Bryan Cave LLP

Summaries of FDIC Litigation Against Former Directors & Officers

As Previously Published on BankBryanCave.com

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FDIC as Receiver of Heritage Community Bank v. Saphir, et al., Filed Nov. 1, 2010

FDIC Files Lawsuit Against Directors and Officers of Failed Illinois Bank

Wednesday, November 3, 2010

Written by Bard Brockman

The FDIC filed a lawsuit against directors and officers of Heritage Community Bank (Glenwood, Ill.), which was taken into FDIC receivership in early February 2009. The FDIC lawsuit was filed in federal court in Chicago on November 1, 2010, and it is the FDIC's second suit against directors or officers of failed institutions since the advent of the current real estate recession. For a copy of the complaint, click here.

The FDIC's case theory revolves around the bank's commercial real estate ("CRE") lending program. The lawsuit alleges that the directors and officers failed to protect the bank from the "substantial inherent risks of large-scale CRE lending," by:

- routinely financing CRE projects without any meaningful analysis or adequate appraisals;
- repeatedly making loans with excessive loan-to-value ratios; and
- failing to properly evaluate the creditworthiness of CRE borrowers and guarantors.

One unique factual allegation in the lawsuit is that the bank routinely drew down interest reserves from specific loans and recorded it as income. That practice, the FDIC alleged, generated phony profits, which the bank used to justify "substantial dividends" to the holding company and "generous incentive compensation" to its senior management.

The lawsuit asserts three distinct sets of claims – one set against the bank's directors; a second set against the directors and officers on the bank's loan committee; and a third set against the bank's chief financial officer.

Claims Against Directors

The FDIC alleged that the directors had breached their duties under both federal law (FIRREA) and state law by:

- failing to establish and enforce lending policies, including limits on CRE concentrations and limits on speculative or high-LTV projects;
- failing to establish sufficient reserves for loan losses and maintaining adequate capital; and
- failing to ensure that the bank had sufficient, capable personnel to undertake and administer the CRE lending program.

Claims Against Directors and Officers on Loan Committee

The FDIC similarly alleged that the members of the loan committee had violated FIRREA and state law duties by:

- failing to enforce prudent lending policies;
- failing to make informed decisions about loans they approved; and
- failing to ensure that approved loans were properly monitored.

Claims Against Chief Financial Officer

The FDIC alleged that the bank's CFO was grossly negligent (in violation of FIRREA), was negligent under state law, and breached his fiduciary duties to the bank under state law, by:

- failing to ensure that the bank's ALLL reserves were sufficient in the face of negative indicators, including an increasing number of distressed CRE credits;
- failing to ensure that the bank maintained sufficient capital to cushion against high-risk CRE loan losses; and
- improperly advising the board to approve dividends to the holding company and incentive compensation awards to senior management.

This lawsuit against the directors and officers of Heritage Community Bank is expected to start a small wave of D&O suits. The FDIC recently announced that it expects to file actions against 70 directors and officers of failed institutions. More suits are certainly on the way, and we will continue to update BankBryanCave.com with additional D&O litigation information.

FDIC as Receiver of Integrity Bank of Alpharetta, GA v. Skow, et al., Filed Jan. 14, 2011

FDIC Files Lawsuit Against Directors and Officers of Failed Integrity Bank

Friday, January 21, 2011

Written by Bard Brockman

The FDIC filed its third lawsuit against selected former directors and officers of a failed financial institution on January 14, 2010. The defendants in the lawsuit are certain former directors and officers of Integrity Bank (Alpharetta, Ga.), which the FDIC placed into receivership on August 29, 2008. The complaint, which was filed in the U.S. District Court for the Northern District of Georgia, asserts claims for negligence, gross negligence and breach of fiduciary duty.

The central theme of the complaint is that the defendants served on the bank's Director Loan Committee, and in that capacity they pursued an "unsustainable growth strategy designed to exploit the then-expanding 'bubble' in the residential and commercial real estate market." Directors who did not serve on that committee were not sued. The FDIC alleged a variety of misdeeds by the defendants, including the following:

- the adoption of a loan policy that set a lending limit in excess of the statutory legal lending limit;

- the abdication of the credit and lending functions to a Senior Lender who was compensated based on the volume of loan originations, without regard to the quality of the credit; and
- an over-concentration in speculative ADC loans that ultimately represented nearly 80% of the bank's total loan portfolio

However, the more than $70 million in damages alleged focus on twenty-one (21) specific ADC loans approved by, or subject to the oversight of, the Director Loan Committee.

There are three interesting side notes that are not apparent from a reading of the FDIC's complaint. First, in April 2010, federal prosecutors indicted two former executives of Integrity Bank (including one of the director defendants in the FDIC civil suit) on charges of conspiracy, bribery, bank fraud and securities fraud. In public statements following the indictments, the prosecutors alleged that these executives had conspired with a major borrower to essentially "rob the bank from the inside." However, the losses alleged in the Complaint do not involve the borrower involved in the fraud loses. It will be interesting to see if the other director defendants point to that alleged criminal conduct as the true proximate cause of the bank's failure.

The second notable item is that one of the former Integrity Bank directors sued by the FDIC, Jack S. Murphy, is the current chairman of the Georgia Senate Banking Committee. It does not appear that Sen. Murphy has any plans to resign his chairmanship, and he has received strong public support from fellow Republicans in the Georgia Senate.

The third item worth noting is that while there are numerous allegations of negligence, it is alleged that virtually every specific loan involved a loan to one borrower or specific loan to value limitation.

FDIC as Receiver of 1st Centennial Bank v. Appleton, et al., Filed Jan. 14, 2011

FDIC Files Fourth Lawsuit Against Former Bank Directors and Officers

Friday, January 21, 2011

Written by Bard Brockman

On January 14, 2010, the FDIC filed its fourth lawsuit against former directors and officers of a failed financial institution. The defendants in this action are the former directors and the former VP of Real Estate Construction for 1st Centennial Bank (Redlands, Cal.), which was put into receivership on January 23, 2009.

