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 AMENDED AND RESTATED COMPLAINT IN INTERVENTION

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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 here 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. 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, 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 Resolution Trust Corporation'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, through its Amended and Restated Complaint in Intervention (the "Amended Complaint"), demands that W Holding's and Westernbank's long-serving directors, officers, and their spouses be held personally liable[1] 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 months before 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.

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

[1] The spouses of the director and officer defendants are filing their own motion to dismiss.

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 Amended Complaint asserts a single count for "gross negligence" against the directors, officers, and their spouses, based on eight loans (out of hundreds) that Westernbank made between 2004 and 2009 (the "Loans"). The Court should dismiss the FDIC's claim for the following reasons:

First, the Amended 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 Amended Complaint alleges no more than negligence, if it even alleges that, and negligence claims are foreclosed by the business judgment rule.

The Amended 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,[2] for the following reasons:

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

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[2] The FDIC's claim is legally insufficient, because it has not stated a plausible claim and its allegations are not more plausible than alternative explanations, as demonstrated below. *See Bell Atlantic 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").

process. Only defective decision-making is unprotected by the business judgment rule. The decision itself, even if "stupid" or "irrational,"[3] is immune from challenge.

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[,]"[4] and even if it weren't unwinnable, this Court has 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 took down the bank's borrowers with it. Indeed, the more plausible explanation is that

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

the most desperate economic crises this country has experienced since the Great Depression was the actual and proximate cause of everyone's losses here.

Third, the FDIC purports to bring a common law based gross negligence claim that does not exist under Puerto Rico law and should be dismissed with prejudice.[5]

Fourth, even if Puerto Rico did recognize a claim for gross negligence, the FDIC cannot revive time-barred claims.[6] Here, seven of the eight loans expired under Puerto Rico's 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, and claims it can save them with the 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.

Fifth, this action, or at least any part of it based on the Inyx and Intercoffee asset-based loans, is barred by the decision in *Wylie v. Stipes*, *supra*. The very core of the FDIC's allegations, that the directors failed to employ any modicum of due care and 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

[5] The FDIC may have avoided labeling its claim a claim for breach of fiduciary duty so it could make the rather far-fetched argument that this is some unique cause of action not subject to Puerto Rico's one-year limitations period for tort claims. But the fact that the FDIC must plead and prove gross negligence to overcome the business judgment rule does not make this any less of a tort claim. Gross negligence plainly is a type of negligence and thereby a type of tort. We expect that the FDIC, if granted leave to replead, might argue that it asserts a federal common law claim authorized by FIRREA. We will cross that bridge if we come to it.
[6] This would also be the case as to any future attempt to allege a claim under FIRREA.

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.

Sixth, the FDIC overreaches in asserting claims against Mr. Cesar Ruiz, who was neither a member of the Senior Lending Committee nor the Senior Credit Committee— the bodies charged with approving the Loans—but merely sat on the banks' board, approved only the minutes of meetings, and was only even remotely involved with one out of the eight loans the FDIC travels on.

Finally, in the event the Court were to decide that the FDIC has adequately alleged a legally cognizable and satisfactorily plausible claim for gross negligence that not only exists, but is neither barred by collateral estoppel nor the statute of limitations, it should require the FDIC to plead its claims with more specificity, to give proper notice to the defendants.

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 Set Forth in Rule 8(a)

The FDIC's Amended Complaint places all its bets on one claim—gross negligence. After more than two years of investigation, access to every single bank document, and depositions of the officers and directors—pre-suit discovery that only the government could get—it is telling that the only claim the FDIC could gin up against the D&Os[7] was one count

[7] The FDIC makes claims against the directors and officers in four capacities: (a) as directors on Westernbank's board of directors; (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"). When

for gross negligence—no alleged fraud or breaches of the duty of loyalty, not even excessive emoluments or corporate waste.[8] The extensive factual record's failure to support alleging other or more serious claims illustrates the problems with the gross negligence claim. When put to the *Twomby/Iqbal* test, and shorn of conclusory and untenable supporting allegations, the Amended Complaint alleges at most 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 even conclusions masquerading as "facts" because neither are entitled to any weight. *See Iqbal*, 556 U.S. at 678-79. After cleansing the complaint of conclusions, the Court must "draw on its judicial experience and common sense" and determine whether the plaintiff has pleaded a plausible claim and whether other, alternative explanations of innocence are more likely than plaintiff's allegations of wrongdoing. *Maldonado v.*

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referring to the term "D&Os" we are incorporating each of these capacities to the extent the FDIC alleges them as a basis for liability. It should be noted that some of the moving parties here are directors, but not officers, and vice versa. Moreover, we do not concede that acting in each of these capacities could support liability and have combined all within the term "D&Os" for convenience. If this sounds confusing, it is, 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 VI**, *infra*.

