



1303 J Street, Suite 600, Sacramento, CA 95814-2939 T: 916/438-4400 F: 916/441-5756

February 10, 2012

Chief Justice Tani G. Cantil-Sakauye
and Associate Justices
California Supreme Court
350 McAllister Street
San Francisco, CA 94102-4797

Re ***U.S. Bank v. Superior Court (Behar-Greek)*, Supreme Court No. S200030; Amicus Letter in Support of Petition for Review and Request For Stay**

Dear Chief and Associate Justices:

Amicus curiae California Bankers Association (“CBA”) and the American Bankers Association (“ABA”) respectfully submit this *amicus curiae* letter in the referenced matter in support of Petitioner Union Bank N.A.’s Petition for Review and Request For Stay in order to provide the Court with the banking industry’s perspective on the critical importance of applying the “apex doctrine” to members of the board of directors of a company.

CBA is a nonprofit organization established in 1891 that represents most of the FDIC-insured depository financial institutions that do business in this state. CBA frequently files *amicus* letters and briefs in state and federal courts on matters that significantly affect the banking industry.

ABA is the principal national trade association of the financial services industry. The ABA’s headquarters are located in Washington, DC. Its members, located in each of the fifty states, the District of Columbia, and Puerto Rico, include financial institutions of all sizes. ABA members hold a majority of the domestic assets of the banking industry in the United States. The ABA frequently submits *amicus curiae* briefs to state and federal courts in matters that significantly affect its members and the business of banking

I. Introduction

The apex doctrine as articulated in *Liberty Mutual Ins. Co. v. Superior Court*, 10 Cal. App. 4th 1282 (1992) recognizes a company’s interest in preventing its senior level officials from discovery requests that could be met through less intrusive methods, such

as obtaining evidence from lower level employees who have more direct relevant knowledge. The *Liberty Mutual* court's rationale for its holding is to prevent a company from being exposed to potential discovery abuse and harassment. *Liberty Mutual*, 10 Cal. App. 4th at 1289.

In this matter, Real Parties in Interest seek to depose members of Petitioner's board of directors regarding the bank's assertion of a defense under the National Bank Act even though information regarding the scope and nature of the board's action could be obtained through other avenues and even though the elements of the asserted defense are not relevant to the elements of their claims. We wish to explain why the banking industry supports application of the apex doctrine to a company's board of directors. A bank is a special type of corporation that makes it particularly vulnerable to the concerns that the apex doctrine was developed to address. More than in other types of business, a bank director has a special duty to uphold the financial institution's public trust and confidence. Bank directors are not only responsible to the stockholders who elected them, but also must be concerned with, and are legally bound to protect, the safety of depositors' funds and the influence that the bank exercises on the communities it serves. Concomitantly, there are more demands on a bank's board than on other companies' boards generally. These facts would make litigants against banks more likely to achieve the fruits of discovery abuse and thus undermine the interests articulated in *Liberty Mutual*.

In this letter we will explain and elaborate on the following: (i) a director is a covered official within the meaning of *Liberty Mutual*; (ii) the *Liberty Mutual* rationale of preventing discovery abuse applies even more strongly when the board of directors rather than the chief executive officer is targeted for discovery; (iii) directors in most instances are less likely than executive officers to possess superior or unique knowledge of relevant facts; and (iv) we will explain why the nature of bank supervision and operations makes banks particularly vulnerable to discovery abuse if the apex doctrine is not applied to directors.

II. The Apex Doctrine Applies to Discovery Requests to Corporate Directors

A. A Director of a Company is an Apex Official

The straight forward question before this Court is whether the apex doctrine as articulated in *Liberty Mutual* applies not just to a company's top executive officers but also to members of a company's board of directors. We note at the outset that while the top official subject to be deposed in *Liberty Mutual* was the company's chief executive officer, the court held that the rule applies to "a corporate president *or other official* at the highest level of corporate management." 10 Cal. App. 4th at 1289 (emphasis added).

The two component questions are: is a director an “official” of a corporation, and is the position “at the highest level of corporate management”?