The FDIC's complaint asserts state law claims for negligence, breach of fiduciary duty, and breach of the directors' duty to supervise. It also asserts a claim under FIRREA for gross negligence. The complaint focuses on 16 specific loan losses, and it seeks damages in the minimum amount of $26.8 million flowing from those bad loans.

The crux of the FDIC's lawsuit is that the 1st Centennial defendants "recklessly implemented an unsustainable business model pursuing rapid asset growth concentrated in high-risk loans in commercial real estate without having adequate credit administration and loan underwriting policies and practices to manage the risk." Even after the local real estate market had softened significantly, the FDIC alleged, the defendants did not take steps to curtail the bank's lending , carefully monitor the existing loan portfolio, or seek to minimize loan losses. By the end of 2008, the percentage of Acquisition, Development and Construction loans to total capital had increased to 1,264%, more than ten times the regulatory guidance.

Another central theme of the FDIC's lawsuit is that the bank's CEO, Chief Credit Officer and VP of Real Estate Construction were all unqualified to carry out their duties and responsibilities to the bank. This does not necessarily present the other director defendants with a defense, however, as the FDIC has specifically alleged the board did not adequately supervise the bank's management.

FDIC as Receiver of Corn Belt Bank and Trust Company v. Stark, et al., Filed Mar. 1, 2011

FDIC Sues Former Directors and Officers of Corn Belt Bank & Trust

Tuesday, March 22, 2011

Written by Bard Brockman

The FDIC filed its fifth lawsuit against former officers of directors of a failed banking institution on March 1, 2011. The defendants are four members of the Loan Committee for Corn Belt Bank & Trust (Pittsfield, Illinois). Three of the defendants were directors (one of whom as bank president), and the fourth defendant was Corn Belt's Senior VP of Lending. See a copy of the FDIC's complaint.

The FDIC seeks to recover damages for five failed loans to borrowers in the truck leasing business. According to the FDIC's complaint, Corn Belt's internal loan review specifically warned the defendants about the following weaknesses in the loans: (i) they provided 100% financing to a start-up company; (ii) the borrower was outside the bank's geographical footprint; (iii) the loans would be secured by semi-tractors and other rolling stock; and (iv) the guarantees covered only a small portion of the debt. The FDIC also alleges that the defendants knew or should have known that: (i) the loan terms did not require the borrower to make an equity contribution; (ii) the borrower had inadequate cash flow; (iii) the debt service coverage ratios were insufficient; (iv) the credit request relied only on forward-looking financial statements; and (v) the loans allowed the borrower to make draws in excess of the amount required to purchase semi-tractors.

Among the noteworthy allegations in the FDIC's complaint is that the president and chief lending officer closed a $1.8 million loan, despite the fact that it had not been approved by the Loan Committee. The FDIC is equally critical of the Loan Committee on this extension of credit. Once the Loan Committee learned that the loan had been closed, the FDIC alleges, it did not object or question the officers who had extended the unauthorized credit.

The FDIC asserted claims against all defendants for negligence (under Illinois law) and gross negligence (under FIRREA) for approving the failed loans, which the FDIC contends resulted in loan losses to Corn Belt of approximately $10.4 million. The FDIC asserted similar claims against the former president and chief lending officer for making the unauthorized loan, and for failing to properly administer loans and protect the bank's security interest in collateral.

This is the FDIC's first lawsuit that focuses on commercial lending practices outside of the real estate arena, and it serves to put the banking community on notice that the FDIC is not singularly focused on failed real estate loans.

<u>FDIC as Receiver for Washington Mutual Bank v. Killinger, et al., Filed Mar. 16, 2011</u>

FDIC Sues Three Former Washington Mutual Executives and Their Wives

Friday, April 1, 2011

Written by Jake Bielema

On March 16, 2011, the FDIC brought suit in the United States District Court in Seattle against three top executives of the failed Washington Mutual Bank, alleging that those executives' "gross negligence and breaches of fiduciary duty" caused WaMu to lose "billions of dollars." In a further sign that the FDIC intends to be aggressive in such matters, the FDIC named as defendants two of the executives' wives, alleging that they improperly received transfers of property before and after WaMu's September 2008 failure.

The lawsuit represents the sixth lawsuit to date filed by the FDIC against former directors and/or officers of failed banks following the recent economic downturn. It is significant because WaMu represented the largest bank failure in U.S. history, with assets that stood at more than $300 billion dollars when it failed.

The complaint does not set a specific amount of damages sought, but the damages could well exceed $900 million. The complaint generally alleges that the executives focused on short term gains to increase their own compensation, and disregarded the best interests of the institution for the longer term. Specifically, the complaint alleges that the bank's home loans division recklessly made billions of dollars of loans which were highly risky, single family residential loans, which dramatically heightened the risk profile of the loans held in WaMu's portfolio. The complaint alleges that this high concentration in high risk residential loans, positioned the bank such that it would be impossible for it to survive what characterized as "the inevitable decline in the overrated housing market."

There have also been reports that the FDIC reached an agreement with WaMu's outside directors for a payment of $125 million to settle all potential claims. If these reports are in fact accurate, it is interesting that the settlement amount was negotiated and finalized without the initiation of any litigation.

Finally, the FDIC has made it clear that it will be pursuing more of these types of claims. The FDIC's Professional Liability Lawsuits page shows that the FDIC's Board has approved lawsuits against 158 individual directors and officers of failed banks, while filed lawsuits only name 40 individual defendants so far. Thus, it would appear that far more litigation is on the way.

FDIC as Receiver for Wheatland Bank v. Spangler, et al., Filed May 5, 2011

FDIC Sues Former Directors and Officers of Wheatland Bank

Thursday, May 19, 2011

Written by Bard Brockman

The FDIC filed its seventh D&O lawsuit since the beginning of the current economic downturn. The complaint was filed against the former directors and officers of Wheatland Bank of Naperville, Illinois. See a copy of the FDIC's complaint.

