UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER OF WESTERNBANK PUERTO RICO, plaintiff intervenor, v. FRANK STIPES GARCIA, et al.,	CIVIL ACTION NO. 11-02271 (GAG) RE: DECLARATORY JUDGMENT

FRANK C. STIPES GARCÍA, JUAN C. FRONTERA GARCIA, HÉCTOR DEL RÍO TORRES, WILLIAM VIDAL CARVAJAL, CÉSAR RUIZ AND PEDRO R. DOMINGUEZ'S MOTION TO DISMISS THE FEDERAL DEPOSIT INSURANCE CORPORATION'S SECOND AMENDED AND RESTATED COMPLAINT IN INTERVENTION[1]

[1] Instead of defending its legally insufficient claims against the motions to dismiss, the Federal Deposit Insurance Corporation (the "FDIC") went back to the well and drew up a third complaint, which it calls its Second Amended and Restated Complaint in Intervention. We shall call it what it is, the FDIC's "Third Complaint" herein, and shall demonstrate its failure to cure the infirmities of the FDIC's Amended and Restated Complaint in Intervention (the "Second Complaint"). The only major differences between the Second and Third Complaint are additional allegations that attempt to: (i) revivify irreparably time-barred claims, (ii) plead with more specificity; and (iii) allege an additional claim for fraudulent conveyance. No material changes have been made, and the incurable problems of the Second Complaint remain uncured. Consequently, this motion substantially resembles the first motion to dismiss. Where there are differences, we will alert the Court to them.

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INTRODUCTION AND BACKGROUND

Over the course of fifty-two years, Westernbank of Puerto Rico grew from a small community institution into one of the largest, most profitable, and healthiest banks in the Commonwealth of Puerto Rico. It did so by working hand in hand with the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico ("OCFI") and with federal regulators, rising from humble beginnings as a local Mayaguëz bank to become the Commonwealth's second-largest, with branches throughout the island. Federal regulators and the OCFI conducted annual examinations and awarded Westernbank the highest possible score for twelve consecutive years, from 1993 to 2005.

Despite a subsequent collapse of real estate prices on a scale unseen in this country for a hundred years, and despite an equally unprecedented meltdown of financial markets – which caused the worst economic crisis since the Great Depression – federal regulators continued to applaud Westernbank's soundness and never once complained about the loans the FDIC now claims were so unsound as to have been the result of "gross negligence."[2] In fact, other litigation has demonstrated that the largest of these loans resulted from outrageous borrower fraud, and that the relevant decisions by the bank's officers and directors were reasonable, protected by the business judgment rule, and not actionable.

Only after a worldwide panic struck, while Westernbank, like everyone else, was working hard to ride out a global recession, did the OCFI knock down its doors and seize it,

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[2] Puerto Rico's civil law system does not recognize a claim for "gross negligence." *Valle v. Am. Int'l Ins. Co.*, 108 D.P.R. 692 (P.R. 1979); *Gierbolini v. Employers Fire Ins. Co.*, 104 D.P.R. 853 (P.R. 1976). "Puerto Rico courts do not recognize gross negligence or any other degrees of negligence found in common law. . . . In sum, Puerto Rico tort law does not recognize a specific civil cause of action for intentional or grossly negligent acts." *Benito-Hernando v. Gavilanes*, 849 F. Supp. 136, 140 (D.P.R. 1994). The FDIC has quite obviously sued for breach of fiduciary duty, through purported breaches of the duties of loyalty and due care, a common law claim found in most jurisdictions, including the Commonwealth of Puerto Rico. It requires pleading and proving intentional or grossly negligent (i.e., reckless) wrongdoing, as discussed below. For the Court's convenience, we shall indulge the FDIC's "gross negligence" label herein, with the caveat that it describes only the standard of care and not the claim itself.

thereby ending its 52-year history of stability and success. Then came appointment of the Federal Deposit Insurance Corporation (the "FDIC") as receiver, followed by a heavily-discounted fire sale of Westernbank's assets. Now, the FDIC has embarked on a quest to scapegoat the bank's officers and directors, whose lives have been as thoroughly turned upside down by this chain of events as any other investors or creditors. Dusting off the RTC's twenty year-old playbook, the FDIC asserts powers under 12 U.S.C. § 1821 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), and invites the Court on a stroll down memory lane, to a bygone era when hundreds of Savings and Loans ("S&Ls") failed because insiders turned them into piggybanks, wasting their assets on such things as teak and gold fitments for private yachts. The only thing those cases have in common with this one is the federal takeover of a bank.

The Savings and Loan crisis resulted from blatant looting by directors and officers who misused S&Ls for their own benefit. Nothing of the sort is alleged here. Instead the FDIC demands that W Holding's and Westernbank's long-serving directors, officers, and their spouses be held personally liable[3] for damages far beyond their means, which resulted from events they reasonably did not foresee, in operating a bank to which federal regulators gave the highest marks until the eve of a worldwide economic collapse. Many of the directors and officers lost a life's work in the demise of Westernbank, and their collective losses dwarf anything the FDIC might ever recover in this action, which demands they pay damages (1) for not predicting a global recession that would start in 2007, last at least five years and devastate the historically strong Puerto Rico real-estate market, and (2) for not anticipating these events by making drastic changes to the bank's tried-and-true, and regulator-approved, business model.

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[3] The spouses of the director and officer defendants, and the conjugal partnerships established between the spouses and the director and officer defendants, are filing their own motion to dismiss.

The FDIC demands that the directors and officers be found grossly negligent for not seeing into the future adroitly enough to anticipate a worldwide economic meltdown, despite the fact that financial luminaries, FDIC senior officials, and other market regulators admit that neither they nor anyone else should reasonably have anticipated the worst economic crisis since 1929 and its effects on the housing market. The admonition that hindsight is 20-20 could not better describe a situation than it does this one, where the Third Complaint asserts a single count for "gross negligence" against the directors, officers, and their spouses, based on eight loans (out of hundreds) that Westernbank issued between 2004 and 2009 (the "Loans"). The Court should dismiss the FDIC's claim for the following reasons:

First, the Third Complaint cannot avoid the reach of the business judgment rule, which protects directors and officers from exactly the sort of claim the FDIC asserts, visible only in hindsight, fueled by invective and innuendo. The FDIC might assert that applicable precedent supports its attempt to plead around the business judgment rule, but that is all it is, a mere attempt. When stripped of contradictions, legal conclusions, and held up to the light of reason, the Third Complaint alleges no more than negligence, if it even alleges that, and negligence claims are foreclosed by the business judgment rule.

The Third Complaint makes four types of conclusory allegations, on which it bases its theories of liability: (i) deficient loans; (ii) failure to heed regulator "warnings"; (iii) aggressive and risky growth; and (iv) failure to oversee loan approval and administration. None of these theories allege a plausible claim,[4] for the following reasons:

[4] The Third Complaint is legally insufficient, because its allegations are not more plausible than alternative explanations. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555-56 (2007) ("Plausible" means more likely than not, and is context-specific.); *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (mere possibility of wrongdoing is not enough; plaintiff must plead facts, not "labels," "conclusions," or "formulaic recitation of the elements").

As to the allegedly "deficient loans," the FDIC tries in vain to reverse-engineer a claim from the results of a decision, instead of alleging a defect in the decision-making process. Only defective decision-making is left unprotected by the business judgment rule. The decision itself, even if "stupid" or "irrational," is immune from challenge.[5]

The allegedly "unheeded" regulator "warnings" never occurred. As we demonstrate below, the OCFI and federal regulator examinations regularly resulted in the best possible asset-health and stability scores. Only in 2007, after the world economy began to quake, and after Westernbank discovered a fraud on its asset-based division, did the regulators minimally reduce the bank's scores. By the time the late 2008 examination finished, Westernbank had shut down almost all of the so-called "Loss Loans" on which the FDIC travels, and had done so independently of any regulator's "warnings." This is hardly the sort of deliberate disregard the FDIC alleges, even if that were legally sufficient, which it is not, as we demonstrate below.

The allegation of "aggressive and risky growth" is legally unfounded. As a matter of law, this allegation could not support a claim of gross negligence, even if such a claim were available. The alleged "failure to oversee loan approval and administration" is the "most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[6] Even if the FDIC's claim weren't based on "the most difficult theory" of all, and even if it weren't unwinnable as a matter of law, this Court already rejected an identical claim in *Wylie ex rel. W Holding Co., Inc. v. Stipes*, 797 F. Supp. 2d 193, 203 (D.P.R. 2011) (Gelpí, J.).

Second, the FDIC did not, and cannot, plead a plausible causation theory. It is not plausible to claim that the directors and officers ("D&Os") caused the bank's losses, in a situation where all regulators gave the bank high marks until the world economy collapsed and

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[5] *In re Caremark Int'l. Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).
[6] *In re Caremark*, 698 A.2d at 967.

took down the bank's borrowers with it. Indeed, the more plausible explanation is that the most desperate economic crises this country has experienced since the Great Depression were the actual and proximate cause of everyone's losses here.

Third, the FDIC cannot revive time-barred claims.[7] Here, seven of the eight loans expired under the applicable one-year statute of limitations long before the FDIC took over Westernbank in April 2010. The FDIC evidently knows these claims are time-barred, but argues that it can save them with an arcane tolling doctrine called "adverse domination," which it specifically alleges. This doctrine is only available when state law has adopted it, and Puerto Rico has not. But even if this doctrine existed under Puerto Rico law, it could not apply here, because the bank disclosed every one of the alleged deficiencies in the loans long before April 2010.

Fourth, this action, or at least any part of it based on the Inyx and Intercoffee asset-based loans, is barred by *Wylie v. Stipes*, *supra*. The core of the FDIC's allegations, that the directors were so willfully blind as to be grossly negligent, already was litigated, and dismissed, by this Court, which adopted the findings of an extensive investigation by a special litigation committee. Indeed, this Court adopted the finding that the D&Os were not grossly negligent, but were victimized by a fraud, both inside and outside the bank, that the banks' *adequate* internal controls could not detect. The Court should not allow the FDIC to get a second bite at this apple and force the D&Os to re-litigate claims that the Court dismissed. In any event, the preclusive effects of the *Wylie* case render any theories of gross negligence as to the Inyx and Intercoffee loans implausible, if not barred by principles of collateral estoppel.

Fifth, the FDIC overreaches in suing Cesar Ruiz, who was neither a member of the Senior Lending Committee nor the Senior Credit Committee— the bodies charged with

[7] This would also be the case as to any future attempt to allege a claim under FIRREA.

approving the Loans—but merely sat on the banks' board, approved only minutes of meetings, and was only even remotely involved with one out of the eight loans the FDIC travels on.