Under common corporate governance principles, a company’s CEO is accountable to, and reports to, the board of directors. Cal. Corp. Code. § 300 (“all corporate powers shall be exercised under the ultimate direction of the board.”). The Merriam-Webster dictionary definition of official is “one who holds or is invested with an office,” and an office is “a position of authority or some degree of executive authority.” Certainly, one who holds a position that bears a significant amount of authority—as a member of a board that directs the exercise of *all of a company’s powers*—must be deemed to hold an “office” within that company. In addition “inside” directors, who are executive officers who also serve as directors, exercise direct executive authority within the company when they act in that capacity. These authorities amply support the proposition that a corporate director is an official within a company.

Next, are members of the corporate board situated at the highest level of corporate management? The answer lies in the nature of the relationship between a company’s CEO (which *Liberty Mutual* describes as situated at the apex of the corporate hierarchy) and the board. *Liberty Mutual*, 10 Cal. App. 4th at 1286. Another well-established principle of corporate governance is that one of the key responsibilities of a board is to select the company’s chief executive officer. Cal. Corp. Code § 312(b) (“officers shall be chosen by the board and serve at the pleasure of the board.”); *CEO Succession: The Ultimate Test of Board Performance*, Russell Reynolds Associates, July/August 2010 (“Item number one on any description of corporate board duties is hiring and firing of the chief executive.”). The FDIC describes the board’s duties in this regard this way:

It is a primary duty of a board of directors to select and appoint executive officers who are qualified to administer the bank's affairs effectively and soundly. Section 4.1 – Management, Federal Deposit Insurance Corporation Examination Manual.

The FDIC concurs that the board’s responsibility extends beyond selecting executive officers:

It is also the responsibility of the board to dispense with the services of officers who prove unable to meet reasonable standards of executive ability and efficiency. *Id.*

Intricately tied to the responsibility to select the CEO is determining the CEO's compensation and evaluating the CEO's performance. Section 303A.05 - NYSE Listed Company Manual. These authorities in the aggregate signify a clear, vertical relationship between a company's CEO and its board: the board is responsible for searching for and retaining the CEO, setting the CEO's compensation, evaluating the CEO's performance, receiving reports from the CEO and her staff during board meetings and, when the interests of the company warrant it, dispensing with the CEO's services. The CEO and the board, as we will discuss more fully below, serve the company in different capacities, but it is beyond dispute that both sit atop the corporate hierarchy. Therefore, by the terms of the *Liberty Mutual* decision itself, the apex doctrine applies to members of a company's board of directors.

B. Deposition of the Board Would Maximize Potential for Abuse

Liberty Mutual's rationale in support of the apex doctrine applies even more strongly to corporate directors than to executive officers because the potential for abuse and harassment is increased exponentially. A board could only act or make a decision as a body by a majority of directors present during a meeting when a quorum is present (Cal. Corp. Code § 307(a)(8)). This means that a discovery request directed at the board would almost always involve, as in the present case, every member of the board who participated in the meeting or meetings pertinent to the litigation, rather than just the CEO as was the case in *Liberty Mutual*.

Moreover, targeting every member of the board of directors with discovery requests could create an "all hands on deck" crisis with a company's entire senior leadership. Directors are part-time officials and will certainly have to rely on the company's top executive management—most notably the CEO and the company's chief legal officer—to brief the board on the demand and address their needs, such as to acquaint them with the discovery process, arrange for legal representation, coordination, and the like. Members of the company's top management are, after all, the individuals normally responsible for managing board relations. As directors normally interact with management during board meetings, the request would also likely take up precious board meeting time. In short, we can think of few greater opportunities for discovery abuse or harassment of a corporation's entire senior leadership structure than to depose the board of directors, as the trial court would allow in this case.

C. Directors Are Even Less Likely Than Executive Officers to Possess Superior or Unique Information

An independent reason for applying the apex doctrine to corporate directors is that the nature of a board's duties makes a director even less likely in the vast majority of cases to be in possession of superior or unique knowledge of facts relevant to a claim compared to an executive officer. The role of a member of a company's board of directors contrasts starkly with that of an executive officer. A board exercises its powers during board meetings that convene, for most companies, once every two or three months (but more often for banks, as explained below). A board's duties include such supervisory responsibilities as establishing the company's long- and short-term business objectives, monitoring operations, and overseeing the company's business performance. The board oversees management and provides direction to the company rather than run operations. *See General Guidelines, FDIC Pocket Guide For Directors.* Individual responsibility and management are delegated to professional executives who manage the company's day-to-day affairs. It is the difference, for instance, between approving the company's Rules of Ethics and observing during regular working conditions whether a particular employee has violated those rules.

