



## Alerts

### District Court Declines to Extend Business Judgment Rule to Corporate Officers

August 2, 2012

*Professional Lines Alert*

On July 11, 2008, federal bank regulators seized IndyMac Bank. This resulted in the then-largest bank failure of all-time and generated extensive litigation. The Federal Deposit Insurance Corporation (FDIC) as receiver for IndyMac sued the bank's former CEO and director, Matthew Perry, for his role in IndyMac's collapse and the enormous losses sustained by the FDIC. The claim was brought by the FDIC as successor to the bank under the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).

*FDIC v. Perry* was brought in the U.S. District Court for the Central District of California. The FDIC alleged that Mr. Perry acted negligently in his role as CEO by permitting IndyMac to continue to originate and purchase loans for sale in the secondary market despite signs that the secondary market was weakening. The FDIC further alleged that Mr. Perry presided over the origination of more than \$10 billion in high-risk residential loans despite the bank's inability to sell the loans into the secondary market. This resulted in more than \$600 million in losses when IndyMac transferred the loans into its own investment portfolio. Mr. Perry moved to dismiss under Fed. R. Civ. P. 12, arguing that the alleged wrongdoing fell within the shelter of California's business judgment rule.

#### Question Before the Court and How the Court Decided It

*Does California's business judgment rule immunize corporate officers from negligence claims?*

No. The district court denied Mr. Perry's motion to dismiss, holding that because the FDIC specifically sued Mr. Perry for his role as a corporate officer and not as a director, California's business judgment rule defense did not apply.

Under California common law, the business judgment rule has two components—one immunizing directors from personal liability if they act in accordance with its requirements, and another insulating those management decisions made by directors in good faith in what they believe is in the organization's best interest. *Berg & Berg Enters., LLC v. Boyle*, 178 Cal. App. 4th 1020, 1045 (2009). Although California courts routinely apply common-law business-judgment-rule protection to directors, the court observed that there is no precedent to extend such protection to corporate officers. The *Perry* court therefore declined to extend such protection to corporate officers.

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Moreover, the business judgment rule is now codified under Cal. Corp. Code § 309. Section 309 expressly limits the shelter of the business judgment rule to directors, and the legislature has expressly refused to extend the protection of the rule to officers.

Finally, the court found that its decision involved a controlling question of law and permitted an immediate interlocutory appeal under 28 U.S.C. § 1292(b). Thus, the decision is now pending before the U.S. Court of Appeals for the Ninth Circuit.

### **What the Court's Decision Means for Practitioners**

The *Perry* court's ruling is peculiar to California. Courts in other states have in fact extended the business judgment rule to officers and the statutes of other states are clear in extending that protection. *Federal Deposit Insurance Corporation, as Receiver for Integrity Bank v. Skow*, No. 1:11-CV-0111, slip op. (N.D. Ga. Feb. 27, 2012). In addition, the Ninth Circuit may ultimately determine that there is a common-law protection afforded officers in California notwithstanding the language of Cal. Corp. Code § 309. However, if *Perry* is not overturned, officers can expect the FDIC to focus more closely on officers in bringing FIRREA cases. Generally, the most common targets of FIRREA cases to date are the members of the bank's directors loan committee, some of who may also be officers. *Perry* provides an incentive to investigate high-ranking loan officers more closely in bringing professional liability claims.

*Federal Deposit Insurance Corporation, as Receiver for IndyMac Bank, F.S.B. v. Perry*, No. CV 11-5561, 2012 WL 589569, slip op. (C.D. Cal. Feb. 21, 2012).

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