a director or officer of a failed bank would be well-served to wait to see if he or she receives a demand letter from the FDIC. Absent a demand, discretion may be the best course of action. But for directors and officers who find themselves in the cross-hairs (typically those who served on loan committees), there is little if any downside to making a formal written request for access to specific bank records. Requests should include an offer to enter into a suitable confidentiality arrangement. If history provides any guide, however, these requests will almost certainly go unanswered (at least until the FDIC decides to authorize a lawsuit). Unfortunately, there is very little that a potential defendant can do at this stage.

When a Professional Liability Claim Is Made. Once the FDIC decides to pursue professional liability claims in connection with a bank failure, defendants then have renewed opportunities to obtain the information

CONCLUSION

It should be clear by now that from the moment officers or directors receive a demand letter from the FDIC, the focus should be on obtaining key documents that will be necessary to their defense: documents demonstrating good faith and a rational loan approval process. To be sure, the chances of securing these documents from the FDIC in a pre-litigation phase are quite low, despite the FDIC's promise to provide access in "suitable" circumstances. Thus, it will be incumbent upon defense

counsel to discern the focus of the investigation and compile whatever information is available from myriad sources—be they the bank's holding company, the personal files of other directors and officers, the public record, or personal recollections—to prepare a persuasive presentation rebutting the central allegations raised by the FDIC. This is no small task, but it is worth the effort as it will prepare the defense, and may have an outside chance of dissuading the FDIC from authorizing suit in the first place. ■



Authorized Reprint

JOURNAL OF

TAXATION *and* REGULATION *of* FINANCIAL INSTITUTIONS

Copyright © 2015 Civic Research Institute, Inc. This article is reproduced here with permission. All other reproduction or distribution, in print or electronically, is prohibited. All rights reserved. For more information, write Civic Research Institute, 4478 U.S. Route 27, P.O. Box 585, Kingston, NJ 08528 or call 609-683-4450. Web: <http://www.civicrosearchinstitute.com/tfi.html>.