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Well Enough Alone: Liability for Wrongful Foreclosure

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WELL ENOUGH ALONE: LIABILITY FOR WRONGFUL FORECLOSURE

Chad J. Pomeroy[*]

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INTRODUCTION

In late 2010, two weeks before Christmas, Steve Curtis came home and found a foreclosure notice on the door of his Layton, Utah home.[1] The notice indicated that Bank of America, his lender, had begun foreclosure proceedings and that his house would soon be put up for auction.[2] Shocked, Curtis contacted the bank to tell it that he had never missed a mortgage payment and to ask it to cease its foreclosure process.[3] Unfortunately, the bank resisted, interrupting the foreclosure only after Curtis hired a lawyer and, even then, failing to proceed with a mortgage modification the parties had earlier agreed to and demanding reinstatement and legal fees and charges.[4] Curtis did not lose his house, but the entire process was painful and costly, an almost Kafkaesque series of bureaucratic mistakes and miscommunications.[5] And, most importantly, the entire process was wrongful: Mr. Curtis did not default on his loan, so the bank was not entitled to foreclose. Mr. Curtis should never have been damaged the way he was.

This scenario is, obviously, awful. The very idea of losing your home is painful, and the possibility of doing so through no fault of your own, or due to some sort of bureaucratic mistake or negligence, is particularly poignant. This should never happen—and yet it has happened, it is currently happening, and it will happen again.[6]

This palpable sense of a wrong in need of righting seems to cry out for some sort of intervention—for a real and concrete change to protect people who suffer this misdeed. Indeed, granting the legitimacy of that outrage and frustration, one may be tempted to construct whole new laws and rules of

1. *See* Candice Madsen, *Layton Mayor Steve Curtis Shares Story of Wrongful Foreclosure*, DESERET NEWS (Mar. 1, 2011), http://www.deseretnews.com/article/705367718/Layton-mayor-Steve-Curtis-shares-story-of-wrongful-foreclosure.html.

2. *See id.*

3. *See id.*

4. *See id.*

5. *See id.* Curtis contacted a homeowner advocate, Marco Fields, who described how difficult it is to work with the banks in these situations: "This is so far beyond advocacy. This is so far beyond a counselor. At the end of the day, you are going to need a five-star attorney." *Id.*

6. *See, e.g.*, Katie Fairbank, *Family Has $91,500 Waived after Bank of America Foreclosure Nightmare Lasted Years*, DALL. MORNING NEWS (Dec. 13, 2012), http://www.dallasnews.com/news/investigations/2012/12/13/problem-solver-family-has-91500-waived-after-bank-of-america-foreclosure-nightmare-lasted-years (detailing homeowners who "were mistakenly put into foreclosure," whose house "was sold at auction on the courthouse steps," and who "got a knock on the door and were told they had three days to get out"); Jessica Silver-Greenberg & Ben Protess, *Banks Find More Wrongful Foreclosures Among Military Members*, N.Y. TIMES (Mar. 3, 2013, 10:30 PM), https://dealbook.nytimes.com/2013/03/03/banks-find-more-wrongful-foreclosures-among-military-members/ ("The nation's biggest banks wrongfully foreclosed on more than 700 military members during the housing crisis and seized homes from roughly two dozen other borrowers who were current on their mortgage payments . . . ."). The examples are legion, and they are not difficult to find; a simple internet search reveals example after example, sad story after sad story.

liability intended to protect the defenseless and punish banks that wrongfully foreclose.[7] One should, however, resist that temptation.[8] This is because our legal system already has adequate safeguards and remedies to address wrongful foreclosure.

Part I of this Article both sets the stage for the current environment, in which banks and their officers and directors are under the spotlight and face an increasing amount of pressure due to their perceived role in the instigation of the Great Recession, and then examines in detail improvident lending and wrongful foreclosure, two of the wrongful acts banks have committed in connection with our current financial crisis that have generated a substantial amount of public interest and comment. Part II examines the potential of officer and director liability for these disparate elements of the Great Recession, looking first at the traditional scope of officer and director liability, and then turning to current calls to fundamentally expand this liability. Finally, Part III argues that the traditional scope of officer and director liability is sufficient, in the context of wrongful foreclosure, such that no expansion of responsibility is called for. This is because wrongful foreclosure, while a concrete and important part of our recent banking travails, is not implicated in the commencement or propagation of the Great Recession, which is the primary justification given for increased liability. Accordingly, this Article concludes that no expansion of liability for wrongful foreclosure is called for.

I. BANKS, THE GREAT RECESSION, AND FALLOUT

"There is nothing new under the sun."[9] Our economy is cyclical, "characterized by the repeated sequence of recessions, giving way to periods of prosperity, which are then followed again by recessions."[10] This view is widely held[11] but has seemed inadequate recently, given the long and prolonged economic slump that began in 2007 and continues, to some extent, to this day and which is widely known as "the Great Recession." This economic downturn is inextricably tied to the modern banking industry and its behavior over the last quarter century. In particular, many analysts and commentators believe that the banking industry substantially

7. The group of actors that wrongfully foreclose is not limited to banks. Any secured lender can foreclose—wrongfully or rightly—but most instances (and certainly most publicized instances) will involve banks.

8. In other words, we should not give into the siren call of what is, in the author's estimation, the most pernicious importuning in the English language: "There oughtta be a law!"

9. *Ecclesiastes* 1:9.

10. Thomas Brennan, Lee Epstein & Nancy Staudt, *Economic Trends and Judicial Outcomes: A Macrotheory of the Court*, 58 DUKE L.J. 1191, 1195 (2009).

11. "[T]he ups and downs in the economy are recurrent and expected . . . ." *Id.* at 1195 n.7.

instigated the recession and should be held accountable. This Part looks at the Great Recession as it relates to banking, generally, and to a number of banking actions and activities that have come under increased scrutiny as the recession has played out.

A. Banking and the Great Recession

The Great Recession is the largest economic downturn since the Great Depression and has had an unprecedented effect upon global economic progress and prosperity.[12] This was set off by a deep financial crisis that quickly spread to the wider economy.[13] It is not necessary here to attempt to comprehensively sum up the causes of the Great Recession or to exhaustively describe the role of the banking industry therein. Perhaps more than any other element of the U.S. economy, finance and banking is a global industry, reaching into, and affected by, national and international economic issues. It is part of a large machine, driven by global appetites for risk and return and responding to worldwide patterns of investing and spending, and we do not need to understand the entire machine for purposes of this Article.[14]

Instead, we can start in the late 1990s and early aughts, when the United States experienced a housing boom and a tremendous appreciation in real property values in concert with the banking sector's accelerated investment into residential real property lending. Both household homeownership rates and home prices rose significantly. More and more people were buying homes, which were appreciating faster and faster. This occurred to an especially significant degree in states such as California, Florida, Arizona, and Nevada. In those states, home prices doubled or more between 2000 and 2006.[15] Standing alone, this appreciation seemed

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12. "From 2007 to 2009, real GDP fell by 3.1 percentage points, real personal income per capita fell by 8.3 percentage points, and the national unemployment rate rose from 4.6 percent to 9.3 percent." Robert A. Moffitt, *The Great Recession and the Social Safety Net*, 650 ANNALS AM. ACAD. POL. & SOC. SCI. 143, 143 (2013).

13. *See, e.g.*, RICHARD A. POSNER, A FAILURE OF CAPITALISM 18–29 (2009).

14. This will be, of necessity, a relatively simplistic explanation of the origins of the Great Recession. "The financial crisis . . . had a number of causes—ranging from macro-economic conditions of excessive liquidity stemming from low interest rates and saving imbalances between the United States and Asia, which, in turn, fueled a bubble in housing prices in the United States; to micro-economic factors of risky borrowing against residential real estate through subprime loans; to conflicts of interest afflicting key gatekeepers, especially credit rating agencies; to legal factors flowing from a pervasive deregulatory philosophy." Franklin A. Gevurtz, *The Role of Corporate Law in Preventing a Financial Crisis: Reflections on* In re Citigroup Inc. Shareholder Derivative Litigation, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 113, 115–16 (2010) (footnotes omitted). The focus of this Article (and of many others), however, is the role of the American banking industry in the Great Recession.

