

If the Shoe Fits: Sizing Up the Applicability of IvI Exclusions to the FDIC

“Want to *spook out a local business leader? Ask him or her to serve on a bank board.*”¹

I. INTRODUCTION

In 2010, 157 institutions insured by the Federal Deposit Insurance Corporation (FDIC) failed in the United States.² That year, the FDIC categorized an additional 884 institutions as “problem institutions,” a collection representing \$390 billion in assets that were at risk.³ These figures reflect the height of the bank failure trend that occurred during the United States’ financial crisis in the late 2000s.⁴

Fortunately, the number of failed banks has decreased every year since 2010, falling to a total of sixteen bank failures in 2013.⁵ Nonetheless, the first seven months of 2014 resulted in fourteen banks closing and millions of dollars that stood to be recovered.⁶ The FDIC has expanded its efforts to recoup losses

1. Chris Cumming, *Liability Concerns Impede Director Recruitment at Banks*, AM. BANKER (Apr. 23, 2014, 3:43 PM), http://www.americanbanker.com/issues/179_75/liability-concerns-impede-director-recruitment-at-banks-1066974-1.html [<http://perma.cc/A3KC-SRMD>] (emphasizing impact of increase in lawsuits filed against bank directors on willingness to serve).

2. See FDIC, *Quarterly Banking Profile: Second Quarter 2014* (2014), <https://www2.fdic.gov/qbp/2014jun/qbp.pdf> [perma.cc/JWK5-3D64]. The FDIC is an independent agency of the federal government that seeks to promote public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions. See *Who Is the FDIC?*, FDIC, <https://www.fdic.gov/about/learn/symbol/> (last updated Oct. 30, 2014) [<http://perma.cc/RT56-3QVR>] (describing FDIC’s role in mitigating risk to deposit insurance funds and consequences of institutional failures). The FDIC manages more than half of the institutions in the banking system and examines banks for operational safety and soundness. See *id.* Premiums for deposit insurance coverage paid by banks and thrift institutions fund the FDIC, as well as earnings from investments in U.S. Treasury securities. See *id.*

3. See *Quarterly Banking Profile*, *supra* note 2, at 22. Additionally, in 2010, 22.15% of FDIC-insured institutions were unprofitable. See *id.* at 5.

4. See *id.* at 22. From the start of the financial crisis in 2007 and leading up to 2010, the number of bank failures climbed each year. See Nickel, *Looking Back at Bank Failure Rates*, FORBES MAG. (Mar. 25, 2013, 9:00 AM), <http://www.forbes.com/sites/moneybuilder/2013/03/25/looking-back-at-bank-failure-rates/> [<http://perma.cc/PG64-UGX7>] (identifying explosion of bank failures in 2008 and failure rate peak in 2010). Prior to the crisis, in 2005 and 2006, there were no bank failures. See *id.* There were three bank failures at the beginning of the financial crisis in 2007, twenty-five in 2008, and 140 in 2009. See *id.*

5. See *Quarterly Banking Profile*, *supra* note 2, at 22.

6. See *Failed Bank List*, FDIC, <https://www.fdic.gov/bank/individual/failed/banklist.html> (last updated Oct. 30, 2015) [<http://perma.cc/AMS3-MKQH>] (listing fourteen banks closed between January 17 and July 25,

resulting from bank failures, ultimately seeking recovery from the banks' directors and officers.⁷ Since the 2008 financial crisis, the agency has filed more than ninety lawsuits against directors or executives of failed banks.⁸ To accommodate the ramped-up recovery efforts, the FDIC has increased its staffing and available resources, despite the current federal budgetary constraints.⁹

When an FDIC-insured bank closes, the FDIC frequently becomes the bank's receiver.¹⁰ As such, the FDIC is responsible for collecting the bank's assets, liquidating those assets, and distributing the proceeds to the bank's creditors.¹¹ Additionally, the FDIC launches investigations to determine why the bank failed.¹² During the investigation, the FDIC determines whether to pursue claims against directors, officers, or other third parties.¹³ The FDIC may bring actions against directors and officers, hereinafter referred to collectively as directors, for corporate waste, breaches of fiduciary duty, and

2014); *see also* Cumming, *supra* note 1 (stating FDIC filed over ninety lawsuits against directors or executives since start of financial crisis).

7. Thomas K. Hanekamp & Kathryn A. Formeller, *Application of the Insured v. Insured Exclusion in Failed Bank Litigation*, 18-20 MEALEY'S EMERG. INS. DISP. 1 (2013) (discussing FDIC attempts to recover losses from failed banks by targeting directors and officers).

8. *See* Cumming, *supra* note 1 (tying FDIC lawsuits to bank directors' low willingness to serve on bank board); *see also* Hanekamp & Formeller, *supra* note 7 (claiming accelerating pace of number of lawsuits filed by FDIC). The FDIC filed lawsuits against nearly 15% of the financial institutions that have failed since 2008. *See* Hanekamp & Formeller, *supra* note 7.

9. *See* Hanekamp & Formeller, *supra* note 7 (suggesting FDIC beginning pursuit of funds lost by failed banks).

10. *See id.* (explaining process following close of federally insured bank and role of FDIC as receiver). As receiver, to maximize recoveries, the FDIC may sue professionals, including officers, directors, attorneys, accountants, appraisers, brokers, and others who have participated in a financial institution's failure. *See Professional Liability Lawsuits*, FDIC, <https://www.fdic.gov/bank/individual/failed/pls/> (last updated Oct. 26, 2015) [<http://perma.cc/V57P-ZZX7>] (explaining FDIC's pursuit of professional liability litigation).

11. *See* Hanekamp & Formeller, *supra* note 7 (noting FDIC's role in resolving institutional failures and paying off creditors).

12. *See id.* The FDIC typically follows an eighteen-month timeline for its investigations into why a bank failed. *See id.*; *see also* Thomas P. Vartanian & Robert H. Ledig, *United States: Bank D&O Defense Manual*, MONDAQ, <http://www.mondaq.com/unitedstates/x/179310/Directors+Officers+Executives+Shareholders/Bank+DO+Defense+Manual> (last updated May 28, 2012) [<http://perma.cc/7M2Z-GRV9>] (describing process of FDIC liability investigation). After an insured depository institution closes, the FDIC's professional liability division investigates to determine who is accountable. *See* Vartanian & Ledig, *supra*. The FDIC's professional liability division can open as many as eleven types of professional liability investigations for each failed institution, such as investigations of directors, officers, attorneys, and accountants. *See id.* The FDIC's Office of Inspector General (OIG) may also conduct an independent investigation to determine why the institution failed. *See id.*

13. *See* Hanekamp & Formeller, *supra* note 7. The FDIC may bring tort claims within three years of the bank's closure date and breach of contract claims within six years. *See id.*; *see also* Vartanian & Ledig, *supra* note 12 (discussing time frame of FDIC investigations). During investigations, the FDIC might make a prelitigation demand on the failed bank's former directors for the payment of civil money damages. *See* Vartanian & Ledig, *supra* note 12. The FDIC will also send its demand letter to the directors' insurance carrier. *See id.* Demand letters inform the director of a potential lawsuit and provide their insurance carriers with the requisite notice of a claim made against the insured. *See id.* The FDIC preserves insurance coverage as a potential source of recovery if case litigation commences and liability is found by providing notice. *See id.*

negligence or gross negligence.¹⁴

The risk of litigation confronts directors with each decision they make in their official capacities, so banks routinely obtain directors and officers liability insurance (D&O) policies.¹⁵ These policies aim to shift the risk of personal liability from the directors to a third-party insurance carrier.¹⁶ Today, D&O policies are necessary because FDIC lawsuits have adversely affected directors' willingness to serve on a bank board.¹⁷ According to an American Association of Bank Directors (AABD) survey, the ill effects of bank directors' fear of personal liability are widespread.¹⁸ The survey indicated that almost one-quarter of bank respondents have lost directors, been told "no" by director candidates, or lost members or potential members of their board loan committees from fear of personal liability.¹⁹

Failed banks typically lack valuable assets.²⁰ A company's D&O policy (and the policy's proceeds) is frequently one of the few valuable assets left.²¹ Therefore, when the FDIC seeks to recover losses to its own insurance fund, it targets the proceeds from the failed bank's D&O policy.²² Consequently, the strength of the D&O policy is critical for a bank's directors, as well as the FDIC.²³

14. See Vartanian & Ledig, *supra* note 12; see also Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989, 12 U.S.C. § 1821 (2012) (authorizing FDIC to prosecute claims for failed bank against bank's directors seeking monetary damages). Section (d)(2)(A)(i) states that, as receiver, the FDIC "succeeds to all rights, titles, powers, and privileges of the insured depository institution." *Id.* § 1821 (d)(2)(A)(i); see also Vartanian & Ledig, *supra* note 12 (noting FDIC investigators identify signs of possible criminal activity). Although the FDIC lacks criminal jurisdiction, it may refer potential criminal cases to the Department of Justice (DOJ). See Vartanian & Ledig, *supra* note 12. Additionally, the OIG may work with the Federal Bureau of Investigation (FBI) where the OIG suspects criminal activity. See *id.*

15. See Michael D. Sousa, *Making Sense of the Bramble-Filled Thicket: The "Insured vs. Insured" Exclusion in the Bankruptcy Context*, 23 EMORY BANKR. DEV. J. 365, 366 (2007) (emphasizing importance of D&O policy as shield from personal liability).

16. See Sousa, *supra* note 15, at 366 (describing use of D&O policies for risk mitigation).

17. See *id.* (stating D&O policies now fixture in modern corporate environment); see also Cumming, *supra* note 1 (explaining rise in FDIC lawsuits harms directors' willingness to serve). The consequences of frequent lawsuits have been quantified in a study by the American Association of Bank Directors, which suggests bank directors refused to serve on bank boards out of fear of being subjected to personal liability. See DAVID BARIS, AM. ASS'N OF BANK DIRS., AABD SURVEY RESULTS MEASURING BANK DIRECTOR FEAR OF PERSONAL LIABILITY 1 (2014), <http://aabd.org/aabd-survey-results-measuring-bank-director-fear-personal-liability-good-news/> [<http://perma.cc/HSN4-SN7L>].

18. See BARIS, *supra* note 17, at 1 (naming fear of personal liability most oft-cited reason for rejecting position).

19. *Id.* According to the survey, of the eighty banks that responded, 11.3% reported that at least one director resigned because of fear of personal liability. See *id.* Additionally, 11.3% of the respondents reported that at least one person offered a position as director rejected the offer due to fear of personal liability. See *id.*

20. See Hanekamp & Formeller, *supra* note 7, at 1 (reasoning failed banks usually low on valuable assets).

21. See *id.* (explaining FDIC desires D&O policy proceeds for recovery).

22. See *id.* (discussing FDIC practice of recovering from failed banks through D&O policies).

23. See *id.* (observing how weak insurance policies can make directors personally liable). The FDIC even considers policy breadth in determining whether to bring a lawsuit against directors. See Vartanian & Ledig,

Holes in the bank's D&O policy's coverage are perilous.²⁴ They may require the directors to pay out-of-pocket damages, and the FDIC may forego payment.²⁵ One of the common gaps that exists in the D&O policy's coverage is the Insured v. Insured (IvI) exclusion.²⁶ Generally, the IvI exclusion excuses the insurer from payment when a claim is brought by, or on behalf of, an insured party against an insured party.²⁷ This Note will consider the circumstances in which an IvI exclusion to a D&O policy may excuse an insurer from coverage when the FDIC brings claims against the directors of a failed bank.²⁸

This Note will begin with the history of D&O policies and the IvI exclusion.²⁹ In doing so, the Note will discuss the creation of the FDIC and the need for D&O policies, the so-called D&O insurance crisis, and the role of the Savings and Loan (S&L) crisis of the 1980s and early 1990s in creating the IvI exclusion.³⁰ Next, the Note will explore the current disagreement within the United States over the treatment of IvI exclusions.³¹ Within this discussion, the Note will address major arguments both for and against the application of the

supra note 12 (identifying FDIC requirements in filing lawsuits). According to an FDIC issued policy statement, the agency may file lawsuits against former directors only after reviewing "the factual circumstances surrounding the bank's failure . . . if the claim would be sound on the merits and . . . litigation would likely be cost-effective." *Id.* To determine the cost-effectiveness of litigation, the FDIC assesses the defendant's personal assets and insurance coverage and estimates whether those will be enough to pay for any damages. *See id.*

24. *See* Hanekamp & Formeller, *supra* note 7, at 1; *see also* Sousa, *supra* note 15, at 369-70 (explaining directors' personal assets easily reachable if gap in coverage).

25. *See* Hanekamp & Formeller, *supra* note 7 (declaring availability of D&O policy proceeds plays significant role in settlement discussions). If the D&O policy does not cover the failed bank's directors due to an exclusion, such as the IvI exclusion, insurance proceeds may be unavailable to the FDIC. *Cf. id.* at 2.