The FDIC's theory about the ultimate failure of Wheatland Bank has a ring of familiarity to it by now. It contends that the bank pursued rapid asset growth concentrated on high-risk commercial real estate (CRE) loans, without implementing adequate loan underwriting and credit administration practices to manage the risk. The FDIC also alleges that the bank routinely violated its loan policies, approved loans that had little chance of repayment, and repeatedly ignored regulators' warnings about its risk lending practices.

The complaint asserts two primary case theories. First, it alleges that the members of the bank's Loan Committee (which included two non-director officers) approved high-risk insider loans to "favored shareholders or borrowers" without adequate analysis or collateral, and failed to pursue the borrowers or guarantors after those loans went into default. The FDIC asserts alternative claims against the Loan Committee defendants for gross negligence (under FIRREA), negligence, breach of fiduciary, and breach of loyalty for the more than $22 million of losses caused by eight loan defaults.

Second, the FDIC asserts negligence and gross negligence claims against the director defendants for their failure to properly supervise the operations of the bank. Specifically, the FDIC alleges that the director defendants permitted management to violate the bank's business plan and loans policies; that they failed to select and retain competent management; and that they failed to exercise independent judgment in evaluating the actions and competency of management.

This second set of claims is perhaps the most intriguing. It signals that the FDIC is not concentrating solely on the directors and officers who comprise the loan committee. Instead, the FDIC will seek to hold directors liable for alleged breaches in connection with their ultimate role in supervising the management and operations of the bank.

FDIC as Receiver of IndyMac Bank, F.S.B. v. Perry, Filed Jul. 6, 2011

FDIC Sues Former IndyMac CEO for Over $600 Million

Monday, August 1, 2011

Written by Bard Brockman

On July 6, 2011, the FDIC filed a civil complaint against Michael Perry, the former chief executive officer of IndyMac Bank, F.S.B. ("IndyMac"). A copy of the complaint is available here. The lawsuit is the FDIC's eighth lawsuit against directors or officers of failed banks in the current economic downturn, and it comes a little more than one year after its first D&O lawsuit (against four senior officers of IndyMac's home builders division).

In its complaint against Mr. Perry, the FDIC chronicles IndyMac's meteoric rise as an independent mortgage lender. For instance, between 2000 and 2006, IndyMac increased its mortgage loan production from approximately $10 billion to almost $92 billion, most of which was sold in the secondary market. According to the complaint, IndyMac's principal mortgage product was a high-risk "Alt-A" loan, which was typically marketed to borrowers with less than full documentation, lower credit scores and higher loan-to-value ratios.

The crux of the FDIC's complaint is that Mr. Perry neglected to comply with his duties as CEO, and that he presided over IndyMac's aggressive generation of residential loans at a time when he knew the secondary market was volatile and uncertain. When IndyMac could not profitably sell those loans in the secondary market, it transferred the loans to its internal "Hold for Investment" portfolio. The mortgage loans generated in the six-month period between April and October 2007 alone resulted in more than $600 million of liquidated losses for the bank. The FDIC believes that IndyMac suffered additional losses for loans generated in 2008, but it has not determined the amount of those losses just yet.

To support its contention that Mr. Perry knew that the secondary market for residential loans was rapidly deteriorating, the FDIC quotes from dozens of Mr. Perry's e-mails dating back to 2004. It also cites several unhelpful admissions that Mr. Perry allegedly made in internal e-mails after the bursting of the real estate bubble (e.g., "we were idiots, absolute idiots to allow ourselves to do 80/20 piggybacks at the tail end of a long run in housing . . .").

Before its failure, IndyMac grew to be the nation's second largest mortgage lender and the seventh largest S&L association. The FDIC seems determined to make many of the key players at IndyMac answer for that very public failure.

FDIC as Receiver of Haven Trust Bank v. Briscoe, Filed Jul. 14, 2011

FDIC Sues Former Directors and Officers of Haven Trust Bank

Monday, July 18, 2011

Written by Bard Brockman

The FDIC filed its ninth lawsuit against directors or officers of failed financial institutions since the onset of the current economic downturn. On July 14th, the FDIC filed a civil complaint against the directors and three senior officers of Haven Trust Bank (Duluth, Ga.), which was placed into receivership in December 2008. The FDIC estimates the failure of Haven Trust Bank will cost the Federal Deposit Insurance Fund approximately $248 million. We have posted a copy of the complaint.

Some of the core allegations in the FDIC's complaint are very familiar by now. The FDIC alleges that the Haven Trust defendants implemented an unsustainable business model focused on rapid asset growth heavily concentrated in high-risk commercial real estate ("CRE") loans. It further contends that the defendants failed to maintain adequate internal controls, loan underwriting policies, and sufficient credit administration procedures necessary to oversee and manage the operations of the bank. The FDIC alleges that the defendants continued to pursue an aggressive CRE lending strategy throughout most of 2008, after regulators had cautioned them about the bank's poor asset quality and rapidly deteriorating capital ratios.

The unique allegations in the complaint center on the influence the FDIC contends was exercised by two of the directors, R.C. Patel and Mike Patel, who collectively owned a controlling interest in the bank. Specifically, the FDIC contends that the bank made numerous imprudent insider loans (exceeding $7 million) to the Patels or their relatives, all for the Patels' personal benefit. The FDIC also alleges that despite the bank's rapidly declining capital-to-asset ratios, the defendant directors authorized dividend payments to the bank holding company in the months prior to the receivership.

The FDIC's complaint asserts state law claims for negligence and breach of fiduciary duty, and an additional claim for gross negligence under FIRREA. The total amount of the damages sought is estimated to exceed $40 million.