15. *See* Press Release, Henry M. Paulson, Jr., Sec'y, U.S. Dep't of the Treasury, Remarks on U.S. Housing Market before FDIC's Forum on Mortgage Lending to Low and Moderate Income

wonderful. But it was symptomatic of a number of profound changes in the real estate and banking sectors that took place in the run-up to the Great Recession. Historically, commercial lending to residential purchasers was a low-risk, low-reward prospect, characterized by local banks extending loans to known borrowers based upon safe and conservative lending guidelines.[16] This lending paradigm changed significantly in the late 1990s.[17] At that point in time, lenders began to experiment heavily and to adjust the types of loans traditionally offered to borrowers. "For years, the only type [of loan available to residential borrowers] was a fully amortizing fixed interest rate mortgage."[18] This changed, though, as banks—buffeted by changing market conditions, encouraged by the risk-free nature of a lending market effectively underwritten by Fannie Mae and Freddie Mac, and driven by the market's demand for more and more mortgage-backed securities—sought to originate even more and more loans. Instead of fixed-rate loans, they began to offer variable rates, which started low and increased over time.[19] From there, the banks only got more imaginative, creating more and more risky and exotic types of loans marketed to an ever-broader swath of homebuyers.[20] These riskier loans quickly gained

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Households (July 8, 2008), http://www.treasury.gov/press-center/press-releases/Pages/hp1070.aspx. If these states sound familiar, it is because they were those hit hardest by the Great Recession, a connection that foreshadows the link between this outsized cycle of real estate appreciation and depreciation and the Great Recession, and a tie explained by the banking industry's involvement in the U.S. real estate market.

16. *See, e.g.*, JESSE DUKEMINIER ET AL., PROPERTY 645 (8th ed. 2014) ("Until the mid-1980s, a [potential borrower] would go to a local savings and loan association and borrow money to purchase [a] home. The association would make the loan from money in customer savings accounts, would secure the loan with a mortgage, and would hold the promissory note and the mortgage until the loan was fully repaid or otherwise terminated. Thus, the flow of mortgage money was geographically constrained . . . ."). Ultimately, a well-secured loan (i.e., a loan secured by real property the value of which exceeded the loan balance) extended pursuant to prudent lending guidelines simply was not particularly risky because, if the debtor defaulted, the creditor would simply seize the real estate security, sell it pursuant to foreclosure laws, and be made whole. *See, e.g.*, POSNER, *supra* note 13, at 20.

17. These changes were long in the making and had many mothers. Congress established the Federal National Mortgage Association (Fannie Mae) in 1938 and the Federal Home Loan Mortgage Corporation (Freddie Mac) in 1970, both of which created a secondary mortgage market by buying and selling loans originated by local lenders. *See* DUKEMINIER, *supra* note 16, at 645–46. This had the salutary effect of evening out the national lending market by allowing well-capitalized banks to lend into non-local markets, but it also began to create the patina of "risk-free" lending, permitting lenders to originate loans and then sell them without ever having to worry about whether or not the debtors performed. *See id.* It further deepened the potential problems associated with this newly risk-free environment by drastically increasing the capital devoted to lending. This occurred because Fannie Mae and Freddie Mac eventually agreed to guarantee securities composed of purchased mortgage loans (the now-infamous "mortgage-backed security"), which securities were then sold to open market investors. *See id.* This avenue of investment was highly attractive on the open market, thereby increasing the supply of capital for such loans (thereby reducing interest rates). *See id.*

18. *Id.* at 646.

19. *See id.*

20. The prime market typically focuses on people with high credit scores, verifiable income, and loan-to-value ratios of 80% to 90%, while the subprime market focuses on people with compromised

traction and market share, forming the core of an entirely new market, known as the subprime market or the Alt-A market.[21]

This worked fine for a time. For years, the banks originated these loans, packaged the loans into mortgage-backed securities, and used the proceeds from those sales to fuel profits and operations. This cycle was good for banks, for buyers, and for sellers, with the explosion of financing options enabling buyers to purchase at unprecedented rates, which created the rapidly expanding and appreciating home market described above. This cycle fed upon itself, with homeowners selling at artificially high prices[22] and then purchasing new homes at artificially high prices.[23] The values continued to rise, so long as buyers continued to buy, enabling buyers to push the market ever higher and protecting banks loans, which were secured by always-appreciating collateral.

Unfortunately, this state could not last. Starting in 2006, the market began to correct. As soon as this occurred, the lending–purchasing cycle described above collapsed inward. Buyers ceased buying, so sellers could not sell, meaning those sellers were unable to reap a profit and become buyers themselves—and also meaning that those non-selling homeowners began to default.[24] This had an enormously negative effect on banks because these now-trapped sellers very often could not service their loans, given the earlier proliferation of subprime loans, *which were targeted to people who were unlikely to repay their loans*.[25] This set off a raft of foreclosures, which affected bank profitability and capitalization (and which also weakened the market even further, driving prices lower, making

credit scores, unverified income, and lower loan-to-value ratios. *See id.* at 646; *see also* Marvin N. Bagwell, *Can't Live Without Air: Title Insurance and the Bursting of the Real Estate Bubble*, 30 PACE L. REV. 180, 196 (2009) ("Those who bought these securities wanted greater returns, so the bankers and the mortgage lenders who supplied them invented ways to increase the return. . . . And to further increase the supply of mortgages, lenders created their progeny: 'no-docs,' (no income verification loan); so-called 'ninja loans' (no income, no job, no assets); 'exploding loans' (loans where the interest rate adjusted rapidly and surprisingly upwards) and liar's loans (no nothing).").

21. *See* Michael Lewis, *The End*, PORTFOLIO (Nov. 2008), http://www-stat.wharton.upenn.edu/~steele/Courses/434/434Context/The%20End%20by%20Michael%20Lewis.pdf (noting that, between 2000 and 2005, the subprime market grew from $130 billion to $625 billion, with almost all of that increase bundled together and sold as mortgage-backed securities). By 2006, as much as 40% of the $3 trillion U.S. mortgage market was subprime. *See* POSNER, *supra* note 13, at 25.

22. Artificial from a historical standpoint.

23. During this period of time, many market participants began purchasing homes and real estate not for personal use but for purely speculative reasons, assuming that their recent purchases would appreciate and create a profit that was often used to purchase additional real estate, with the same goal and expectation ever in mind.

24. The bursting of the cycle was, in retrospect, inevitable and was bound to be set off by any pause in the inflationary cycle. Any lack of appreciation meant that the most recent round of subprime borrowers would find themselves trapped and unable to sell, thus setting off the deflationary spiral of defaults and depreciation.

25. "The unraveling of America's housing market revealed trillions of dollars . . . of over-inflated assets and thousands of mortgages in or nearing default." Lisa Sutton, *The Roots of the Credit Crunch of 2008*, 28 REV. BANKING & FIN. L. 3, 6 (2008).

it more difficult to sell, and pushing even more borrowers into default). As this deflation accelerated, banks found themselves paralyzed by fear and illiquidity—they could no longer generate new investment[26] and so ceased lending to borrowers of all stripes, prime and subprime alike.[27] Businesses and individuals alike were unable to borrow, for long- or short-term needs, meaning companies stopped hiring and consumers stopped purchasing.[28] This was a "credit crunch" affecting the entire global economy and spawning the phrase "the Great Recession."[29]

Banks and lending, then, were central to the greatest economic calamity in 75 years. Though banks are too often cast as the sole villain,[30]

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26. Through either investment in a ravaged stock market or through the generation of profit by originating new loans that could be packaged into marketable securities. Indeed, the complexity and lack of transparency surrounding previous generations of these securities exacerbated the wider liquidity crisis even further. Because these assets were poorly evaluated, and because the underlying assets were depreciating rapidly, banks and other asset holders were forced to write down their value, further compromising already battered balance sheets and making it even more difficult to raise funds. *See id.* at 7 ("[F]or credit markets, the real trouble rested in banks' inability to sell their leveraged loans.").