26. *See id.* at 3 (detailing historical origin and purpose of IvI exclusion). The IvI exclusion was a product of the mid-1980s, created after insured corporations sued their own directors in an attempt to recover losses caused by mistaken business judgments or unauthorized actions. *See id.* at 4-5. The exclusion was formed for three key reasons: to prohibit collusive lawsuits from manipulative insurers into paying for the poor decisions of an insured organization's directors by suing the directors to recover corporate losses; to prevent coverage for board room fighting; and to address the concern that the insurance policy, which is a third-party liability contract, would operate more like a first-party fidelity bond. *See id.*; *see also* Sousa, *supra* note 15, at 370 (describing primary intent behind development of IvI exclusion as preventing collusive lawsuits).

27. *See* Hanekamp & Formeller, *supra* note 7 (summarizing point of IvI exclusion as precluding coverage for certain claims). There is no standard IvI—its language varies from case to case. *See id.* at 5. One example of an IvI from *W. Holding Co. v. AIG Insurance Co.*, however, excused the insurer paying "for Loss in connection with any Claim made against an Insured . . . which is brought by, on behalf of or in the right of, an Organization or any Insured Person other than an Employee of an Organization, in any respect and whether or not collusive." 748 F.3d 377, 379 (1st Cir. 2014) (ruling IvI did not excuse insurer from advancing defense costs to insured directors); *see also* Gregory J. May, *D&O Disarray*, BEST'S REV. (Aug. 2014), http://www.nelsonmullins.com/articles/may-bests-review-08_04_14 [<http://perma.cc/8GTF-YYYY>] (exemplifying debate surrounding IvI exclusion to D&O policy through recent *W. Holding Co.* decision).

28. *See infra* Part III.

29. *See infra* Part II.

30. *See infra* Part II.

31. *See infra* Part III.

IvI exclusion.³² Finally, this Note will present suggestions for a uniform approach to the application of the IvI exclusion.³³

II. HISTORY

A. Creation of D&O Policies

The current state of affairs regarding D&O policies is a product of nearly a century's worth of U.S. economic history.³⁴ D&O policies were first introduced following the 1930s stock market crash and ensuing Great Depression to protect directors from liability imposed by shareholder lawsuits.³⁵ At that time, however, most directors felt no need to purchase liability insurance, which, therefore, remained readily available and affordable.³⁶

B. A History of the Stock Market Leading to the Great Depression

The decade preceding the Great Depression, the "Roaring Twenties," experienced general prosperity, low unemployment, heavy consumer spending, and newfound wealth.³⁷ The stock market appeared to be thriving too; the Dow began its postwar boom at 63.90 points in August 1921, broke 100 points for the first time on August 22, 1922, and rose by 400% between 1922 and its peak in 1929.³⁸ This was accompanied by an increase in borrowing, however, and

32. See *infra* Part III.

33. See *infra* Part IV.

34. See Sousa, *supra* note 15, at 372-74 (providing historical development of D&O insurance).

35. See *id.* (offering historical context resulting in D&O policies). The Great Depression began when the stock market crashed on October 29, 1929, a day referred to as Black Tuesday. See Nick Taylor, *The Great Depression*, N.Y. TIMES, http://topics.nytimes.com/top/reference/timestopics/subjects/g/great_depression_1930s/index.html (last visited Sept. 28, 2015) [<http://perma.cc/PB6D-6MWX>] (outlining history of Great Depression). The Dow Jones Industrial Average (Dow) had fallen almost 23% that day, and the stock market continued to decline thereafter. See *id.* The Depression brought widespread unemployment, virtually stagnant production and consumption, and an 89% fall in stock prices. See *id.*

36. See Sousa, *supra* note 15, at 372 (noting few directors perceived need for D&O policies until end of 1960s). The general belief that D&O policies were unnecessary persisted until the end of the 1960s, when changes in the interpretation of securities law meant a corporation's directors could be personally liable for corporate wrongdoings. See *id.*

37. See Taylor, *supra* note 35 (stating prosperous "New Era" preceded Great Depression); see also *Historical Timeline: The 1920's*, FDIC, <https://www.fdic.gov/about/history/timeline/1920s.html> (last updated Jan. 2, 2014) [<http://perma.cc/KV4D-AC76>] (explaining people bought "in record numbers everything from houses to cars to appliances"). Assembly line production surged, and stock prices steadily climbed. See *Historical Timeline: The 1920's*, *supra*. Leading up to the Roaring Twenties, the United States had fought and won World War I, which ended in 1918; excitement continued with the increasing affordability of Henry Ford's gasoline automobiles and the availability of new electric devices, like washing machines and vacuum cleaners. See *Causes of the Great Depression*, GALE CENGAGE LEARNING, <http://ic.galegroup.com/> (password protected, query "Causes of the Great Depression") [<http://perma.cc/JH4Y-YN8U>] (describing Roaring Twenties as "exciting, fascinating, and entertaining" for United States).

38. See *Historical Timeline: The 1920's*, *supra* note 37. The Dow reached its pre crash high on September 3, 1929, closing at 381.17 points. *Id.* While stock prices rose steadily at first, the growth

banks offered installment loans, mortgages, and loans to stock market speculators on 90% margins.³⁹

When buying on a margin, a debtor borrows money to make an investment and uses the investment as collateral.⁴⁰ Buying on a margin is risky because in unstable markets, investors who make initial margin payments for stock may have to provide additional cash if falling stock prices devalue the security.⁴¹ Additionally, these bank loans were used for stock speculation—buying and selling stock without regard for the stock’s actual value or the health of the company that issued it.⁴² Thus, by March 1929, some financial experts worried banks were making too many loans for stock speculation, but the stock market continued to rise, despite financial experts’ warnings.⁴³

The financial environment of the 1920s created new financial products, which spawned corporate securities issues.⁴⁴ Meanwhile, the United States lacked insider trading laws, national economic planning, or any significant

accelerated between 1926 and 1929 and surpassed realistic values. *Cf. Causes of the Great Depression, supra* note 37. Thus, stock prices inaccurately represented companies’ health and signaled trouble for the economy. *Id.*

39. *See Historical Timeline: The 1920’s, supra* note 37 (indicating borrowing associated with Roaring Twenties). During the 1920s, department stores began offering credit cards to their wealthier customers, oil companies offered courtesy cards for charging gas, and banks provided novel ways for individuals to borrow. *See id.*

40. *See Margin: Borrowing Money To Pay for Stocks*, U.S. SEC (Apr. 17, 2009), <http://www.sec.gov/investor/pubs/margin.htm> [<http://perma.cc/U7RR-6RGE>] (warning margin accounts potentially risky). Individuals looking to invest in a company and purchase stock worked with investment brokers to borrow money, which the brokers got from banks. *See Historical Timeline: The 1920’s, supra* note 37 (describing process of buying on margin). Margin borrowing exposed investors to potentially high losses because if stock prices dropped, the borrower could lose his money and the money he borrowed, while still being responsible for paying interest on the loan. *See Margin: Borrowing Money To Pay for Stocks, supra*. Investors often made large profits as the market climbed, so they continued to buy stocks with their profits and borrow money. *See Causes of the Great Depression, supra* note 37.

41. *See Margin: Borrowing Money To Pay for Stocks, supra* note 40 (articulating danger of buying on margin). The high demand for stocks resulting from investors continuously buying stocks inflated stock prices until they far exceeded the stock’s real worth. *See Causes of the Great Depression, supra* note 37.

42. *See Causes of the Great Depression, supra* note 37. Stock speculation was so pervasive that the SEC described the stock market as “caught in a speculative euphoria between 1925 and 1929.” *Historical Timeline: The 1920’s, supra* note 37. Banks and individuals also engaged in land speculation, motivated by a “get rich quick” attitude. *See Causes of the Great Depression, supra* note 37 (underscoring reckless spending in 1920s). For example, Americans bought parcels of land in Florida and Southern California without first visiting the land, only to later discover they purchased swamps and deserts. *See id.* Many individuals then turned to the stock market, seeking to recover their losses. *See id.* Only 2% of Americans owned stock in the mid-1920s, but by the late 1920s, almost everyone with a decent income saved to buy stock. *See Causes of the Great Depression, supra* note 37. Investors were vulnerable to misleading information about stocks and the health of companies in which they invested. *See id.* The public lacked the means by which to verify the companies’ financial reports when companies appeared strong. *See id.*

43. *Causes of the Great Depression, supra* note 37.

44. *See Historical Timeline: The 1920’s, supra* note 37. For example, the First National City Bank (now Citibank) created instruments, including the unit trust, today referred to as the mutual fund, and compound interest savings accounts. *See id.*

watchdog agency to monitor the economy.⁴⁵ Further, the government adopted a *laissez-faire* approach to economic regulation that caused market instability through the fall of 1929, and subsequently, the Great Depression.⁴⁶

The Great Depression was a worldwide economic crisis that lasted until 1939 and carried severe consequences.⁴⁷ Unemployment spiked, and wages fell for those fortunate enough to remain employed.⁴⁸ Americans' heavy use of credit in purchasing homes, cars, furniture, and household appliances in the preceding years led to foreclosures and repossessions when homeowners could not repay what they had borrowed.⁴⁹ Many banks failed because they made loans to stock market speculators, who never repaid them.⁵⁰ President Herbert Hoover was in office during the worst years of the Great Depression, but because he did not believe in directly intervening with the economy, his response to the Great Depression was ineffective.⁵¹

45. See *Causes of the Great Depression*, *supra* note 37 (emphasizing void in government regulation of U.S. economy).

46. See *id.* In fact, the three preceding presidents—Warren Harding, Calvin Coolidge, and Herbert Hoover—all followed this *laissez-faire* approach, and they neither gathered nor analyzed statistics that would have indicated the problems with stock investing and overproduction of goods. See *id.* Consequently, “[t]his approach to government was a major contributing factor in the Great Depression.” *Id.* The stock market began to crash on Black Thursday, and panic erupted, prompting a record-breaking thirteen million stocks traded that day. See *Historical Timeline: The 1920s*, *supra* note 37. Bankers tried to stabilize the market, but success was short-lived. See *id.* Days later, on Black Tuesday, sixteen million shares were traded and the Dow fell thirty points (approximately 12%) to close at 230.07 points. See *id.* Despite this intense plunge, Taylor stresses that Black Tuesday “was just one in a series of losses during a time of extreme market volatility that exposed those who had bought stocks ‘on margin’—with borrowed money.” Taylor, *supra* note 35 (suggesting 1920s prosperity masked signs of looming depression).

47. See *Historical Timeline: The 1930's*, FDIC, <https://www.fdic.gov/about/history/timeline/1930s.html> (last updated Jan. 2, 2014) [<http://perma.cc/C9X8-4QXK>]. The Great Depression was the longest and harshest depression experienced in the United States, and it had shocking social and economic effects. See *id.* The Great Depression persisted until intensive preparations for World War II began after the December 7, 1941 attack on Pearl Harbor. See *Causes of the Great Depression*, *supra* note 37 (suggesting long-lasting consequences of Great Depression). World War II helped end the Great Depression because the war created civilian and military jobs and improved wages. See *id.*

48. See Taylor, *supra* note 35 (discussing unique problems and separate depression farmers encountered during most of 1920s). Consumers lost buying power, industrial production declined, and the number of business failures grew, perpetuating job losses. See *id.*; see also *Historical Timeline: The 1930's*, *supra* note 47. Between 1929 and 1939, industrial production dropped 47%, Gross Domestic Product (GDP) fell 30%, wholesale price index declined—indicating deflation—33%, and unemployment exceeded 20%. *Historical Timeline: The 1930's*, *supra* note 47. The height of the depression occurred between 1932 and 1933. See *id.* In 1932, 25% of Americans were unemployed, and national income was half of what it was in 1929. See *id.* (quantifying financial trauma during height of depression in 1932). In 1933, about 4000 commercial banks and 1700 S&Ls failed; foreclosures clogged banks and S&Ls with unsalable assets. See *id.*

49. See Taylor, *supra* note 35 (insinuating borrowing played role in economic fallout during Great Depression); see also *Causes of the Great Depression*, *supra* note 37 (revealing frequency of bank closures). Bank runs and closures were common during the height of the Great Depression, and depositors lined up at banks to demand all their money. See *Causes of the Great Depression*, *supra* note 37. Yet, banks had already loaned out most of depositors' money, so individuals standing near the end of lines got nothing—their lifesavings were gone. See *id.*

50. See *Historical Timeline: The 1930's*, *supra* note 47.

51. See Taylor, *supra* note 35 (discussing Hoover's inaction in addressing Great Depression). Hoover

C. Recovering from the Great Depression

On March 6, 1933, newly elected President Franklin Delano Roosevelt declared a nationwide bank holiday and closed all banks—a decision that allowed banks to regain their equilibrium.⁵² He introduced a series of emergency measures called the New Deal.⁵³ The New Deal's major initiatives included stock market reform, unemployment aid, and fortification of the banking system.⁵⁴

During the Great Depression's height between 1932 and 1933, the government developed regulatory legislation and created agencies with new and emergency functions.⁵⁵ For example, Congress enacted the Reconstruction Finance Corporation Act of 1932 (RFC),⁵⁶ the Federal Home Loan Bank Act of 1932,⁵⁷ the Securities Act of 1933,⁵⁸ the Banking Act of 1933,⁵⁹ the Securities

resisted calls from Congress, governors, and mayors to overcome unemployment by financing public service jobs because Hoover believed it was up to state and local governments to remedy the situation. *See id.*; *see also Causes of the Great Depression, supra* note 37 (illustrating Hoover's dependence on local governments, private charities, and Americans to aid needy). Meanwhile, millions of Americans were homeless, while others lived at the edges of cities in makeshift shantytowns disdainfully named "Hoovervilles." *See Taylor, supra* note 35. Thus, the presidential election in 1933 resulted in Democratic nominee Franklin Delano Roosevelt winning by a landslide. *See Taylor, supra* note 35 (noting high unemployment and banking crisis Roosevelt faced upon taking office).