[8] The FDIC alleges two other claims: one against Mr. Tamboer and a direct action against the insurance companies, but none to the D&Os. Moreover, Count 3, labeled "Adverse Domination" does not plead a cause of action, but instead, a tolling concept, which does not even apply, as we demonstrate below.

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 facts in isolation, and a complaint should be dismissed when the complaint, viewed as a whole, cannot support a plausible claim or the *alternative explanations make the claim unlikely*. *See Twombly*, 550 U.S. at 570 (concluding that the 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 Amended 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 is 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.[9] 14 L.P.R.A. § 3563. Puerto Rico looks to Delaware law in applying the rule. *Marquis Theatre Corp. v. Condado Mini Cinema*, 846 F.2d 86, 91 (1st. Cir. 1988) ("the law of corporations [in Puerto Rico] is closely patterned after Delaware corporate law, and the applicable principles [of the business judgment rule]

[9] Indeed, as permitted under Delaware and Puerto Rico law, 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.

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 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 corporate officer's 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 thus "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.

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, i.e. that they engaged in intentional misconduct, or carelessly, to wit—grossly negligently. 14 L.P.R.A. § 3563 (only gross negligence can result in personal liability); *McMullin v. Beran*, 765 A.2d 910, 917 (Del. 2000) (plaintiff must provide evidence that the board of directors, in reaching its challenged decision, breached the triad of fiduciary duties—loyalty, good faith, and due care). The FDIC makes no attempt to plead bad-faith, intentional bad acts, or disloyal conduct, opting instead for the murkier, more difficult, breach of the duty of due care by grossly negligent conduct.

Pleading gross negligence is a tall task. *See Resolution Trust Corp ("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"); *Federal Deposit Ins. Corp. ("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"). The FDIC must plausibly plead 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); *see also 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.").

Not surprisingly then, the FDIC asserts four implausible theories that it alleges support a legal conclusion of complete indifference by the D&Os—i.e. "devil may-care attitude"—as to the welfare of Westernbank: (1) the D&Os' failure to implement sufficient internal controls and their approval, extension, renewal, and increases of Loans despite deficiencies in the Loans (Am. Compl. at ¶84, bullet points ("bp") 2, 5, and 6); (2) the D&Os' failure to heed "warnings" of federal regulators (*id*. at ¶84, bp 7); (3) the D&Os' strategy to cause rapid growth of Westernbank's asset-based, construction, and real estate divisions (*id.* at ¶84, bp 1); and (4) the D&Os' failure 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 Amended Complaint concerns events between 2004 and 2009—a period during which the D&Os in their capacity in the SLC or SCC approved hundreds of loans—the FDIC complains of only eight. It refers to them as the "loss loans," but we will simply refer to them as the "Loans." The D&Os (not including Cesar Ruiz) voted on only seven of those loans. Of those seven, alleged liability is partially premised on various extensions and additional credit, not all on original loan approvals. It is implausible, for the following reasons, to allege that, during this period the D&Os were: (i) grossly negligent in implementing internal controls or (ii) deviated from their usual exercise of care in approving and extending these seven loans (out of hundreds) 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 concedes that individuals inside Westernbank's Business Credit Division ("WBCD") subverted the admittedly adequate internal controls and procedures to prevent the SCC or the D&Os from ever discovering the problems with WBCD's asset-based loans. Am. 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. The FDIC must concede that the cause of these loans going bad was not any D&O negligence, because the allegations regarding the controls, procedures, and oversight on which the FDIC tries to build that claim are swept away by the explicit findings of the special litigation committee established to investigate the Inyx fraud.