27. Once the liquidity of the system froze—due to an inability to generate additional loans and securities—markets failed, leaving governments as the lenders of last resort. Kathryn Judge, *The First Year: The Role of a Modern Lender of Last Resort*, 116 COLUM. L. REV. 843, 874–75 (2016). Banks and other financial institutions throughout the world were exposed to the U.S. housing market-based contagion due to the global proliferation of mortgage-backed securities and derivatives drawn therefrom. *See* Olufunmilayo B. Arewa, *Risky Business: The Credit Crisis and Failure (Part I)*, 104 NW. U. L. REV. COLLOQUY 398, 403 (2010).

28. "[A]n increase in *leverage* in the system makes it more vulnerable to a sudden re-appraisal of risks and abrupt shifts in the liquidity demand . . . ." Jose Gabilondo, *Leveraged Liquidity: Bear Raids and Junk Loans in the New Credit Market*, 34 J. CORP. L. 447, 464 (2009) (quotation omitted and alterations in original).

29. A "credit crunch" or "credit crisis" is not novel. It occurs when credit suddenly contracts, creating a cascading cycle of less lending, lower growth, and ever-tighter credit. *See* Sutton, *supra* note 24, at 3. This is precisely what is described herein and, while damaging, this is not new or outside normal economic cycles. *See id.* at 4–5. The Great Recession, however, is widely recognized as a massive crunch of especial duration and severity. *See id.* at 5 ("Faced with the largest decline in the stock market in decades and a near collapse of the entire economic system, the federal government responded with unprecedented bailouts totaling billions, and perhaps trillions, of dollars."); *see also The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. On Oversight and Government Reform*, 110th Cong. 11 (2008) (statement of Alan Greenspan, Chairman, Federal Reserve) (describing the crisis as a "once in a century credit tsunami").

30. The entire financial industry, as well as millions of individual borrowers, played a role. Particularly culpable were credit reporting agencies, which helped stoke and grow the market for mortgage-backed securities. These securities are technical instruments, composed of hundreds or thousands of individual mortgage-backed loans and then separated into different tranches that dictate payment order (with the first tranche being repaid first and the second, second). *See* Felix Salmon, *Recipe for Disaster: The Formula that Killed Wall Street*, WIRED MAG. (Feb. 23, 2009), http://www.wired.com/techbiz/it/magazine/17-03/wp_quant?currentPate=all; *see also* Nestor M. Davidson, *New Formalism in the Aftermath of the Housing Crisis*, 93 B.U. L. REV. 389, 399–400 (2013) ("In the secondary [mortgage] market, . . . loans are packaged and sold into trusts that then issue—and create a market for the subsequent trading of—securities backed by mortgage debt. Securitization thus turns a relatively long-term, illiquid payment stream due on residential mortgages into a relatively liquid asset, designed to shield investors from claims arising from the original loan as well as to provide bankruptcy remoteness."). Notably, these investors counted on the credit rating agencies to assess the risk of such an investment, but these agencies failed them, seeking banking fees

there is no doubt that they played a central role in our recent (and ongoing) economic problems, with a number of misdeeds assuming a place of central importance.

B. Negligent Lending Practices

The front end of the financial crisis, as broadly described above, is strongly associated with poor lending practices and the system that built up around those practices.[31] The banks caused themselves (and, eventually, the entire global economic community) enormous harm by investing in debtors who were unlikely to repay and by building a significant part of their capital structure around those investments.[32] It is important, though, to examine that lending in a bit more detail—to understand both the decision-making processes that led the banks to make the loans they did, the manner in which those loans saturated the wider financial markets, and the substantial criticism that has built up around those processes.[33]

The core idea is simple: banks should not lend to people who cannot, or who will not, repay their debts. And, obviously, many banks did just that. The subprime lending environment outlined above both contributed to the real estate bubble and mightily exacerbated the resultant financial

and hiding behind complex formulae and financial arcana and ultimately giving artificially positive ratings to securities backed by mortgages that were (in retrospect) certain to fail. *See id.* "Wall Street investment banks took huge piles of loans that in and of themselves might be rated BBB, threw them into a trust, carved the trust into tranches, and wound up with 60 percent of the new total being rated AAA." Lewis, *supra* note 21, at 8. "As a result, flaws in credit rating agency assessments of structured finance instruments often are considered a principal underlying cause of the credit crisis." Arewa, *supra* note 27, at 404. *See also* Gevurtz, *supra* note 14, at 117 ("The prevailing view was that one could create tranches which, because of their senior position, justifiably could claim even extremely low investment-grade (such as AAA) levels of risk despite the underlying assets in the pool being more risky home loans, including subprime loans.").

31. "Poor" is, for some, too kind a word. *See, e.g.*, Robert J. Ridge & Mackenzie A. Baird, *The Pendulum Swings Back: Revisiting Corporate Criminality and the Rise of Deferred Prosecution Agreements*, 33 U. DAYTON L. REV. 187, 187 (2008) ("In the wake of the economic turmoil touched off by the subprime mortgage fiasco, Congress has been called upon to enact criminal statutes specifically addressing mortgage fraud and predatory lending practices.").

32. Or, more pointedly, were unlikely to repay absent a sharply appreciating real estate market.

33. It is interesting to the author that, while many commentators and academics (including this one) discuss and analyze the poor decision-making exercised by banks as a proximate cause of the Great Recession, very few (if any) commentators and academics appear at all interested in the obvious corollary of this bad decision-making: that many, many debtors were willing to either obfuscate facts in securing loans—albeit with overt or tacit bank support—or to simply walk away from their legal obligations. Of course, there were debtors who did not realize the nature of their loans, and there were debtors who did everything they could to pay for as long as they could. There were, obviously, all sorts of circumstances brought to bear in a financial and economic disaster as long and as widely in the making as the one at issue. However, there seems to be a strong, almost visceral, resistance among academics to asking why it is that so many individual borrowers were willing to lie and/or walk away from their obligations. Perhaps this area of study and analysis is better suited to sociological or political science theorists and not legal academics.

recession.[34] But the problems were deeper than simply making "bad" loans because of the financing, collateralization, and marketing of these debts.

As outlined above, during the run-up to the Great Recession, banks packaged together their subprime loans into mortgage-backed securities and sold them to investors all over the world.[35] Such a simple description hardly does justice to the banks' involvement in this practice, though. Citigroup, for example, packaged and sold collateralized debt obligations (CDOs) composed of loans it originated *and* loans purchased from other lenders.[36] The company would then sell some of these CDOs and collect fees for managing them.[37] This meant that Citigroup was investing directly in CDOs (by holding on to some and by purchasing others) and so building an ever-expanding inventory of them on its books.[38] These strategies worked fine, so long as debtors paid, enabling Citigroup to continue to sell and service more and more CDOs. However, once the market for CDOs dried up, Citigroup was saddled with the CDOs it had invested in and the ones it was trying to market.[39] This resulted in Citigroup recognizing massive losses by writing down the value of the CDOs it was carrying on its books.[40] But the downside exposure did not end there. Citigroup had

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34. Again, this is a simplification of the underlying causes of the financial crisis, and there are many moving pieces involved. This view of the banks' poor lending practices and the connection between those decisions and the subsequent recession are, however, widely accepted. *See, e.g.*, Bagwell, *supra* note 20, at 196 ("It is no wonder that *Time* magazine named Angelo Mozilo, the founder of Countrywide Financial (now Bank of America Home Loans), one of the major subprime purveyors, as the number one person to blame for the economic meltdown." (citing Nancy Gibbs, *25 People to Blame*, TIME, Feb. 22, 2009, at 21)). In his article, Mr. Bagwell frankly admits that the title industry generally knew the real estate bubble was about to burst because the loans being made by the banks were so transparently absurd. *See id.* at 180–81 ("Under the system that we employ to conduct real estate closings or settlements . . . a title company representative is present at every closing from the smallest residential re-finance to a multi-million dollar acquisition and mortgaging of a Manhattan skyscraper. After the closing, title closers would often return to their offices, wondering how in the world the borrowers were going to afford their mortgage. How could a security guard clearing $35,000 annually afford a half-million dollar mortgage? Was the GM building really worth a billion and a half dollars? The time came when title people would wager on how long it would take the borrower to go into foreclosure after the closing date.").