52. *See Taylor, supra* note 35; *see also Historical Timeline: The 1930's, supra* note 47.

53. *See Taylor, supra* note 35 (emphasizing Roosevelt Administration's strides toward economic revival). Roosevelt made great progress during his first hundred days in office: he reformed banking and the stock market; insured private bank deposits; protected home mortgages; created a program to build large public works; created a program to build hydroelectric dams to bring power to the rural South; brought federal relief to millions; and sent thousands of young men into the national parks and forests to plant trees and control erosion. *See id.*

54. *See Historical Timeline: The 1930's, supra* note 47. Although the New Deal's measures relieved the most severe effects of the Great Depression, it was ultimately the dawning of World War II that revived American factories. *See Taylor, supra* note 35 (explaining ramped-up military production reduced unemployment). "Jobless workers were absorbed as trainees for defense jobs and then by the draft that went into effect in 1940, when Roosevelt was elected to a third term." *Id.*

55. *See Historical Timeline: The 1930's, supra* note 47 (expressing significant regulatory developments originated in response to Great Depression).

56. *See Reconstruction Finance Corporation Act, Pub. L. No. 72-2, 47 Stat. 5 (1932)* (providing "emergency financing facilities for financial institutions"). The Reconstruction Finance Corporation (RFC) Act provided loans to banks, savings banks, building and loan associations, credit banks, industrial banks, mutual savings banks, and life insurance companies. *See* § 5, 47 Stat. at 06-07.

57. *See Federal Home Loan Bank Act, Pub. L. No. 72-304, § 2, 47 Stat. 725 (1932)* (establishing Federal Home Loan Banks (FHLBs) and Federal Home Loan Bank Board (FHLBB)). The Federal Home Loan Bank Act created the FHLBB to charter federal S&Ls, gave the FHLBB authority to regulate and supervise federal S&Ls, and allowed FHLBs to lend money to S&Ls to finance home mortgages. *See id.* §§ 3, 6-10.

58. *See Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933)* (requiring full and fair disclosure in sale of securities). The Securities Act of 1933 requires publically held corporations to make strong disclosure statements to eliminate bankers' monopoly on information. *See id.* §§ 6-10, 48 Stat. at 78-81; *see also Historical Timeline: The 1930's, supra* note 47. The Securities Act of 1933 further provides recourse to investors if the registration statement includes untrue statements or omits material statements. *See* § 11(a), 48 Stat. at 82. Investors may sue various individuals, including those who signed the inaccurate statement, as well as directors and partners of the issuing company, accountants, and underwriters of the security. *See id.*

59. *See Banking Act of 1933, ch. 89, Pub. L. No. 73-66, 48 Stat. 162 (1933)* (establishing FDIC as

Exchange Act of 1934,⁶⁰ and the Banking Act of 1935.⁶¹ Unfortunately, not all of these reforms were effective.⁶² For instance, the Hawley-Smoot Tariff Act of 1930 may have lengthened the Great Depression.⁶³ It drastically raised U.S. tariffs on imports, prompting foreign governments to retaliate and hinder free trade.⁶⁴

The Banking Act of 1933, however, was particularly important.⁶⁵ It established the FDIC as a temporary government organization with the authority to provide deposit insurance to banks, and it funded the FDIC with initial loans of \$289 million through the U.S. Treasury and the Federal Reserve Board (FRB).⁶⁶ The Banking Act of 1933 vested the FDIC with the power to regulate and supervise state nonmember banks and extended federal oversight to all commercial banks.⁶⁷ Since the FDIC's creation in 1933, no depositor has lost a penny in FDIC-insured institutions.⁶⁸

Before the Great Depression exposed the repercussions of speculation, business leaders faced minimal accountability for risky decision-making.⁶⁹ After the stock market crash and the enactment of federal securities laws,

temporary government organization and regulating use of bank assets); *see also Historical Timeline: The 1930's*, *supra* note 47 (crediting temporary establishment of FDIC with eliminating threat of bank runs). The Banking Act of 1933 extended federal oversight to all commercial banks for the first time. *See Historical Timeline: The 1930's*, *supra* note 47.

60. *See* Securities Exchange Act of 1934, Pub. L. No. 73-291, §§ 6(a), 10(b), 48 Stat. 881 (1934) (requiring registration statement and prohibiting deceptive practices); *see also Historical Timeline: The 1930's*, *supra* note 47. The act also created the Securities and Exchange Commission (SEC) and required companies with securities traded on national exchanges or over-the-counter to file applications and annual reports with the SEC detailing the health of the company. Pub. L. No. 73-291, §§ 4(a), 6(a), 10(b), 48 Stat. at 881.

61. *See* Banking Act of 1935, Pub. L. No. 74-305, 49 Stat. 684 (1935) (making FDIC permanent federal agency).

62. *See Historical Timeline: The 1930's*, *supra* note 47.

63. *See id.* (referring to Hawley-Smoot Tariff (Tariff Act of 1930)).

64. *See id.*

65. *See Understanding Deposit Insurance*, FDIC, <https://www.fdic.gov/deposit/deposits/> (last updated Oct. 9, 2014) [http://perma.cc/3LC8-G8D9] (summarizing FDIC insurance coverage); *cf. Historical Timeline: The 1930's*, *supra* note 47. During the Great Depression, panic-stricken depositors made large-scale withdrawal demands, which were “the fatal blow to banks that might otherwise have survived.” *Historical Timeline: The 1930's*, *supra* note 47. To alleviate disruptions caused by bank failures and bank runs and thereby boost confidence in the banking system, President Roosevelt signed the Banking Act of 1933. *See id.*; *see also supra* note 55.

66. *See* §§ 8-9, 48 Stat. at 168-69, 180; *see also Historical Timeline: The 1930's*, *supra* note 47 (identifying key functions of Banking Act of 1933). FDIC deposit insurance went into temporary effect on January 1, 1934, with its deposit insurance level at \$2,500. *See Historical Timeline: The 1930's*, *supra* note 47.

67. § 8, 48 Stat. at 172; *see also Historical Timeline: The 1930's*, *supra* note 47. In a provision known as the Glass-Steagall Act, the Banking Act of 1933 prohibited banks from paying interest on checking accounts and separated commercial and investment banking. *See* § 11, 48 Stat. at 181; *see also Historical Timeline: The 1930's*, *supra* note 47.

68. *See Understanding Deposit Insurance*, *supra* note 65.

69. *See supra* note 46 and accompanying text (highlighting no measures in place to mitigate risk or hold individuals or companies responsible).

everything changed, and business leaders finally acknowledged their defenselessness.⁷⁰ Directors of for-profit corporations could face claims from two sources: shareholders and third-party claimants.⁷¹ Shareholders could sue on the corporation's behalf in a derivative suit or in the shareholder's own right.⁷² Third-party claimants could now include the corporation's employees, creditors, suppliers, customers, and government agencies.⁷³

D. D&O Policies After the Great Depression

D&O policies were introduced in the 1930s as a tool to protect corporate directors from liability threatened by shareholder suits at a time when statutory indemnification rights were limited or unclear.⁷⁴ D&O policies remained available and affordable until the end of the 1960s, when corporations began purchasing the policies on a widespread basis.⁷⁵ In fact, in 1965, fewer than 10% of corporations carried D&O policies, but by 1971, 70 to 80% of major corporations carried them.⁷⁶ This change was a reaction to broadened

70. See Roberta Romano, *What Went Wrong With Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1, 4 (1989) (linking corporations' awareness of individual risk to development of D&O policies).

71. See *id.* at 3.

72. See *id.* (stating directors liable to shareholders for breaches of fiduciary duty).

73. See *id.* (distinguishing third-party litigation by corporate defendant and no conflict between firm and individual defendants). Today, state indemnification statutes often differentiate between third-party actions, in which expenditures for settlements or judgments are reimbursable, and shareholder derivative suits, in which indemnification is limited to expenses. See *id.* at 3-4.

74. See Romano, *supra* note 70, at 4 (linking origin of D&O policies to 1930s); see also Sousa, *supra* note 15, at 372 (noting despite 1930s introduction of D&O policies, rarely purchased until 1960s). While in shareholder suits the shareholders themselves are suing their corporation's directors, they still want director indemnification to encourage able directors to serve, despite the risk of liability. See Romano, *supra* note 70, at 4; see also *supra* notes 17-19 and accompanying text (opining risk of personal liability deters candidates' acceptance of directorship). Director indemnification rights can also encourage directors to take an appropriate level of risk, rather than be overcautious. See Romano, *supra* note 70, at 4. Indemnification alone may not sufficiently protect directors because states limit the extent of direct indemnification. See *id.* This is where D&O policies come into play. See *id.* There is "a powerful incentive for managers to have their firms purchase D&O insurance because the same state corporation codes that impose limits on direct indemnification permit corporations to purchase liability insurance for their directors and officers, which compensates them whether or not they can be indemnified for the loss." *Id.*; see also DEL. CODE ANN. tit. 8, § 145(g) (1987). Section 145(g) states:

"A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation . . . against any liability asserted against such person . . . whether or not the corporation would have the power to indemnify such person against such liability under this section."

DEL. CODE ANN. tit. 8, § 145(g) (1987).

75. See Sousa, *supra* note 15, at 372 (reflecting turnaround of corporations buying D&O policies in 1960s); see also Romano, *supra* note 70, at 21 (noting boom in insurance coverage by 1968).

76. See Romano, *supra* note 70, at 22 (stating percent of corporations with D&O policies jumped from 1965 to 1971). Furthermore, the dollar amount of insurance issued grew from an insubstantial amount in 1963 to over one billion dollars in 1968. See *id.* D&O policies thrived as a commercial enterprise in the late 1960s and early 1970s because the catastrophes the policies were designed to prevent were extraordinary and unlikely

interpretations of securities laws, which reaffirmed the possibility that an organization's directors would be held personally liable for their corporate decisions.⁷⁷ With director liability rules in flux, two key 1968 court decisions were said to “herald a new era of D&O liability.”⁷⁸ These cases were *SEC v. Texas Gulf Sulphur Co.* and *Escott v. BarChris Construction Corp.*⁷⁹

Both *Texas Gulf Sulphur* and *BarChris* are credited with opening the floodgates to finding director exposure in situations “where even defendants who had not personally profited from [a] transaction could be held liable.”⁸⁰ In the wake of *Texas Gulf Sulphur*, the growth in director liability occurred largely through suits extending coverage under the Securities Exchange Act of 1934.⁸¹ *BarChris*, in contrast, reiterated the duties that already existed for corporations' directors under the Securities Act of 1933.⁸² Further, in 1966, courts liberalized the Federal Rules of Civil Procedure for class action lawsuits and interpreted the rules in a manner favorable to plaintiffs in securities cases.⁸³

to occur at most companies. See Sousa, *supra* note 15, at 372.

77. See Sousa, *supra* note 15, at 372.

78. See Romano, *supra* note 70, at 21 (reasoning changes in tort doctrines of liability and damage recovery compelled purchase of D&O policies); see also *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 851 (2d Cir. 1968) (expanding scope of liability to anyone possessing insider information, even if person did not profit); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 682-84 (S.D.N.Y. 1968) (barring due diligence defense when mere reliance on material, false statements without reasonable verification efforts found).