That investigation's 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 the investigation's 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—Am. Compl. ¶80), but the "fact that the [systems in place] proved to be ineffective" does not make a director or officer liable. *Wylie*, 797 F. Supp. 2d at 203 *citing Stone ex rel. AmSouth Bancorporation 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 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 though the D&Os had access to a time machine when they made real-time decisions. Am. Compl. at ¶¶80(A)-(H). This exercise must fail because it is not the *result* that matters, but the *process* that led to the result, and only when there is "a *wide* disparity between the process the directors used . . . and that which would have been rational" does a gross negligence claim lie. *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. Am. 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 those loans 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 the FDIC fails to point to any fact that might 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 *quality* of the decisions. Am. Compl. at ¶80 (listing things like 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" as supporting a gross negligence claim). But "the *content* of the board decision that leads to a corporate loss," without any 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; 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 the decisions mattered, 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.* Therefore, stripped down to the legally-sufficient allegations, the Amended Complaint utterly fails to plead a plausible gross negligence claim based on the theory that the D&Os were grossly negligent in implementing internal controls and in 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 2007 and raised specific issues only after the bank halted lending on the Loans

For over *twelve* years, the FDIC consistently awarded the highest ranking possible to Westernbank. Despite its glowing endorsements, the FDIC 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 . . . ." Am. Compl. at ¶¶8, 84 at bp 7. This allegation is nothing more than a bald assertion of a conclusion that is contradicted by the FDIC's own contemporaneous

statements. It has no significance, and the facts the FDIC alleges to support it are implausible.[10]

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 Amended Complaint and alleges that they consisted solely of "warnings" and "deficiencies," and "criticized" the management and administration of the loans. Am. 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 (Am. Compl. at ¶80 (chart)), the regulators again commended the bank with an award of four "1s", two "2s," and the best overall CAMELS score possible 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

[10] The FDIC attempts to support this conclusory allegation with reference to certain ROEs that the FDIC has not filed with this Court—probably because they contradict what the FDIC wants to say. This Court can consider the ROEs, because the documents are referred to in the FDIC's complaint and are central to the FDIC's allegations. *Venture Assocs. Corp. v. Zenith Data Sys. Corp.*, 987 F.2d 429, 431 (7th Cir. 1993). The D&Os have not yet filed these extremely confidential documents. We represent that each fact asserted here regarding the ROEs can be found there, in the same fashion the FDIC uses the ROEs in its own complaint. We are willing to submit the relevant portions under seal once a confidentiality order is entered.

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% of the Loans***, the FDIC consistently gave the bank the highest 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. The downgrade came on the heels of 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 downgrade in scores, not some theretofore invisible gross negligence that occurred 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 nothing troublesome 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 swing. In light of the then-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. In the midst of this economic crisis, the banking regulators first begin to identify problems

involving commercial real estate and construction loans, which is not surprising given the real estate crash, which limited the ability of borrowers to repay those loans. In the 2008 ROE, the regulators, for the first time ever, classified as "substandard"—meaning 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 itself noted that these loans had taken a turn for the worse "in part [] due to Puerto Rico's well-publicized economic slowdown" and that "when combined with the deterioration in Puerto Rico's economy, in particular its real estate market, this 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, and especially did not disregard the examinations. Even the ROEs admit that the bank took proactive action, independent of the examinations before the regulators downgraded the six non-asset based Loans in 2008. After Frank Stipes returned in 2007 and replaced Jose Biaggi 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. Am. 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 sum, in the run-up to the worst economic calamity this country has suffered since the Great Depression, the federal 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" in late 2008 in advance of its seizure a little more than a year later, 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 sort 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 claims 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." Am. 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 cited any peer-institution comparison to establish a benchmark for "responsible" growth. And even if the FDIC had met its pleading burden, such a comparison would not, without more, establish causation between the alleged "reckless" growth and the FDIC's alleged losses. *See 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. Am. 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 the FDIC terms a "reckless growth strategy" (without explaining what about it was "reckless" or why), a fact which 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 Mr. Stipes and his family, not to mention the other D&Os' losses. 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. 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 in order to boost compensation, at least for purposes of showing motive in a securities fraud claim, is invalid 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 finally alleges, in conclusory fashion, that the D&Os failed to supervise the bank in general, 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." Am. 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 individuals delegated with the responsibility to administer the loans did their job properly. This is, at bottom, 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).

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 throughout the Amended Complaint that Westernbank had internal controls and procedures in place to control the underwriting and administration of loans. Am. Compl. at ¶¶65, 66, 77, 78; *see also* **Section II.A.i**.

To the extent the FDIC might argue that it has alleged that 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 such a theory (*Wylie*, 797 F. Supp. 2d at 193), and other courts also have rejected it. *See Caremark*, 698 A.2d at 972 (rejecting theory that directors breached their fiduciary duties for 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 . . . ."). Therefore, the Amended Complaint fails to state an oversight claim against the D&Os under the first theory.