35. *See supra* note 30 and accompanying text. These mortgage-backed securities are also known as collateralized debt obligations or "CDOs."

36. *See* Gevurtz, *supra* note 14, at 116–17. Sometimes, Citigroup also packaged other obligations in with these home loans. *See id.*

37. *See id.* "Managing" here generally means servicing the loans by sending out payment notices, receiving payments, and generally making sure the loans are paid timely and following through if they are not. As we will see, this arrangement—whereby a non-owner services a loan that has been bundled with many others and then parsed into non-intuitive slices—ultimately led to significant problems when the Great Recession led to a wave of foreclosures throughout the country.

38. *See id.* at 117.

39. *See id.* "Compounding the inventory risk to an even greater degree, Citigroup included a 'liquidity put'—an option allowing purchasers of the CDOs to sell them back to Citigroup at original value . . . ." *Id.*

40. *See id.* at 118 ("In stages, Citigroup was forced to recognize losses by writing down the value of its one-time $50 billion plus inventory of CDOs and subprime mortgage-backed home loans, in many cases to between twenty-one and forty-one cents on the dollar.").

actually borrowed substantial funds to finance its CDO splurge. It established Special Investment Vehicles (SIVs), which issued commercial paper (short-term notes) and then directed the proceeds into subprime loans and CDOs.[41] Of course, this meant that, once the underlying investments were no longer profitable, the SIVs could not repay their debt, leaving Citigroup liable for massive obligations at the very time that its assets were being devalued.[42] And Citigroup was, of course, not alone in this frenzy of risk-taking tied to subprime lending. Bank of America announced a ten-year subprime lending pledge of $750 billion in 2003, JPMorgan Chase made a similar $800 billion pledge when it merged with Bank One Corporation, and Washington Mutual promised $120 billion in 1998.[43] The desire was strong, and many, many banks moved heaven and earth to originate these kinds of loans.[44]

What they were doing, then, was exposing themselves to massive financial risks, the magnitude and potentiality of which seems, in retrospect, very clear. How did this happen? Well, the answer appears (at least in part) to be pretty clearly that these institutions were simply poorly managed. More specifically, the risks faced by this subprime enterprise were poorly managed. "Risk management" is an oft-used word in business these days, but that is likely because it is a very important part of managing complex entities in a competitive environment,[45] and these financial institutions simply did not do a good job. Citigroup, again for example, had risk management systems in place to prevent its executives from taking unreasonable risks.[46] However, these systems were inherently flawed in that the risk managers were not kept independent from the very executives

41. *See id.*

42. *See id.* This echoes some of the accounting maneuvers utilized by Enron in connection with special-purpose entities, or SPEs. *See, e.g.*, Malcolm Gladwell, *Open Secrets*, NEW YORKER (Jan. 8, 2007). Citigroup claimed it was not obligated to stand behind the SIVs' obligations, but it did so nevertheless. *See* Gevurtz, *supra* note 14, at 118.

43. *See* Jerry W. Markham, *The Subprime Crisis—Some Thoughts on a "Sustainable" and "Organic" Regulatory System*, 4 FLA. INT'L U. L. REV. 381, 384–85 (2009).

44. The actions were varied and widespread. Banks ignored or fired their risk managers for imposing restraints on the banks' exposure to subprime lending; they invested in derivatives based on their risky mortgage-backed securities; and originators (with help from, or approval of, the banks) engaged in unscrupulous and deceptive practices in originating subprime mortgages. *See, e.g.*, Ronald S. Borod, *Belling the Cat: Taming the Securitization Beast Without Killing It*, 31 REV. BANKING & FIN. L. 643, 644, 659–60 (2012).

45. "[R]isk assessment includes the entire field of contingencies that affect matters of concern in recognizable ways. Thus defined, a comprehensive program of risk assessment and management would require considering the likelihood of all possible future world states that might affect outcomes of interest to the assessor. Once risks are assessed, questions of risk management arise concerning allocations of organizational responsibility and design of information systems for assuring risk control and monitoring consistent with risk tolerance levels." Robert F. Weber, *An Alternative Story of the Law and Regulation of Risk Management*, 15 U. PA. J. BUS. L. 1005, 1012–13 (2013) (footnotes omitted).

46. *See* Gevurtz, *supra* note 14, at 118.

who were so eagerly building up massive CDO inventories.[47] Indeed, the risk management system was so lax and so poorly run that there is some indication that officers and directors at Citigroup did not even *know* that its CDO operations posed a significant risk to the entity as a whole.[48] This sort of failure to assess risk was widespread. The risk management department of the Swiss bank UBS, as another example, explicitly utilized a model that built into its assumptions the idea that "the so-called 'super senior' risk that UBS retained on its balance sheet in securitization transactions could only lose 2 percent of its value."[49] Based on this approach, UBS acquired more and more "super senior" obligations, amassing approximately $50 billion by 2007.[50] Perhaps not coincidentally, UBS booked $50 billion in asset write-downs by 2009 and was kept in business only by repeated taxpayer-funded bailouts.[51]

These banks, then, were failed by their officers and directors when it came to assessing risk.[52] As we shall see, this has created significant stress on the traditional rules that insulate officers and directors from liability, due to the magnitude and nature of the losses arising therefrom.[53] Prior to examining that pressure, though, this Article turns to another discrete aspect of bank misbehavior and the Great Recession—that of wrongful foreclosure.

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47. *See id.* This lack of independence grew from both personal connections and because the risk managers reported to executives who were running the CDO activities and who profited enormously from large bonuses tied to profitability. *See id.* at 119.

48. "Complaints by foreign regulators that Citigroup's risk management practices were dangerously lax led the Federal Reserve to bar Citigroup from making any acquisitions of other financial companies for twelve months between the spring of 2005 and 2006." *Id.*

49. Robert F. Weber, *Combating the Teleological Drift of Life Insurance Solvency Regulation: The Case for a Meta-Risk Management Approach to Principles-Based Reserving*, 8 BERKELEY BUS. L.J. 35, 98 (2011) (quoting GILLIAN TETT, FOOL'S GOLD: HOW UNRESTRAINED GREED CORRUPTED A DREAM, SHATTERED GLOBAL MARKETS AND UNLEASHED A CATASTROPHE 162 (2009)).

50. *See id.*

51. *See id.*

52. "Although primary responsibility for risk management rests with the corporation's top management team, the board of directors is responsible for ensuring that the corporation has established appropriate risk management programs and for overseeing management's implementation of such programs. The financial crisis of 2008 revealed serious risk management failures on an almost systemic basis throughout the business community." Stephen M. Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. CORP. L. 967, 967–68 (2009) (citations omitted). That this responsibility rests upon officers and directors and that they can be liable for failure of oversight is clear. *See id.* (citing the famous *Caremark* case, In re Caremark International Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996), which established that boards of directors have a duty to ensure that proper risk management occurs).

53. *See infra* Part II.B.

C. Wrongful Foreclosure

If negligent lending practices were the cause of the Great Recession, wrongful foreclosures were the result. Each of those debtors who could not pay their mortgages—whose defaults, in total, triggered the collective write-downs on banks' balance sheets so catastrophic that the entire financial system nearly collapsed—was a person[54] who could no longer afford her home. And, every time that happened,[55] the bank had a choice to make: to foreclose or not to foreclose.

Briefly put, foreclosure is the remedy available to a secured creditor. Relevant here, foreclosure is the process whereby a lender seizes and sells the real property of a non-paying debtor, with the proceeds therefrom going toward the satisfaction of the debt.[56] The law surrounding this process has evolved significantly over time, with substantial common law and statutory protections having built up to protect borrowers.[57] At present, every state has numerous rules and regulations that are meant to ensure that mortgaged property is seized and sold in a well-defined and transparent manner that is designed to minimize the likelihood that mortgagors will be taken advantage of or treated unfairly.[58] The foreclosure process, then, is a

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54. Not every loan was a home loan, and not every borrower was a person. Some loans were commercial, and some borrowers were business entities. But a significant number of the nonperforming loans that swamped the American banking system were those taken out by individuals—by our neighbors, by our family members, by us—to buy ever-appreciating homes and investment properties.