Sixth, in the event the Court were to decide that the FDIC has adequately alleged a legally cognizable and satisfactorily plausible claim that is neither barred by collateral estoppel nor the statute of limitations, it should require the FDIC to plead with more specificity, to give proper notice to the defendants. Because we already demonstrated these pleading deficiencies and the FDIC ignored them, the Court also is authorized to dismiss these claims outright.[8]

Finally, the FDIC's new claim for fraudulent conveyance is premature, legally insufficient, and fails to state a claim under either FIRREA or Puerto Rico law.

For these reasons, as more fully discussed below, the Court should dismiss the FDIC's claims with prejudice, or, in the alternative, require the FDIC to re-plead its gross negligence claim and provide a more definite statement.

ANALYSIS

I. The FDIC Cannot Plead a Plausible Gross Negligence Claim That Meets the *Twombly/Iqbal* Standards of Rule 8(a)

The FDIC's Third Complaint places all its bets on one claim—gross negligence. After more than two years of investigation, access to every document and depositions of the D&Os—pre-suit discovery that only the government could get—and after three tries at pleading plausible claims—it is telling that the FDIC sues the D&Os[9] for gross negligence—not for fraud or

[8] Despite the FDIC's pledge that it took to heart the arguments in our prior motion [*See* D.E. #170 ("FDIC's proposed [Third Complaint] asserts additional facts and clarifies FDIC's claims in certain respects, in response to various arguments made in the defense motions to dismiss . . . .")], its Third Complaint did not cure any of its predecessor's deficiencies. Rule 15's comments admonish parties to "consider carefully and promptly the wisdom of amending to meet the arguments" in a motion to dismiss. *See* Advisory Comments to Fed. R. Civ. P. 15. The FDIC has not done that here, which warrants dismissal with prejudice.

[9] The FDIC sues the D&Os in four capacities: (a) as directors of Westernbank; (b) as officers of Westernbank; (c) as members of Westernbank's Senior Credit Committee ("SCC"); and (d) as members of Westernbank's Senior Lending Committee ("SLC"). We do not concede that acting in any of these capacities could support liability and have combined them in the term "D&Os" for convenience. Also, some of the movants are directors, but not

breaching the duty of loyalty, not even for excessive emoluments or corporate waste.[10] The absence of other claims illustrates the problems with the gross negligence count. When put to the *Twomby/Iqbal* test, and shorn of conclusory and untenable supporting allegations, the Third Complaint alleges no more than simple negligence, if it alleges anything at all.

A. The exacting Rule 8(a), Twombly, and Iqbal standard

The United States Supreme Court has made clear that a district court must scrutinize a complaint early—at the pleading stage—and dismiss it unless the plaintiff sets forth sufficient factual allegations to establish not just a claim, but a plausible claim. *Twombly*, 550 U.S. at 544; *see Iqbal*, 556 U.S. at 662. Plausibility means more likely than not, and is context specific. *Twombly*, 550 U.S. at 555-56. A mere possibility of wrongdoing is not enough. The plaintiff must plead ***facts***, not "labels," "conclusions," or "formulaic recitation of the elements" to persuade this Court that a plausible claim exists. *Iqbal*, 556 U.S. at 678.

Indeed, the Court's first order of business is to scrub a complaint of any legal conclusions or conclusions masquerading as "facts," because they are entitled to no weight. *See Iqbal*, 556 U.S. at 678-79. After purging the complaint of conclusions, the Court must "draw on its judicial experience and common sense" and decide (1) if the plaintiff pled a plausible claim and (2) if alternative explanations of innocence are more likely than plaintiff's allegations of wrongdoing. *Maldonado v. Fontanes*, 568 F.3d 263, 268 (1st Cir. 2009) ("[T]he court's assessment of the pleadings is context-specific, requiring the reviewing court to draw on its judicial experience and common sense."). This analysis depends on the full factual picture, not

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officers, and vice versa. If this sounds confusing, we apologize, but it is the direct result of the FDIC's failure to plead who, in what role, did what, and when. This is a separate basis for dismissal that we discuss in **Section V**, *infra*.

[10] The FDIC alleges three other claims: one against Mr. Tamboer, one against the insurers, and an untenable fraudulent transfer claim against Messrs. Stipes and Dominguez. Count 3, labeled "Adverse Domination" does not assert a claim, but a tolling concept, which does not even apply, as we demonstrate below.

facts in isolation, and a complaint should be dismissed when, viewed as a whole, it does not support a plausible claim or *alternative explanations make the claim unlikely*. *See Twombly*, 550 U.S. at 570 (concluding that plaintiffs did not nudge their claims across the line from conceivable to plausible, where defendants offered obvious alternative explanations); *see also Iqbal*, 556 U.S. at 680 (finding alleged wrongdoing more compatible with, and more likely explained by, lawful conduct).

The FDIC's Third Complaint merely asserts that the challenged conduct was grossly negligent and a cause in fact of alleged damages. It does nothing to carry the burden of alleging a plausible claim. After all this time and the FDIC's deployment of awesome governmental power in its pre-suit investigation, the best it can do—after three tries—is still not good enough. The Court should dismiss the claim with prejudice.

B. The FDIC's gross negligence claim, analyzed in light of Twombly/Iqbal, at most alleges negligence—a claim that was not asserted and would be barred by the business judgment rule if it had been

The D&Os' decisions and actions are governed and protected by the business judgment rule. Puerto Rico expressly protects directors and officers from negligence claims where they have applied their business judgment.[11] 14 P.R.L.A. § 3563. Puerto Rico looks to Delaware law in applying this rule. *Marquis Theatre Corp. v. Condado Mini Cinema*, 846 F.2d 86, 91 (1st. Cir. 1988) (Puerto Rico corporate law "is closely patterned after Delaware corporate law, and the applicable principles [of the business judgment rule] are well established in Delaware jurisprudence."); *see also Wylie v. Stipes*, 797 F. Supp. 2d at 193 (applying Delaware law).

Puerto Rico, Delaware, and all other states universally agree that directors are immune from fault attached to their business judgments—"[b]usiness decision-makers must operate in

[11] As Delaware and Puerto Rico law permits, W Holding's charter exculpates its directors (the same directors as Westernbank) from liability for negligence claims arising out of the performance of their duties for the corporation.

the real world, with imperfect information, limited resources, and an uncertain future." *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 126 (Del. Ch. 2009). The D&Os' function "is to encounter risks and to confront uncertainty, and a reasoned decision at the time made may seem like a wild hunch reviewed years later against a background of perfect knowledge." *Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982). The "circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later," and "a corporate officer who makes a mistake in judgment as to economic conditions" will "rarely, if ever, be found liable for damages suffered by the corporation." *Id.* at 885-86. This is equally true when the FDIC is the plaintiff:

> [W]ith the benefit of hindsight, the FDIC . . . could almost always allege one or more acts of negligence by bank directors in approving a bad loan. Had the directors obtained better or more current appraisals, more or better security for the loan, and had the bank better monitored the payment history of the loan and subsequent changes in the credit-worthiness of the borrower, almost any loan could have been made more secure, or at least the bank could have suffered a smaller loss on it. The business judgment rule protects bank directors from being guarantors on loans made by banks . . . .

FDIC v. Brown, 812 F. Supp. 722, 723 (S.D. Tex. 1992).

Because the business judgment rule protects the D&Os, the FDIC must plead outside of its reach to avoid dismissal and allege the D&Os acted disloyally, in bad-faith, engaged in intentional misconduct, or acted with such extreme carelessness that they failed to exercise even the slightest degree of diligence, to wit—grossly negligently. 14 P.R.L.A. § 3563 (only gross negligence can result in personal liability); *McMullin v. Beran*, 765 A.2d 910, 917, 921 (Del. 2000) (plaintiff must provide evidence that the board of directors, in reaching its challenged decision, either intentionally or grossly negligently, breached the triad of fiduciary duties—loyalty, good faith, and due care). The FDIC makes no attempt to allege bad-faith, intentional

bad acts or disloyal conduct, opting instead for the murkier breach of the duty of due care by grossly negligent conduct, which is exceedingly difficult to plead, much less prove.

Pleading gross negligence is a tall task. It is such an extreme departure from the standard of due care that it amounts to recklessness. On its third try, the FDIC still did not (and cannot) plausibly allege that the D&Os acted with a "'devil-may-care attitude' or indifference to duty *amounting to recklessness*." *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *4 (Del. Ch. 2005) (emphasis added); *accord In re Walt Disney Co. Deriv. Litig. ("Walt Disney")*, 907 A.2d 693 at 750 (Del. Ch. 2005) (gross negligence is "reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason."); *see RTC v. Blasdell*, 930 F. Supp. 417, 419, 426-27 (D. Ariz. 1994) (dismissing gross negligence claim despite allegations that "board members slept at meetings, failed to ask substantive questions, and otherwise neglected their duties"); *FDIC v. Benson*, 867 F. Supp. 512, 522-23 (S.D. Tex. 1994) (dismissing gross negligence claim despite allegations that D&Os ignored FDIC examination reports that revealed "a pattern of misconduct over years and the indifference with which they carried out their duties," as well as "insider loan abuse," because the FDIC did not allege "anything that could constitute more than [simple] negligence"). After implicitly conceding that its Second Complaint fell short, the FDIC's Third Complaint adds no facts to support its conclusory allegation of gross negligence.

The FDIC still asserts four implausible theories of complete indifference by the D&Os to Westernbank's welfare: (1) failing to implement sufficient internal controls and their approval, extension, renewal, and increases of Loans despite deficiencies in the Loans (Third Compl. at ¶84, bullet points ("bp") 2, 5, and 6); (2) failing to heed "warnings" of federal regulators (*id*. at ¶84, bp 7); (3) causing rapid growth of Westernbank's asset-based, construction, and real estate

divisions (*id.* at ¶84, bp 1); and (4) failing to adequately supervise and monitor administration of the loans. (*id*. at ¶84, bps 3, 4 and 8).

These are merely negligence claims, re-packaged and re-badged with a "gross negligence" label. The Court must evaluate each of these theories, wipe them clean of conclusory statements and conclusions masquerading as facts (*Iqbal*, 556 U.S. at 678-79), and use its own well-founded judgment to determine if any of these four theories is even plausible, and if so, whether they are more plausible than another alternative explanation. *Id*.