79. See *Tex. Gulf Sulphur Co.*, 401 F.2d at 833; see also *BarChris*, 283 F. Supp. at 643. In *Texas Gulf Sulphur*, the SEC brought suit under the SEC Act of 1934 against employees at the defendant mining company who possessed material information but did not disclose it to the public. See 401 F.2d at 839-42. The employees used the insider information to engage in stock purchases, recommend purchases to others, or accept stock options. See *id.* The court held that even the defendants who had not purchased the company's stock, but merely accepted stock options based on the insider information, were liable even if they lacked the specific intent to defraud. See *id.* at 839-42. Finally, the court expanded the definition of material information, broadening directors' disclosure obligations. See *id.* at 849 (concluding facts affecting company's probable future and investors' desire to transact company's securities material). In *BarChris*, the plaintiffs—purchasers of *BarChris* debentures—sued the company under Section 11 of the Securities Act of 1933. See 283 F. Supp. at 652, 655. Plaintiffs claimed *BarChris*'s registration statement, a document filed with the SEC, contained material false statements and omissions. See *id.* The prospectus within the registration statement contained unaudited figures of net sales, gross profit, and net earnings for the quarters, and plaintiffs challenged the accuracy of these figures. See *id.* at 655. The court determined that the false and omitted information concerned material matters, as required under Section 11, to impose liability. See *id.* at 680-81. Under Section 11(b), a defendant can dodge liability based on due diligence if he or she can meet the burden of proof and show that after conducting reasonable investigation, the defendant had reasonable grounds to believe, and did believe, the statements were true. See *id.* at 682-83 (reciting Securities Act of 1933). Neither the defendants who knew that the statements contained false information, nor those who failed to investigate or verify the information, may assert a due diligence defense. See *id.* at 681.

80. See Romano, *supra* note 70, at 21 (verifying consequential expansion of D&O liability in years following two decisions).

81. See *id.* at 22 (explaining rule 10b-5 and 10(b) as sources of expansion).

82. See Romano, *supra* note 70, at 22; see also *BarChris*, 283 F. Supp. at 688 (vocalizing managers' duty to undertake reasonable investigation on validity of statements).

83. See Romano, *supra* note 70, at 22 (providing additional source for D&O policies' popularization in 1960s). By interpreting the rules pursuant to their liberal thrust, courts further facilitated claims against directors. See *id.*

Due to directors' growing exposure to liability through the late 1960s, companies began to appreciate the need for D&O policies.⁸⁴

Although the need for D&O policies briefly waned in the mid-1970s, it rebounded in the late 1970s and early 1980s as corporate directors faced rising litigation levels.⁸⁵ The Supreme Court's refusal to stretch the scope of federal securities laws from 1975 through 1977 caused a decline in demand for D&O policies.⁸⁶ Further, federal courts became less accommodating to class action and derivative suits, with most states following their lead.⁸⁷ The decreased demand was short-term, however.⁸⁸ The mid-1980s experienced a chaotic financial landscape with the D&O crisis on one hand, followed by the S&L crisis on the other.⁸⁹ Beginning in late 1984, the market for D&O policies changed dramatically: premiums skyrocketed, deductibles increased, and coverage shrunk.⁹⁰ More than 80% of firms renewing their D&O policies from

84. *See id.* at 21; *see also* Sousa, *supra* note 15, at 372.

85. *See* Romano, *supra* note 70, at 22 (justifying demand fall from 1975 to 1977).

86. *See, e.g.*, *Santa Fe Indus. v. Green*, 430 U.S. 462, 472-74 (1977) (requiring manipulation or deception for breach of fiduciary duty under 10(b) and 10b-5); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (holding no private action under federal securities laws without allegation of scienter); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (declaring no standing under 10(b) or 10b-5 unless actually purchase or sell stock).

87. Romano, *supra* note 70, at 22. At the state level, the doctrinal trend has been to hem the scope of liability, and virtually all states enacted statutes defining procedures to avoid a fairness review. *See id.* at 23. Also, courts used the business judgment rule to limit the scope of liability by affording directors wiggle room in making decisions, as long as they were informed and acted in good faith. *See id.* *But see* *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (holding business judgment rule inapplicable where directors not properly informed).

88. *See* Sousa, *supra* note 15, at 372. The litigation-filled environment became the foundation for the D&O crisis in the 1980s. *See id.* Statistics produced by the Wyatt Company (Wyatt Survey), the leading source of information regarding D&O claims and insurance, evidenced the rebound in litigation against corporate directors. *See* Romano, *supra* note 70, at 6 (citing THE WYATT CO., 1984 WYATT DIRECTORS AND OFFICERS AND FIDUCIARY LIABILITY SURVEY, COMPREHENSIVE REPORT 22 (1984)). From 1974 to 1984, the number of companies reporting in the Wyatt Survey that they had experienced a liability claim against a director more than doubled from 7% to 18% of respondents. *See* Romano, *supra* note 70, at 6 (relying on 1984 Wyatt Survey). The spike in litigation came with surging insurance premiums. *See id.* (claiming primary impetus for ratchet in premiums as "sheer increase" in claim frequency). Furthermore, the 1980s experienced an escalation in claim costs (payouts) and costs for legal defense. *See id.* at 6-8.

89. *See* Sousa, *supra* note 15, at 373-74 (describing poor economic conditions in mid-1980s); *see also* Nancy Thomas et al., *Individual Liability: What's Behind the Headlines?*, MONDAQ, <http://www.mondaq.com/unitedstates/x/330240/Financial+Services/Individual+Liability+Whats+Behind+the+Headlines> (last updated July 25, 2014) [<http://perma.cc/UUL5-JZP4>] (examining response to last financial crisis and "unparalleled losses" experienced). In general, historically high interest rates prompted the insolvencies in the S&L industry between 1980 and 1982. *See* FDIC, AN EXAMINATION OF THE BANKING CRISES OF THE 1980S AND EARLY 1990S: THE SAVINGS AND LOAN CRISIS AND ITS RELATIONSHIP TO BANKING 167, 167 (2000), https://www.fdic.gov/bank/historical/history/167_188.pdf [<http://perma.cc/2QKZ-VL9C>] [hereinafter EXAMINATION OF THE BANKING CRISES] (introducing problems in S&L industry and considering cause and resolution of crisis). From 1980 to 1982, 118 S&Ls (with \$43 billion in assets) failed, costing the FSLIC an estimated \$3.5 billion to resolve. *See id.* at 168. The calm before the D&O storm, though, was several years of expanding policy coverage and falling prices. *See* Romano, *supra* note 70, at 1 (providing timeline of insurance crisis and listing implications for D&O industry).

90. *See* Romano, *supra* note 70, at 1 (noting four times number of suits filed against directors in 1985

mid-1985 through 1986 reported a premium increase, and more than half of those firms experienced an increase above 200%.⁹¹ Combined, these ingredients curtailed the availability of D&O policies.⁹²

The rise in litigation against corporate directors is often linked to a 1985 Supreme Court of Delaware case: *Smith v. Van Gorkom*.⁹³ In *Van Gorkom*, Trans Union shareholders launched a class action to rescind the cash-out merger of Trans Union into New T Company.⁹⁴ *Van Gorkom* addressed the application of the business judgment rule to the directors' behavior regarding the proposed purchase of Trans Union.⁹⁵ The business judgment rule presumes that a corporation's directors acted on an informed basis, in good faith, and with the honest belief that the decision was in the best interest of the company.⁹⁶ The court found that the directors' approval of the merger was not the product of an informed business judgment, and the court therefore refused to apply the rule to shield the directors from liability.⁹⁷

than 1984). "The average cost of paid claims in the Wyatt Surveys, excluding legal fees, was \$1,988,200 in 1986, up from \$1,306,000 in 1984 and \$877,361 in 1980." *Id.* at 8 (citing 1987 Wyatt Survey). An increase in payouts automatically raises the expected value of future claims, which raises the price for insurance. *See id.* at 8. The cost of directors' legal defense rose roughly 35% from 1974 to 1986. *See id.* Both personal and corporate deductibles increased over the period spanning 1984 to 1987, which was accompanied by a drastic hike in policy premiums. *See id.* at 9-10. Despite all of these consequences, insurers also restricted policy coverage by implementing exclusions and revising coverage extension provisions. *See id.* at 10.

91. *See Romano, supra note 70, at 10.*

92. *See Sousa, supra note 15, at 373* (offering sources for near-collapse of commercial sector in D&O marketplace in 1986).

93. *See* 488 A.2d 858 (Del. 1985); *see also Sousa, supra note 15, at 373* (linking increased litigation against corporate directors to *Van Gorkom* decision). *But see Romano, supra note 70, at 23-24* (suggesting *Van Gorkom* lowered standard of conduct required of directors). Romano recognized the prevailing theory that *Van Gorkom* expanded directors' liability for negligence, but argues it likely had the opposite effect by lowering the standard of conduct by defining breaches of the duty of care in terms of gross rather than ordinary negligence. *See Romano, supra note 70, at 23-24.* Romano argues that the case does not reject the business judgment rule, but instead deemed it inapplicable. *See id.* She notes, however, the reaction to *Van Gorkom* indicates the decision created uncertainty about how the liability standard would be applied. *See id.* at 24-25. Romano and Sousa agree that at least one consequence of increased litigation is higher insurance premiums. *See id.* at 27; *see also Sousa, supra note 15, at 373.*

94. *See* 488 A.2d at 863.

95. *See id.* at 870. The lower court had concluded that the Board of Directors' approval of the merger proposal was within the protection of the business judgment rule because the Board had dedicated sufficient time and attention to the transaction. *See id.* By considering the proposal on three occasions over a four-month period, the Board acquired enough information to reach an informed business judgment. *See id.* at 870-71.

96. *See id.* at 871. The business judgment rule stems from the fact that directors are charged with a strict fiduciary duty to the corporation and its shareholders when the directors carry out managerial roles. *See id.* A business judgment is "informed" if, prior to making the decision, the directors have informed themselves of all material information reasonably available to them. *See id.* at 872; *see also Mitchell v. Highland-Western Glass Co.*, 167 A. 831, 833 (Del. Ch. 1933) (stating rule does not protect "unintelligent or unadvised judgment"). An affirmative duty lies beneath the rule, which requires more than the absence of bad faith or fraud. *See Van Gorkom*, 488 A.2d at 872.

97. *See id.* at 864 (opposing lower court's conclusion of informed judgment). The Delaware Supreme Court ruled that the directors' were not informed when they voted to sell Trans Union at \$55 per share. *See id.* at 874. The directors:

The *Van Gorkom* decision revealed the risk of director liability for failure to make an informed business judgment when acting in a managerial capacity.⁹⁸ This new avenue for litigation made insurers hesitant to provide coverage to directors, whose additional exposure to liability increased the likelihood that insurers would have to pay.⁹⁹ The availability of D&O policies therefore became limited, and unfavorable market conditions remained until mid-1986.¹⁰⁰

The scope of policy coverage was also stunted during the 1980s.¹⁰¹ The litigious environment prompted insurance companies to restrict policies by inventing exclusions.¹⁰² High-profile cases from the mid-1980s, such as *National Union Fire Insurance Co. v. Seafirst Corp.*,¹⁰³ led to the development of the IvI exclusion as one mechanism to diminish coverage.¹⁰⁴ In *Seafirst*,

[D]id not adequately inform themselves as to Van Gorkom's role in forcing the "sale" of the Company and in establishing the per share purchase price; . . . were uninformed as to the intrinsic value of the Company; and . . . were grossly negligent in approving the "sale" of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency.

Id. Thus, while there were no allegations or proof of the directors' fraud, bad faith, or self-dealing, they were still unworthy of the business judgment rule's protection. *See id.* Further, the directors did not act with complete truthfulness toward stockholders because they failed to disclose all material facts that were known, or should have been known, to the board before getting stockholders' approval of the merger. *See id.* at 864. *Van Gorkom* also confirmed the standard of care applicable to a director's duty of care—gross negligence. *See id.* at 873; *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984) (basing liability under business judgment rule on "concepts of gross negligence"), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

98. *See Sousa, supra* note 15, at 373-74 (tracing rising litigation against corporations' directors to "1985 watershed decision [*Van Gorkom*]").

99. *See id.* at 374 (explaining increased likelihood of director liability).

100. *See id.* at 374-75 (presenting data showing most severe consequences of insurance crisis). The D&O marketplace also experienced significant premium increases and reductions in coverage for insureds. *See id.* at 375. A 1987 Wyatt Survey revealed 50% of the corporate respondents had recently experienced a 300% or more increase in their insurance premiums, 27% experienced a 300% or more increase in their deductibles, and 27% reported a 50% or more reduction in their maximum coverage. *See id.*; *see also* THE WYATT CO., 1987 WYATT DIRECTORS AND OFFICERS AND FIDUCIARY LIABILITY SURVEY 55, 57 (1987). Finally, the rate of cost escalation and capacity reduction in the D&O market began to decline by mid-1986. *See Romano, supra* note 70, at 2. Although many corporations were still having trouble acquiring D&O coverage in 1986, only a small portion were unable to resolve that problem. *See id.*

101. *See Sousa, supra* note 15, at 375-76 (explaining insurers hedge risk with restrictive policies via expansion of exclusions list).

102. *See id.* at 365. One of the exclusionary endorsements introduced in the early 1980s was the "regulatory exclusion." *See Vartanian & Ledig, supra* note 12 (listing exclusions beyond typical dishonesty, fraud, and intentional misconduct). The regulatory exclusion provision excludes from coverage claims brought by any government agency, including any FDIC claim, against an insured party, even when the FDIC is not acting as an insured. *See id.* Additionally, insurers often added such provisions as a response to the S&L crisis that occurred during the late 1980s. *See Joe Adler, FDIC Has Major Stake in Battle Over D&O Coverage*, AM. BANKER (Oct. 18, 2013, 1:03 PM), http://www.americanbanker.com/issues/178_202/fdic-has-major-stake-in-battle-over-do-coverage-1062936-1.html (specifying coverage exclusion of damages when plaintiff regulator followed S&L crisis).

