



United States
Court of Appeals,
Ninth Circuit, 1999.
184 F.3d 1040.
<http://www.ce9.uscourts.gov>^a

Federal Deposit Insurance Corp. v. Castetter

BACKGROUND AND FACTS *Edward Peterson, a banker with twenty-six years of experience, opened Balboa National Bank in California in February 1983. Peterson was president, chief executive officer, and a member of the board of directors. None of the other directors, including Robert Castetter, had any significant banking experience. Peterson decided that the bank would focus on lending money to auto buyers. Frances Cragen, an experienced, high-level employee in Bank of America's auto loan department, came to work for Balboa. Peterson died unexpectedly in May 1984. The federal Office of the Comptroller of the Currency (OCC) examined the bank and found many problems. The board hired a new president and told him to implement better procedures for lending and collecting. The board also hired outside consultants for advice. In December, the directors fired Cragen and hired a national accounting firm to look more closely at the bank's lending practices. Problems continued, however, and the accounting firm's reports were found to be invalid. In 1987, the OCC found the board's supervision to be "inexcusable" and the bank's condition to be critical. Meanwhile, directors personally contributed over \$2.8 million to the bank in an attempt to save it. In 1988, the OCC ordered the bank to close. The Federal Deposit Insurance Corporation (FDIC)^b filed a suit in a federal district court against Castetter and the other directors, contending that they were negligent and personally liable for the bank's losses. The court applied California's business judgment rule in favor of the directors. The FDIC appealed to the U.S. Court of Appeals for the Ninth Circuit.*

a. In the "Info Links" column, click on the "Appeals Court Decisions" icon. On that page, click on "1999" to open the menu. Click on "July," and then scroll down the list to the name of the case (released "07/21/99") and click on it to access the opinion.

b. The Federal Deposit Insurance Corporation is a federal agency that insures, up to \$100,000, the deposits in banks and savings associations.

IN THE LANGUAGE OF THOMAS, Circuit Judge.

THE COURT

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* * * The California business judgment rule is intended to protect a director from liability for a mistake in business judgment which is made in good faith and in what he or she believes to be the best interest of the corporation, where no conflict of interest exists. It requires directors to act in good faith and with the prudence that an ordinary person would under like circumstances. However, it also entitles a director to rely on information supplied by others. *If directors meet the requirements of the business judgment rule, they are entitled to immunity from personal liability for acts of ordinary negligence* under California law. [Emphasis added.]

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* * * Under California law, a *prima facie* showing of good faith and reasonable investigation is established when a majority of the board is comprised of outside directors and the board has received the advice of independent consultants.

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Here, the defendant directors established a *prima facie* showing of a reasonable investigation. A majority of the board consisted of outside directors and it is undisputed that the board sought and obtained the advice of a number of outside expert consultants.

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This is not to say that directors of California corporations may immunize themselves simply by acquiring information. It is clear that the rule does not protect a director in certain situations, such as where there is a conflict of interest, fraud, oppression, or corruption. Neither does the business judgment rule protect a director who has wholly abdicated his corporate responsibility, closing his or her eyes to corporate affairs. But the rule does protect well-meaning directors who are misinformed, misguided, and honestly mistaken. * * *

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In this case, there is no dispute that the directors acted in good faith and with the belief that their actions were in the best interests of the corporation. The directors were initially misguided by the analysis of former President Peterson, who had over a quarter century of experience as a bank regulator. They were further misguided by an analysis of a national accounting firm. They attempted to follow the advice of several consultants, and invested—and lost—substantial sums of their own money. Despite these efforts, they were unable to avert the bank's collapse. The undisputed record indicates that the directors were entitled to the protection of the business judgment rule.

DECISION
AND REMEDY

The U.S. Court of Appeals for the Ninth Circuit affirmed the judgment of the lower court. The business judgment rule insulated the bank's directors from individual liability for the bank's losses.