When put to the test, these allegations, at most, assert negligence based on 20-20 hindsight, which the Court should dismiss under the business judgment rule.

i. It is implausible to allege that the D&Os failed to implement sufficient internal controls and failed to apprise themselves of relevant information in approving and extending the Loans

Although the Third Complaint concerns events between 2004 and 2009—a period during which the D&Os on the SLC or SCC approved hundreds of loans—the FDIC complains about only eight. It calls them the "loss loans," but we will refer to them simply as the "Loans." The D&Os (not including Cesar Ruiz) voted on only seven of them. Of those seven, alleged liability is partially premised on extensions and additional credit, not only on original approvals. As we demonstrate below, it is implausible to allege that, during this period, the D&Os were (1) grossly negligent in implementing internal controls, or (2) deviated from their usual exercise of care, and approved and extended these particular loans with a "reckless indifference to or a deliberate disregard of the whole body of stockholders . . . ." *Walt Disney*, 907 A.2d at 750:

First, the FDIC's Third Complaint (like its second) concedes that individuals inside Westernbank's Business Credit Division ("WBCD") subverted admittedly adequate internal controls and procedures, to prevent the SCC or the D&Os from discovering the problems with

WBCD's asset-based loans. Third Compl. at ¶80(C). The Inyx and Intercoffee asset-based loans account for almost 51% of the Loans and almost 52% of all losses alleged by the FDIC. *Id*. at ¶79. It is not too soon to require the FDIC's concession that the legal cause of these loans going bad cannot have been any alleged gross negligence by the D&Os, because the allegations regarding controls, procedures, and oversight on which the FDIC bases that claim are swept away by the express findings of the special litigation committee that investigated the Inyx fraud.

Those findings, which this Court accepted in dismissing a shareholder derivative action, directly contradict the FDIC's theory, and include the following preclusive facts:

- "[T]he corporation's information systems appear to have represented a good faith attempt to be informed of relevant facts;"
- "During the relevant period [2005-2007] the Board had in place internal controls over loan initiation and monitoring at WBCD;"
- "Between the years of 2005–2007 an Auditing Committee, consisting of four directors, held 22 formal meetings with W Holding's outside auditors;"
- "The committee received and reviewed annual management letters from W Holding's outside auditors. In addition, the Board held 12 meetings each year from 2005–2007, in which the Board members received updates on W Holding's financial results;" and
- "The Board also had in place a Senior Credit Committee, which was required to approve any loan over $20 million dollars ($15 million for the WBCD)."

Wylie, 797 F. Supp. 2d at 203. This Court held those findings persuasive enough to conclude that Westernbank had sufficient monitors and controls to bar any claim for D&O liability based on failure to oversee the WBCD. *Id*. The accuracy of hindsight makes it easy to say that more controls might have revealed the WBCD's fraud (as the FDIC alleges—Third Compl. ¶80), but the "fact that the [systems in place] proved to be ineffective" does not make a director or officer liable. *Id.* at 203, *citing Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362, 373 (Del. 2006) ("[T]he directors' good faith exercise of oversight responsibility may not invariably prevent

employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both . . . . [A]bsent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf."). Binding precedent renders the FDIC's allegations of liability implausible and legally insufficient.

Second, the FDIC's theory that the D&Os failed to implement sufficient internal controls is implausible as to loans that were approved or extended from 2004 to 2006, which include the original Sabana loan and extension, all the Inyx loans, the Museum Tower loan, and all but the final Intercoffee loan, because of the FDIC's admissions in its Reports of Examination ("ROEs"). There simply could not have been any material issues at that time as to the sufficiency of the bank's controls, because the FDIC awarded Westernbank the highest possible CAMELS scores, as discussed below in **Section I(B)(ii)**.

Third, using perfect hindsight, the FDIC tries to reverse engineer a gross negligence claim by pointing to the *results* or *consequences* of the D&Os' business judgment, as if the D&Os had access to a time machine when they made real-time decisions. Third Compl. at ¶¶80(A)-(H). This gambit must fail, because it is not the *result* that matters, but the *process* that led to the result. Only when there is "a *wide* disparity between the process the directors used . . . and that which would have been rational" can a gross negligence claim survive dismissal. *Guttman v. Huang*, 823 A.2d 492, 507 n. 39 (Del. Ch. 2003) (emphasis in original).

Here, the FDIC admits that the D&Os' process was rational. Each of the seven loans was approved by a committee, not by one individual. Third Compl. at ¶65 ("SLC was responsible for evaluation and approval of [loans] . . . ."); ¶66 ("SCC was responsible for evaluation and approval of asset based loans."); and *Id.* ("The Board also was responsible for evaluation and

approval of asset based loans . . . ."). This fact alone—that the loans were the subject of committee action—undermines any suggestion that they were irrationally approved. Even more evidence of a proper process is Westernbank's requirement that the board perform a second-tier review of loans over $50 million. *Id*. at ¶¶65, 66. In both the initial and second-tier review, the D&Os analyzed substantial information in deciding whether to approve, extend, or increase credit on the loan. *Id*. at ¶80 (listing appraisals, financial analysis of borrowers, future profit calculations, and borrower character, among other things, that the committee members reviewed). This is plainly a rational process and, on its third try, the FDIC still fails to allege any facts to undermine that conclusion, much less show that it would be more plausible to conclude the process was irrational, which is what the law requires. *Walt Disney*, 907 A.2d at 749-50.

Ignoring its pleading burden, the FDIC instead complains about the *content* of the decisions. Third Compl. at ¶80 (claiming that the "faltering economy," "speculative future profits," "uncertain future contingencies," "speculative future zoning changes," "lack of understanding of Florida real estate market," and "severe decline in market conditions" support its gross negligence claim). But "the *content* of the board decision that leads to a corporate loss," without a valid complaint as to the process, can never be the basis of a gross negligence claim. *Walt Disney*, 907 A.2d at 749-50 (emphasis added) (director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss). Moreover, the mere fact that a loan went unpaid does not support a gross negligence claim, or prove that anything was improper in the process used to approve the loans. *See., e.g., First Nat'l Bank of Lincolnwood v. Keller*, 318 F. Supp. 339, 347-48 (N.D. Ill. 1970); *Belmont Holdings Corp. v. SunTrust Banks, Inc.,* 2010 WL 3545389 at *6 (N.D. Ga. 2010) (absent evidence that directors "did not believe" financial statements, they could not be

liable for negligence (much less gross negligence); mere fact that loan reserves in financial statements turned out to be insufficient, due to "a later course of economic events," did not state a claim). Even if criticism of D&O decisions were relevant, the Court would have to assess the decisions in the context they were made, not in hindsight. *See Washington Bancorp. v. Said*, 812 F. Supp. 1256, 1266 (D.D.C. 1993) ("To impose liability on directors for [] good-faith business decisions," based on "hindsight," "would effectively destroy the corporate system in this country, for no individuals would serve as officers and directors.").

Finally, any criticisms of the board, SLC, or SCC's process, or even the quality of the process' results, are rendered implausible by *Wylie.* Stripped of legally-insufficient allegations, the Third Complaint fails to plead a plausible gross negligence claim based on alleged D&O gross negligence in implementing internal controls and approving and extending the Loans.

ii. It is implausible to argue that the D&Os disregarded regulator warnings when the regulators consistently ranked the bank as a top bank from 1993 to 2006 and raised specific issues only after the bank halted lending on the Loans

For over *twelve* years, the FDIC consistently awarded the highest rating to Westernbank. Nonetheless, the FDIC now invites the Court to use hindsight for time travel and allow the FDIC to change its mind many years later as to the loans in question, retract those ratings and erase those admissions, to accommodate its theory that the loans in question went bad because the D&Os "failed to heed and act upon examiner and auditor warnings . . . ." Third Compl. at ¶¶8, 84 at bp 7. This is a naked assertion of a conclusion contradicted by the FDIC's own contemporaneous statements, and remains so after three attempts to plead it. It can have no legal significance, and the facts the FDIC alleges to support it are implausible.[12]

[12] The FDIC attempts to support this conclusory allegation with reference to certain ROEs the FDIC has not filed with the Court—which contradict the FDIC's allegations. The Court can consider the ROEs, because they are referred to in the Third Complaint and are central to the FDIC's allegations. *Venture Assocs. Corp. v. Zenith Data*

The FDIC's theory is implausible because its ROEs contradict any implication that the FDIC's suggestions for improvements were anything other than suggestions—not "warnings." The FDIC failed to attach the ROEs to the Third Complaint and alleges that they consisted solely of "warnings" and "deficiencies," and "criticized" the management and administration of the loans. Third Compl. at ¶¶60-63. The FDIC fails to note that regulators for over twelve years (1993 to 2005) awarded Westernbank the highest possible scores (all "1s" and two "2s" in 2005) in six areas, i.e. **C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk—colloquially known as the "CAMELS" rating system, which regulators use as a shorthand to analyze a bank's risk management.

In 2005, when the FDIC now claims the D&Os were grossly negligent in approving the Sabana, Inyx, and Intercoffee loans (Third Compl. at ¶80 (chart)), the regulators again commended the bank with an award of four "1s", two "2s," and the best possible overall CAMELS score of "1." 2006 ROE at 1. Even in 2006, when the FDIC now claims the D&Os were grossly negligent in approving the Plaza CCD and Museum Towers loans, and approving additional credit on the Inyx, Intercoffee, and Sabana I loans, the regulators awarded the bank a mix of 1s and 2s, including awarding 1s and 2s on the newly-added criteria of "Information Technology," "Trust," and "Compliance," and graded the bank overall a "2"— the second-highest rating given to a bank, which denotes that a "financial institution[] [is] fundamentally sound." 2006 ROE at 33. An institution that receives a "2" has satisfactory "[o]verall risk management practices," and there are "no material supervisory concerns"—which contradicts any purported "warnings" the FDIC alleges it gave. In other words, during the years that the FDIC alleges the D&Os were grossly negligent in approving initial and additional credit on ***82%***

Sys. Corp., 987 F.2d 429, 431 (7th Cir. 1993). The D&Os have not filed these confidential documents. We represent that each fact asserted here regarding the ROEs can be found therein, and we stand ready to submit the relevant portions under seal once a confidentiality order is entered.

of the Loans, the FDIC consistently gave the bank the highest possible ratings, noting that any suggestions it made were swiftly corrected. Therefore, the FDIC fails to plead any plausible gross negligence theory as to 82% of the Loans. *See Twombly*, 550 U.S. at 557.