103. No. C85-396R, 1986 U.S. Dist. LEXIS 28065 (W.D. Wash. Mar. 18, 1986).

104. *See Vartanian & Ledig, supra* note 12 (tracing IvI exclusion to lawsuits in mid-1980s when insured corporations sued own directors); *Sousa, supra* note 15, at 386 (stating IvI exclusion introduced during mid-

seeking to avoid coverage, National Union claimed the policy it issued to Seafirst was not intended to, nor did it actually, cover claims by Seafirst itself against Seafirst's former officers.¹⁰⁵ Seafirst argued that the policy unambiguously covered direct actions by Seafirst against its directors.¹⁰⁶ The court concluded the D&O policy at issue "plainly and unambiguously cover[ed] direct actions by Seafirst itself against its own directors."¹⁰⁷

E. S&L Crisis

In light of *Seafirst* and other "collusive" cases, insurers designed the IvI exclusion to preclude coverage when insured corporations sued their own directors to recover losses caused by the directors' mistaken or unauthorized business judgments.¹⁰⁸ Courts first explored the IvI exclusion's application amidst the S&L crisis.¹⁰⁹ During the S&L crisis, which emerged in the early 1980s and persisted into the 1990s, hundreds of failed financial institutions were placed into receivership.¹¹⁰

1980s); Hanekamp & Formeller, *supra* note 7. The IvI's introduction sought, among other things, to preclude collusive lawsuits where an insured organization could force its insurer to pay for the poor business decisions of its directors. Hanekamp & Formeller, *supra* note 7; *see also Seafirst Corp.*, 1986 U.S. Dist. LEXIS 28065, at *15 (requiring insurer cover insured corporation's claims against own directors). In *Seafirst*, plaintiff-insurer National Union Fire Insurance Company (National Union) issued a \$55 million D&O policy to Seattle-First National Bank (Seafirst). 1986 U.S. Dist. LEXIS 28065, at *1-2. Seafirst purchased the policy to protect its directors against liability based on claims arising out of directors' wrongful acts committed in their corporate capacities. *See id.* at *1-3. Seafirst's Energy Division purchased loan participation from a bank that the United States Controller of Currency later declared insolvent and closed. *See id.* at *2. In a shareholder derivative action, Seafirst's shareholders alleged that Seafirst's former directors were guilty of negligent mismanagement related to the losses sustained from purchasing the loan participation. *See id.* at *3. The court let Seafirst take over the shareholder derivative claims and pursue them as direct claims by the corporation against the former directors. *See id.* at *3-4.

105. *Seafirst Corp.*, 1986 U.S. Dist. LEXIS 28065, at *4.

106. *Id.* at *5.

107. *Id.* at *15. In resolving this issue, the court relied on rules of contract interpretation, which apply to insurance policies, and considered the actual policy language as the final integration of the parties' intent. *See id.* at *12-13. The rules require that, after reading the policy as a whole and giving force and effect to each clause, the court construe the policy language according to its plain and ordinary meaning. *See id.* If, after applying these rules, the policy is unambiguous, then it may be interpreted as a matter of law. *See id.* at *14. Language is ambiguous if it is fairly susceptible to two different, but reasonable, interpretations. *See id.* at *14. Seafirst's purchased policy provides coverage in the event "any claim or claims are made against the Directors and Officers, individually or collectively, for a [w]rongful [a]ct." *Id.* The court reasoned that the word "any" in the phrase "any claim or claims" clearly includes direct actions, and no other policy provision limits the scope of the phrase so as to preclude direct actions from coverage. *Id.* at *15-16. Such situations, where the insured company wants its insurer to pay for the directors' harmful business judgments, are referred to as "friendly" or collusive lawsuits. *See Twp. of Ctr. v. First Mercury Syndicate, Inc.*, 117 F.3d 115, 119 (3d Cir. 1997) (stating IvI exclusions primarily seek to prevent collusive lawsuits); *see also Hanekamp & Formeller, supra* note 7.

108. *See Sousa, supra* note 15, at 388-89 (noting decision quickly caused insurers to issue endorsements changing policies); *see also Hanekamp & Formeller, supra* note 7; Vartanian & Ledig, *supra* note 12.

109. *See Hanekamp & Formeller, supra* note 7 (noting IvI exclusion subject of insurance coverage actions associated with S&L crisis); Sousa, *supra* note 15, at 389.

110. *See Hanekamp & Formeller, supra* note 7 (comparing S&L crisis and current litigation against

In 1980, the Federal Savings and Loan Insurance Corporation (FSLIC) insured roughly 4,000 state and federally chartered S&Ls totaling \$604 billion in assets.¹¹¹ S&Ls began losing money due to rising interest rates, and net S&L income declined in 1981 and 1982.¹¹² The FHLBB, which regulated S&Ls, generally had weaker examination, supervision, and enforcement practices than those of the federal banking agencies; thus, when much of the S&L industry faced insolvency in the early 1980s, the FHLBB's examination force was understaffed, poorly trained for the new environment, and limited in its responsibilities and resources.¹¹³ The FHLBB's minimal response to the initial S&L decline highlighted the flawed structure and supervision of the S&L industry and set the stage for the major losses sustained in the late 1980s.¹¹⁴

directors of failed banks). With respect to the 2008 financial crisis, the FDIC filed lawsuits against approximately 15% of financial institutions that have failed since 2008; in comparison, it filed lawsuits in connection with 24% of failed institutions during the 1980s and 1990s S&L crises. *See id.* During the S&L crisis, FSLIC liquidated the failed institutions' assets and distributed the proceeds to creditors. *See id.* Additionally, the FSLIC and FDIC regularly filed civil lawsuits against the directors of the failed institutions for their negligent or fraudulent management practices during the S&L crisis. *See id.*

111. *See AN EXAMINATION OF THE BANKING CRISES, supra* note 89, at 168 (reviewing S&L crisis and resulting legislation enacted altering FDIC operations). While the FDIC played a critical role in the eventual cleanup of the S&L industry, it was not responsible for regulating the S&L industry. *See id.* at 167. "Until 1989, S&Ls were regulated by the FHLBB and insured by the FSLIC within a legislative and historical framework separate from the one that surrounded commercial banks." *Id.* at 167. To encourage home ownership, the Federal Home Loan Bank Act of 1932 established the Federal Home Loan Bank System as a source of liquidity and low-cost financing for S&Ls. *See id.* at 170. The FHLBB supervised twelve regional Home Loan Banks that comprised the Bank System. *See id.* Though federally sponsored, thrift-institution members of the regional banks owned the regional banks through stock holdings. *See id.* The following year, however, the Home Owners' Loan Act of 1933 empowered the FHLBB to charter and regulate federal S&L associations. *See id.* "[T]he National Housing Act of 1934 created the FSLIC to provide federal deposit insurance for S&Ls similar to what the FDIC provided for commercial banks and mutual savings banks." *Id.* Unlike the FDIC, which was an independent agency, the FSLIC was placed under the authority of the FHLBB, meaning the chartering and insurance functions for federally chartered S&Ls were housed within the same agency. *See id.*

112. *See AN EXAMINATION OF THE BANKING CRISES, supra* note 89, at 168 (outlining downward trend of S&Ls in early 1980s). "Net S&L income, which totaled \$781 million in 1980, fell to *negative* \$4.6 billion and \$4.1 billion in 1981 and 1982." *Id.* From 1980 through 1982, 118 S&Ls, with \$43 billion in assets, failed, costing the FSLIC an estimated \$3.5 billion to resolve. *See id.* at 168-69.

113. *See id.* at 168-70 (explaining structural problems of S&L industry in early 1980s). The FHLBB conducted its examinations of S&Ls completely separately from the FHLBB's supervisory function; thus, in contrast to the banking agencies, no agency had a single direct line of responsibility for a troubled institution. *See id.* at 171.

114. *See id.* at 171. The FHLBB designated each regional FHLB president as the Principal Supervisory Agent (PSA) for that region, with senior bank staff acting as supervisory agents. *Id.* at 171. Field examiners, however, reported to the FHLBB in Washington, rather than to the regional PSA, and the regional PSA essentially reported to no one. *See id.* Moreover, risk for conflicts of interest was high because regional banks were owned by the institutions they supervised. *See id.* "This system generated mistrust and disrespect between the S&L examiners, who were federal employees, and the supervisory agents, who were employees of the privately owned regional Banks." *Id.* at 172. The FHLBB had enforcement powers similar to those of the banking agencies, but it used these powers far less frequently. *See id.* Because the S&L supervisory environment was not conducive to immediate corrective enforcement actions, the FHLBB preferred either to use voluntary supervisory agreements or to rely on the states to use their powers. *See id.*

Early insolvencies were leniently addressed because most political, legislative, and regulatory decisions at that time had undertones of deregulation.¹¹⁵ As a result, losses in the S&L industry accumulated throughout the decade.¹¹⁶

In response to the S&L crisis, Congress enacted FIRREA, legislation that imposed several major banking reforms and provided the FDIC with broad investigative and enforcement authority to pursue claims against institutions and individuals.¹¹⁷ FIRREA's main objective was to "restore public confidence" in the S&L industry to foster "a safe, stable, and viable system of affordable housing finance."¹¹⁸ FIRREA abolished the FHLBB and the FSLIC, gave the FDIC initial responsibility for managing the Resolution Trust Corporation (RTC), and assigned the FDIC permanent responsibility for operating the new Savings Association Insurance Fund (SAIF).¹¹⁹

115. *See id.* (labeling government response to early crisis deregulation). Many of the actual and threatened insolvencies of S&Ls were predictable because of the interest-rate mismatch of the institutions' balance sheets. *See id.* "What followed, however, was a patchwork of misguided policies that set the stage for massive taxpayer losses to come . . . [M]any government officials believed that the insolvencies were only 'on paper,' caused by unprecedented interest-rate levels that would soon be corrected." *Id.* at 173. To prevent actual insolvency, the FHLBB cut the net worth requirements for federally insured S&L associations and used various other accounting mechanisms to preserve the appearance and operation of S&Ls. *See id.* at 173-74 (explaining how FHLBB relaxed rules and enhanced S&L appearances, limiting corrective enforcement ability). The FHLBB also sought to attract new capital to the industry by easing ownership restrictions for stock-held institutions, but this ultimately added to the cost of the crisis. *See id.* at 175. Additionally, the Reagan Administration had a free-market philosophy and opposed any governmental cash expenditures to resolve the S&L problem. *See id.* at 177. Following years of deregulation, the S&L industry changed drastically, and the period from year-end 1982 to year-end 1985 was characterized by extremely rapid growth, especially in commercial real estate lending. *See id.* at 178. S&Ls' real estate investments, however, were unsound and their oversupply of real estate contributed to the eventual plunge in real estate values and slowed economic recovery. *See id.* at 179-80. Deregulation shifted investment portfolios away from traditional home mortgage financing and into new high-risk developments, which was likely the main cause for thrift failures after 1982. *See id.* at 180. The high-growth period between 1982 and 1985 was also the time when S&L examination and supervision were the weakest. *See id.* at 180.

116. *See* AN EXAMINATION OF THE BANKING CRISES, *supra* note 89, at 186. Despite steps taken in 1987 and 1988 to resolve this issue, there were still 250 insolvent S&Ls based on regulatory accounting principles at year-end 1988. *See id.* "Resolution of the S&L crisis did not really begin until February 6, 1989, when newly inaugurated President George [H. W.] Bush announced his proposed program, whose basic components were enacted later that year in FIRREA." *Id.* The S&L crisis highlighted an expansive public policy failure that cost over \$160 billion to resolve, which included \$132 billion from federal taxpayers. *See id.* at 187. "[M]uch of this cost could have been avoided if the government had had the political will to recognize its obligation to depositors . . . rather than viewing the situation as an industry bailout." *Id.*

117. *See* AN EXAMINATION OF THE BANKING CRISES, *supra* note 89, at 187-88 (linking increase in S&L assets to new regulatory climate); *see also* FIRREA, 12 U.S.C. § 1821 (d)(2)(A)(i) (2012); Thomas, *supra* note 89 (reasoning Congress passed FIRREA to diminish impact of thrift failures and expand FDIC enforcement power); *supra* notes 13-14 and accompanying text (discussing powers afforded to FDIC).

118. *See* Thomas, *supra* note 89 (citing H.R. REP. NO. 54(1), 101st Cong., 1st Sess. 291, reprinted in 1989 U.S.C.C.A.N. 86, 307).