FDIC as Receiver of Michigan Heritage Bank v. Cuttle, Filed Aug. 8, 2011

FDIC Files Lawsuit Against Former Senior Loan Officer

Monday, October 10, 2011

Written by Bard Brockman

On August 8, 2011, the FDIC filed a lawsuit against Timothy J. Cuttle, the former Senior Loan Officer of Michigan Heritage Bank, which was placed into receivership in April 2009. A copy of the FDIC's complaint is available here. Although the FDIC has included loan officers among the defendants in some of its prior D&O lawsuits, this is the first time in the current litigation cycle that the FDIC has targeted its claims against a single loan officer.

The FDIC's focus on the Senior Loan Officer is likely largely attributable to the Bank's detailed written Lending Policy, which assigned strict and specific responsibilities to the Bank's loan officers. According to the FDIC's complaint, the Senior Loan Officer violated the Lending Policy, as well as prudent lending practices, in connection with eleven (11) commercial loans, which resulted in losses in excess of $8.2 million. The complaint asserts state law claims for negligence and breach of fiduciary duty, and a gross negligence claim under FIRREA, for the following types of misconduct:

- causing the Bank to approve and fund loans based on inadequate collateral;
- causing the Bank to approve and fund loans based on inadequate, incomplete, in accurate or unrealistic appraisals;
- failing to adequately inspect real estate taken as collateral;
- causing the Bank to approve and fund loans without requiring adequate sources of repayment;
- causing the Bank to approve and fund loans without adequately analyzing debt service coverage ratios and the borrowers' abilities to perform on the loans;
- failing to ensure that loans closed according to the terms approved; and
- causing the Bank to approve and fund CRE loans in which the project equity contribution from the borrower was not evaluated or was inadequate.

Although the FDIC targets the Senior Loan Officer, the lawsuit makes clear that the loans at issue were approved by a Senior Loan Committee, and in a few instances, by the Bank's board of directors. So why has the FDIC seemingly departed from its prior practice and not sued the Senior Loan Committee or the directors in this case?

The complaint offers clues to two possible explanations.

First, for many of the loans at issue, the FDIC alleges that the Senior Loan Officer withheld key information from the Senior Loan Committee and the board, and that the Bank would not have approved the loans had that information been disclosed.

Second, and perhaps more importantly, the complaint reveals that the Bank eventually demoted the officer and removed him from the Senior Loan Committee in May 2007 – two years before the Bank's failure. He eventually left the Bank's employ. That affirmative disciplinary action may have spared the Senior Loan Committee and the board of directors from being named as co-defendants in the lawsuit.

FDIC as Receiver of The Columbian Bank and Trust Co. v. McCaffree, Filed Aug. 9, 2011

FDIC Sues Directors of Columbian Bank and Trust

Tuesday, October 11, 2011

Written by Bard Brockman

In the second of three D&O lawsuits filed on successive days in August, the FDIC sued six former directors of Columbian Bank and Trust (Topeka, KS), which was placed into receivership in August 2008. A copy of the FDIC's complaint is available here.

The FDIC's complaint alleges that Columbian embarked on an aggressive commercial and CRE lending program in 2003 to drive up the Bank's revenues. In furtherance of this lending program, the FDIC contends, Columbian incentivized its loan officers to generate loans, at the expense of credit quality. The FDIC further alleges that this "uncontrolled" lending campaign, combined with the defendants' several other failures — most notably, the failure to heed regulators' warnings and to follow the Bank's own loan policies – caused the 40-year-old Columbian Bank to collapse in just five years.

The complaint focuses on losses resulting from loans to twelve sets of borrowers. The FDIC is seeking to hold the former directors for the total amount of those loan losses, which is over $52 million.

Aside from the FDIC's contention that the loans at issue violated the Bank's loan policy and were the product of a negligent underwriting and approval process, the loans bear few common characteristics. In one example, the FDIC alleges that Columbian made a series of loans ($18 million in total) to a newly-formed LLC to purchase and rehab a commercial office building in Kansas City that had no signed leases or tenants. Columbian apparently never prepared a DSC or cash flow analysis on the project; nor did it obtain financial statements on the borrower or its guarantors. The project failed, and the Bank ultimately suffered losses of nearly $8 million.

The FDIC's complaint presents two case theories: (1) that the defendants were negligent and/or breached their fiduciary duty with respect to approval of the failed loans; and (2) that the defendants were negligent and/or breached their fiduciary duty in connection with their failure to properly supervise the Bank's officers and employees. These two case theories are presented in the context of claims for gross negligence (under FIRREA), negligence under state law, and breach of fiduciary duty under state law.

Perhaps the most interesting aspect of the FDIC's complaint is the allegation that the six defendants, along with "other culpable former directors," constituted a majority of the Bank's board. This clearly suggests that the FDIC has elected not to sue all of the former Columbian directors, despite its assertion that they are "culpable" for the Bank's failure.

Why the FDIC has chosen not to sue other former directors of Columbian is not clear from the complaint. One possible explanation is that the defendant directors all served on the Director's Loan Committee and that the other former directors did not. This does not seem plausible, however, since Columbian's own loan policy invests ultimate responsible for all lending activities with the full board. Other possible explanations could be that the non-defendant directors did not vote for the loan loss transactions at issue in the complaint, or that they voiced concern with Columbian's aggressive lending strategy. Regardless of the reason they were omitted from the complaint, we view this as an encouraging sign that the FDIC will not automatically seek to attach liability to any and every person who served as a director of a failed banking institution.

FDIC as Receiver for Cooperative Bank v. Rippy, Filed Aug. 10, 2011

FDIC Sues Former Directors and Officers of Cooperative Bank

Wednesday, October 12, 2011

Written by Bard Brockman

On August 10, 2011, the FDIC sued nine former directors and officers of Cooperative Bank (Wilmington, NC), which was placed into receivership in June 2009. A copy of the FDIC's complaint is available here.