In 2007, the regulators downgraded Westernbank's CAMELS score to a "3" for the first time in twelve years. This followed the bank's internal discovery and prompt public disclosure that one of its largest asset-based loans was in the hands of a career swindler, who had defrauded individuals inside the WBCD. The seismic shift to the bank's bottom line resulting from Jack Kachkar's Inyx fraud explains the marginal CAMELS downgrade, not some theretofore invisible gross negligence in 2005, which the FDIC now alleges in hindsight. Indeed, the 2007 ROEs explained that the bank's asset quality score went from a "2" to a "3" because the percentage of adversely classified loans increased from 17.20% in 2006 to 40.29% in 2007—**with 87% of the increase attributed to the defrauded WBCD's Inyx loans**. Notably, the regulators found no problem with any of other six Loans that were untainted by Inyx's fraud on the WBCD.

By 2008, the housing collapse and worldwide economic crisis was in full force. In light of the already-depressed Puerto Rico economy, it is no surprise that Westernbank, like every other bank that lent money to businesses and developers, felt the effect. During this economic crisis, bank regulators first began to identify problems involving commercial real estate and construction loans. This is an unremarkable result of the real estate crash, which limited borrowers' ability to repay those loans. The 2008 ROE, for the first time ever, classified as "substandard"—i.e., subject to deficiencies but not in default—the remaining six Loans, which were construction loans, not asset-based loans. These were Sabana I and II, Plaza CCD, Museum Towers, Yasscar Development, and Yasscar Caguas. The FDIC noted that these loans

had taken a turn for the worse "in part [] due to Puerto Rico's well-publicized economic slowdown . . . particular[ly] its real estate market, [which] resulted in very high levels of adversely classified assets." 2008 ROE at 1-2.

Westernbank did not need to wait on regulators' examinations to spot problem loans, nor did it disregard the examinations. Even the ROEs admit that the bank took proactive steps, independent of the examinations, before the regulators downgraded the six non-asset-based Loans in 2008. After Frank Stipes returned in 2007 as Westerbank's president, the bank spotted potential problems with its non asset-based loans, ceased construction lending to minimize the risk and impact of the economic downturn, and *completely shut down* in July of 2007 five of the six Loans, other than insignificant credit advancements to the Plaza CCD loan in September and December. 2008 ROE at 24; 2007 ROE at 15. Therefore, it is incorrect and completely implausible to allege that the D&Os "negligently" continued to prop up these loans in the face of regulator warnings. Third Compl. at ¶¶ 8, 84 at bp 7. Indeed, the more likely explanation is that the problems with these loans had more to do with the unprecedented economic collapse than any alleged negligence, let alone gross negligence.

In the run-up to the worst economic calamity in this country since the Great Depression, the regulators found Westernbank's condition to be sound, and the bank to be well managed, by the same directors and officers the FDIC now seeks to scapegoat for alleged gross negligence to the tune of $176 million. The fact that Westernbank went from a "1-2" rating year-after-year-after-year, to a "4" rating in late 2008, was not caused by any D&O negligence, let alone gross negligence. What caused it was the sudden onset and shocking severity of the Great Recession, and the consequent impairment of the nation's banks from Main Street to Wall Street, the largest of which were rescued and recapitalized by the federal government to prevent their problems

from further reverberating through the banking system. These are simply not the type of facts gross negligence claims are made of.

iii. The FDIC's theory of Westernbank's alleged aggressive growth is legally meritless and cannot support a plausible claim for gross negligence

The FDIC still claims, without more, that the D&Os "pursu[ed] an aggressive and reckless growth and lending strategy that placed short term income and profits ahead of the safety and soundness of the federal insured depositor funds entrusted to the Defendants." Third Compl. at ¶¶4, 84 at bp 1. However, there is nothing *per se* actionable about pursuing an aggressive growth strategy, and the FDIC's conclusory description of the strategy as "reckless" and "plac[ing] short term income and profits ahead of safety and soundness . . ." is a bare conclusion, supported by no alleged facts, which the Court should disregard (*Twombly*, 550 U.S. at 555-56) and discard for the following reasons:

First, unlike other D&O suits, the FDIC entirely fails to give ***any*** sort of basis for the conclusion that the bank's growth was "reckless." The FDIC has neither cited any statistical analysis nor any peer-institution comparison to establish a benchmark for "responsible" growth. Even if it had, such a comparison would not demonstrate that allegedly "reckless" growth caused the FDIC's alleged losses. *First Nat'l Bank of Bellaire v. Comptroller of Currency*, 697 F.2d 674, 686 (5th Cir. 1983) ("[W]ithout a connection between the peer group analysis and a finding of unsafe and unsound capital levels, therefore, the peer group analysis does not support the Comptroller's finding that the Bank's capital level was unsafe and unsound.").

Second, the only point of this allegation of purportedly "reckless" growth is to portray the D&Os as greedy executives with a lust for profits at the expense of prudence that might be evidence of negligence. Third Compl. at ¶56 ("driven by the desire for short term income and profits"). This theory is implausible because *none of the D&Os ever sold even a single share of*

stock during the time period when the FDIC alleges that they embarked on what it terms a "reckless growth strategy" (without explaining what about it was "reckless" or why), a fact that the FDIC does not dare contradict in its allegations. In fact, the $176 million for which the FDIC wants to make the D&Os insurers pales in comparison to the more than $500 million in losses suffered by the Stipes family, not to mention the other D&Os' families. The FDIC can build no gross negligence claim on this implausible theory, and the Court should reject it.

The Court also should reject this implausible theory because penalizing directors for pursuing what the government later considers risky business strategies would be contrary to the essence of the business judgment rule. "The business judgment rule exists precisely to ensure that directors and managers acting in good faith may pursue risky strategies that seem to promise great profit." *Trenwick Am. Litig. Trust v. Ernst & Young, LLP*, 906 A.2d 168, 193 (Del. Ch. 2006). The business judgment rule is "designed to allow corporate managers and directors to pursue risky transactions without the specter of being held personally liable if those decisions turn out poorly." *Citigroup*, 964 A.2d at 126. *See also FDIC v. Castetter*, 184 F.3d 1045 (9th Cir. 1999) (bank directors held not liable for negligence as a matter of law, because evidence showed they were "surrounded by sources of information" in deciding to grow the bank rapidly and use funding sources that the FDIC later alleged were unreliable).Yet, imposing such personal liability is precisely what the FDIC seeks in this case. This allegation could never support a plausible claim for negligence, let alone gross negligence.

Finally, an alleged desire to maintain an "inflated" stock price to boost compensation, at least for purposes of showing motive in a securities fraud claim, is irrelevant as a matter of law, as it would expose to liability "virtually every company in the United States that experienced a downturn in stock price." *Acito v. Imcera Group., Inc.*, 47 F.3d 47, 54 (2d Cir. 1995);

Footbridge Ltd. v. Countrywide Home Loans, Inc., 2010 WL 3790810, at *18 (S.D.N.Y. 2010); *In re Federated Dep't Stores, Inc., Sec. Litig.*, 2004 WL 444559 (S.D.N.Y. 2004); *In re Best Buy Co., Inc. Sec. Litig.*, 2005 WL 839099 (D. Minn. 2005).

iv. The FDIC's theory that the D&Os failed to adequately supervise and monitor the Loans is contradicted by the facts in this case and fails to support a plausible claim for gross negligence

The FDIC alleges, once again in conclusory fashion, that the D&Os failed to supervise the bank, allowing "the Bank's commercial loan portfolio to deteriorate[,]" and failing "to ensure that loans complied with the Bank's policies and procedures and prudent banking practices." Third Compl. at ¶84 at bp 2, 8. In other words, the FDIC alleges that the D&Os should be liable for losses not attributable to their actions, but the actions of others, because they allegedly failed to "ensure" that the persons responsible for administering the loans did so properly. This is, as discussed above, an oversight claim that the FDIC did not and cannot adequately allege. Director oversight liability "is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. 1996). Further, as the *Citigroup* court noted, board decisions to approve transactions outside the parameters of internal company guidelines, which do not have the force of law, fall directly within the ambit of decisions protected by the business judgment rule. *See Citigroup*, 964 A.2d at 135 (explaining that "director liability is not measured by the aspirational standard established by internal documents detailing a company's oversight system").

A failure to monitor theory requires alleging and proving either that the directors "utterly failed to implement any reporting or information systems or controls" or, if such controls existed, that they "consciously failed to monitor or oversee [the company's] operations thus

disabling themselves from being informed of risks or problems requiring their attention." *Stone*, 911 A.2d at 370. The FDIC cannot and does not even attempt to allege the first condition, admitting in the Third Complaint that Westernbank had internal controls and procedures in place to control loan underwriting and administration. Third Compl. at ¶¶65, 66, 77, 78; *see* **Section I.B.i**.

Moreover, if the FDIC argues that it has alleged the D&Os are subject to liability for gross negligence because they should have more quickly detected the Inyx fraud and its infection of the WBCD, this Court already rejected that idea (*Wylie*, 797 F. Supp. 2d at 193). Other courts have, too. *See Caremark*, 698 A.2d at 972 (rejecting theory that directors breached fiduciary duties by failing to detect employees' federal law violations); *Stone*, 911 A.2d at 373 ("The lacuna in the plaintiffs' argument is a failure to recognize that the directors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both . . . ."). The Third Complaint fails to state an oversight claim against the D&Os on a failure to monitor theory.

The Third Complaint also fails to state a legally sufficient claim on the theory that the D&Os consciously disregarded risks, especially *business risks*, which is what the FDIC seeks to allege here. *E.g.*, Third Compl. at ¶84 at bps 2, 3 and 4 (criticizing: continuing approval of "high risk commercial loans;" failing to understand the "extreme risks of such strategies;" and the "extreme risks inherent in these loans."). Indeed, allegations that the D&Os were aware of purported "warning signs" that should have put them on notice (*e.g., id.* at ¶¶60-63, 80(B) at bp 1, (G) at bp 4, and (H) at bp 4), are exactly the sort of allegations that *cannot* support an oversight liability claim. *Citigroup*, 964 A.2d at 126-27. Much as the FDIC does here, the

Citigroup plaintiffs alleged "red flags" consisting of (1) warnings by the Financial Accounting Standards Board staff, (2) a faltering economy, and (3) subprime lender losses. *Id*. at 127-128. The court held that those purported red flags, and others, could not support a claim for oversight failure, but instead were risks that the board factored into its good-faith business decisions. *Id*. at 128; *accord In re Goldman Sachs Group, Inc. S'holder Litig*., 2011 WL 4826104, at *22-23 (Del. Ch. 2011) (granting motion to dismiss oversight liability claim, where alleged failure was the directors' inability to fully appreciate the risks posed by subprime securities that caused substantial losses, even though various indicators suggested the securities were overly risky.)

