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D&O Insurance/Coverage Exclusions

# D&O POLICY EXCLUSION DOESN'T BAR COVERAGE FOR FDIC SUIT

W Holding Co. v. AIG Ins. Co.



A federal judge in Puerto Rico has ruled that an "insured vs. insured" exclusion in the D&O insurance policy of the failed Westernbank does not bar coverage for government regulators' charges that its former directors' reckless loan practices led to its collapse.

• *Holding Co. et al. v. AIG Insurance Co. et al.*, No. 11-2271, 2014 WL 3378671 (D.P.R. July 9, 2014). The ruling by U.S. District Judge Gustavo A. Gelpi of the District of Puerto Rico appeared to be a double setback for the insurers that wrote D&O policies for W Holding Co., parent of the now-defunct Westernbank Puerto Rico, one of many banks taken over by the Federal Deposit Insurance Corp. after the 2008 financial crisis.

***Exclusion and relatedness***

First, the decision closed the door on the argument that the insured-vs.-insured exclusion excused AIG Insurance Co. and excess insurers from paying for the Westernbank directors' legal bills.

AIG argued that, as the effective owner of the bank, the FDIC was an insured suing another insured -- the directors -- but Judge Gelpi said that exclusion does not apply because the agency is more like the advocate of Westernbank's investors and creditors.

Second, the ruling potentially opened up additional tens of millions of coverage dollars to finance the directors' defense when the judge found the charges against the directors should be divided into two groups: one set that relates to the 2006-2007 policy year, and the second set that stems from the 2009-2010 policy period.

If he had found all the claims were related to charges that sprang from the 2006-2007 period, there would have been few funds to cover those claims because the 2006-2007 policy proceeds are nearly exhausted, the judge said.

***Experts watching outcome***

The case had been closely watched by insurance and banking law specialists because the insured-vs.-insured exclusion's application and the claims' relation to specific policy periods are central to most litigation the FDIC brought after taking over banks that failed during the 2008 financial crisis due to risky subprime mortgage-backed securities.

Westernbank collapsed in April 2010 and was taken over by the FDIC, which soon charged the bank's former directors and officers with breach of duty and negligence for allegedly losing more than $176 million through reckless loan practices.

When the bank's directors sought reimbursement for legal bills from Chartis Insurance Co. (later acquired by AIG) they were denied based on several exclusions, and W Holding filed this action in the District Court.

The director plaintiffs filed a declaratory judgment action seeking a ruling that there was coverage under the similarly worded policies of AIG predecessor Chartis and several excess insurers.

Earlier rulings by Judge Gelpi indicated the insured-vs.-insured exclusion did not apply but this opinion contains the definitive, final decision on that issue unless the insurers appeal it.

***'Standing in the shoes'***

In response to AIG's argument that in the final analysis, the FDIC "stands in the shoes of" the owner, Judge Gelpi wrote, "The FDIC is not suing on behalf of an 'insured' or an 'organization.' It thus does not run afoul of the exclusion."

As to the relatedness question, the judge said the insurers favor grouping charges together based on the type of allegation and then deciding in which year that type of claim had its genesis.

Judge Gelpi instead grouped the claims according to the disputed loans involved and assigned those claims to a policy period. That meant most of a large group of claims could be "related" to the 2009-2010 policy year, which had expended comparatively few funds.

Some insurance experts, however, find that approach to dealing with relatedness to be somewhat arbitrary -- making it difficult for other courts to choose a logical method. As a result, they say, opinions on the question of how to relate claims to a particular policy year have been inconsistent.

Kevin M. LaCroix, a specialist in corporate and insurance law who often discusses D&O coverage issues on his blog D&O Diary, noted in a post the "frustratingly elusive nature of relatedness issues."

"The difficulty here, as in all coverage cases involving relatedness issues, is determining what degree or quantum of relatedness is sufficient to make alleged wrongful acts interrelated." LaCroix said.

He indicated he was less than satisfied with Judge Gelpi's "simple solution" of "gerrymandering the overlapping allegations" from one set of loans into the 2006-2007 policy period while shifting all other loan allegations into the 2009-2010 policy.

The opinion's reasoning "illustrates why court decisions on interrelatedness issues are all over the map," LaCroix said.

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