In its complaint, the FDIC alleges that the board and senior management of Cooperative Bank instituted a strategy in 2001 to grow from the Bank's assets from $443 million to $1 billion by the end of 2005. The Bank did not meet that goal, but the board and senior management reaffirmed the goal to become a $1 billion bank, and pursued an aggressive growth plan in furtherance of that goal. That aggressive growth plan, the FDIC alleges, caused the Bank to become over-concentrated in acquisition, development and construction ("ADC") loans. Furthermore, the FDIC contends, the defendants "failed to manage the inherent risks associated" with the aggressive growth strategy. Specifically, the director defendants permitted a lax loan approval process that did not include a formal loan committee to review an analyze loans; instead, the Bank relied on various levels of loan approval authority, which were routinely violated. State and federal regulators repeatedly warned Cooperative's management about the risks associated with its high concentration in speculative loans and weaknesses in its lending function, but the FDIC states those warnings were ignored.

The FDIC's complaint seeks approximately $34.5 million of damages on negligence and breach of fiduciary duty theories. The alleged damages flow from two types of loan losses.

The first set of losses resulted from Cooperative's "Lot Loan Program," in which the Bank provided credit to borrowers to buy vacant lots for the purported purpose of eventually building vacation homes in developments along the North Carolina coast. In reality, the FDIC alleges, Cooperative provided lot loans to out-of-state, speculative buyers (many of whom intended to "flip" the lots) on artificially-inflated appraisals.

The Lot Loan program was particularly ill-advised, the FDIC contends, because the Bank's senior management acknowledged from the start that the lot loans would not be profitable for the Bank. The senior managers viewed the Lot Loan Program as a "loss leader," which would put the Bank in a better position to provide construction financing when the buyers were ready to build.

In the course of setting up the Lot Loan Program, the Bank's senior management represented to the Bank's ALCO Committee that the lot loans would be limited to a 90% loan-to-value ratio, and that payments would not be interest-only (which had been a concern of the regulators). Even at 90% LTV, the lot loans violated the Bank's own Loan Policy, which allowed only a 65% LTV limit for raw land and a 75% LTV limit for land development. To make matters worse, the lot loans were no-equity loans, with interest-only payments, and the majority of the lot loans were "stated income" (no-document) loans.

Cooperative's board learned about the high-risk Lot Loan Program at a board meeting on July 17, 2007, and specifically determined that the lot loans did not comply with the Bank's Loan Policy. Nevertheless, the board took no corrective action, and the Bank continued to make risk lot loans for several more months. The FDIC is seeking to recover damages of nearly $10 million against the Bank's senior management – the president and EVP for mortgage lending – for the lot loans extended before the July 17, 2007 board meeting. It is also seeking to hold the senior managers and all of the directors liable for approximately $4.5 million of losses on lot loans extended after that July 17, 2007 board meeting.

In addition, the FDIC is seeking to damages of over $20 million for losses suffered on nine commercial real estate loans. The key allegations with respect to these losses is that the director defendants approved these loans without any formal loan review or evaluation process. Instead, the Bank's president called individual directors and secured telephonic approval until he had enough votes to approve a loan. The director defendants did not have copies of the loan files or any other presentations to evaluate the loan when they purportedly approved them by telephone.

FDIC as Receiver for Silverton National Bank, N.A. v. Bryan, Filed Aug. 22, 2011

FDIC Sues Directors and Officers of Silverton Bank

Wednesday, September 14, 2011

Written by Bard Brockman and Rob Klingler

On August 22, 2011, the FDIC filed a complaint in the U.S. District Court for the Northern District of Georgia against the former directors and executive officers of Silverton Bank, N.A. Silverton was declared insolvent and placed into FDIC receivership on May 1, 2009.

Silverton, formerly known as The Banker's Bank, was not a traditional banking institution. It provided correspondent and clearinghouse services, among other financial services, to community banks only. Silverton was owned by investor banks, and its board was comprised entirely of experienced community bankers.

The FDIC's account of Silverton's failure contains many of the same hallmark allegations present in its prior D&O lawsuits:

- overly-aggressive growth goals;
- compensation that incentivized loan production regardless of asset quality;
- expansion of lending into unfamiliar geographic markets;
- heavy focus on risky CRE and ADC lending;
- significant weaknesses in loan underwriting and credit administration;
- ignored warnings from state and federal banking regulators; and
- complete disregard of deteriorating economic conditions.

As it has done in prior lawsuits, the FDIC has identified several failed credit transactions that it contends are examples of negligence, gross and a breach of fiduciary duty by the directors or officers who approved them. In total, the FDIC seeks damages in excess of $61 million for fifteen (15) specific credit transactions.

Although it contains some familiar allegations and case themes, the FDIC's complaint against the Silverton D&Os is unique, both in substance and tone. For the first time in the current downturn, the FDIC seeks to hold directors liable for instances of what it describes as "corporate waste." Specifically, the complaint recites several examples of Silverton's "extravagant spending" while the economy was in decline, including: (i) the purchase of two corporate aircraft for the bank holding company; (ii) the construction of a new airplane hangar for the holding company on leased property; (iii) the construction of a "lavish" new office building, which Silverton occupied 20 months before the expiration of its then-current lease. The FDIC alleges that the directors who authorized these specific expenditures are liable for more than $10 million of "corporate waste."

The tenor of the FDIC's allegations against the Silverton D&Os is more strident than in its prior lawsuits. The FDIC is particularly critical of the Silverton board, which was comprised of CEOs or presidents of other community banks. That experience and specialized knowledge, the FDIC contends, imposed a heightened duty on the directors to discharge the duties owed to the bank.

