Client Alert

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Insurer May Not Question Duty to Reimburse Defense Costs Incurred By Directors and Officers of Failed Banks

In a case of first impression, a federal judge in Georgia has barred an insurer from even questioning whether it has a duty to defend the directors and officers of a failed bank. *See OneBeacon Midwest Ins. Co. v. F.D.I.C.*, Civil Action No. 2:12-CV-0106, 2014 WL 86986 (N.D. Ga. Mar. 5, 2014). In *OneBeacon*, the court ruled that it lacked subject matter jurisdiction over the insurer's declaratory judgment action against the bank's directors and officers and the Federal Deposit Insurance Corporation ("FDIC") where the FDIC had stepped into the bank's shoes as receiver.

OneBeacon Midwest Insurance Company ("OneBeacon") insured Habersham Bancorp ("Habersham") under a management and professional liability policy. The policy required, among other things, that OneBeacon advance covered defense costs to Habersham.

On August 25, 2011, the FDIC, as receiver for the failed Habersham, sent a claim addressed to each of the bank's directors and officers. The claim sought payment of civil damages for the directors' and officers' alleged breach of duties owed to Habersham prior to the bank's closure. The alleged errors and omissions included actions taken in connection with certain loan transactions entered into by Habersham, and the directors' and officers' purported failure to properly manage Habersham's affairs. The FDIC estimates total losses to Habersham of at least $38 million as a result of the directors' and officers' alleged errors and omissions, and demands payment of that amount from the directors and officers. OneBeacon sought a declaratory judgment that certain policy provisions and exclusions precluded coverage for the directors' and officers' potential liabilities.

The directors and officers moved to dismiss, asserting that the claim is precluded by Section 1821(j) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which provides that "no court may take any action, except at the request of the Board of Directors by regulation or order, to restrain or affect the exercise of powers or functions of the [FDIC] as a conservator or a receiver." The court granted the motion to dismiss and OneBeacon sought reconsideration. OneBeacon also asked that it be allowed to amend its complaint to "cure jurisdictional defects" by dropping the FDIC as a defendant so that the complaint would address the officers' and directors' defense costs only, not indemnity funds. The court denied the request, finding that even the amended complaint would be subject to jurisdictional defects.

The court reasoned that FIRREA imposes a broad jurisdictional bar preventing courts from taking any action to restrain or affect the exercise of powers or functions of the FDIC. The exceptions to the strict limitation are very narrow. The court concluded that OneBeacon's claim "would 'restrain or affect' the FDIC in the exercise of its function to collect money due the failed bank." And, OneBeacon conceded that "even in its amended claims, the FDIC has an interest (albeit contingent and speculative) in the Policy as a tort claimant." The suit, therefore, implicated the jurisdictional bar even without the FDIC as a defendant, and the court had no authority to adjudicate it.

The court also distinguished the matter at hand from *F.D.I.C. v. OneBeacon Midwest Ins. Co.,* 2013 WL 951107 (N.D. Ill., Mar. 12, 2013) ("*Wheatland II*"), a case heavily relied upon by OneBeacon. There, a federal court in Illinois found that it was not constrained by FIRREA's jurisdictional bar, even though the

FDIC was involved in the case. However, in *Wheatland II*, the court found that each of the parties had "agree[d] that the FDIC would *not* be bound because it was not a party to [carrier's amended complaint]." In contrast, there was no such agreement in *OneBeacon*, where the FDIC and the directors and officers vigorously opposed OneBeacon's position.

IMPLICATIONS

OneBeacon confirms that insurers may not question the availability of coverage for directors and officers of failed banks where the FDIC is involved in the proceeding or has some potential interest in its outcome. The decision also lays the groundwork for arguments that other matters that actually or potentially implicate the conservator or receiver interests of the FDIC may be insulated from insurers' challenges to coverage or defense. Financial institution policyholders should carefully consider, therefore, whether allegations or claims made against them actually or potentially may implicate the interests of the FDIC as a conservator or a receiver of their institution.

Contacts

Walter J. Andrews
wandrews@hunton.com

Lon A. Berk
lberk@hunton.com

Lawrence J. Bracken, II
lbracken@hunton.com

John C. Eichman
jeichman@hunton.com

Robert J. Morrow
rmorrow@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Michael S. Levine
mlevine@hunton.com

Sergio F. Oehninger
soehniger@hunton.com

William T. Um
wum@hunton.com

Christine Terrell
cterrell@hunton.com