55. As an absolute, this is an exaggeration. As discussed immediately above, see *supra* note 54, the loans at issue were varied, and it is impossible to accurately categorize them as a whole in any really meaningful way. But, generally speaking, the loans that were packaged into CDOs and that became so toxic and so disruptive were secured by mortgages on the real property at issue.

56. Any sales proceeds left over after the satisfaction of the underlying debt (which, by the point of foreclosure, will usually include costs, penalties, and fees) will be turned over to the debtor. Either personal or real property can serve as the security for a loan. The law relating to these two different types of security is significantly different, and this Article focuses, of course, on real property security.

57. *See, e.g.*, R. Wilson Freyermuth, *Foreclosure by Arbitration?*, 37 PEPP. L. REV. 459, 463–67 (2010). Under early common law, there were virtually no protections for borrowers (known as the mortgagor), who conveyed a fee simple subject to a condition subsequent to the lender (known as the mortgagee). If the mortgagor repaid timely (thus satisfying the condition subsequent), he could re-enter the property and terminate the mortgagee's fee. *See id.* This was a harsh arrangement, and the law eventually recognized the lender's interest as a special one, serving specifically as security. *See id.* Accompanying this recognition, the law intervened in numerous ways to provide protections and relief to debtors who did not pay. *See id.*

58. At present, there are two primary methods of foreclosure: judicial and non-judicial. *See id.* Judicial foreclosure involves an actual court proceeding and so ensures that the mortgagor receives the protections of applicable court rules and procedures. *See id.* Non-judicial foreclosure, on the other hand, permits a mortgagee to include a power of sale in the mortgage document and so conduct a private sale through a trustee. *See id.* The process by which this is done, and the attendant protections favoring the mortgagor, varies from state to state, but some general rules prevail. *See id.* "Generally, the mortgagee need not file any judicial proceeding, or obtain a court order authorizing the sale. Before conducting a sale, the mortgagee must give prior notice of the sale, . . . to all persons designated by the statute as entitled to notice. Finally, before conducting a sale, the mortgagee must advertise the sale in the manner specified by the authorizing statute." *Id.* at 466–67. There is also a third method of foreclosure, known

technical one with many requirements and procedures that must be followed carefully.[59]

Wrongful foreclosure occurs anytime a lender forecloses when she is not entitled to do so, which includes situations where the lender has failed to follow or honor any of the technical, procedural protections discussed above.[60] Traditionally, this was a relatively rare claim, compensating wrongfully foreclosed debtors either by rescinding the sale or awarding them damages equal to the value of the property less the outstanding indebtedness.[61] These remedies seem fair, and it appears that this tort historically sufficed to ensure that mortgagees would generally follow all appropriate procedural and common law requirements, ostensibly ensuring fair foreclosures.[62]

This state of affairs effectively collapsed, though, in the heat of the Great Recession. Recall that, in the dizzying lead-up to the housing crisis, banks made a huge number of ill-advised loans and then combined, dissected, sold, and assigned those mortgage-backed loans to investors and sellers throughout the world.[63] Not surprisingly, as debtor default and a worsening economy spiraled downward, twinned in a whirlpool of financial catastrophe, these loans generated an enormous surge in foreclosures.[64] This wave of foreclosures was unheard of: during this

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as strict foreclosure, that involves the transfer of title without any sort of sale, but this is only available in a small number of states and only in limited circumstances. *See, e.g.*, Strict Foreclosure, BLACK'S LAW DICTIONARY 719 (9th ed. 2009).

59. Most state statutes require lenders to ensure that proper and adequate notice is given to interested parties; that a preliminary title search is done; and that the sale is done in a regulated fashion, publicly and at an accessible location. *See, e.g.*, William A. Walsh, In re Bundles*: Finding a New Basis for Determining "Reasonably Equivalent Value" Under Section 548 of the Bankruptcy Code*, 40 DEPAUL L. REV. 175, 196 n.139 (1990).

60. A prima facie case for wrongful foreclosure generally requires a plaintiff to establish that the defendant foreclosed on a borrower who was not in default or that the defendant foreclosed without following the procedural protections of the state's foreclosure laws. *See, e.g.*, James L. Buchwalter, 52 CAUSES OF ACTION 2d 119, § 4 (July 2016 Update).

61. Anna Kalinina, *A Grossly Inadequate Procedure: Non-Judicial Foreclosure in Texas*, 65 BAYLOR L. REV. 1061, 1069 (2013).

62. The word "ostensible" is appropriate here because, though these procedures are meant to ensure a transparency that will result in a full and fair sale, it rarely occurs in this way. There is simply no avoiding the fact that these sales are at their heart distressed sales, and that as such they generally generate "fire sale" prices. Thus, it is certainly wonderful that foreclosure sales must be held in the county where the real estate is located at a reasonable time (rather than, say, on Mount Everest in the middle of the night). That requirement will prevent a creditor from scheduling a sale that is certain to be attended by no one and so generate a low sales price or ensure that the creditor is the only bidder (both of which would ultimately harm the debtors' interests and result in their losing the full value of their house). But, regardless of where it is held, the sale will not be a normal one, providing potential buyers with the time and ability to review title, physical condition, and other relevant purchasing factors. Because of this, the author (and every other real estate attorney the author has ever spoken with) understands that foreclosure sales will very, very rarely result in a fair market value sale.

63. *See supra* note 30 and accompanying text.

64. "In the ten years prior to 2007, mortgage delinquencies averaged 4.7% annually, and the foreclosure start rate . . . was a relatively low 0.42%. After the housing crash, mortgage delinquencies

period of time, there were more than 1.5 million foreclosure starts every year, with much of that concentrated in a relatively few geographic regions that had experienced the largest boom-and-bust swings in housing pricing.[65] And, unfortunately, the banks were not prepared to handle this level of stress.

Foreclosure is, of course, the remedy of the banks and has been fashioned over the years to protect them and ensure they are made whole, even when a debtor defaults. As these financial institutions invented new ways to securitize mortgages, however, they did not think through who would manage foreclosures on a massive scale. Remember that the securitization of these debts meant that they were transferred around in a seemingly endless series of buys and sells.[66] This was not done carefully, as banks often failed to properly complete or document the assignments of the notes (and accompanying mortgages) from originator to intermediary to eventual owner.[67] These issues have received national attention, with a number of courts dismissing foreclosure actions because the plaintiff-banks could not document their present ownership of the notes at issue.[68] In an

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increased to a January 2010 high of 10.57% . . . ." Davidson, *supra* note 30, at 390–91 (citing, among other statistics, those gathered by the U.S. Department of Housing and Urban Development).

65. *See id.* at 398–99.

66. *See supra* note 30 and accompanying text.