Bryan Cave banking partner Walt Moeling, who represented Silverton in connection with certain regulatory matters, has a different perspective on the immediate cause of Silverton's failure. The Atlanta Journal-Constitution interviewed Walt about Silverton's failure. Here is an excerpt from that article:

> Ultimately, Moeling said, Silverton failed not because of its lending or spending, but because it is structured differently than most banks.
>
> As a bank for banks, Silverton's services included clearing checks, offering short-term investments for banks' cash, financing new bank startups and divvying up and selling

> parts of loans – known as "participations" – that were too large for any single bank to handle.
>
> To fund its operations, Moeling said, Silverton depended on member banks' cash deposits in their check-clearing accounts and short-term investments. For each member, those accounts often totaled millions of dollars – well above the FDIC's deposit guarantee of $250,000.
>
> When rumors of Silverton's troubles surfaced in early 2009, a modern-day run on the bank occurred. Member banks pulled out their money and turned to the Federal Reserve to clear their checks and hold their cash.
>
> "Once the cracks began to appear, the member banks felt that they couldn't have uninsured deposits," Moeling said. Silverton "went from very liquid to out of cash, very, very fast."

Finally, the FDIC's complaint is also unique in that it includes a direct claim against the primary and excess D&O insurance carriers. The facts giving rise to that claim are interesting. According to the complaint, Silverton paid the premium for a primary D&O policy with Chubb. Chubb forwarded a Binder that referenced several endorsements, including a Regulatory Exclusion, which would operate to exclude from coverage any claims brought by federal or state regulators. However, when the D&O Policy was issued about one month later, it did not include contain a Regulatory Exclusion endorsement. One month later, on the very afternoon that Silverton was closed and the FDIC was appointed as receiver, Chubb's underwriting officer forwarded the Regulatory Exclusion, which he claimed had been omitted from the policy in error. When the FDIC later asserted a civil demand under the D&O policy, Chubb denied coverage due to the Regulatory Exclusion. As part of its complaint, the FDIC is asserting a claim for declaratory relief against Chubb and the excess carrier, Westchester, to have the court determine whether the Regulatory Exclusion is part of the D&O policies.

FDIC as Receiver for First National Bank of Nevada v. Dorris, Filed Aug. 23, 2011

Recent Settlement Indicates FDIC's Focus on D&O Insurance

Monday, October 10, 2011

Written by Jake Bielema

A recent negotiated settlement in an FDIC failed bank lawsuit, which has as its sole focus potentially available funds under a D&O policy, and in fact assigns claims under that policy to the FDIC, further suggests that the FDIC's real focus in failed bank litigation is on proceeds that may be available under D&O policies, as opposed to the personal assets of former directors and former officers.

The First National Bank of Nevada ("FNB Nevada") failed on July 25, 2008, less than thirty days after First National Bank of Arizona ("FNB Arizona") was merged with an into FNB Nevada. On August 23, 2011, the FDIC filed an action in the District of Arizona against the former CEO and Vice Chairman of the Bank's holding company as well as of both FNB Nevada and FNB Arizona and additionally against the holding company's Executive Vice President ("EVP"), who was also the EVP of FNB Nevada and FNB Arizona. There was nothing remarkable about the FDIC's complaint, which basically alleged negligence and gross negligence in lending, primarily at FNB Arizona, which allegedly resulted in millions of dollars of bad loans that ultimately contributed to the Bank's failure.

What is remarkable about the FNB Nevada case is that shortly after the complaint was filed, on September 2, 2011, the FDIC and the two named defendants jointly filed a Motion for Entry of Judgment which would in effect settle all of the FDIC's claims against the two named defendants. In the proposed settlement contemplated by the Motion for Entry of Judgment, each of the individuals consented to the entry against them of separate judgments in the amount of $20 million. Notably, however, those amounts were to be paid only through what the FDIC is able to recover from the D&O carrier, Catlin, which had denied coverage and refused to defend the FDIC's claims on behalf of the named defendants. The settlement specifically provides that the FDIC will not pursue any aspect of the judgment against the named defendants individually, and will limit its efforts at recovery to its claims for wrongful denial of coverage against the D&O carrier.

This settlement no doubt had some appeal to the two named defendants, in that it, if approved, it will result in a full release of any and all claims against them individually, as well as an agreement not to pursue any aspect of the agreed upon judgment from them individually. However, the insurance company is likely to take the position that the settlement, which was entered into without development of any actual evidence or proof that either of the named defendants engaged in any kind of actionable wrong-doing, was collusive and was entered into without any rational analysis, and solely at the expense of the carrier. The response to that, however, is likely to be that the D&O carrier should not now be heard to criticize the manner and extent to which the FDIC's claims were analyzed or defended, after it refused to provide any coverage under the policy or to provide any defense to the named defendants.

In any event, it is yet another indication that the FDIC's primary focus in the failed bank litigation is the proceeds of directors and officer liability policies, not the personal assets of former officers and directors of failed institutions.

FDIC as Receiver for Alpha Bank v. Blackwell, Filed Oct. 7, 2011

FDIC Sues Former Directors and Officers of Alpha Bank & Trust

Wednesday, October 12, 2011

Written by Bard Brockman

On October 7, 2011, the FDIC filed a complaint against the former directors and senior officers of Alpha Bank & Trust (Alpharetta, Ga.), which was put into receivership on October 24, 2008. A copy of the FDIC's complaint is available here. Alpha Bank & Trust ("Alpha" or the "Bank") opened in May 2006 and operated for only thirty (30) months. Nevertheless, the FDIC estimates that the failure of Alpha will cause the Deposit Insurance Fund to lose $214.5 million.

According to the complaint, Alpha embarked on an aggressive growth strategy that focused on making risky loans in the acquisition, development and construction ("ADC") and commercial real estate ("CRE") sectors. The complaint also alleges that the Bank incentivized loans officers to generate loans, regardless of credit quality or loan performance, and that the

Bank either disregarded or rejected warnings from regulators and third-party loan review consultants.

