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D&O Insurance Carrier Barred from Seeking Declaratory Judgment on Coverage

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OneBeacon Midwest Insurance Co. v. Federal Deposit Ins. Corp., et al., No. 12-0106 (N.D. Ga., March 5, 2014)

Insurance Company issued a claims-made D&O policy to the bank that was not a duty to defend policy, but rather placed the duty on the insurer to advance covered defense costs. The Bank went into receivership and the FDIC served claims on former directors and officers (the D&O defendants) for alleged breach of duties to properly manage the affairs of the bank which led to $38 million in losses. Insurance Company did not receive notice of the FDIC claim until after the end of the extended reporting period in the policy.

Insurance Company filed an action in the U.S. District Court for the Northern District of Georgia against the FDIC and the D&O defendants seeking a declaratory judgment that there was no coverage based on exclusions under the policy as well as the failure to give timely notice. The defendants moved to dismiss on grounds that Section 1821(j) of the Financial Institution's Reform, Recovery and Enforcement Act of 1989 (FIRREA) which provided that no court could take any action to restrain or affect the exercise of powers or functions of the FDIC as a receiver. Courts have interpreted this Section to mean that the FDIC may perform its duties as a receiver without judicial interference.

The District Court granted the motion to dismiss Insurance Company's declaratory relief action. The Court relied on *FDIC v. OneBeacon Midwest Ins. Co.*, 833 F. Supp.2d 754 (N.D.Ill.2010), a decision by U.S. District Court for the Northern District of Illinois. There, the Court held that OneBeacon was precluded from bringing a counterclaim seeking a declaration of coverage under the D&O policy it issued for the Wheatland Bank (*Wheatland I*) based on a finding that a preemptive determination of rights under the D&O policy would "affect the FDIC's authority to collect all obligations in money due the failed bank." The Georgia District Court found *Wheatland I* to be persuasive and held that issuing a declaratory judgment on Insurance Company's claims would affect the FDIC's ability to collect money due on the Bank. The Court stated that Insurance Company was not without a remedy because it could pursue the administrative remedies under the FIRREA statute and even file suit once those remedies were exhausted.

However, the District Court in the Northern District of Illinois subsequently granted Insurance Company's motion to reconsider *FDIC v. OneBeacon Midwest* No.11C3972 (N.D.Ill. 2013) (*Wheatland II*) based on the argument that

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Insurance Company was only seeking a declaratory judgment on the coverage to provide defense costs to the D&O defendants and the proceeds of that coverage were not a receivership asset. The District Court held that the claims for declaratory relief on reimbursement of defense costs were ripe for adjudication and found it would be unfair to require Insurance Company to wait and run the risk that the D&O defendants could not satisfy a judgment for reimbursement when the case was over.

Insurance Company then brought a similar motion for reconsideration in the Georgia District Court case based on the ruling in *Wheatland II*. Insurance Company even proposed to dismiss the FDIC as a defendant from its proposed amended complaint seeking a declaration on defense cost coverage alone.

Nevertheless, the Georgia District Court chose, surprisingly, to disregard *Wheatland II* and denied the motion for reconsideration.

Question Before the Court and How the Court Decided It

Whether proposed amendments which would drop the FDIC as a party and seeking a declaratory judgment that the D&O defendants were not entitled to defense costs coverage under the policy should be granted?

No. The District Court found that the reasoning of the Illinois District Court in *Wheatland II* did not persuade a different result. Even if Insurance Company dropped the FDIC from the coverage suit, its claim for a declaratory judgment on defense cost coverage still would affect the FDIC in its exercise of power and trigger the jurisdictional bar of Section 1821 (j) under FIRREA. The Court reasoned that even filing a claim that no defense costs coverage is owed to the Bank's D&O defendants would hamper the FDIC recovery efforts. The District Court once again stressed that Insurance Company was not left without a remedy because its claims could be pursued through FIRREA's administrative process.

What the Court's Decision Means for Practitioners

This decision appears to bar the filing of insurance declaratory judgment actions in failed-bank cases where insurance coverage for a failed-bank's D&O defendants is a source of funds for the FDIC to recover. Such declaratory judgment actions have been filed in the past by carriers as companion cases to FDIC bank failure claims. This decision allows the FDIC to even move to dismiss declaratory judgment actions limited to defense cost coverage for the D&O defendants. The pursuit of the uncertain administrative process under FIRREA could deplete the policy limits before the coverage issue is ever resolved by a court. The decision in *Wheatland II* on the defense cost issue is a more reasoned approach.

For more information, please contact your regular Hinshaw attorney.

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