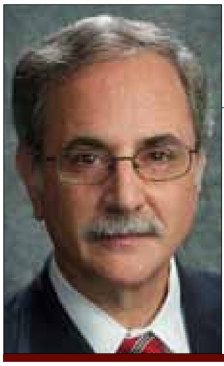
BEST'S REVIEW
www.bestreview.com June 2012



By
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Bank Errors

Insight: The FDIC is suing failed banks for alleged D&O-related liabilities.

As of early April, the Federal Deposit Insurance Corp. had filed 27 lawsuits against directors and officers of failed banks. In several of these actions, the FDIC also named spouses of some executives, outside professionals and D&O insurers. According to its website, as of March 20 the FDIC has authorized lawsuits, involving 54 failed banks, against 469 individuals for D&O liability. Numerous additional lawsuits may be forthcoming.

The FDIC typically asserts claims for negligence, gross negligence and breach of fiduciary duty. Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the federal statute governing FDIC claims, the FDIC must prove that directors or officers were grossly negligent, unless state law imposes liability based on a lower standard such as ordinary negligence. The factual allegations have focused on compliance with lending standards and practices.

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Defendants frequently seek dismissal of the negligence claims and negligence-grounded breach of fiduciary duty based on the "business judgment rule" and state law exculpation provisions. Such defenses, however, may not be viable against gross negligence claims. In addition, defendants may assert the statute of limitations. FIRREA provides for a six-year limitations period for contract claims and a three-year period for tort claims, or the period applicable under state law if longer. Defendants may also seek to assert that pre-closing activities by the FDIC in its corporate capacity or post-closing activities in its regulatory capacity caused or contributed to the bank's losses. During the earlier savings and loan crisis, these defenses were not well-received by the courts. However, the Supreme Court's decision in *O'Melveny & Myers v. FDIC* held that any defense that would have been good against the bank was good against the FDIC as receiver because the FDIC stands in the shoes of the bank.

Recovery from available D&O insurance is a significant target of the FDIC's litigation efforts as evidenced by the naming of D&O insurers in several of the pending lawsuits. Various defenses should play a significant role in coverage litigation. D&O policies issued to banks may include regulatory exclusions, which preclude coverage for claims by regulatory entities such as the FDIC. During the savings and loan crisis, the FDIC contended that such defenses were not viable against the FDIC as a matter of public policy. The weight of authority rejected the FDIC's position. Additionally, the "Insured v. Insured" exclusion in D&O policies may play a prominent role in such coverage litigation. The FDIC is likely to emphasize that it represents shareholders and creditors in addition to its role as receiver of the bank. It will also argue that its lawsuit is not collusive and thus does not contravene the purpose of the exclusion. Courts may differ in their treatment of those arguments. Nevertheless, *O'Melveny* should bolster the insurers' position because the exclusion would have barred a suit brought by the bank in whose shoes the FDIC stands. The dishonesty and personal-gain exclusions may also apply in certain cases but may require final adjudication before they bar coverage. Because alleged wrongful acts may span several years, there may also be issues involving retroactive dates and numbers of policy periods.

Given the number of pending suits and the likelihood of more to come, FDIC litigation over failed banks is likely to provide a significant source of coverage disputes for D&O insurance. BR

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