Similarly, in this case, adding together the FDIC's alleged "warnings" (which were not even warnings (as demonstrated in **Section I.B.ii**,)), and viewing them in light of the inherent risks of the commercial and construction lending markets, and the collapse of the economy and real estate market, does not and cannot support a claim that the D&Os breached any supervisory duties, let alone did so through grossly negligent conduct. The FDIC has failed to adequately allege a plausible claim of oversight liability.

C. The FDIC fails to plead that the D&Os caused any loss

The FDIC has failed to plead the first two elements of a gross negligence claim, i.e., a duty and breach through conduct so careless as to amount to recklessness. But even if the FDIC could allege facts to establish those two elements, it would still have to allege facts to support a plausible theory of causation. After three tries, no such facts are alleged, only conclusions, which requires dismissal. *Vazquez-Cruz v. Commonwealth of P.R.*, 618 F. Supp. 2d 120 (D.P.R. 2009) (Plaintiff must make "factual allegations, either direct or inferential, regarding each material element necessary to sustain recovery under some actionable theory."); *Twombly*, 550 U.S. at 557-58 ("something beyond the mere possibility of loss causation must be alleged . . .

."). Even if the FDIC did attempt to allege facts, no set of facts could support a plausible causation theory and allow the FDIC to carry its massive burden of demonstrating that the D&Os' alleged conduct was the cause in fact and proximate cause of both the FDIC's seizure of Westernbank and the $176 million dollar losses that allegedly resulted from its fire sale.

II. All Claims Relating to Seven of the Eight Loans are Time-Barred Because the "Adverse Domination Doctrine" is Unavailable as a Matter of Law

FIRREA provides a three-year federal repose period for the FDIC to bring claims *after* it takes over as receiver. 12 U.S.C. § 1821(d)(14). State law, on the other hand, determines when the FDIC's claims accrue and whether they expired *before* takeover. *FDIC v. Consol. Mortg and Fin. Corp.*., 805 F.2d 14, 17–18 n. 4 (1st Cir. 1986); *FDIC v. James T. Barnes of P.R., Inc.*, 834 F. Supp. 543, 547 (D.P.R. 1993); *FDIC v. Dawson*, 4 F.3d 1303, 1307-09 (5th Cir. 1993) (State law determines in every respect whether claims expired before the FDIC acquired them on takeover of the bank); *RTC v. Krantz*, 757 F. Supp. 915, 921 (N.D. Ill. 1991) (A literal reading of the statute would allow the FDIC to "revive claims relating to acts done during the Great Depression."). If claims are time-barred under applicable state law before an FDIC takeover, they remain time-barred after the takeover. *FDIC v. Torrefaccion Cafe Cialitos*, 62 F.3d 439, 442 (1st Cir. 1995) ("The federal limitations period does not [] operate to extend claims that have already lapsed under the state limitations period before the FDIC has acquired them.").

A. Puerto Rico's one-year limitations period controls, as the FDIC now admits

Puerto Rico's one-year limitations period for tort claims controls, as the FDIC now admits in its Third Complaint. 31 P.R.L.A. § 5298; *Ocasio Juarbe v. E. Airlines, Inc.*, 125 D.P.R. 410 (P.R. 1990); Third Compl. at ¶¶ 80(A), (B), (E), (G), H), 90. Whatever might be the FDIC's reasons for labeling its claim a claim for "gross negligence," it plainly asserts breaches of the fiduciary duties of loyalty and due care. The fact that the FDIC must plead and prove

intentional wrongdoing or gross negligence to overcome the business judgment rule does not turn an alleged breach of fiduciary duty into a claim for gross negligence, or transform it into anything other than a tort for limitations purposes. Put simply, gross negligence is a variety of negligence,[13] and all claims for negligence are torts. Therefore, the limitations period is one year. *E.g.*, *Colon v. Blades*, 2011 WL 6792759, at *8 (D.P.R. 2011) (breach of fiduciary duty claim was a tort under 31 P.R.L.A. § 5141, subject to one-year limitations period).[14]

The one-year period runs "from the time the aggrieved person had knowledge." 31 P.R.L.A. § 5298. A person has knowledge of a negligent lending claim (1) "from the time of the perpetration of the wrong complaint of" if the person has "notice of the injury, plus notice of the person who caused it," or (2) from the time that person could have acquired knowledge through the exercise of due diligence, whichever comes first. *RTC v. Blasdell*, 930 F. Supp. at 429; *Rodriguez-Suris v. Montesinos*, 123 F.3d 10, 13, 16 (1st Cir. 1997). Here, the FDIC alleges that underwriting deficiencies "were readily apparent to the Defendants" when they approved the Loans. Third Compl. at ¶80. The Directors' alleged knowledge is imputed to Westernbank, and

[13] "Puerto Rico tort law does not recognize a specific civil cause of action for intentional or grossly negligent acts." *Benito-Hernando v. Gavilanes*, 849 F. Supp. 136, 140 (D.P.R. 1994); *Valle v. Am. Int'l. Ins. Co.*, 108 D.P.R. 692 (P.R. 1979); *Gierbolini v. Employers Fire Ins. Co.*, 104 D.P.R. 853 (P.R. 1976). This is irrelevant for limitations purposes, since the FDIC's claim is plainly a tort claim, no matter what label is applied to it.

[14] Although the FDIC admits in its Third Complaint that the one-year limitations period controls (*See* Third Complaint at ¶¶ 80(A), (B), (E), (G), H), 90), it might still incorrectly argue for the three-year limitations period of 32 P.R.L.A. § 261, applicable to claims to recover a penalty or forfeiture from directors (not officers, like William Vidal), or "to enforce a liability created by law." 32 P.R.L.A. § 261. There is no Puerto Rico Supreme Court opinion applying (or misapplying) this limitations period to a claim for breach of fiduciary duty (or "gross negligence"), but the virtually identical California statute, on which the Puerto Rico legislature modeled Section 261, does not apply to gross negligence or breach of fiduciary duty claims, only to express statutory claims that did not exist at common law. *Briano v. Rubio*, 46 Cal. App. 4th 1167, 1180 (Cal. Ct. App. 1996) (construing Cal. Code Civ. P. § 359); *accord Lehman v. Superior Court*, 145 Cal. App. 4th 109, 122 (Cal. Ct. App. 2006). The *Briano* court held the three-year limitations period of § 359 inapplicable to a statutory codification of director liability claims under California Corporations Code § 309, because that provision merely "codified and refined existing law," which meant the statutory claim was *not* a claim to enforce "a liability created by law." *Id*. (holding California Corporations Code § 309—the equivalent of Puerto Rico's 14 P.R.L.A. § 3563—a codification of common law and not a "liability created by law."). So it is here. No matter what label the FDIC applies, its claim is not a creature of recent statutory origin. Thus, any alleged claims that accrued more than one year before takeover are time-barred.

in turn to the FDIC. Accordingly, the FDIC's gross negligence count accrued on the date of approval and disbursement of the Loans. *FDIC v. Jackson*, 133 F.3d 694, 697 (9th Cir. 1998).

The FDIC became Westernbank's receiver on April 30, 2010. Third Compl. at ¶1. Therefore, the FDIC cannot assert claims that accrued more than one year earlier, or before April 30, 2009. Of the eight loans on which the FDIC bases its Third Complaint, any claims relating to seven of them accrued before April 30, 2009 and the limitations period expired before takeover:

- Sabana I: last date of alleged conduct is May 15, 2008 (*id*. at ¶ 79, #1), so the claim expired on **May 15, 2009**;
- Sabana II: last date of alleged conduct is May 15, 2007 (*id*. #2), so the claim expired on **May 15, 2008**;
- Inyx: last date of alleged conduct is November 7, 2006 (*id*. #3), so the claim expired on **November 7, 2007**;
- Intercoffee: last date of alleged conduct is September 28, 2007 (*id*. #4), so the claim expired on **September 28, 2008**;
- Museum Towers: last date of alleged conduct is April 5, 2006 (*id*. #6), so the claim expired on **April 5, 2007**;
- Yasscar Development: last date of alleged conduct is May 15, 2007 (*id*. #7), so claim expired on **May 15, 2008**; and
- Yasscar Caguas: last date of alleged conduct is October 10, 2007 (*id*. #8), so claim expired on **October 10, 2008**.

Therefore, seven of the eight loans were time-barred before the FDIC seized Westernbank.

B. The adverse domination doctrine supplies no basis to toll the time-barred claims

Desperate to resurrect these long-dead claims, the FDIC asserts tolling through "adverse domination." Because the FDIC specifically alleges it (Third Compl. at ¶90), it is a proper subject for this motion to dismiss. *E.g.*, *Indep. Trust Corp. v. Stewart Info. Servs. Corp.*, 665 F.3d 930, 935 (7th Cir. 2012) (A complaint that sets forth the elements of an affirmative

defense, such as the statute of limitations, is subject to dismissal on that basis under Rule 12(b)(6).).

This tolling doctrine is not available to the FDIC because no reported Puerto Rico Supreme Court opinion recognizes it, and no statutory provision incorporates it. Only one court of this district even discussed it, in *dicta* thirty years ago, noting its basis in questionable precedent from the early twentieth century, and declining to adopt it. *FDIC v. Bird*, 516 F. Supp. 647, 651 (D.P.R. 1981). Adverse domination was not needed to "rul[e] on [the] motion to dismiss[,]" but the *Bird* court stated that "the available legal precedent" supporting the theory, "most of which dates from the first two decades of [the twentieth century], is of questionable value at this time in our history." *Id*. at 651-52 (questionable "precedents of another era do not necessarily govern today").[15] The *Bird* court's *dicta* failed to address two critical questions: (1) in deciding if this tolling doctrine applies, does federal common law or state law control? (2) if and when it applies, what degree of board culpability and control triggers the doctrine?