67. *See* Davidson, *supra* note 64, at 403. "These deficiencies have sometimes been framed as a question of standing and real party in interest, and sometimes framed as a question of failure of proof on a substantive element needed for foreclosure (which is to say, did the lender actually have the right to foreclose at the time it did?)." *Id.*

68. *See, e.g.*, *id.* at 403–04. There are numerous cases wherein banks brought foreclosure cases but could not properly trace or demonstrate ownership of the underlying debts, attaching notes and mortgages running to the originators, rather than the plaintiff-bank (often bringing the cause on behalf of a trust, which owned numerous securitized loans and was, itself, owned by numerous other entities). Often, the plaintiff-banks could not show assignments that had been executed contemporaneously with the alleged transfers, instead submitting affidavits that merely alleged that the assignments had been made. *See id.* (citing numerous cases). This made it difficult to certify that the party before the court was the real party in interest, and it also raised issues regarding the enforceability of assigned notes as negotiable instruments. *See id.* Moreover, this problem was worsened by a relatively recent innovation affecting real property recording known as the Mortgage Electronic Registration System, or "MERS." MERS is a private database that tracks ownership of real property interests. *See* Chad J. Pomeroy, *A Theoretical Case for Standardized Vesting Documents*, 38 OHIO N.U. L. REV. 957, 978 n.122 (2012). As the securitization of mortgage loans (involving, as it does, the packaging of the loans together and the allocation of fractional interests among many different owners) accelerated in the run-up to the Great Recession, the recording system adapted to reflect the fact that the true owners of a given note and mortgage (i.e., the beneficiaries of the trust that held the note, along with hundreds or thousands of other such notes) never actually held the note or even knew who the borrower was or what the collateral was. *See id.* (citing Kurt Eggert, *Held up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 546–48 (2002)). Traditionally, this would have caused some difficulty because every single transfer and assignment would have to be recorded, but MERS streamlined the process by taking the bulk of that process out of the public recording system and putting it in-house. *See id.* (citing Beau Phillips, *MERS: The Mortgage Electronic Registration System*, 63 CONSUMER FIN. L.Q. REP. 262, 263 (2009)). MERS members simply paid an annual fee and then appointed MERS as their agent for all registered and recorded mortgages. Thereafter, MERS would show on the public records as the "owner," and MERS would track the "real" ownership

attempt to counteract these difficulties, banks often filed affidavits concerning lost notes and assignments and the terms thereof.[69] It is this practice that gave rise to the term "robosigning," which generally refers to a bank employee or agent signing an affidavit attesting to the ownership or nature of a loan or mortgage without any actual firsthand knowledge.[70]

This sort of behavior is unlawful and wrongful, but it became widespread, as banks attempted to address the tsunami of loan defaults and foreclosures they faced.[71] Important here, this practice also constitutes wrongful foreclosure.

Again, wrongful foreclosure occurs anytime a lender forecloses without a right to do so or without following proper procedures.[72] That means that every incorrect affidavit and every missing note leading to a foreclosure led to a *wrongful* foreclosure.[73] Thus, the Great Recession culminated in many, many people being foreclosed upon wrongfully—

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internally and remain the nominee for the real owner, regardless of how the ownership is assembled or assigned, thus preserving security priority and completely eliminating the need for any recorded assignments or other documents. *See id.* Unfortunately, that opacity was (apparently) often accompanied by poor record-keeping and bureaucratic carelessness, which the courts found troubling for a variety of reasons.

69. *See* Victoria V. Corder, *Homeowners and Bondholders as Unlikely Allies: Allocating the Costs of Securitization in Foreclosure*, 30 BANKING & FIN. SERVS. POL'Y REP. 19, 23 (2011) ("Mortgage servicers and securitizing banks have gotten into the habit of filing a 'lost-note affidavit' when they fail to present proof to the court that they own a mortgage . . . . [L]ost-note affidavits are the rule in the industry rather than the exception . . . .").

70. *See* Davidson, *supra* note 30, at 410.

71. "[T]he Inspector General for the U.S. Department of Housing and Urban Development (HUD) has provided some insight in a review of five of the largest servicers for mortgages insured by the Federal Housing Administration. The HUD Inspector General reviewed files on claims over the 2009 and 2010 fiscal years, and revealed practices of signing hundreds of affidavits per day, with daily production goals set for the number of affidavits to be processed. One employee, for example, admitted signing '12- to 18-inch stacks of documents at a time without a review,' and notaries were also found to be deficient, with one servicer having had up to 1000 documents per day notarized without witnessing the signature." *Id.* at 410 (citations omitted). This eventually led to a $32 billion settlement between state and federal governments and the country's five largest loan servicers. *See id.* at 427–28. The settlement—with Ally, Bank of America, Citi, JPMorgan Chase, and Wells Fargo—arose from robosigning allegations and was structured to provide up to $20 billion in loan modifications and refinancing assistance to troubled borrowers, a fund to compensate wrongfully foreclosed homeowners, and a fund for states to pay for consumer-protection efforts. *See id.* It also included a variety of enhanced servicing standards. *See id.*

72. *See supra* note 60.

73. Christopher K. Odinet, *Banks, Break-ins, and Bad Actors in Mortgage Foreclosure*, 83 U. CIN. L. REV. 1155, 1178 (2015) (referring to robosigning as a "wrongful foreclosure practice[]"). Of note, this does not mean that these actions constituted foreclosure upon someone who was not in default. Many seem to labor under the impression that the robosigning scandal, and other associated issues, means that banks were randomly seizing and selling homes, regardless of whether the homeowner had defaulted on his obligation. That likely happened in only a very few instances. Banks misbehaved to cover for sloppy or lazy record keeping, and that is wrongful, but almost all foreclosures occurred with respect to properties owned by defaulting debtors.

people who should not have lost their houses lost their houses.[74] And when bad things like that happen, people look for someone to hold accountable.

II. DIRECTOR AND OFFICER LIABILITY

The Great Recession, then, is bookended by the related sins of poor lending and wrongful foreclosure. Neither of these misdeeds are new. Each has a long history and has been around for many years. What was new, in the context of the Great Recession, was the sheer scale involved. As has been discussed, the lending practices of the late 1990s and early 2000s were so lax, so wrongheaded, and so widely spread that they infected the entire financial system and, ultimately, the global economy. Thus, the well-known problem of bad lending[75] seemed, suddenly, to be something uniquely malignant and almost new, causing unanticipated damage to virtually everyone. Similarly, wrongful foreclosure is a longstanding tort, addressed by courts and legislatures for well over 100 years.[76] But, again, this offense seemed to take on new meaning, as the number of wrongful foreclosures spiraled out of banks' overmatched hands in the wake of the Great Recession.

It is this difference in magnitude, and the concomitant fallout, that has spurred many to suggest that a new paradigm of responsibility is called for, particularly in the context of director and officer liability. Traditionally, these individuals have largely been insulated from liability for all but the most egregious behavior, but there is change in the air, with some seeking a much-enhanced approach to officer and director liability.

A. *Traditional Liability*

Though there is some dispute regarding the overlap between corporate and banking law,[77] bank officers and directors enjoy a high level of protection from personal liability, at least in part due to traditional

74. Again, this is a group largely composed of defaulting debtors. They should not have lost their homes in the manner they did because procedural and evidentiary rules and protections were not met. That does not mean, though, that they should never have lost their houses for failing to pay their debts.

75. *See, e.g.*, Bruce E.H. Johnson, *Lender Liability Litigation Checklist: A Summary of Current Theories and Developments*, 59 UMKC L. REV. 205, 250–51 (1991) (discussing cases brought by the Federal Deposit Insurance Corporation and the Federal Savings & Loan Insurance Corporation against employees of banks, pursuing claims based upon negligent or reckless lending in connection with the savings and loan crisis of the 1980s).

76. *See, e.g.*, 59 C.J.S. *Mortgages* § 650 (2016) ("A mortgagor is entitled to recover damages for a wrongful or fraudulent foreclosure of the mortgage, as where an unlawful foreclosure is attempted solely from a malicious desire to injure the mortgagor.") (citing both recent cases and a case from 1887).

77. *See, e.g.*, Gevurtz, *supra* note 14.

corporate doctrine.[78] This means that their decisions—the decisions they make in determining the direction and actions of the bank[79]—are subject to what is known as the business judgment rule,[80] which is a wonderful thing if you are an officer or director.