119. *See* AN EXAMINATION OF THE BANKING CRISES, *supra* note 89, at 187-88 (stating Congress enacted two statutes in response to problems in 1980s); *see also* Thomas, *supra* note 89 (noting statutory response to banking crisis). FIRREA contained several provisions that expanded the DOJ's and the FDIC's ability to investigate, prosecute, and punish gross misconduct directed toward financial institutions. *See* Thomas, *supra* note 89. Thomas states that both the RTC and the FDIC took advantage of the expanded authority to file more

The IvI exclusion provision became the subject of insurance coverage actions associated with the S&L crisis.¹²⁰ Insurers asserted the IvI exclusion and argued that, as receiver, the FDIC stood in the place of the failed bank.¹²¹ By suing the failed bank's directors, the FDIC was one insured suing another insured, triggering the exclusion.¹²² Courts offer differing opinions when

than 900 professional liability claims against failed S&L directors and third parties, such as accountants and attorneys. *See id.* The second act passed was the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), which dramatically changed the FDIC's operations. *See AN EXAMINATION OF THE BANKING CRISES, supra* note 89, at 188 (explaining FDICIA response to S&L-caused taxpayer losses and FDIC's near insolvency in early 1990s). The FDICIA addressed the flawed belief that many problem institutions (both thrifts and commercial banks) were too big to fail, and, therefore, the government should provide funds to keep them open. *See Vern McKinley, Run, Run, Run: Was the Financial Crisis Panic over Institution Runs Justified?, CATO INST., POL'Y ANALYSIS NO. 747, at 9 (Apr. 10, 2014), http://object.cato.org/sites/cato.org/files/pubs/pdf/pa747_web_1.pdf [<http://perma.cc/A5Y4-4J2X>].* To mitigate the "too big to fail" mentality, the FDICIA created a prompt corrective-action system that requires bank regulators to act before an institution is in imminent danger of failing at the expense of the deposit insurance system. *See id.*

120. Hanekamp & Formeller, *supra* note 7, at 5. "In the aftermath of the S&L crisis, the FDIC and the RTC brought suit or settled claims against hundreds of former directors and officers of failed banks and recovered approximately \$1.3 billion in claims against former directors and officers." Vartanian & Ledig, *supra* note 12. As a result, issues with the application of the IvI exclusion arose when the FDIC became the failed bank's receiver and initiated litigation against the failed bank's directors. *See id.*

121. Vartanian & Ledig, *supra* note 12; *see also* *Mt. Hawley Ins. Co. v. FSLIC*, 695 F. Supp. 469, 483 (C.D. Cal. 1987) (holding IvI exclusion unambiguously excludes coverage of FSLIC's claim against D&O defendants). The insurer in *Mt. Hawley* denied coverage for claims brought by the FSLIC as receiver for the failed bank, based on its policy's IvI exclusion. *See* 695 F. Supp. at 483. The insurer reasoned that because the FSLIC was receiver for the failed bank, it took the place of the failed bank and acted as an insured party, triggering the exclusion. *See id.*

122. *See Mt. Hawley*, 695 F. Supp. at 483 (finding FSLIC acts as one insured suing other insured); *see also* *Gary v. Am. Cas. Co.*, 753 F. Supp. 1547, 1554 (W.D. Okla. 1990), *aff'd on other grounds*, 975 F.2d 677 (10th Cir. 1992) (applying IvI exclusion to FDIC, who stood in shoes of failed bank). After the bank in *Mt. Hawley* failed, the FSLIC became its receiver, and in that capacity sued various bank directors, alleging negligent and fraudulent breach of fiduciary duty. *See* 695 F. Supp. at 481. The court in *Mt. Hawley* stated that the FSLIC "[stood] in the shoes" of the failed bank when the FSLIC brought the claim against the directors. *See id.* at 482. As receiver for the failed bank, FSLIC has full power to carry on the business of the bank and has succeeded to the "rights, titles, powers and privileges" of the bank as well as to the "rights, powers, and privileges of its members, officers, and directors." *Id.* Accordingly, the FSLIC asserted claims belonging to the bank that would not have been covered under the policy if the bank itself asserted the claims; thus those claims should not be covered when FSLIC as its receiver asserts claims on behalf of the bank. *See id.* at 482-83. In *Gary*, the court applied this line of reasoning to the FDIC, stating the FDIC was "standing in the shoes of the bank in prosecuting these claims." 753 F. Supp. at 1554. The FDIC argued that because the FDIC performs numerous functions and represents not just a failed bank and its shareholders, but also the bank's depositors, creditors, the deposit insurance fund, and the public at large, the exclusion is inapplicable to the FDIC, or at least ambiguous as to whether the exclusion applies. *See id.* The court rejected that argument and adopted the rationale used in *Mt. Hawley*, that claims not covered when asserted by the bank should not be covered when asserted on behalf of the bank by its receiver. *See id.* at 1555; *see also Mt. Hawley*, 695 F. Supp. at 481. Further, the *Gary* court held that who might ultimately benefit from the D&O policy's proceeds was irrelevant. *See* 753 F. Supp. at 1554. In *Evanston Ins. Co. v. FDIC*, the court also applied the IvI exclusion, basing its rationale on an interpretive analysis of the exclusion's language. *See* No. CV 88-0407 WDK (Bx), 1988 U.S. Dist. LEXIS 16263, at *2 (C.D. Cal. 1988). In applying an objective test, the *Evanston* court reasoned that the exclusion's phrase "in the right of the [b]ank" means persons other than the bank asserting the bank's claims against its directors. *Id.*

addressing this exclusion.¹²³ In cases where the court did not implement the IvI exclusion, some reasoned that, as receiver, the FDIC did not simply step into the shoes of the failed bank.¹²⁴ Others found different grounds, such as a linguistic interpretation of the policy or exclusion's terms, upon which to deny the exclusion's application to the FDIC.¹²⁵

123. See Hanekamp & Formeller, *supra* note 7 (warning IvI exclusion's application unsettled, but answer impacts FDIC's potential recoveries and directors' personal liability). Compare *Gary*, 753 F. Supp. at 1554 (implementing IvI exclusion to bar coverage of FDIC claims), and *Evanston Ins. Co.*, 1988 U.S. Dist. LEXIS 16263, at *2 (applying IvI exclusion based on objective interpretation of exclusion's language), and *Mt. Hawley*, 695 F. Supp. at 482 (holding no coverage of claims by FSLIC under plain terms of policy), with *FDIC v. Zaborac*, 773 F. Supp. 137, 143 (C.D. Ill. 1991) (refusing application of IvI exclusion to FDIC despite noncollusive nature underlying lawsuit), and *Fid. & Deposit Co. v. Zandstra*, 756 F. Supp. 429, 432 (N.D. Cal. 1990) (adopting view FDIC does not step into shoes of failed bank), and *Finci v. Am. Cas. Co.*, 593 A.2d 1069, 1081-82 (Md. 1991) (focusing on policy language as basis for not applying IvI exclusion). In *Gary*, the FDIC cited three cases in which courts concluded that exclusions identical or similar to the one in *Gary* were ambiguous or did not apply to the FSLIC. See 753 F. Supp. at 1554-55 (citing *Am. Cas. Co. v. FSLIC*, 704 F. Supp. 898, 901 (E.D. Ark. 1989); *Branning v. CNA Ins. Co.*, 721 F. Supp. 1180, 1184 (W.D. Wash. 1989); *FDIC v. Nat'l Union Fire Ins. Co.*, 630 F. Supp. 1149, 1157 (W.D. La. 1986)) (differentiating cases FDIC cites based on beneficiaries of policy proceeds). The court in *Gary* declared that each of the courts' conclusions relied on the premise that the federal agencies' claims were not brought solely in the capacity of the successor to a failed financial institution, but rather for the benefit of depositors and creditors of the failed institution and for itself as a creditor. See 753 F. Supp. at 1555.

124. See Hanekamp & Formeller, *supra* note 7 (mapping out diverging application of IvI exclusion and exploring reasons). Compare *Gary*, 753 F. Supp. at 1554, and *Mt. Hawley*, 695 F. Supp. at 481-82, with *Zandstra*, 756 F. Supp. at 433 (using omission of language in policy as basis for inapplicability).

125. See *Finci*, 593 A.2d at 1081-82 (using policy language as basis for not applying IvI exclusion). Besides reasoning that the FDIC does not merely stand in the shoes of the failed bank, *Zandstra* focused on the intent behind the exclusion: to prevent collusive lawsuits. See 756 F. Supp. at 431-32. The IvI exclusion provision excluded from coverage:

[l]oss in connection with any claim made against the Directors and Officers by any other Director or Officer of the Association [Homestate] or by the Association, except for a shareholders' derivative action by a shareholder of the Association, when such shareholder is not a Director or Officer of the Association.

Id. at 430. The court concluded the exception for shareholder derivative actions in the IvI exclusion indicated the insurer intended to protect itself from collusive lawsuits. See *id.* at 431. While this intent is legitimate, the court explained collusion is not implicated in this case because "[t]here can be no real dispute that FDIC is a genuinely adverse party to the defendant . . . directors." *Id.* at 432. But see *Zaborac*, 773 F. Supp. at 143 (holding collusion prevention only one of many purpose for IvI exclusion). *Zaborac* disagreed with *Zandstra*'s collusion-based rationale because other situations exist in which the party assigned the rights to a lawsuit does not bring it collusively, but is still within the scope of the IvI exclusion. See *Zaborac*, 773 F. Supp. at 143. Nevertheless, *Zaborac* concluded the exclusion did not preclude coverage of FDIC lawsuits because the FDIC does not simply stand in the shoes of the party under which it assumes the lawsuit. See *id.* The FDIC occupied the role of a shareholder in the underlying action and brought the suit against the bank while wearing that hat. See *id.* at 144. Therefore, the IvI exclusion did not prevent coverage of the FDIC's action. See *id.* While *Zaborac* was decided in favor of the FDIC, it benefited insurers in a critical respect. See *id.* at 145. Contrary to the FDIC's assertion, *Zaborac* concluded that IvI exclusions otherwise applicable to the FDIC do not violate public policy. See *id.* An exclusion ostracizing the FDIC does not undermine any congressional purpose or annul the FDIC's powers because the FDIC had no right to recover under the policy, as contractually negotiated between the insurer and the insured company. See *id.* Therefore, by excluding coverage, no rights have been taken away from the FDIC. See *id.* at 145-46 (citing *Simons v. Columbus*, 593 F. Supp. 876, 880-81

F. Twenty-First Century Market Shifts

High levels of failed bank litigation resurfaced, and the D&O market experienced another major shift starting in 2000.¹²⁶ The market shift was largely a result of the spike in corporations filing for bankruptcy protection and the display of corporate wrongdoing at companies such as Enron Corporation, Adelphia Communications, Inc., and Tyco International Ltd.¹²⁷ Moreover, Congress passed the Sarbanes-Oxley Act (SOX) in 2002, placing additional burdens on corporations and their directors.¹²⁸ These developments increased the probability of plaintiffs suing directors.¹²⁹

During the 2008 financial crisis, the focus on accountability reached beyond institutions as entities and extended to institution's directors, officers, and employees.¹³⁰ Criticism surrounding a perceived failure to prosecute

(N.D. Miss. 1984), *aff'd*, 805 F.2d 1031 (5th Cir. 1986) (contract exclusions do not violate public policy)).

126. See Thomas, *supra* note 89 (describing pursuit of directors in late 2000s as "open season on financial institutions"). With the emphasis on improved corporate governance in the 2000s and heightened scrutiny of corporate business decisions, today's directors "face more exposure than ever before." Sousa, *supra* note 15, at 377. Premiums for D&O policies climbed and they increased by roughly 30% in 2002. See *id.* at 376.

127. Sousa, *supra* note 15, at 376. Additionally, 2001 and 2002 saw a boom in securities fraud class action lawsuits that unhappy shareholders filed against their corporations and corporate directors. See *id.* (indicating shareholders claimed corporation's misrepresentations about assets fraudulently inflated stock values).

128. See *id.* at 376-77 (linking SOX to insurers' increased apprehension about insureds' exposure to liability). SOX created an independent auditing oversight board under the directorship of the SEC, imposed "white-collar" criminal penalties for certain criminal fraud offenses, provided for enhanced and more extensive corporate financial disclosure and reporting requirements, and improved recourse procedures for shareholders harmed by securities fraud. *Id.*; see also Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745; Carolyn H. Rosenberg et al., *Negotiating D&O Policies: Key Terms and Conditions*, 37 S&P'S REV. SEC. & COMMODITIES REG. 31 (Feb. 25, 2004) (stressing importance of negotiation quality for D&O policy given potential exposure and impact of SOX).