Other circuit courts have addressed these questions, holding that limitations issues, including tolling doctrines, are controlled by state law, and that this one in particular requires the FDIC to satisfy applicable state-law standards for the extent of culpability and control by the board. *E.g., Dawson*, 4 F.3d at 1309 ("If the FDIC is to toll the state statute of limitations prior to its appointment as receiver under the adverse domination doctrine, it must show the district court that the state law of adverse domination would permit tolling."); *see RTC. v. Artley*, 28 F.3d 1099, 1101 (11th Cir. 1994) ("Defendants argue that Georgia law applies, and that Georgia

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[15] The "questionable" legal precedent was three federal cases: a 1927 Ninth Circuit case; a 1928 Oregon district court case; and a 1943 Second Circuit case. It is unclear what law those courts relied on, but none of them were applying Puerto Rico law. *Bird*, 516 F. Supp. at 651 (citing *Adams v. Clarke*, 22 F.2d 957 959 (9th Cir. 1927) (relying on treatise and state trust law tolling concepts); *Schilling v. Parman*, 35 F.2d 780 (D. Or. 1928) (citing *Nat'l Bank of Commerce v. Wade*, 84 F. 10, 15 (C.C.D. Wash. 1897) (relying on trust treatise but citing contrary authority holding that trust relationship does not toll limitations period absent allegations of fraudulent concealment)); *Michelsen v. Penney*, 135 F.2d 409, 415 (2d Cir. 1943) (citing only a law review article)).

law does not recognize 'adverse domination' in these circumstances. We agree with defendants."); *FDIC v. Cocke*, 7 F.3d 396, 400 (4th Cir. 1993) (same); *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 85-86 (1994) (where RTC brought state-law claims, state law governed the question whether the directors' and officers' knowledge was imputed to the FDIC). Thus, we look to Puerto Rico law, which does not recognize adverse domination.

i. Puerto Rico has not adopted the adverse domination doctrine, which renders it inapplicable

Puerto Rico has not adopted the adverse domination doctrine, and neither have many states. *E.g., Artley*, 28 F.3d at 1102 (no adverse domination under Georgia law); *RTC v. Wood*, 870 F. Supp. 797, 811 (W.D. Tenn. 1994) (same—Tennessee law); *RTC v. Walde*, 856 F. Supp. 281, 286 (E.D. Va. 1994) (Virginia law); *RTC v. Gravee*, 1995 WL 75373 (N.D. Ill. 1995) (Illinois law); *In re Southeast Banking Corp.*, 855 F. Supp. 353, 358 (S.D. Fla. 1994) (Florida law); *RTC v. Armbruster*, 52 F.3d 748, 752 (8th Cir. 1995) (Arkansas law); *In re Antioch Co.*, 456 B.R. 791, 859 (Bankr. S.D. Ohio) (Ohio law), *aff'd*, 2011 WL 3664564 (S.D. Ohio 2011).

Because Puerto Rico does not recognize adverse domination, the FDIC may not use it to resurrect any part of its claim based on the seven loans listed above, and this Court should dismiss them as time-barred. *See, e.g., Armbruster*, 52 F.3d at 752 (holding that Arkansas does not recognize adverse domination and claims were time-barred); *Artley*, 28 F.3d 1099, 1102 (11th Cir. 1994) (same); *FDIC. v. Cocke*, 7 F.3d 396, 402-03 (4th Cir. 1993) (declining to apply the doctrine, but noting that Virginia recognizes the tolling doctrine of equitable estoppel in cases involving intentional concealment).[16]

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[16] If the Court were unwilling to dismiss claims that are time-barred on their face, despite no legal basis for tolling them, it could certify the question to the Puerto Rico Supreme Court. *Romero v. Colegio De Abogados De P.R.,* 204 F.3d 291 (1st Cir. 2000) (certifying unsettled question of Commonwealth law to Puerto Rico Supreme Court).

ii. *Even if this Court were to adopt the adverse domination doctrine, allegations of gross negligence are insufficient, and the FDIC would have to plead and prove that a majority of the directors knew about and committed intentional wrongdoing*

Assuming *arguendo* that the Court were disinclined to dismiss claims that are facially time-barred, and were inclined to predict that the Puerto Rico Supreme Court would adopt the adverse domination doctrine, the case of *FDIC v. Dawson*, 4 F.3d at 1307-09, is instructive. *Dawson* held that mere allegations of negligence, even gross negligence, are not enough, and there can be no tolling based on adverse domination without allegations and proof of director fraud and actual domination of the board by the alleged wrongdoers. The *Dawson* test comports with congressional intent, which is evidenced by the 1994 amendment to 12 U.S.C. § 1821 (as part of the Riegle-Neal Interstate Banking and Branching Efficiency Act), providing a claw-back limitations period for state-law claims involving intentional acts of fraud and self-dealing. 12 U.S.C. § 1821(d)(14); H.R. Rep. No. 103–103(II), 1993 WL 219268, at *4. Thus, Congress has expressly addressed the issue of tolling FDIC claims that expired before takeover, and has limited such tolling to intentional torts. In this case, there are no allegations of fraud or any intentional misconduct by any members of the board, let alone a majority. Therefore, even if Puerto Rico had adopted the adverse domination doctrine, it could not apply here. And, of course it could never apply to claims against Mr. Vidal, who was never a director.

A less stringent standard is unsupported by the cases, and even if the Court were to adopt such a standard, the FDIC's alleged adverse domination is implausible under *Twombly/Iqbal*. The reason for the doctrine is to ensure that claims are not time-barred before underlying wrongs are disclosed to those who can represent the corporation in a suit against the directors. *E.g., Bird*, 516 F. Supp. at 651. Thus, it stands to reason that if the information *was* disclosed, there can be no tolling, as a Delaware district court held in *In re Marvel Entm't Group, Inc.*, 273 B.R.

58 (D. Del. 2002).[17] That conclusion is even more compelling in a case, like this one, where the *directors already were sued* over the same alleged wrongdoing the FDIC now asserts.

Here, W Holding and Westernbank *did* disclose the material facts underlying the FDIC's claims almost four years ago, on June 26, 2007. That disclosure was sufficient as a matter of law, because W Holding's shareholders sued almost immediately, filing a pending Rule 10b-5 class action and a derivative action that this Court later dismissed. *See Wylie*, 797 F. Supp. 2d at 193; *Hildenbrand v. W Holding, Inc.*, Case No. 07-1886 (D.P.R. filed Sept. 21, 2007). *Wylie* and *Hildenbrand* demonstrate that the purported wrongdoing—which the FDIC incredibly alleges was undiscoverable until April 2010—was known to the entire world almost three years earlier.

Moreover, even if the FDIC were to argue that not all details of the alleged wrongs were known in 2007, the *Wylie* and *Hildenbrand* plaintiffs were empowered to learn them through discovery, which would prevent application of even an unsupportable liberalization of the un-adopted adverse domination doctrine. More importantly, W Holding subsequently disclosed every other fact the FDIC complains about and relies on in a Form 10-K filed on February 5, 2008 and a restated 10-K (for 2007) filed on March 16, 2009.[18]

Therefore, even if Puerto Rico had adopted the adverse domination doctrine (which it hasn't), and even if it had created a unique liberalization of the doctrine that (1) did not apply only to intentional torts, (2) did not require active concealment, (3) did not require board domination by intentional wrongdoers, and (4) could be triggered by the failure of someone with standing to discover the actionable information before the claim became time-barred, there would be no tolling available here as a matter of law, because the material facts on which the

[17] Delaware decisions are persuasive, as this Court noted in *Wylie*, 797 F. Supp. 2d at 193.

[18] Judicial notice of SEC filings is appropriate on a motion to dismiss, particularly when a complaint refers to them. *See Bryant v. Avado Brands*, 187 F.3d 1271 (11th Cir. 1999) (citing *Kramer v. Time Warner*, 937 F.2d 767 at 787 (2d Cir. 1991)).

FDIC bases the Third Complaint were disclosed on June 26, 2007, or were discoverable almost immediately after that date by persons with standing who *did* file suit, or, at the very latest, were disclosed in a public filing on March 16, 2009, more than a year before the FDIC seized the bank. *Accord In re Marvel*, 273 B.R. at 76 (court rejected adverse domination tolling where company's Form 10-K had disclosed facts underlying plaintiff's claim).

C. The FDIC's new allegations fail to revive the time-barred claims

The FDIC alleges a new theory in its Third Complaint in a final attempt to save its time-barred claims, and vaguely asserts in its "Adverse Domination" section that "increases, renewals, extensions, administration, and funding . . . delayed losses and defaults on the loans until within one year before the Bank's failure." Third Compl. at ¶90. This new alleged tolling basis fails for the following reasons:

First, this theory is premised on an incorrect assumption that the FDIC's gross negligence claim accrued on the date of default, or some later date when a quantum of damages was crystallized. That might be the law for a contractual non-payment claim, but not a claim based on allegedly negligent lending, which accrues as soon as the money leaves the bank. *Jackson*, 133 F.3d 694 at 697 ("[B]anks sustain injury as soon as bad loans are funded: money that should not have left the bank is gone.").

Tort claims arising from the granting of so-called "bad loans" accrue on loan approval—not default—because a plaintiff can discover negligence before default and the gravamen of the claim is the contention that the loan shouldn't have been made. *See id.* ("[D]irector approval of bad loans is not something that cannot be discovered until default occurs, assuming that nothing is done to conceal the circumstances surrounding the loan approvals."). In fact, the FDIC claims that the alleged negligence here was "readily apparent" from day one. Third Compl. at ¶90.

Therefore, even if the FDIC's allegations were true, and even if the FDIC could prove that the Directors' acts did delay losses and defaults, it does nothing to toll the limitations period.

Second, while unclear, the FDIC seems to allege that the limitations period should be tolled under some sort of continuing tort theory. The FDIC has advanced this theory before and seen it rejected. This time should be no different. For example, in *FDIC v. Schuchmann*, 224 F. Supp. 2d 1332, 1341 (D.N.M. 2002), the district court rejected an identical attempt to avoid the statute of limitations by arguing, as the FDIC does here, that the defendants "continued to engage in wrongful conduct past the statute of limitations deadline." *Id*. at 1341. The *Schuchman* court found the FDIC's argument unpersuasive, and it is no more persuasive here, because the continuing tort theory cannot apply where the alleged injury is "definite and discoverable." *Id*. *Schuchmann* held the FDIC's alleged injury was discoverable long before the limitations period expired, because the FDIC's complaint alleged that the defendants, and in turn the FDIC (through imputation), knew "there were serious problems with the loan from the outset." *Id*. at 1341-42. Here, the FDIC makes the same allegation, asserting that "[t]he Loss Loans had key deficiencies . . . that were readily apparent" at the time the Directors' allegedly approved them. Third Compl. at ¶90. Thus, the FDIC's continuing tort theory fails as a matter of law.