In light of these circumstances, a director is typically not privy to the details of the company's operations. The *Liberty Mutual* court, in justifying the apex doctrine, noted that the CEO will generally not have knowledge of specific incidents handled several levels down the corporate pyramid. *Liberty Mutual*, 10 Cal. App. 4th at 1287. The court was simply stating the obvious even though the company's executive officer actually does have day-to-day managerial responsibilities. A corporate director, by comparison, is far less likely to have direct knowledge of specific incidents occurring at the company. Indeed in most instances a director will only have indirect knowledge derived from information contained in the materials that are prepared by management and communicated to the board at regular or special meetings.

This is not to suggest that a director's testimony is never relevant or superior to what could be discovered by other means. But the nature of a director's responsibilities strongly supports the wisdom of directing a litigant to obtain necessary discovery through less intrusive methods first from persons at more appropriate levels of a company who have first-hand rather than derivative or second hand knowledge of the relevant facts. Here too, the rationale for the apex doctrine applies equally to directors, if not more.

D. Bank Boards Are Particularly Vulnerable to Discovery Abuse

The board of directors of a bank shares most of the same duties as directors of non-bank companies as set forth in the relevant corporate governance statutes to which the company is subject.¹ On top of that, banks are further subject to expanded duties that are befitting the critical roles that they play in the nation's payment systems, as holders of the public's deposits, and as providers of credit. Every bank in the United States is subject to an additional layer of regulation comprising of numerous federal banking laws and regulations that are enforced by the various federal bank supervisory agencies.² A direct consequence of these added responsibilities is that bank boards regularly meet significantly more often than boards of companies that are not banks. According to the 2001 Corporate Governance Survey by Professional Bank Services, Inc., which is a national survey of banks, 76.8% of bank boards meet 11-13 times a year while 11.7% meet 14-24 times a year. Only a handful of bank boards meet less often, typically smaller privately-held banks. This compares with only 13% of Fortune 1000 companies (including banks) that meet 7-11 times a year and 52% that meet just quarterly, as reported by the Korn Ferry Institute in its 34th Annual Board of Directors Study. The magnitude of a bank board's additional duties only exacerbates the risk of disruptions that the apex doctrine, properly applied, was developed to prevent.

Federal banking laws and regulations and the agencies that enforce them make bank boards directly responsible for reviewing and approving a myriad of policies and

¹ State-chartered banks comply with the corporate governance statutes of the state in which they are incorporated. National banks receive a charter from the Office of the Comptroller of the Currency but are required to elect to follow Delaware corporations law, the law of corporations of the state in which its main office or holding company is situated, or the Model Business Corporation Act. 12 C.F.R. § 7.2000(b).

² These are the Federal Reserve Board (Fed) for state chartered banks that are members of the Fed, Federal Deposit Insurance Corporation for state-chartered banks that are not Fed members, Office of the Comptroller of the Currency for nationally chartered institutions, and the Consumer Financial Protection Bureau with respect to consumer protection statutes for banks with more than \$10 billion in assets.

procedures to which only financial institutions are subject.³ The upshot of this extra layer of regulation does not mean that bank directors must act as managers. The role of the bank director is still to supervise and direct the company, but the range of issues for which they are responsible is broader than for other companies. We do not suggest that a bank board would be at risk of neglecting its duties due to the need to handle meritless discovery requests, but rather that a litigant is more likely to reap the fruits of discovery abuse (such as securing a settlement of a meritless claim) by targeting a bank's board if not restrained by the sensible apex doctrine. More than most other companies, banks will strive assiduously to protect their directors' time and attention.

E. For National Banks, the Trial Court's Decision Undermines Purpose of the National Bank Act's Dismiss "at Pleasure" Provision

The decision of the trial court in this case compels a national bank such as Petitioner Union Bank into a forced choice that could undermine the purpose of the National Bank Act. The dismiss "at pleasure" provision of Section 24(Fifth) of the

³ The following is just a sampling of these policies and procedures: *credit underwriting* (12 C.F.R. Part 364 - Appendix A, Section II.D); *interest rate exposure* (*Id.*, Section II.E); *asset quality* (*Id.*, at Section II.G); *the Allowance For Loan and Lease Losses (ALLL) policy* (FDIC Financial Institution Letter No. 63-2001, July 25, 2001); *information security program* (12 C.F.R. Part 364, Appendix B, Section III.A); *Bank Protection Act procedures (pertaining to physical security)*, 12 C.F.R. Part 326.4); *Bank Secrecy Act compliance program (suspicious activity and money laundering monitoring)*, 12 C.F.R. Part 326.8(b)); *Customer Identification Program* (31 C.F.R. Part 103.121(b)); *bank-owned life insurance (BOLI) policies* (Financial Institution Letter 127-2004, Interagency Statement on the Purchase and Risk Management of Life Insurance, December 7, 2004); and *commercial real estate concentrations* (Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices, December 12, 2006).