129. See Sousa, *supra* note 15, at 377 (arguing directors' current need for coverage vital). A recent PricewaterhouseCoopers (PwC) analysis reports that 111 shareholder class actions were filed in the first seven months of 2003. See Rosenberg et al., *supra* note 128, at 31. The PwC report showed there were 60 settlements in the first seven months of 2003, totaling \$1.5 billion, although these numbers were slightly down from 2002. See *id.* Also, insurance premiums for D&O policies are increasing both in the United States and abroad. See *id.*; see also Poh Mui Hoon, *D&O Insurance – Do You Need It?*, BUS. TIMES SING. (Aug. 18, 2014, 6:00 AM), <http://www.btinvest.com.sg/specials/boardroom/do-insurance--do-you-need-it/> [<http://perma.cc/F8J5-BFSE>] (expressing importance of D&O policies in Singapore). "The bottom line is that D&O Insurance supports good governance by making the risks of business decisions manageable and transparent." Hoon, *supra*.

130. See McKinley, *supra* note 119, at 2 (noting strong fear of bank runs associated with 2007-2009 crisis). The Financial Crisis Inquiry Commission (FCIC), which was created after the recent financial crisis to investigate its causes, highlighted ten specific cases of runs at individual institutions, which contributed to the financial crash. See *id.* at 2. Besides the runs at the ten institutions, potential causes of the crisis included the Federal Reserve, "lending to institutions with a high probability of insolvency, lending for an extended period of time, and lending to nonbanks." *Id.* at 4; see also Thomas, *supra* note 89, at 1 (referencing goal to pursue individuals subject of Judge Jed Rakoff's extrajudicial comments). Judge Rakoff recently asked, "Why have no high-level executives been prosecuted in the wake of the Financial Crisis?" prompting enforcers to ramp up their efforts to do so. Thomas, *supra* note 89, at 2; see also *supra* notes 2-9 and accompanying text. The OIG and other new entities are collaborating with existing agencies to help prosecutors build criminal indictments of individuals. See Thomas, *supra* note 89, at 2. A similar call for individual liability as was heard during the S&L crisis is being repeated today with the legal and regulatory reforms emanating from the recent financial

individuals has prompted today's prosecutors to "dust[] off old tools, such as . . . (FIRREA), and use[] them to target individuals in new ways."¹³¹ Of the cases stemming from the recent financial crisis, most decided that the IvI exclusion did not unambiguously bar coverage of lawsuits brought by the FDIC.¹³²

For example, in *St. Paul Mercury Insurance Co. v. Hahn*, the court denied summary judgment for the insurer, Travelers, based on the ambiguity of the specific language used in the exclusion.¹³³ The *Hahn* court reasoned that the insurer must bear the risk caused by any ambiguities in the exclusion because the insurer had every opportunity to explicitly include the FDIC in its IvI exclusion, but failed to take that protective measure.¹³⁴ The court in *W. Holding Co. v. AIG Insurance Company-Puerto Rico* arrived at a similar conclusion but focused on the role assumed by the FDIC in bringing the underlying claims.¹³⁵ The FDIC alleged it had succeeded to the rights of the

crisis. *See id.*

131. Thomas, *supra* note 89, at 2. Financial Industry Regulatory Authority (FINRA) statistics show that, despite the overall decrease in the number of regulatory actions from 2012 to 2013, the number of individuals barred from association with a broker-dealer increased 46%, and the number of individuals suspended increased 22%. *See id.* at 2. Since 2010, FINRA has consistently increased the number of actions filed against individuals and the number of individuals barred and suspended. *See id.* at 3. The SEC's statistics on enforcement actions show the same trend. *See id.* at 2. Total penalties, disgorgement, and other monetary relief have reached \$3.02 billion. *See id.* at 3.

132. *See* William Um & Michael Levine, *Most Courts Limit Scope of Insured v. Insured Exclusion*, LAW 360 (Nov. 13, 2014, 10:19 AM), <http://www.law360.com/articles/594619/most-courts-limit-scope-of-insured-v-insured-exclusion> [<http://perma.cc/RV4N-5BQW>] (reporting 2014 California district court decision aligns with majority holding exclusion inapplicable to FDIC). For example, the court in *St. Paul Mercury Ins. Co. v. Hahn* held the IvI exclusion at issue did not exclude coverage of FDIC claims because the exclusion's phrase "on behalf of" was ambiguous when applied to the FDIC. *See* No. SACV 13-0424 AG (RNBx), 2014 WL 5369400, at *3 (C.D. Cal. Oct. 8, 2014). *But see* *BancInsure, Inc. v. McCaffree*, 3 F. Supp. 3d 904, 912-13 (D. Kan. 2014) (holding IvI exclusion unambiguous, not negated by regulatory exclusion, and bars coverage of FDIC claims), *aff'd*, *BancInsure, Inc. v. FDIC*, Nos. 14-3063, 14-3064, 2015 U.S. App. LEXIS 13764, at *1 (10th Cir. Aug. 6, 2015). In *Hahn*, the court rejected the insurer's reasoning for applying the exclusion that the FDIC "stands in the shoes" of the failed bank when it acts as receiver. 2014 WL 5369400, at *3. The insurer relied primarily on a U.S. Supreme Court case, *O'Melveny & Myers v. FDIC*, where the Court said the FDIC, as receiver, "steps into the shoes" of the failed bank. *See id.* at *4; *see also* *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 86 (1994). *Hahn*, however, interpreted *O'Melveny* to not require the court to apply the IvI exclusion because *O'Melveny* did not address whether "on behalf of" means the same thing as "steps into the shoes," or whether FDIC, who represents a number of interests, even steps into the shoes of the bank for these particular claims. 2014 WL 5369400, at *4. Recently, *St. Paul Mercury Ins. Co. v. FDIC* joined the majority and will not apply the IvI exclusion, finding the exclusion ambiguous as it applies to the FDIC. *See* *St. Paul Mercury Ins. Co. v. FDIC*, 774 F.3d 702, 710 (11th Cir. 2014) (ruling courts' varying interpretations of identical or similar policy language key indicator of ambiguity); *see also* *Progressive Cas. Ins. Co. v. FDIC*, 926 F. Supp. 2d 1337, 1340 (N.D. Ga. 2013) (declaring ambiguity exists when courts reach opposite conclusion with similar exclusion).

133. *See* 2014 U.S. Dist. LEXIS 153643, at *8 (holding phrase "on behalf of" ambiguous when applied to FDIC).

134. *See id.* at *9-10 (suggesting insurer in best position to prevent ambiguities and therefore must bear risk in ambiguity).

135. *See* *W. Holding Co. v. AIG Ins. Co.*, 748 F.3d 377, 386 (1st Cir. 2014) (construing ambiguities in insured's favor). *W. Holding* was an appeal by the insurer, Chartis, from an order requiring Chartis to advance

failed bank's depositors and account holders, and the court concluded that this made it "likely possible—even if only remotely so—that the FDIC is suing on these non-insureds' behalf," a standard imposed by Puerto Rico Law.¹³⁶ Additionally, in *St. Paul Mercury Insurance Co. v. FDIC*, the United States Court of Appeals for the Eleventh Circuit aligned itself with the First Circuit in ruling for the FDIC based on policy ambiguity.¹³⁷

defense costs to Westernbank's former directors after the FDIC sued the directors. *See id.* at 379. An FDIC investigation found certain bank directors had breached their fiduciary duties. *See id.* It demanded Westernbank's directors pay \$367 million for the loss their breaches allegedly caused the bank. *See id.* Chartis claimed it was not obligated to cover the defense costs based on the following arguments: the policy only obliges Chartis to advance the costs of defending against covered claims; the policy's IvI exclusion bars coverage for claims "brought . . . on behalf of or in the right of" Westernbank; there would not have been coverage if Westernbank had sued its directors, as the FDIC has here, because that would activate the IvI exclusion; the FDIC, having stepped into the shoes of Westernbank as its receiver, is suing the directors "on behalf of or in the right of" Westernbank; and there is not a remote possibility of a covered claim, thus there is no duty to advance defense costs. *Id.* at 384-85.

136. *See id.* at 384-85. The court differentiated cases that applied the IvI exclusion to FDIC claims, stating in those cases, the FDIC either did not sue any bank directors, or chose not to assert any claims on behalf of non-insureds. *See id.* at 385-86. In noting the existing "battle of dueling case[]law," the court resolves any doubts in the insured's favor. *Id.* at 386. Puerto Rico "only requires a mere likelihood of a remote possibility of coverage" before an insurer must advance defense costs. *Id.* at 385. Therefore, there was enough for the court to require Chartis to advance defense costs to Westernbank. *See id.* at 386. Despite mandating the advancement of defense costs, the court cautioned the parties that it was not over yet, stating, "[H]aving lost the likelihood-of-success skirmish, Chartis may still 'win' the coverage 'war at a succeeding trial on the merits.'" *Id.* at 386 (quoting *Narragansett Indian Tribe v. Guilbert*, 934 F.2d 4, 6 (1st Cir. 1991)) (separating likelihood of success from success).

137. *See St. Paul Mercury*, 774 F.3d at 702 (finding application of IvI exclusion to FDIC ambiguous). *St. Paul Mercury* is an appeal from *St. Paul Mercury Ins. Co. v. Miller*, where the United States District Court for the Northern District of Georgia applied the IvI exclusion to FDIC-launched claims. *See St. Paul Mercury Ins. Co. v. Miller*, 968 F. Supp. 2d 1236, 1242 (N.D. Ga. 2013) (finding exclusion applies because language unambiguous as applied to FDIC). In *Miller*, the IvI exclusion purported to bar coverage for claims "brought or maintained by or on behalf of any Insured . . . in any capacity." *Id.* at 1240. The *Miller* court found the exclusion unambiguous because pursuant to FIRREA, the FDIC succeeds to "all rights, titles, powers, and privileges of the insured depository institution." 12 U.S.C. § 1821 (d)(2)(A)(i); *see also Miller*, 968 F. Supp. 2d at 1242. Therefore, in acting as receiver for the failed bank, the FDIC steps in the shoes of the failed bank and obtains its rights that existed prior to receivership. *Miller*, 968 F. Supp. 2d at 1242 (citing *O'Melveny*, 512 U.S. at 86). *Miller* was part of a trio of cases where the same Georgia federal court reached different results. *See* 968 F. Supp. 2d at 1242 (applying exclusion and precluding coverage); *Davis v. BancInsure, Inc.*, No. 3:12-cv-113-TCB, 2013 U.S. Dist. LEXIS 46249, at *39 (N.D. Ga. Mar. 20, 2013) (concluding IvI exclusion precludes FDIC from coverage); *Progressive Cas. Ins. Co.*, 926 F. Supp. 2d at 1339 (holding IvI exclusion's applicability to FDIC ambiguous); *see also Hanekamp & Formeller, supra note 7* (commenting on difficulty predicting outcome in any particular case evidenced by "Georgia Trilogy"). With *St. Paul Mercury's* reversal of *Miller*, Georgia signaled the trend of courts refusing to apply the IvI exclusion to the FDIC. 774 F. 3d at 710-11. The case originated when *St. Paul Mercury* filed the action in response to a separate federal lawsuit, which the FDIC brought as receiver for Community Bank & Trust against Charles M. Miller and Trent D. Fricks, former bank officers. *See id.* at 703. In the underlying action, the FDIC sued the defendants, seeking to recover losses caused by the officers' gross negligence and breaches of fiduciary duty related to the bank's home funding loan program. *See id.* at 703-04. The Eleventh Circuit reviewed the lower court's decision de novo, addressing whether claims the FDIC brought as receiver for a closed bank against former bank directors are covered when the D&O policy excludes from coverage actions brought "by or on behalf of" any "Insured" or the "Company." *Id.* at 706. The IvI exclusion at issue in *St. Paul Mercury* stated the insurer is not liable "for Loss (including Defense Costs) on account of any Claim made against Any Insured," but did not expressly

Yet, in contrast to the prevailing view, a federal district court from Kansas held in *BancInsure v. McCaffree* that the insurer owed no duty of coverage under the D&O policy for claims asserted by the FDIC against the insured bank and its directors.¹³⁸ The FDIC and defendant directors argued that because the FDIC's claims against the directors were not collusive in nature, the court should not apply the exclusion in this case.¹³⁹ The *McCaffree* court reasoned that the purpose of the IvI exclusion was not relevant; the policy's language allowed the IvI exclusion and regulatory exclusion endorsement to coexist, and because the IvI exclusion expressly applied to receivers, the exclusion's plain language unambiguously barred coverage for FDIC claims.¹⁴⁰ The Tenth Circuit recently affirmed this decision in *BancInsure, Inc. v. FDIC*.¹⁴¹

In light of the inconsistencies throughout the country as to the IvI exclusion's application, bank directors and prospects are left with uncertainty and concern for their own coverage.¹⁴² Even in cases where the risk of paying

refer to the FDIC. *Id.* at 704. The FDIC argued St. Paul Mercury's failure to expressly refer to the FDIC in the exclusion and defined terms makes the exclusion inapplicable. *See id.* at 706. As the bank's receiver, the FDIC argued it does not just step into the shoes of the failed bank; rather, it "steps into a number of pairs of different shoes" because it sues to recover not only its own losses, but also those of depositors and other creditors. *Id.* at 707. The court concluded the policy is ambiguous. *Id.* Ultimately, the court based its finding of ambiguity on the fact that several courts that addressed similarly worded exclusions reached different results. *See id.* at 709-11. The fact that courts have interpreted similarly worded IvI exclusions in different manners is evidence that they are ambiguous when applied to the FDIC. *See id.*; *see also Progressive Cas. Ins. Co.*, 926 F. Supp. 2d at 1340.

