

California Court Holds the Business Judgment Rule Does Not Protect Corporate Officers in California

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The business judgment rule is a longstanding corporate law principle that shields corporate directors from personal liability for their business decisions, even if the decisions lead to bad results, so long as the decisions are made in good faith, and with reasonable care and diligence. The business judgment rule recognizes the realities of business by not requiring directors to be liable for every business risk they take, or substituting a court's judgment for that of a director.

Lawyers have generally believed that the protection of the business judgment rule extends to corporate officers as well as directors. However, a recent federal district court decision held that *under California law, the business judgment rule does not insulate officers from liability for their mistaken decisions.*

In *Federal Deposit Insurance Corporation v. Perry*, C.D. Cal., No. CV 11-5561 ODW (MRWx), December 13, 2011, IndyMac CEO Michael Perry was denied the protection of the business judgment rule in an action brought against him in his capacity as CEO. Mr. Perry moved to dismiss the FDIC's claims that he negligently permitted the sale of US\$10 billion in "risky" residential loans to the secondary market, arguing that the business judgment rule applied. The court disagreed, basing its decision on (1) the fact that California's codified business judgment rule refers only to directors and not officers, (2) the existence of California legislative history that indicates omission of officers from the statute was intentional and (3) the absence of any



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direct California precedent holding that the business judgment rule protects officers as well as directors. One concept underlying this decision is the rationale that directors may rely on information received from corporate officers in making business decisions, while officers are closer to the business data and information on which decisions are based and therefore may be held to a higher standard of care.

This decision is significant to all corporate officers **doing business in California** (including corporate officers of out-of-state corporations doing business in the state), and may expose such individuals to lawsuits and liability for claims that they failed in their duties.

If you would like more information on how this decision may impact you, please contact your Squire, Sanders & Dempsey (US) LLP lawyer or the one of the professionals listed here.

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