Additionally, the FDIC holds bank boards responsible for ensuring that the following policies are written, clearly communicated, and monitored: loans, including internal loan review procedures; Investments; asset-liability/funds management; profit planning and budget; capital planning; internal controls; compliance activities; audit program; conflicts of interest; and code of ethics. FDIC Pocket Guide For Directors.

National Bank Act⁴ is intended to give a national bank latitude in employment decisions involving bank officers so that it would not be bound to retain any officer whose discharge was in the best interests of the bank and its depositors. *Westervelt v. Mohrenstecher*, 76 F. 118, 122 (8th Cir.1896). But since this privilege, which is in part intended to establish a single standard for banks that operate in multiple states, necessarily entails some action by the board, preserving the privilege also leaves the bank exposed to a litigant having an incentive to depose the bank's board.

Some federal circuit courts have interpreted Section 24(Fifth) in varying degrees to limit the application of state employment laws pertaining to wrongful discharge. (See, *Ana Leon T. v. Federal Reserve Bank of Chicago*, 823 F.2d 928, 931 (6th Cir. 1987), the Act "preempt[s] any state-created employment right to the contrary.") While the preemptive effect of Section 24(Fifth) has been limited in more recent decisions (*Kroske v. U.S. Banc Corp.*, 432 F.3d 976 (9th Cir. 2005), *cert. denied*, 127 S. Ct. 157 (2006): state law that is consistent with federal anti-discrimination laws not preempted by Section 24(Fifth)), many national banks continue to have their boards ratify hiring and termination decisions pertaining to officers as a matter of prudence to preserve their available defenses under the National Bank Act.

As the evidence in this case suggests, Petitioner's board's action with respect to Plaintiffs' termination was perfunctory. This is because invocation of the National Bank Act privilege requires only board ratification of actions taken or to be taken by management to whom authority for employment decisions is delegated. *Mackey v. Pioneer Nat'l Bank*, 867 F.2d 520 (9th Cir. 1989 (a board of directors may delegate its authority to hire and to terminate bank officers if ratified by the board). As Petitioner correctly argues, whether a national bank has properly invoked the privilege depends only on two questions: was the terminated employee a bank officer, and did the board authorize or ratify the officer's termination. *Wells Fargo Bank v. Superior Court (Wertz)*, 53 Cal. 3d 1082, 1091 (1991).

The trial court's refusal to apply the apex doctrine under the facts in this case leaves national banks with the difficult choice between preserving the privilege by continuing to involve the board in employment decisions or forgoing the privilege in order to prevent harassment. The evidence in this case indicates that Petitioner's board

⁴ 12 U.S.C. § 24 (Fifth): To elect or appoint directors, and by its board of directors to appoint a president, vice president, cashier, and other officers, define their duties, require bonds of them and fix the penalty thereof, dismiss such officers or any of them at pleasure, and appoint others to fill their places.

ratified Plaintiff's termination together with 30 other of the bank's officers. While Petitioner is a large bank, several national banks are many times larger (Bank of America, for example, is roughly 17 times larger with total assets of \$1,466 billion compared to Union Bank's \$83 billion). If the trial court's decision below is allowed to stand, a national bank could spend a substantial portion of its board meetings just managing discovery requests. The only sensible response may be to forgo what latitude is furnished by Section 24(Fifth), the consequence of which is to limit a bank's flexibility to act in the best interest of the constituents that they serve. This forced choice frustrates the central purpose of the federal statute.

III. Conclusion

For the forgoing reasons, amici CBA and ABA respectfully request that this Court grant the Petition for Review and Request For Stay.

Sincerely,

[Original Signed]

Leland Chan (Bar No. 142049)
Attorney for Amicus Curiae
California Bankers Association