The complaint seeks to recover $23.92 million in damages directly tied to losses suffered on thirteen separate bad credits. The defendants were all members of the Director's Loan Committee, and according to the complaint, they each voted to approve one or more of the subject loans. Their alleged failures and omissions included the following:

- failure to follow the Bank's existing loan policies;
- failure to inform themselves and each other about the true nature and condition of the Bank's loan portfolio;
- failure to adopt and enforce prudent underwriting procedures and appropriate loan-to-value ratios;
- approving loans to borrowers who were or who should have been known to be not creditworthy;
- approving loans to be made on an unsecured or under-secured basis;
- approving loans made on the basis of inadequate or non-existent appraisals;
- causing or permitting loans to be made without properly and promptly perfecting security interests in the loan collateral; and
- failure to exercise their duties to manage and supervise the affairs of the Bank in a safe, sound and prudent manner.

The complaint asserts a state law claim for negligence and a claim for gross negligence under FIRREA. Interestingly, the FDIC does not assert a separate state law claim for breach of fiduciary duty, even though it has consistently pled that claim in nearly every other D&O lawsuit to date.

FDIC as Receiver for Mutual Bank v. Mahajan, Filed Oct. 25, 2011

FDIC Sues Former Directors, Officers and Outside Counsel of Mutual Bank

Friday, November 11, 2011

Written by Bard Brockman

The FDIC sued the former directors and two former officers of Mutual Bank (Homewood, Illinois), along with Mutual Bank's outside law firm, on October 25, 2011. Mutual Bank was placed into FDIC receivership in July 2009, and its failure currently is estimated to cost the Deposit Insurance Fund $775 million. A copy of the FDIC's complaint is available here.

One of the unique aspects of this lawsuit is the FDIC's allegations of corporate waste. For example, the FDIC alleges that the directors approved a $250,000 payment for sponsorship of a "bank function." The bank function was actually the wedding of one of the directors, who was also the chairman's and principal shareholder's son. In another example, the FDIC alleges that the directors allowed $495,000 of Bank funds to be used to make payments to another director for his wife's defense of a Medicare fraud case. In yet another example, the FDIC alleges that the directors permitted roughly $300,000 of Bank funds to be used to fund travel to an unnecessary directors' meeting in Monte Carlo. In total, the FDIC is seeking to recover at least $1.09 million from the directors who approved the wasteful transactions.

The FDIC is also suing the directors for their approval of $10.5 million of illegal dividend payments in 2007 and 2008, at a time when the Bank was hemorrhaging and under severe regulatory criticism. The dividends were paid to the bank holding company, which in turn paid them to the shareholders, with 95% of the dividends being paid to the controlling family, which had four members on the Bank board.

The bulk of the FDIC's complaint is devoted to its claims against the directors and senior officer defendants for approval of twelve loans that resulted in losses of over $115 million for the Bank. As a backdrop for those claims, the FDIC describes a litany of the Bank's operational deficiencies and failures, including: (i) a "dangerous" concentration in CRE and ADC loans; (ii) a failure to maintain a proper credit administration staff; (iii) an inappropriate reliance on outside mortgage brokers to structure and facilitate large loans; (iv) a failure to establish procedures to ensure compliance with the Bank's loan policy and prudent lending practices; (v) an inability to generate timely and accurate financial reports; (vi) a routine disregard of the Bank's loan policy; and (vii) an arrogant disregard of bank regulators and their criticisms.

Most of the bad loans were for purchase or refurbishing of existing hotel properties, and most of them were made after the commercial real estate market had started to decline and collateral values had plummeted. In one example, in February 2008, the director and officers defendants approved a loan for nearly $29 million to a limited liability company to renovate a hotel in south Florida. Approximately $20 million of the loan was used to refinance a prior loan that was already in default. The Bank disbursed the funds without first obtaining formal approval by the loan committee. Furthermore, at the time of the loan, the borrower had not received the required construction permits. The Bank failed to monitor the project, and it disbursed construction draws on sham purchase orders. In the end, the FDIC alleges, the estimated losses attributable to this loan are in excess of $16 million, plus interest.

Finally, the FDIC also asserts claims for legal malpractice, breach of fiduciary duty, and aiding and abetting against the Bank's primary outside counsel (who was also a director) and his law firm. In short, the FDIC alleges the Bank's lawyer was aware of the regulators' warnings about the Bank's overconcentration in out-of-area projects; its poor underwriting practices; its inability or unwillingness to monitor and control large loans; and its overconcentration in the hotel industry. Despite that knowledge, the FDIC alleges, the lawyer and his firm actively facilitated "massive" loans to developers that they knew or should have known would inflict huge losses on the Bank. The FDIC also alleges that the lawyer and his firm failed to counsel the Bank on the illegality of the $10.5 million of dividend payments to the holding company. In total, the FDIC is seeking $79 million in damages against the lawyer and his firm, plus a disgorgement of the more than $3 million of legal fees paid to the firm between January 2007 and April 2009.

FDIC as Receiver for Westsound Bank v. Johnson, Filed Nov. 18, 2011

FDIC Sues Former Directors and Officers of Westsound Bank

Tuesday, January 24, 2012

Written by Bard Brockman

In mid-November 2011, the FDIC filed a complaint against eleven former directors and officers of Westsound Bank (Bremerton, WA), which was closed in May 2009. The lawsuit is the FDIC's seventeenth action against former D&Os of failed banking institutions since the advent of the Great Recession. A copy of the FDIC's complaint is available here.

The FDIC's core allegations resemble those asserted in its prior D&O lawsuits. Specifically, it alleges that the Westsound board embarked on a "reckless" business strategy focused on high-risk ADC and CRE lending. The FDIC further contends that the board and the Directors Loan Committee ("DLC"): (i) failed to properly manage and supervise the bank's lending function; (ii) approved loans in violation of and without regard to the bank's loan policy; (iii) ignored regulators' warnings about excessive loan concentrations and lax oversight of the lending function; and (iv) approved additional loans and loan renewals and advances to mask non-performing credits.

The FDIC seeks to recover damages in excess of $15 million on claims for gross negligence (under FIRREA), and state law claims for negligence and breach of fiduciary duty. Its alleged damages are tied to 35 specific credits, including seven ADC/CRE loans, and seven other loans to insiders allegedly made without board approval in violation of Reg. O.

