A Lesson On Good Corporate Governance?

Amundsen Davis Financial Services Alert
October 2, 2018

While on its face, a recent decision from the United States Court of Appeals for the 7th Circuit discusses what is not included in the duties of an officer, one can glean from the decision the importance that a Board of Directors embrace good corporate governance. The case of *Levin v. Miller*, 900 F.3d 856 (7th Cir. 2018), involved the bankruptcy of Irwin Financial Corporation ("Irwin"), the holding company for two failed banks. In *Levin*, the court was asked by the bankruptcy trustee to find that the officers of Irwin had breached their fiduciary duty by not providing the Board of Directors with material information concerning a tax refund received by Irwin.

The facts of the case reflect the downward spiral experienced by many financial institutions during the Great Recession of 2008. In this particular case, Irwin's subsidiary banks needed to raise additional capital. Irwin, as the parent holding company, was encouraged by outside legal counsel and bank regulators to support its subsidiary banks, consistent with the Federal Reserve Board's Source of Strength Doctrine (which requires a bank holding company to serve as a financial source of strength to its subsidiary banks). Irwin applied for Troubled Asset Relief Program (TARP) funds, but its application was never approved. In addition, Irwin sought to raise additional capital from outside investors, but similarly, was not successful. Irwin entered into a Tax Allocation Agreement with the subsidiary banks which provided that if a bank had been entitled to a refund had it filed its return separately, Irwin would transfer the appropriate amount to that bank upon receiving the refund. This approach was consistent with regulatory guidance regarding tax allocation agreements. Irwin subsequently received a tax refund of $76 million and distributed that amount to the subsidiary banks.

In September of 2009, the FDIC was named as receiver for the subsidiary banks and Elliott Levin was appointed Chapter 7 Trustee of Irwin's bankruptcy estate.

Levin alleged that the officers of Irwin breached their duty to provide information material to a decision by the Board of Directors of Irwin with respect to bankruptcy. Specifically, he claimed that the officers should have informed the Board of Directors that Irwin could maximize its value if it declared bankruptcy before transferring proceeds from the tax refund to the subsidiary banks. The court ruled against Levin, stating, among other things, that his theory assumed that the officers should have recognized that the banks were going to fail and that the transfer of the tax refund proceeds to the banks was a waste. The court

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noted that an officer is obligated to obey a board's lawful instructions. Specifically, the court stated: "The Board's response to the crisis was driven by the demands of federal and state regulators and guided by expert outside counsel. Taking account of the regulatory directives and expert legal advice, the Board exercised its judgment and chose to devote its resources to saving the banks. As agents, the officers had no right to spend company resources pursuing a different strategy." *Levin*, 900 F.3d at 864.

In another sense, this case drives home the importance of good corporate governance. Specifically, it drives home the point that it is the Board of Directors and not management that is responsible for the management of the company. For example, Indiana law provides: "All corporate powers [of the company] shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the director of, its board of directors…." Indiana Code §23-1-33-1(b). The case also reflects the importance of holding regular executive sessions without management present, which allows the board to discuss matters which may prove awkward or difficult if management were present (especially if those matters involve the performance of the company or management). The court also noted the independence of the Irwin board, which underscores the importance of creating an independent board and the objectivity which it brings with respect to an analysis of a company's performance and that of its management. Lastly, the case also highlights the ability of a board, in the exercise of its business judgment, to place reasonable reliance on the advice of outside experts.

Although the Great Recession is over, some of its effects are still being felt. By reflecting on the holding of this case, those effects can be a positive reinforcement for a board in establishing good corporate governance practices and exercising appropriate oversight of management.