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FEDERAL COURT RULES THAT "INSURED V. INSURED" EXCLUSION BARS D&O COVERAGE FOR BANK OFFICERS IN SUIT BY FDIC

In a recent decision concerning insured directors and officers of banks and other companies under their directors and officers (D&O) insurance policies, the United States District Court for the Northern District of Georgia held that the "insured *v.* insured" exclusion of a failed bank's D&O policy barred coverage for the bank's officers in an action brought by the Federal Deposit Insurance Corporation (FDIC) in its capacity as the bank's receiver. The result in *St. Paul Mercury Insurance Co. v. Miller, et al.*, 2:12-CV-0225-RWS (August 19, 2013), is a noteworthy departure from a number of other decisions ruling that claims brought by the FDIC as receiver do not trigger such exclusions and thus do not preclude bank officers and directors from obtaining the benefit of D&O coverage in defending and settling such claims.

Insured *v.* insured (or entity *v.* insured) exclusions are common provisions in D&O policies that exclude coverage for some claims made against an insured person or entity by another insured under the same policy. The *St. Paul Mercury* case arose from the failure of the Community Bank & Trust (CB&T) in Georgia. Following its appointment as receiver, the FDIC brought suit against two CB&T officers for their alleged roles in improperly approving unrecovered loans that led to the bank's failure. The insurer denied the officers' claims for D&O coverage, contending that the FDIC's claims as receiver were made "on behalf of" the insured bank and that coverage was therefore barred by the insured *v.* insured exclusion in the CB&T policy.

The court agreed. It relied heavily on the US Supreme Court's decision in *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 86 (1994), which held that the FDIC "steps into the shoes" of a failed bank when it acts as receiver, and therefore claims asserted by FDIC in that capacity are subject to the same defenses that could have been raised against the bank itself. Moreover, the court declined to follow other case law holding that insured *v.* insured exclusions did not bar coverage of claims by the FDIC as receiver, on the grounds that the policies in those cases did not contain language excluding coverage for any claims brought "by or on behalf of any [insured] in any capacity." The court further held that this language must be enforced regardless of whether it actually advanced the exclusion's general purpose of preventing collusive lawsuits between co-insureds.

The District Court's reasoning in *St. Paul Mercury* is seriously flawed. First, the *O'Melveny* decision on which it relied did not involve an insurance claim, but rather focused on the validity of alleged legal defenses to direct civil damages claims asserted by the FDIC against third parties. Despite the court's insistence that "there is no rule that the [FDIC] should always win," the real issue here was whether the insurer owed defense and indemnity coverage *to the bank's officers* – not the FDIC – under their employer's D&O policy. Because the insurer's defense was raised against a coverage claim by those officers, the *O'Melveny* decision is inapposite.

Second, the court found that the FDIC's action against the officers was brought "on behalf of" the insured bank (*i.e.*, CB&T), even though numerous courts have recognized that the FDIC may act in numerous different capacities, including on behalf of a failed bank's depositors. *See, e.g.*, *American*

Cas. Co. of Reading, Pa. v. Baker, 758 F.Supp 1340, 1348-50 (C.D. Cal. 1991); *FDIC v. Zaborac*, 773 F. Supp. 137, 142-44 (C.D. Ill. 1991). The court also overlooked the similarity in the D&O context between the roles of the FDIC and of bankruptcy trustees, who often bring claims against directors and officers "on behalf of" a bankrupt firm's creditors or stakeholders other than the debtor itself. Rather than construe the policy at issue broadly in favor of coverage, the court's decision denies the officers any D&O protection while also reducing the total pool of funds potentially recoverable by the FDIC for the failed bank's depositors.

Nevertheless, the *St. Paul Mercury* decision will likely be cited by insurers in future cases involving the application of similar insured *v.* insured exclusions to D&O coverage of claims brought by the FDIC as receiver, as well as in cases involving claims by bankruptcy trustees.

St. Paul Mercury highlights an important lesson for D&O policyholders. The result in this case could have been avoided if CB&T had demanded and obtained an express carve-out from the insured *v.* insured exclusion providing that the exclusion will not apply to claims brought by a bankruptcy trustee, receiver, conservator or other similar type of official. Insurers commonly agree to incorporate such exceptions since they do not interfere with the exclusion's primary aim of discouraging collusive lawsuits. Indeed, most public company D&O policies now contain such carve-outs, and *St. Paul Mercury* will be easily distinguished in the context of claims involving such policies. D&O policyholders are strongly advised to consult knowledgeable coverage counsel at purchase and renewal to ensure that they steer clear of such readily avoidable traps for the unwary.

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