Finally, even if this court were to accept the continuing tort theory, the continuing conduct must actually be tortious, and cannot merely be the continuing ill effects of the original alleged tort. *Bonilla v. Trebol Motors Corp.*, 913 F. Supp. 655, 659 (D.P.R. 1995) ("[I]n order to establish a continuing tort violation, codefendants necessarily must prove that plaintiffs engaged in a series of tortious acts."). The Third Complaint fails to allege any continuing tortious conduct by the Directors in the form of increasing, renewing, extending, or administering the

time-barred Loans at any time within a year before the FDIC took over Westernbank. The only actionable conduct the FDIC alleges is listed in the chart at paragraph 79 of its complaint. Based on that chart, 7 of the 8 loans are time-barred on their face.

Other than its "Loss Loan" chart, which purports to be an exhaustive list of the alleged tortious conduct, the FDIC now attempts to resurrect four of the seven time-barred loans with new alleged acts and dates within the one-year limitations period. These new alleged acts, however, are not tortious acts, and the FDIC thinks so little of them that it declines to include them in its own "exhaustive" chart of alleged tortious conduct. The apparent mystery of why the FDIC doesn't assert that these acts were tortious is solved by a quick review of what the Third Complaint actually says about them.

For example, the Third Complaint vaguely asserts, in passive voice (making it impossible to know who did what), that there were "multiple loan renewals and extensions" on the Sabana I loan, which delayed losses until less than a year before takeover. Third Compl. at ¶80. The FDIC does not allege who renewed or extended this loan, whether anyone advanced additional money, or how these alleged renewals or extensions were unlawful, except to say they were done "without obtaining additional collateral or repayment." *Id.* This allegation wouldn't pass muster under the lenient *Conley v. Gibson* standard, let alone the rigorous *Twombly/Iqbal* standard. The same is true for new allegations on the remaining three loans—Museum Towers, Yasscar Development, and Yasscar Caguas—as the FDIC alleges the "responsible Defendants" (whoever they are) renewed the loans based on "stale appraisals." *Id.* at ¶ 80(F). These are not independent torts and cannot extend the limitations period.[19] Moreover, these new "acts" only relate to four of the seven time-barred loans, meaning that the FDIC has alleged no additional facts as to the remaining three Loans—Sabana I, Inyx, and Intercoffee—

[19] The alleged act of improperly administering the Loans does not apply to the Directors. Third Compl. at ¶80.

which remain time-barred even if a continuing tort tolling theory were available, applicable and satisfied, which it is not.

III. The FDIC is Estopped from Re-Litigating Issues Already Decided by This Court in *Wylie v. Stipes*

It is indisputable that a party may not re-litigate in a second action any adverse decisions on issues that were actually litigated and decided in the first action. *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 331-332 (1979); *Mala v. Palmer*, 755 F. Supp. 2d 386, 390-392 (D.P.R. 2010). To trigger such issue preclusion or collateral estoppel: (1) the issue sought to be precluded in the later action must be the same as the issue in the first action; (2) the issue must have been actually litigated in the first action; (3) the issue must have been decided by a valid and binding final judgment; and (4) the decision on the issue must have been essential to the judgment. *Mala*, 755 F. Supp. 2d at 391. Unlike claim preclusion (res judicata), mutuality of parties is no longer required for offensive collateral estoppel against a party to the first action, and a district court is granted broad discretion in deciding whether to allow it. *Parklane Hosiery*, 439 U.S. at 331.

All four factors are met here because: (i) the *Wylie* plaintiffs brought derivative claims for breach of fiduciary duty based on the D&Os' allegedly negligent failure to implement adequate internal controls at Westernbank (*Wylie*, 797 F. Supp. 2d at 194); (ii) the parties litigated that issue and the Court dismissed the actions on summary judgment (*id*. at 204); (iii) the *Wylie* plaintiffs never challenged the judgment or appealed it, which rendered it final; and (iv) the Court's decision that the D&Os were not negligent was essential to the Court's decision to dismiss the action (*id*. at 202-204).

Thus, the *Wylie* judgment required and includes a decision on this issue that binds the FDIC. The FDIC claims it "succeeded to all rights, titles, powers, privileges, and assets of

Westernbank, including [the bank's] rights and claims against its former officers and directors . . . ." Third Compl. at ¶ 21. These rights and claims include the adverse judgment against Hunter Wylie and the other shareholders who sued derivatively and lost. *See Lubin v. Skow*, 382 Fed. Appx. 866, 870 (11th Cir. 2010) (affirming district court's holding that FIRREA grants the FDIC ownership over all shareholder derivative claims against the bank's officers). The FDIC is estopped from re-litigating the same issues that the D&Os, Westernbank, and the Court already spent considerable time and resources in resolving.

IV. The FDIC Pleads no Plausible Theory of Gross Negligence as to Mr. Ruiz

The FDIC cannot plead a plausible gross negligence claim against any defendants, and is estopped even if it could, but irrespective of those obstacles, the FDIC overreaches in its claims against Mr. Ruiz. Mr. Ruiz is 77 years old. He was a vice-president of Westernbank during years of unparalleled success and stability. From 1999 to December 31, 2008, he was a director of the bank. Third Compl. at ¶26. He was also the bank's secretary from April 2001 to February 28, 2007. *Id.*

What the Third Complaint does not allege is instructive. Mr. Ruiz never served on either the SCC or the SLC. Of the 21 separate transactions that the FDIC attacks, the Third Complaint alleges that Mr. Ruiz only voted for two of them, both related to a single loan—Intercoffee—and, although unclear, only in his capacity as a board member. Third Compl. at ¶80. While the Third Complaint misleadingly tags Mr. Ruiz with an "x" to indicate his approval of the initial Intercoffee loan and a subsequent credit increase (Third Compl. at ¶¶79, 4), no facts are alleged to support the bare claim that Mr. Ruiz approved the September 28, 2007 credit increase. Although loans over $50 million required board approval (Third Compl. at ¶66), there is no

allegation that credit increases also required board approval, and, in any case, such an allegation would be implausible, because it would be untrue.

At most, the board, and Mr. Ruiz, approved ***minutes*** of the loan committees' credit increases. Mere approval of such minutes, without more, fails even to allege, much less demonstrate, that Mr. Ruiz recklessly caused $176 million in damages. *E.g.*, *FDIC as Receiver of Integrity Bank of Alpharetta, GA v. Skow, et al.*, No. 11-cv-0111, slip opinion at 19-21 (N.D. Ga. Feb. 27, 2012) (dismissing claims against directors because they did not serve on the loan committee that approved the loans). Moreover, Mr. Ruiz and the directors were unconditionally entitled to rely on the SCC and SLC's decisions in voting to approve the minutes. *See Brehm v. Eisner*, 746 A.2d 244, 261 (Del. 2000). No gross negligence claim can be based on loans, extensions, or credit increases, which did not require separate board evaluation and approval. The mere approval of minutes is not actionable, period.

Moreover, even accepting as true for purposes of this motion the allegation that Mr. Ruiz approved the initial Intercoffee loan, we have demonstrated above that the FDIC did not and cannot allege a plausible gross negligence claim as to that loan (*See* **Section I.B**), and even if it could, that claim is barred by this Court's decision in *Wylie* (*See* **Section III**).

V. Because The FDIC, After Three Tries, Has Failed to Plead Its Claims With Specificity, The Court Should Dismiss Them Outright

Rule 10(b) of the federal rules provides that "If doing so would promote clarity, each claim founded on a separate transaction or occurrence . . . must be stated in a separate count or defense." Fed. R. Civ. P. 10(b). *See, e.g., Bray v. Fresenius Med. Care Aktiengesellschaft, Inc.*, 2007 WL 7366260, at *10 (N.D. Ill. 2007) (dismissing complaint where plaintiffs "failed to separate different occurrences pursuant to Rule 10(b)"); *Veltmann v. Walpole Pharm., Inc.*, 928

F. Supp. 1161, 1163-64 (M.D. Fla. 1996) (dismissing complaint that violated Rule 10(b), making it "virtually impossible to ascertain . . . which defendant committed which alleged act").

Here, we alerted the FDIC in our prior motion of its failure to plead with specificity. We explained that the FDIC is asserting claims against the directors and officers in four capacities: as alleged directors, and officers, of Westernbank, as alleged members of the SCC, and as alleged members of the SLC. Each of these capacities has different legal consequences, and because of the way the FDIC alleges its claim, it is impossible to know which D&O did what (i.e., loan approval, administration, oversight, etc.), or when, or in what capacity. The Third Complaint covers a span of five years, in which, at various times, the D&Os acted in different capacities, and may or may not have acted in a particular capacity at all, which could give rise to unique defenses that the D&Os simply have no way to discern from the Third Complaint. The D&Os are entitled to the basic protection of notice pleading. Because the FDIC has completely ignored, after three tries, its burden to plead specific claims, the Court would be fully within its discretion to dismiss these claims without a fourth chance to amend.

And finally, the FDIC has reserved unto itself the right to allege additional conduct to support its gross negligence claim. Third Compl. at ¶84 at bp 11. The Court should strike that allegation. *FDIC v. Wise*, 758 F. Supp. 1415, 1420-21 (D. Colo. 1991) (striking allegation reserving right to identify other deficient transactions as it would cause "undue prejudice to the defendants as they would be unable to frame a responsive pleading or a defense.").

VI. The FDIC Cannot Plead a Plausible Fraudulent Transfer Claim That Satisfies the *Twombly/Iqbal* Standards of Rule 8(a)

The FDIC seeks to set aside two family trusts that Mr. Stipes and Mr. Dominguez established long before the FDIC sued, long before the FDIC even investigated the D&Os, and in Mr. Stipes' case, long before the FDIC made any monetary demand. Mr. Dominguez

established his family trust only a week after the FDIC's informal demand. Family trusts are not vehicles that debtors use to defraud creditors, but the FDIC asserts ownership of them anyway, despite failing to allege that Mr. Stipes and Mr. Dominguez were indebted to Westernbank or the FDIC when they established these trusts, and failing even to allege an actionable claim, let alone a final judgment. Although unclear, the Third Complaint appears to allege entitlement under FIRREA (12 U.S.C. § 1821(d)(17)) and Puerto Rico law. It fails under both.