The most interesting loan losses arise from 21 loans made to members of the local Russian/Ukranian community. These loans were among 142 "fraudulent" loans originated by a single loan officer, who the FDIC alleges colluded with a non-bank employee, Aleksandr Kravchenko, to bring loans to the bank. According to the complaint, Mr. Kravchenko frequently purchased properties, and then would find a straw buyer to obtain the loan to buy the property and fund construction of a spec home. Mr. Kravchenko, through his construction company, often received a "development fee" of $10,000 – $15,000 from the loan proceeds, although no work was performed for the fee.

The FDIC contends that, under the bank's loan policy, these loans should have been considered by the Directors' Loan Committee ("DLC"). Instead, these loans were approved through an automated (and easily manipulated) process reserved for loans intended to be sold into the secondary market. Most of the loans provided 100% financing, and many were based on stated-income or incomplete and questionable financial information. Additionally, the appraisals used to support automated approval were based upon an "as-built" valuation, even where the proposed borrower had not submitted building plans. Furthermore, the loan officer who originated the loans earned more than $1 million in commissions alone, including commissions on renewals of non-performing loans, in less than two years. The FDIC alleges that regulators warned the board that the bank's lending function, and specifically the protocol that allowed the loan officer to obtain approval of the questionable credits, was "malfunctioning." It further alleges that the board did not address the problem in a timely fashion, allowing the loan officer to extend credit on the 21 "fraudulent" loans for which the FDIC is now seeking to recover damages.

FDIC as Receiver for Bank of Asheville v. Greenwood, Filed Dec. 29, 2011

FDIC Files Suit Against Former Directors of The Bank of Asheville

Wednesday, January 25, 2012

Written by Jake Bielema

On December 29, 2011, the FDIC filed suit against seven former directors of the Bank of Asheville in the Western District of North Carolina seeking to recover over $6.8 million in losses suffered by the bank prior to receivership. All of the directors named as defendants were members of the bank's Loan Committee, the committee responsible "for the amplification, implementation and administration of the loan policy" and "management of the lending function". The Complaint cites 30 specific commercial real estate and business loans approved by the defendants between June 26, 2007 and December 24, 2009 as causing loss to the bank and those loans form the subject matter of the Complaint. A copy of the FDIC's complaint is available here.

In the Complaint, the FDIC as Receiver essentially cites the Bank's rapid growth strategy concentrated in what it characterizes as "higher risk, speculative commercial real estate loans". The Complaint alleges that the defendants had virtually no previous banking or commercial real estate lending experience, failed to implement even the most basic prudent lending controls, and neglected to adequately supervise inexperienced and under qualified lending personnel. The complaint further alleges that the defendants failed to heed warnings by State and Federal regulators as well as outside auditors of the increasing risk associated with the bank's highly concentrated commercial real estate loan portfolio. The complaint alleges that once those risks began to manifest themselves, the defendants "took actions that masked the bank's mounting problems" by approving additional loss loans and renewing and making additional advances on other non-performing loans, as well as replenishing interest reserves which allowed borrowers to pay interest with more borrowed funds.

The Asheville suit brings to 18 the total number of lawsuits the FDIC has now filed against directors and/or officers of failed banks. What is most notable about the complaint is the absence of any particularly compelling allegation of wrongdoing, such as self dealing or personal enrichment, and the relatively small amount of the losses sought. The Asheville suit appears to be the clearest example yet of a suit that is based almost solely upon allegations of negligence relating to rapid growth and over concentration in commercial real estate, a fact pattern that was prevalent at hundreds of community banks during the real estate boom years. The Asheville suit may signify that the FDIC is becoming more aggressive in deciding which bank failures merit lawsuits, or it may signal that the FDIC believed it needed to file a lawsuit in order to get the attention of a D&O carrier. Based on the number of lawsuits that the FDIC has authorized, it is clear that there will be many more lawsuits to come against former directors and officers of failed banks.

FDIC as Receiver for R-G Premier Bank of Puerto Rico v. Galán-Alvarez, Filed Jan. 18, 2012

FDIC Sues Former Directors and Officers of R-G Premier Bank

Thursday, January 26, 2012

Written by Bard Brockman

On January 18, 2012, the FDIC filed a complaint against former directors and officers of R-G Premier Bank of Puerto Rico, which was closed and put into receivership on April 30, 2010. A copy of the FDIC's complaint is available here.

The roots of R-G Premier's failure, the FDIC contends, can be traced to the 2001 strategic decision to increase its commercial real estate lending. According to the complaint, the board of directors appointed a new Chief Lending Officer, Victor Irizarry, and it structured the Bank to give Irizarry "free rein" to make commercial real estate loans. Among the board's alleged failings was its decision to give Irizarry supervisory control of the Bank's credit risk management department. This reporting structure, the FDIC alleges, effectively squelched the credit risk personnel from voicing any concerns about the underwriting of loans or creditworthiness of borrowers. Internal audits and banking regulators both warned that the credit risk management function should be segregated from the loan department, but the board ignored those warnings.

The FDIC further alleges that the board itself essentially turned a "blind eye" to the Bank's lending function. Specifically, the FDIC alleges that the board failed to institute effective loan reviews, which in turn "undermined its own ability to monitor the health and quality of its rapidly expanding commercial loan portfolio." The board's failure to institute appropriate procedures and controls, combined with its resistance to recommended reform, resulted in the Bank's extension of over $350 million in loans that a "prudent banker should have known would probably never be repaid."

The FDIC asserts two claims for gross negligence against the D&O defendants. First, it asserts a claim against the director defendants (except for the advisory directors) for their grossly negligent failure to adequately supervise the Bank's lending function. And second, it alleges a claim for gross negligence arising from the approval of risky and imprudent loans by the officers and directors, including the advisory directors who voted for those loans. The FDIC prays for damages in excess of $257 million for loan losses arising from 77 specific failed credits.