The Amended Complaint also cannot possibly state that the D&Os consciously disregarded risks, especially *business risks*, which is what the FDIC seeks to allege here. *E.g.*, Am. Compl. at ¶84 at bps 2, 3 and 4 (criticizing risky decisions like: continuing to

approve "high risk commercial loans," and failing to understand "extreme risks of such strategies" and "extreme risks inherent in these loans."). Indeed, allegations that the D&Os were aware of certain "warning signs" that could or should have put them on notice (*e.g.,* Am. Compl. at ¶¶60-63, 80(B) at bp 1, (G) at bp 4, and (H) at bp 4) are exactly the types 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 (i) warnings by the Financial Accounting Standards Board staff, (ii) a faltering economy, and (iii) 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**,)), viewed in the 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 requirements of a gross negligence claim, that is, a duty and the D&Os' breach. But even if the FDIC could plead those two

requirements, it must still allege facts to support the final requirement—a plausible theory of causation. 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) (Plaintiffs must set forth "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 . . . ."). Moreover, 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 acts or failures to act were the cause in fact and the proximate cause of both the FDIC's seizure of Westernbank and the $176 million dollar losses that allegedly resulted from its fire sale.

II. Under Puerto Rico Law, Common Law Claims for Gross Negligence Do Not Exist

Count I must be dismissed because Puerto Rico's civil law system does not recognize common law based claims 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).[11] "Thus, 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).

As noted above, it's possible the FDIC may have used this label for its claim to facilitate arguing that it pursues some unique cause of action not subject to Puerto Rico's one-year limitations period for tort claims. With respect, the FDIC plainly appears to be attempting to assert breaches of the fiduciary duties of loyalty and due care. The fact that the

[11] The FDIC might argue that FIRREA provides a basis for a federal common law claim for gross negligence, but there are no such allegations in its amended complaint.

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.

We realize that if the FDIC is granted leave to replead, it may argue that it asserts a federal common law claim authorized by FIRREA, or even come clean and admit that it is suing for alleged breaches of fiduciary duty. For present purposes, however, we deal with the Amended Complaint as it was filed, which asserts a common law based claim that does not exist. Because Puerto Rico does not recognize a common law claim for gross negligence, and because the FDIC has asserted no other basis for its claim, the claim should be dismissed.

III. 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.

Here, the FDIC's only claim is for gross negligence, under state law. As discussed above, Puerto Rico recognizes no such common law based claims. Even if it did, Puerto Rico's one-year limitations period for tort claims would control. 31 L.P.R.A. § 5298; *Ocasio*

Juarbe v. E. Airlines, Inc., 125 D.P.R. 410 (P.R. 1990). Put simply, gross negligence is a variety of negligence, and all negligence claims 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 L.P.R.A. § 5141, subject to one-year limitations period).

The FDIC might argue for the three-year limitations period of 32 L.P.R.A. § 261, which applies to claims to recover a penalty or forfeiture from a director (not officers, like William Vidal), or "to enforce a liability created by law." 32 L.P.R.A. § 261. There is no published Puerto Rico Supreme Court case applying (or misapplying) this limitations period to a claim for breach of fiduciary duty, but the virtually identical California statute, on which the Puerto Rico legislature modeled Section 261, does not apply it to gross negligence or breach of fiduciary duty claims, and only applies it to express statutory causes of action 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 *no*t a claim to enforce "a liability created by law." *Id.* (holding California Corporations Code § 309—the equivalent of Puerto Rico's 14 L.P.R.A. § 3563—was 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 untimely.

The OCFI appointed the FDIC as Westernbank's receiver on April 30, 2010. Am. 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 Amended Complaint, any possible claims for seven of them accrued before April 30, 2009, which means the limitations period had 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.

In a desperate effort to revive these long-dead claims, the FDIC asserts a tolling doctrine, "adverse domination." Because the FDIC specifically alleges it (Am. Compl. at ¶90), it is properly a subject for motion to dismiss. *E.g.*, *Indep. Trust Corp. v. Stewart Info. Servs. Corp.*, 665 F.3d 930, 935 (7th Cir. 2012) ("[W]hen a plaintiff's complaint nonetheless sets out all of the elements of an affirmative defense [like statute of limitations], dismissal under Rule 12(b)(6) is appropriate.").