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78. Banks almost always use the corporate form, and, even in the exceedingly rare instance that they use a different limited liability structure, the corporate principles discussed here still apply. *See, e.g.*, Amy Deen Westbrook, *Does Banking Law Have Something to Teach Corporations Law about Directors' Duties?*, 55 WASHBURN L.J. 397, 405 (2016). As such, bank officers and directors are, by their nature, *corporate* officers and directors

79. Such as what kinds of loans to make or how to go about pursuing remedies on defaulted debt.

80. This statement is reductionist for a variety of reasons. Firstly, it focuses on personal liability for lawsuits and does not speak to potential liability for enforcement actions brought by the government. *See, e.g.*, 12 U.S.C. § 1818 (2012) (permitting bank regulators to bring actions against bank directors). Secondly, the banking industry is uniquely complex, due to a complex web of applicable rules, regulations, laws, and common law decisions, and there is some texture to the application of the business judgment rule to banking executives. Ultimately, however, "[s]ignificant authority [does] support[] the proposition that the business judgment rule applies to the conduct of bank directors." Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175, 186 (1995); *see also, e.g.*, *Business-Judgment Rule Covers Bankers, N.C. Banking Agency Says FDIC v. Rippy*, WESTLAW J. CORP. OFFICERS & DIRECTORS LIABILITY, Feb. 23, 2015, at *1–*2 (noting specific North Carolina law applying the business judgment rule to bank directors). Both officers and directors are, for the most part, protected by the business judgment rule. *But see* STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE 398–99 (6th ed. 2009) ("Numerous courts, . . . have referred to the business judgment rule as a doctrine protecting directors and officers without distinguishing between the rule's applicability to directors and officers. There is, however, only sparse case law that specifically addresses this question."). But a little additional discussion is required. There are two primary types of plaintiffs relevant here, who can—and who have—sought to hold officers and directors of struggling banks liable for the actions of banks leading up to the Great Recession. The first type of plaintiff is the Federal Deposit Insurance Corporation (the FDIC), which acts as a receiver for failed banks and so succeeds to the rights and assets of that entity. *See* Ryan Scarborough & Richard Olderman, *Why Does the FDIC Sue Bank Officers? Exploring the Boundaries of the Business Judgment Rule in the Wake of the Great Recession*, 20 FORDHAM J. CORP. & FIN. L. 367, 370 (2015). These assets include the bank's claims against its own directors and officers, and the FDIC has been aggressive in pursuing those claims. *See id.* ("From January 1, 2009 through July 24, 2014, the FDIC authorized lawsuits in connection with 145 failed institutions against 1,171 individuals."). The second type of plaintiffs are shareholders of the failed banks. Unsurprisingly, there have been numerous lawsuits by shareholders of banks who were damaged by falling share prices when those banks suffered damage during the Great Recession. *See, e.g.*, John P. Doherty & Richard F. Hans, *The Changing Landscape of Subprime Litigation*, ANDREWS BANKR. LITIG. REP. (Andrews Publ'ns, Wayne, Pa.), Jan. 14, 2008, at *1–*8. (categorizing and discussing the numerous lawsuits brought by bank investors regarding bank involvement in the subprime market). Bank shareholders likely face the burden of the business judgment rule, though this will depend on state law. *See* Schooner, *supra* at 186; Westbrook, *supra* at 414–23. However, the status of the law in FDIC-led litigation is more complicated. Congress passed the Financial Institutions Reform Recovery and Enforcement Act of 1989 in the wake of the 1980's savings and loan scandal, which included 12 U.S.C. § 1821(k) (2012) (effective 1989), a statute that affects the FDIC's ability to pursue a "director or officer of an insured depository institution." 12 U.S.C.A. § 1821 (2012). In particular, it provides that the FDIC must pursue liability against a failed bank's officers and directors pursuant to applicable state standards, *unless* those standards require something more than gross negligence to find liability. *See* DEBORAH A. DEMOTT & DAVID F. CAVERS, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 1:11 (2015–2016 ed. & 2016 Supp.) (reviewing the various court interpretations of § 1821(k), culminating in the Supreme Court decision of Atherton v. FDIC, 519 U.S. 213 (1997)). Effectively, then, if a state's business judgment rule requires a level of culpability at the level of recklessness, it should be preempted by § 1821(k)'s more easily met standard of gross negligence (conversely, if a state's standard of liability is *more* permissive, then that standard

The business judgment rule is, essentially, a presumption of correctitude reflecting the judiciary's hesitance to second-guess the risk-taking decisions of corporate officers and directors.[81] Courts understand that business involves risks that do not always bear fruit and that a prudent investor will often desire officers and directors who will take those risks. Such activity should not be judged based upon either the judge's personal views on how to run a business (given that judges do not have the ability or expertise of corporate executives) or with the benefit of perfect hindsight. Instead, the business judgment rule dictates, courts should give officers and directors the benefit of the doubt.[82] Anything less deferential will subject executives to liability for the kinds of risks that are necessary to normal, proper business operations.

What this means is that officers and directors are difficult to pursue personally. Even if a business does something that turns out badly—indeed, even if a business does something that turns out disastrously—a court will hesitate to assess personal liability against the officers and directors involved in the decision-making process. In other words, "[u]nder the business judgment rule, there is no liability even though a decision is unreasonable."[83] This may seem counterintuitive, but it is a widely accepted proposition. Business (even the business of banking) involves risk, so cutting off risk-taking involves cutting off many avenues of profit and success.

This idea has come under stress, though, as the Federal Deposit Insurance Corporation (FDIC) and shareholders have both tried to recoup as much money as possible, given the enormous losses of the Great Recession. In that context, officers and directors make for choice targets, and one of the ways to strike that target is to attack the business judgment rule.

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can apply). Note that this omits any discussion of *depositor* claims against bank executives. This type of action is not at issue in this Article and is governed by an entirely different standard. *See, e.g.*, Patricia A. McCoy, *A Political Economy of the Business Judgment Rule in Banking: Implications for Corporate Law*, 47 CASE W. RES. L. REV. 1, 3 (1996) ("[C]ourts curtailed the business judgment rule in banking long before . . . 1933. . . . Their rulings conferred an unprecedented negligence cause of action in favor of depositors, who formed the most visible class of debtholders in banks.").

81. *See, e.g.*, Schooner, *supra* note 80, at 181 (broadly summarizing the business judgment rule).

82. Delaware expresses its business judgment rule as a presumption that directors have "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," which has been said to mimic a gross negligence standard. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds*, Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

83. Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 945, 963 (1990).

B. Arguments for Expansion of Traditional Liability

Of course, this desire and these attempts to hold insiders liable are not new or innovative.[84] What is new here is the sustained and serious attempt by these stakeholders to subvert the traditional protections afforded to officers and directors, claiming that the personal liability of bank executives should be expanded and that the kinds of protections discussed above should be curtailed.[85] The motivation of direct stakeholders is apparent: they want money to compensate them for losses, and officers and directors are often choice targets in that quest. The motivation of commentators, while not as susceptible of being summarized in a discrete whole, is largely based upon the systemic risk the banking industry poses to the economy as a whole.

This nature of this argument was well put by a recent federal decision examining this very issue:

> There is every reason to treat bank officers and directors differently from general corporate officers and directors. In general, when a business corporation succeeds or fails, its stockholders bear the gains and losses.... But when a bank, instead of a business corporation fails, the FDIC and ultimately the taxpayer bear the pecuniary loss. The lack of care of the officers and directors of banks can lead to bank closures which echo throughout the local and national economy.[86]

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84. The FDIC has long taken "a practical, cost-benefit approach to its Director and Officer... litigation aimed at ascertaining recoverable amounts... and determining whether it can build a credible case for negligence, breach of fiduciary duty, or gross negligence to recover available amounts." Scarborough & Olderman, *supra* note 80, at 371. Similarly, shareholder lawsuits against the directors and officers of failed banks are well-established and have been around for a long time. *See, e.g.*, Lane v. Chowning, 610 F.2d 1385, 1388–89 (8th Cir. 1979) ("[I]t is well settled that the fiduciary duty of a bank officer or director is owed to the... shareholders of the bank....").

85. *See, e.g.*, Gevurtz, *supra* note 14 (positing a nuanced argument that executive protection in the corporate context should not necessarily influence the banking industry); Scarborough & Olderman, *supra* note 80, at 368 ("In the wake of the Great Recession, the [FDIC] has brought numerous lawsuits in its role as receiver of failed banks against former bank directors and officers."); Heidi Mandanis Schooner, *Top-Down Bank Capital Regulation*, 55 WASHBURN L.J. 327 (2016) (arguing for executive personal liability in situations of capital inadequacy); Westbrook, *supra* note 78, at 397 ("This Article... suggests that... increasing personal liability for directors is not only a good idea for banks, but may influence our conceptions of corporate fiduciary duty...."); Alec Orenstein, Note, *A Modified* Caremark *Standard to Protect Shareholders of Financial Firms from Poor Risk Management*, 86 N.Y.U. L. REV. 766 (2011) (arguing for a stricter fiduciary standard against managers of financial firms).