A. The Third Complaint fails to adequately allege a fraudulent transfer claim under 12 U.S.C. § 1821(d)(17) because Mr. Stipes and Mr. Dominguez were not debtors or institution-affiliated parties at the time of the alleged transfers

To plead a fraudulent transfer claim under 12 U.S.C. § 1821(d)(17) the FDIC had to allege (1) a transfer by either "an institution-affiliated party, or any person who the Corporation or conservator determines is a debtor of the institution", and (2) that Messrs. Stipes and Dominguez transferred interests "with the intent to hinder, delay, or defraud the insured depository institution, the Corporation or other conservator, or any other appropriate Federal banking agency." *See* 12 U.S.C. § 1821(d)(17). The Third Complaint fails on both requirements.

First, Mr. Stipes and Mr. Dominguez were not debtors of the "institution" at the time of the alleged transfers. The term "institution" means the pre-takeover entity—Westernbank—not the FDIC. *See* 12 U.S.C. § 1821(d)(17) (referring to "institution," meaning "insured depository institution," which is defined under 12 U.S.C. § 1813 as "any bank or savings association the deposits of which are insured by the Corporation."). A "debtor of the institution" is a borrower or person who owes money to the bank. *See, e.g., Jahn v. FDIC*, 828 F. Supp. 2d 305, 315 (D.D.C. 2011) (transferor was alleged "debtor of the institution" because it borrowed $2.3 million and $4.2 million from the bank.). The FDIC fails to allege, except in legally insufficient, vague and conclusory terms, that Mr. Stipes and Mr. Dominguez were at any point debtors of

Westernbank. Conclusory allegations like these fail. *See, e.g., In re Image Masters, Inc.*, 421 B.R. 164, 183 (Bankr. E.D. Pa. 2009) (Dismissing bankruptcy trustee's fraudulent transfer claim[20] because trustee's threadbare, formulaic recitations of the legal elements of a cause of action do not suffice to state a claim to relief that is plausible on its face.). Therefore, the FDIC has failed to allege that Mr. Stipes or Mr. Dominguez were debtors under 12 U.S.C. § 1821(d)(17).[21]

Second, Mr. Stipes and Mr. Dominguez were not "institution-affiliated" parties when the FDIC alleges that they established the family trusts. An "institution-affiliated party" is any "director, officer, employee, or controlling stockholder (other than a bank holding company or savings and loan holding company) of, or agent for, an insured depository institution." 12 U.S.C. § 1813(u). The statute's plain language includes only officers and directors. It does not include *former* officers and directors, which is what Messrs. Stipes and Dominguez were at the time of the alleged transfers. This silence was purposeful, because when Congress wanted to speak, and include former officers and directors in provisions of FIRREA, it did so. For example, in a different provision that deals with civil penalties, Congress expressly expanded Section 1813(u)'s definition of "institution-affiliated party" to include former officers and directors:

> The resignation, termination of employment or participation, or separation of an institution-affiliated party (including a separation caused by the closing of an insured depository institution) shall not affect the jurisdiction and authority of the appropriate Federal banking agency to issue any notice or order and proceed under this section against any such party . . . .

[20] Bankruptcy fraudulent transfer cases serve as persuasive authority because Section 1821 is similar to the equivalent bankruptcy statute—11 U.S.C. 548. *See Jahn*, 828 F. Supp. 2d at 305 ("The avoidance and recovery powers granted to the FDIC under [12 U.S.C. 1821(d)(17)] mirror" those of the bankruptcy code).

[21] Notably, under the analogous bankruptcy statute—11 U.S.C. § 548—the FDIC would not be able to set up a fraudulent transfer claim because it would not be an eligible creditor with a non-contingent claim. Only non-contingent claims, meaning claims reduced to judgment or existing legal obligations, allow a creditor to bring a fraudulent transfer claim. *See* 11 U.S.C. 303(b) (describing who may file involuntary cases against debtors and defining eligible creditors as those who hold a claim "that is not contingent as to the liability . . . .").

12 U.S.C. 1818(i)(3).[22] Congressional expansion of the definition of "institution-affiliated party" in Section 1818 (and nine other sections of the same act)—but not Section 1821—can only mean one thing: Section 1821(d)(17) *does not* apply to *former* officers and directors, and does not apply to Messrs. Stipes and Dominguez. *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.").

Finally, the FDIC fails to plead how Messrs. Stipes and Dominguez created family trusts to "hinder, delay, or defraud the FDIC." 12 U.S.C. § 1821(d)(17). The FDIC can plead intent to defraud through either allegations of actual intent or constructive intent (i.e., direct or circumstantial evidence of intent). The FDIC purports to allege constructive intent through so-called badges of fraud. Pleading fraudulent intent by alleging badges of fraud, like any other pleading, is subject to the requirements of *Twombly/Iqbal*, and the FDIC must assert facts—not mere conclusions—showing its theory of relief is plausible. *E.g.*, *In re Caremerica, Inc.*, 409 B.R. 759, 767 (Bankr. E.D.N.C. 2009) (Fraudulent transfer claims "must satisfy Rule 8(a) and the heightened pleading standard introduced in *Twombly* and *Iqbal*.").[23]

The Third Complaint merely asserts that "there was no consideration for the transfers," but does not state how the transfers lacked consideration or why establishing a family trust evidences fraudulent intent to hinder or delay a potential future creditor who held no judgment at the time of the transfer and would not even file a complaint until years later. *See* Third

[22] Congress also expanded the institution-affiliated party definition in nine other sections of Title 12, but not in Section 1821. *See* 12 USCA § 93(c); 12 USCA § 504(m); 12 USCA § 506; 12 USCA § 1972(2)(H); 12 USCA § 1817(j); 12 USCA § 1828(w)(1); 12 USCA § 1847(c); 12 USCA § 1467a(i)(4); 12 USCA § 1786(k)(3).

[23] Fraudulent transfer and state-law fraudulent conveyance claims also must be pled with Rule 9 particularity, i.e., satisfactorily specific allegation of the "badges of fraud" as circumstantial evidence of scienter and fraudulent intent. They are not the only fraud claims in existence where Rule 9 is satisfied by a mere recitation of legal conclusions.

Compl. at ¶¶91, 97; *Waite v. Schoenbach*, 2010 WL 4456955, at *7 (S.D.N.Y. 2010) ("Plaintiff's allegations that the 'transfers were made without fair consideration' are conclusory allegations that are insufficient to withstand a motion to dismiss."). Next, the Third Complaint alleges that Mr. Stipes and Mr. Dominguez were insolvent at the time of the transfer, but offers no facts to support that (incorrect) assertion. *See* Third Compl. at ¶¶92, 98; *Waite*, 2010 WL 4456955, at *7 (allegations that transfers "rendered Defendants insolvent" were conclusory and insufficient). Finally, the complaint makes the baldest of bald assertions that Messrs. Stipes and Dominguez "made the transfers in fraud [sic] of FDIC." Third Compl. at ¶¶92, 98.

At most, the Third Complaint makes conclusory statements of circumstantial intent, but offers no factual allegations to support those statements, which fail under *Twombly/Iqbal*. *See Caremerica*, 409 B.R. at 767 (dismissing fraudulent transfer claim because trustee made only conclusory allegations without "factual content describing the consideration received by each transferor or facts supporting the debtors' insolvency . . . ."); *accord Waite*, 2010 WL 4456955, at *7 ("Plaintiff's allegations that the 'transfers were made without fair consideration" and "rendered Defendants insolvent' are conclusory allegations that are insufficient to withstand a motion to dismiss."); *In re Image Masters*, 421 B.R. at 183 (The court dismissed trustee's fraudulent transfer claims because their threadbare, formulaic recitations of the legal elements of a cause of action do not suffice to state a claim to relief that is plausible on its face.).

B. The FDIC's claim under Puerto Rico law fails because the FDIC is not a creditor, Messrs. Stipes and Dominguez are not debtors, and the other allegations of the claim are legally insufficient

Puerto Rico law requires the FDIC to allege that: (a) it is a creditor; (b) the transfer was made to defraud it; (c) it was injured by the transfer; and (d) it has no other remedy to recover its credit. *Nine v. Aviles*, 53 P.R.R. 471, 475 (P.R. 1938).

The Third Complaint fails the first requirement because the FDIC is not a creditor and Messrs. Stipes and Dominguez are not debtors. Puerto Rico law expressly requires the FDIC to have been a creditor that was owed money through a legal obligation or judgment, at the time of the transfer. *Plaza Bayamon, S.E. v. Rexach Const. Co., Inc.*, 2007 WL 1657502, at *3 (P.R. Cir. Apr. 30, 2007). The Third Complaint does not and cannot allege this, and instead makes the conclusory assertion that Messrs. Stipes and Dominguez were "debtors of the FDIC" and that they "knew of [their] liabilities to the FDIC." Third Compl. at ¶¶ 91-93, 97-99.

One simply cannot be a debtor, who knows of his liabilities, to someone who has not even alleged a claim, much less recovered a judgment, at the time of the challenged transfer. These conclusory allegations are legally insufficient, and the FDIC's Puerto Rico fraudulent conveyance claim is, at most, a claim that is not ripe, if it is a claim at all. *Plaza Bayamon,* 2007 WL 1657502, at *3; *accord Hoult v. Hoult*, 862 F. Supp. 644, 646 (D. Mass. 1994) (Massachusetts fraudulent conveyance statute allowed creditor to sue for fraudulent conveyance only "when his claim has matured," namely, after obtaining a money judgment.).

The Third Complaint's claim for fraudulent conveyance under Puerto Rico law, like its federal-law cousin, also fails to adequately allege that the transfers were made to defraud the FDIC. Here, too, the Third Complaint relies on a conclusory recitation of "badges of fraud," which fails for the reasons discussed above, in **Section VI.A**. *See Caremerica*, 409 B.R. at 767; *Waite*, 2010 WL 4456955 at *7; *In re Image Masters, Inc.*, 421 B.R. at 183. Finally, even if the FDIC's fraudulent conveyance claim were ripe, and even if it could properly allege fraudulent intent, it fails to allege how the alleged transfers injured it or why it has no other remedy. The fraudulent conveyance claim is legally insufficient and should be dismissed.

CONCLUSION

For the reasons set forth above, the D&Os respectfully request that the Court dismiss the Third Complaint with prejudice.

RESPECTFULLY SUBMITTED in San Juan, Puerto Rico, on June 18, 2012.

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CERTIFICATE OF SERVICE

I CERTIFY that on June 18, 2012, I electronically filed this document with the Clerk of the Court using CM/ECF. I also certify that this document is being served today on all counsel of record either by transmission of Notices of Electronic Filing generated by CM/ECF or by U.S. Mail.

s/ Andres Rivero
Andres Rivero