This tolling doctrine is not available to the FDIC because no published Puerto Rico Supreme Court opinion has recognized it. A single court of this district discussed it in *dicta* thirty years ago, noted that it was based on questionable precedent from the early twentieth century, and declined 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 20th century], is of questionable value at this time in our history." *Id.* at 651.[12] And the *Bird* court observed that these questionable "precedents of another era do not necessarily govern today." *Id.* at 652. Left unanswered in *Bird*'s *dicta* were two critical questions: (1) in deciding if this tolling doctrine applies, does federal common law or state law control? and (2) 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 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 of imputation to the FDIC of directors' and officers' knowledge). Thus, we look to Puerto Rico law, which does not recognize the doctrine of adverse domination.

[12] The "questionable" legal precedent amounted to three federal cases—a 1927 Ninth Circuit opinion, a 1928 Oregon district court case, and a 1943 Second Circuit opinion. It is unclear what law those courts relied on, if any, but none of those decisions applied 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 cases applying 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—*Cooper v. Hill*, 94 F. 582, 590 (8th Cir. 1899)—which held 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).

A. 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 other 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); *RTC v. Walde*, 856 F. Supp. 281, 286 (E.D. Va. 1994) (Virginia); *RTC v. Gravee*, 1995 WL 75373 (N.D. Ill. 1995) (Illinois); *In re Southeast Banking Corp.*, 855 F. Supp. 353, 358 (S.D. Fla. 1994) (Florida); *RTC v. Armbruster*, 52 F.3d 748, 752 (8th Cir. 1995) (Arkansas); *In re Antioch Co.*, 456 B.R. 791, 859 (Bankr. S.D. Ohio) (Ohio), *report and recommendation adopted*, 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).[13]

B. 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 under Puerto Rico law, and were inclined to predict Puerto Rico law, *FDIC v.*

[13] 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. *See Romero v. Colegio De Abogados De P.R.,* 204 F.3d 291, 305-06 (1st Cir. 2000) (ordering certification of unsettled question of Commonwealth law to Puerto Rico Supreme Court).

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).[14] 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.

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

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.*, et al, Case No. 07-1886 (D.P.R. filed Sept. 21, 2007). The *Wylie* and *Hildenbrand* lawsuits dispositively demonstrate that the alleged underlying wrongs—which the FDIC rather cynically alleges were undiscoverable until April 2010—were 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.[15]

Therefore, even if Puerto Rico had adopted the adverse domination doctrine (which it has not), and even if it had created a unique liberalization of the doctrine that (1) did not only apply 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 FDIC bases the amended complaint were disclosed on June 26, 2007, or were

[15] 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)).

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 denied request for adverse domination tolling where company had disclosed facts underlying plaintiff's claim in a Form 10-K).

IV. 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 . . . ." Am. 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.

V. 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 from 1972 to 1988, during years of unparalleled success and stability. From 1999 to December 31, 2008, he was a director of the bank. Am. Compl. at ¶26. He was also the bank's secretary from April 2001 to February 28, 2007. *Id.*

What the Amended 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 Amended 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. Am. Compl at ¶80. While the Amended Complaint misleadingly tags Mr. Ruiz with an "x" to

indicate his approval of the initial Intercoffee loan and a subsequent credit increase (Am. Compl. at ¶¶79, 4), no facts are alleged to support the bare claim that Mr. Ruiz approved of the September 28, 2007 credit increase. Although loans over $50 million required board approval (Am. 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 (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, that 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.i and IV**), and even if it could, that claim is barred by this Court's decision in *Wylie.*

VI. In The Event that the Court Decides Not to Dismiss the FDIC's Claims Outright, The FDIC Should Be Required to Re-Plead Its Claims With More Specificity

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 the FDIC makes 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 particular capacities has different legal consequences and in the way the FDIC states its complaint, it is impossible to know which D&O did what, i.e. the approving, the administering, the oversight, etc., and when. The Amended Complaint covers a span of five years when, at various times, the D&Os acted in different capacities, or 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 idea of knowing from the Amended Complaint. The D&Os are entitled the basic protection of notice pleading. Moreover, the FDIC has also reserved unto itself the right to allege additional conduct to support its gross negligence claim. Am. Compl. at ¶84 at bp 11. The Court should strike that allegation. *FDIC v. Wise*, 758 F. Supp. 1415, 1420-21 (D. Col. 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.").

CONCLUSION

For the reasons set forth above, the D&Os respectfully request that the Court dismiss the Amended Complaint with prejudice, or alternatively, require the FDIC to state a more definite claim.

RESPECTFULLY SUBMITTED in San Juan, Puerto Rico, on April 11, 2012.

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CERTIFICATE OF SERVICE

I CERTIFY that on April 11, 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