86. FDIC v. Loudermilk, 984 F. Supp. 2d 1354, 1359 (N.D. Ga. 2013). From 2007 to 2015, the FDIC took over more than 500 failed banks and paid out more than $77 billion from the deposit fund. *See* Westbrook, *supra* note 78, at 411–12.

This idea has obvious appeal, especially given the breadth, depth, and repercussions of the Great Recession—its tangential effects on the economy, its direct effects on taxpayer-funded programs, and the direct connection between that fiscal and economic pain and the seemingly indefensible risks taken by so many bank executives in the name of short-term profits. If officers and directors can, through their poor decision-making, so badly damage the American financial system, then why should the American judicial system afford them extraordinary protection in the form of the business judgment rule and other screens from personal liability?[87]

This argument has found purchase in the historically murky difference between general corporate executives and those of banks and even in a number of state statutes and regulations.[88] But the real impetus, now, is the drastic losses incurred due to the financial meltdown.[89] Simply put, everyone feels like a stakeholder here, and so everyone wants to be made whole and is looking for anyone who can contribute, a group that clearly includes officers and directors.

III. WELL ENOUGH ALONE: LIABILITY FOR WRONGFUL FORECLOSURE

Unfortunately, there is a real danger here of overreacting and causing serious damage to the current banking governance environment. Recall from above that there are numerous bad acts attributable to banks in connection with the Great Recession. That means, certainly, that there is plenty of blame to go around. But it also means that there are numerous different categories of wrongdoing that bear independent thought and analysis.

Wrongful foreclosure is certainly a bad act, and it certainly causes real harm to real people.[90] But it is not the same bad act as improvident lending. Wrongful foreclosure (at the scale recently experienced) occurred *because of* the Great Recession, but it did not cause the Great Recession. There may well be good arguments for expanding personal liability for banking

87. Note, here, that there are numerous laws and regulations that affect this arena, and those are not necessarily implicated by this Article—the focus here is on an attempt to change the basic scope of executive personal liability as historically understood.

88. *See, e.g.*, FDIC v. Skow, 741 F.3d 1342, 1346 (11th Cir. 2013) (examining whether the business judgment rule contradicts the "plain language" of a Georgia statute holding bank executives to an "ordinary negligence" standard of care).

89. The Federal Reserve Bank of Dallas has estimated that the Great Recession has increased governmental expenditures by $12–13 trillion, has inflicted direct output losses of $6–14 trillion, and has cost up to $14 trillion due to "[n]ational trauma and lost opportunity." David Luttrell, Tyler Atkinson & Harvey Rosenblum, *Assessing the Costs and Consequences of the 2007–2009 Financial Crisis and Its Aftermath*, ECON. LETTER (Fed. Res. Bank of Dall., Dall., Tex.), Sept. 2013, at 1–2.

90. *See supra* Introduction.

executives,[91] but those arguments, as articulated above, relate to the kinds of acts that cause systemic risk and loss. Improvident lending decisions, on the scale seen in the last decade, can cause a "credit tsunami" rarely seen, one so large and significant that it seizes the entire financial system, swamps the economy, and requires the effective subsidization of the banking system by the federal government. Wrongful foreclosure cannot do that. As bad a tort as it is, and as much damage as it can cause to individuals, it does not pose a risk to the entire economy and so require the unwilling recruitment of the American taxpayer. That means that there is not the increased need or pressure to change something as well-settled as the business judgment rule.

This rule is deeply embedded in our system of corporate governance, reflecting a number of important public policy analyses and decisions. It encourages corporate service,[92] and it incentivizes (perhaps counterintuitively) appropriate decision-making by ensuring that officers and directors make the best call they can (not the safest call they can).[93] Unfortunately, courts are not well positioned to evaluate this. They cannot adequately analyze and assess the varied kinds of complex decisions that executives have to make in attempting to run a business. Even if aided by experts, no court can truly recreate the combination of experience, knowledge, savvy, and intuition that a business officer or director brings to bear.[94] As such, courts should not penalize officers and directors for smart, calculated risks that ultimately turn out wrong or unprofitable.[95]

91. This Article is essentially agnostic on this question, in the context of liability for poor lending decisions. *But see* Christine Hurt, *The Duty to Manage Risk*, 39 J. CORP. L. 253 (2014) (arguing that imposing broader duties of oversight on bank directors would be unmanageable).

92. "Compelling reasons exist for limiting the circumstances under which directors may be held personally liable. Directors, particularly bank directors, regularly make complex decisions involving risk, and many such decisions may appear in hindsight to have been made improvidently. Competent persons would not serve as directors if such decisions could lead to liability under ordinary tort standards." Resolution Trust Corp. v. Blasdell, 930 F. Supp. 417, 423 (D. Ariz. 1994).

93. "Just like playing a 'prevent' defense in football when you are ahead seems to do nothing but prevent your team from winning, adopting an overly conservative business approach can harm a bank's capital cushion and, in extreme cases, doom it to failure. In short, being too conservative can be as damaging as being too aggressive." Scarborough & Olderman, *supra* note 80, at 370, 379. And American courts have long sought to avoid this sort of damage. *See* Westbrook, *supra* note 78, at 398 ("American jurisprudence has long held that a key social purpose of business corporations is to take business risks . . . .").

94. Of course, not every executive is impressive. That is not the point. The point is that, in any given situation, a court will be second-guessing the executive chosen by the shareholders who evidently believed that she was impressive.

95. In other words, "[t]he business judgment rule seeks to temper concerns that the duty of care will make directors unduly risk-averse by immunizing many of the substantive board decisions that the duty of care might otherwise proscribe." Patricia A. McCoy, *The Notional Business Judgment Rule in Banking*, 44 CATH. U. L. REV. 1031, 1036 (1995). This concern is no less present in the banking industry than in any other. Do we want banks afraid to make loans to new, small businesses? Do we want lenders who refuse to back local enterprises without track records?

That does not mean that courts have no role. They should, and they do, police acts of disloyalty or extraordinarily poor judgment. But they must not merely substitute their judgment for their own, as that would cause managers to seize and fail to take the kinds of actions they were hired to take. By providing a clear and substantial barrier between ex post facto judicial review and the kind of contemporaneous decision-making that executives have to engage in, then, the business judgment rule ensures that shareholders, as a whole, are better served.

If we eliminate this protection, then, the system will suffer. Corporate profits and long-term market capitalization will decrease as a whole, and every stakeholder will be in a worse position. Now, it may be that there are situations that justify such risk. That cost may be worthwhile, for instance, if it would forestall another Great Recession. But there is no reason to think that wrongful foreclosure, even in the numbers seen recently, will ever contribute to a large-scale financial crisis. Bad lending practices started the Great Recession by stoking an unsustainable market and ensuring that banks were heavily invested therein. Wrongful foreclosure just isn't analogous. It's a remedy banks pursue *after* a loan has ceased performance. It is a result, then, not a cause of financial crises. Additionally, the current remedies for wrongful foreclosure—along with the strong efforts of government entities to hold responsible institutions responsible—seem sufficient to both compensate those harmed and to adequately incentivize less tortious behavior into the future.[96]

If the American legal system is going to reject the business judgment rule, and the policy decisions inherent therein, it should do so judiciously and carefully, and only when the costs of doing so are justifiable. That is not the case in the context of wrongful foreclosure.

CONCLUSION

Accordingly, any expansion of the personal liability of bank officers and directors should be precise and careful. It should be tailored to specific torts or problems that pose extraordinary risks and cause extraordinary costs. The legal system should be loath to reject doctrines that have worked well for a long time and that many market actors rely upon. It is true that the Great Recession involved numerous kinds of misbehavior in the banking system, and that did include widespread wrongful foreclosure. But that wrong is not extraordinary and can be adequately addressed by presently available means. It should not, then, generate any changes to doctrines as well ingrained as the business judgment rule.

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96. *See supra* note 72 and accompanying text.