138. *See BancInsure, Inc. v. McCaffree*, 3 F. Supp. 3d 904, 912-13 (D. Kan. 2014) (holding IvI exclusion unambiguous, not negated by regulatory exclusion, and bars coverage of FDIC claims), *aff'd*, *BancInsure, Inc. v. FDIC*, No. 14-3063, No. 14-3064, 2015 U.S. App. LEXIS 13764, at *31 (10th Cir. Aug. 6, 2015); *see also Panel: No Coverage for Bank Receiver's Claims Against Bank's Directors*, 27-4 MEALEY'S LITIG. REP. INS. INSOLV. 10 (2015) (reporting Tenth Circuit affirmed district court decision). In *McCaffree*, BancInsure issued a D&O policy to Columbian Bank and Trust Company, but the bank was later declared insolvent, and the FDIC was appointed as its receiver. 3 F. Supp. 3d at 907. The FDIC subsequently filed suit against former Columbian directors in an underlying D&O action called *FDIC v. McCaffree*. *See id.* The FDIC alleged that the defendants had breached their fiduciary duties and acted negligently in originating and approving risky commercial real estate loans and failing to properly supervise bank-lending functions. *See id.* BancInsure filed the action against the insured directors, arguing the IvI barred coverage of the FDIC claims against the individual defendants. *See id.* at 909.

139. *See McCaffree*, 3 F. Supp. 3d at 910-11 (rejecting defendants' argument).

140. *See id.* at 909-14 (reasoning IvI may preclude coverage of FDIC claims without rendering regulatory endorsement meaningless). "The 'insured v. insured' exclusion specifically applies to claims brought by a receiver, and here, the FDIC clearly asserted claims against the insured officers and directors in its capacity as receiver." *Id.* at 912. The regulatory exclusion endorsement, however, applied only to the regulatory exclusion and provided coverage for some FDIC and other agencies' regulatory actions. *See id.* Finally, because the policy expressly provided that the IvI exclusion applied to receivers, the exclusion's plain language unambiguously barred coverage for FDIC claims. *See id.* at 912-14. While the majority view requires coverage for FDIC claims, even when the FDIC steps into the shoes of a failed bank, the *McCaffree* court distinguished the cases constituting the majority view because those policies did not expressly state that the IvI exclusion applied to receivers. *See id.* at 913-14.

141. *See BancInsure*, 2015 U.S. App. LEXIS 13764, at *10-11 (finding plain language of IvI exclusion unambiguously bars coverage even considering other policy provisions).

142. *See Cumming*, *supra* note 1; *Sousa*, *supra* note 15, at 404; *see also May*, *supra* note 27, at 2 (concluding resolution "may have to wait for another day").

out-of-pocket damages is low, directors are still in fear.¹⁴³ These fears can have an impact on the quality of bank board members.¹⁴⁴ It is therefore vital to adopt an altered approach that provides clarity and a more uniform outcome to the IvI's application.¹⁴⁵

III. ANALYSIS

Although the majority of courts have held that the IvI exclusion is inapplicable to claims brought by the FDIC against a failed bank's directors, the prevailing view's rationale is weak.¹⁴⁶ These courts often based the IvI exclusion's inapplicability on a finding that the provision's language was somehow ambiguous and that ambiguities should be construed against the insurer.¹⁴⁷ While the manner used to address ambiguities is appropriate, courts' preliminary determination of ambiguity is oftentimes incorrect.¹⁴⁸ The court

143. See *Cumming*, *supra* note 1 (recognizing fear disproportionate to actual risk). Transparency issues have elevated bank directors' concerns. See *id.* Until recently, much of the information needed to assess risk, such as documentation of the FDIC's post-crisis settlements, was unavailable. *Id.* The FDIC did not post settlements with failed banks stemming from the 2008 Financial Crisis online until 2013. *Id.* This was, however, only after a *Los Angeles Times* report criticized the FDIC for failing to make many settlements public. See *id.* Still, the FDIC is often unaware of the source of its payment because defendants and insurers decline to provide the data. See *id.* "It is impossible, given such limitations, to do more than estimate how much directors and officers have had to pay out-of-pocket in those settlements." *Id.* Another obstacle to transparency is the FDIC's inadequate disclosure of its role in the D&O debacle. See *Adler*, *supra* note 102 (cautioning FDIC self-interested in D&O policies). For example, the FDIC issued an advisory statement in which it warned institutions to be on notice for potential holes in their D&O policy. See *id.* The letter, however, failed to mention the FDIC's litigation authority, or that a gap in coverage would complicate the FDIC's efforts to recoup losses from the bank's failure. See *id.*; see also *supra* note 23.

144. See *Adler*, *supra* note 102 (warning faulty D&O policy means incapable directors at banks); see also *supra* note 19 and accompanying text (quantifying consequences of directors' fears of liability).

145. See *Sousa*, *supra* note 15, at 404 (advocating framework necessary to provide more uniform application of IvI exclusion). Of course, the IvI exclusion's application depends on the unique facts of a given case and the language used in the D&O policy and IvI exclusion. See *id.* Still, an altered approach can help provide consistency. See *id.*

146. See, e.g., *St. Paul Mercury Ins. Co. v. FDIC*, 774 F.3d 702, 706, 708 (11th Cir. 2014); *W. Holding Co. v. AIG Ins. Co.*, 748 F.3d 377, 380-81 (1st Cir. 2014); *St. Paul Mercury Ins. Co. v. Hahn*, No. SACV 13-0424 AG (RNBx), 2014 WL 5369400, at *8 (C.D. Cal. 2014); *Progressive Cas. Ins. Co. v. FDIC*, 926 F. Supp. 2d 1337, 1339-40 (N.D. Ga. 2013); *FDIC v. Zaborac*, 773 F. Supp. 137, 143-44 (C.D. Ill. 1991); *Finci v. Am. Cas. Co.*, 593 A.2d 1069, 1080-81 (Md. 1991); *Fid. & Deposit Co. v. Zandstra*, 756 F. Supp. 429, 433-34 (N.D. Cal. 1990).

147. See, e.g., *St. Paul Mercury*, 774 F.3d at 709 (finding differing court opinions on similar language grounds for ambiguity); *W. Holding*, 748 F.3d at 384-85 (resolving ambiguity in insured's favor); *Hahn*, 2014 WL 5369400, at *8 (holding IvI exclusion inapplicable because "on behalf of" language ambiguous when applied to FDIC); *Progressive*, 926 F. Supp. 2d at 1339 (finding ambiguity exists when opposite conclusions on similar exclusion reasonable); *Finci*, 593 A.2d at 1081-82 (classifying policy language as ambiguous, and thus IvI exclusion inapplicable); *Zandstra*, 756 F. Supp. at 433 (using omission of term FDIC as basis for ambiguity).

148. See *W. Holding*, 748 F.3d at 386 (following "obligation to resolve any doubts . . . in insured's favor"); see also *St. Paul Mercury*, 774 F.3d at 709 (explaining insurer's affirmative expression of coverage justifies assumption of duty to clearly define coverage limitations). The *St. Paul Mercury* court recommended a low threshold for establishing ambiguity in an insurance policy, tilting the scale in favor of the FDIC and the

should find most IvI exclusion provisions unambiguous when applied to the FDIC as receiver, and only in the rare circumstances where ambiguity exists should courts construe it against the insurer.¹⁴⁹ In the long term, this approach could help avoid the cat and mouse game occurring between the parties to this debate.¹⁵⁰

The primary reason why the IvI exclusion should apply to claims the FDIC brings against a failed bank's directors is that the FDIC, as receiver, takes the place of the failed bank, triggering the exclusion.¹⁵¹ It is logical that claims that are not covered under the policy, if asserted by the failed bank, are also not covered when asserted on behalf of the failed bank by its receiver.¹⁵² The validity of this argument is rooted in FIRREA, which lists the powers and duties of the FDIC as receiver of the failed bank.¹⁵³ Pursuant to Section 1821 (d)(2)(B), the FDIC has the power to operate the institution and to "perform all functions of the institution in the name of the institution," which are consistent with its role as receiver.¹⁵⁴ The statute indicates that, as receiver, the FDIC

insured. *See* 774 F.3d at 709.

149. *Cf.* *Mt. Hawley Ins. Co. v. FSLIC*, 695 F. Supp. 469, 482-83 (C.D. Cal. 1987) (rejecting defendants' argument claiming failure to include agency by name ambiguous). While ambiguity in an insurance policy is resolved against the insurer, in order to be ambiguous, the language must be reasonably susceptible to more than one interpretation. *See id.* at 483; *see also McCaffree*, 3 F. Supp. 3d at 913 (explaining finding of ambiguity depends on natural and reasonable interpretation of language), *aff'd*, *BancInsure, Inc.*, 2015 U.S. App. LEXIS 13764.

150. *See* Adler, *supra* note 102 (presenting circularity in IvI debate because insurers' exclusions respond to aggressive FDIC lawsuits). Interestingly, the FDIC's rampant lawsuits are tied to insurers' rush to employ exclusions, directors' hesitation in serving, and banks' difficulty in attaining qualified directors. *See id.*; *see also* Cumming, *supra* note 1. These events could lead to unqualified directors making the poor decisions that cause bank failures in the first place and require FDIC receiverships that result in lawsuits. *Cf.* Cumming, *supra* note 1 (connecting FDIC lawsuits to bank board quality).

151. *See McCaffree*, 3 F. Supp. 3d at 910, 914 (holding IvI exclusion facially expressly defeats coverage of FDIC claims), *aff'd*, *BancInsure, Inc.*, 2015 U.S. App. LEXIS 13764, at *1-2; *Evanston Ins. Co. v. FDIC*, CV 88-0-0407 WDK (Bx), 1988 U.S. Dist. LEXIS 16263, at *1-2 (C.D. Cal. 1988) (reasoning FDIC making claim "by or in the right of" bank); *Mt. Hawley*, 695 F. Supp. at 482-83 (concluding agency "stands in shoes" of failed bank in bringing underlying suit). Furthermore, the FDIC has admitted that, as receiver, it has "all the rights and claims that the failed bank would have." *Gary v. Am. Cas. Co.*, 753 F. Supp. 1547, 1552 (W.D. Okla. 1990) (addressing FDIC's argument "strong public policy" exists for FDIC to have all bank's rights and claims). If the FDIC is willing to take this position in court, it falls squarely within the IvI exclusion. *Cf. id.* at 1554 (citing *Mt. Hawley*, 695 F. Supp. at 481).

152. *Mt. Hawley*, 695 F. Supp. at 481. It is generally not important whether or not the D&O policy has a regulatory exclusion. *See id.* at 482-83; *see also McCaffree*, 3 F. Supp. 3d at 913-14 (holding removal of regulatory exclusion has no impact on application of IvI exclusion), *aff'd*, *BancInsure*, 2015 U.S. App. LEXIS 13764.

153. *See* FIRREA, 18 U.S.C. § 1821 (d)(2)(A)(i) (2012). As receiver, the FDIC is successor to the bank and possesses "all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution." *Id.*

154. 18 U.S.C. § 1821 (d)(2)(B) (2012). The FDIC may "take over the assets of and operate the insured depository institution with all the powers of the members or shareholders, the directors, and the officers of the institution and conduct all business of the institution." § 1821 (d)(2)(B)(i).

takes the place of the failed bank and stands in its shoes.¹⁵⁵ As a result, the FDIC is an insured, triggering the IvI exclusion under the typical D&O policy.¹⁵⁶

Even if the FDIC brings claims on the behalf of others, such as depositors or shareholders of the institution or the FDIC as a creditor, the FDIC is, nevertheless, unambiguously operating as receiver pursuant to 18 U.S.C. § 1821 (d)(2)(A)-(B).¹⁵⁷ The word *shall* in 18 U.S.C. § 1821 (d)(2)(A) indicates that the beneficiary of D&O policy proceeds is immaterial.¹⁵⁸ Regardless of who the FDIC acts on behalf of, as long as it acts as receiver, the FDIC has, at a minimum, succeeded to the rights of the insured depository institution, and it therefore triggers the exclusion.¹⁵⁹ Thus, in cases like *W. Holding, St. Paul Mercury, Hahn, Zaborac, and Zandstra*, where the courts said the FDIC was acting in multiple capacities, the courts still should have found that the FDIC “stood in the failed bank’s shoes.”¹⁶⁰ This idea was rightly pronounced in *Gary*, which deemed it irrelevant who ultimately benefits from the policy proceeds.¹⁶¹ Either way, the FDIC is only able to assert such claims because it succeeded to the failed bank’s rights and assets, thus the IvI exclusion unambiguously applies to the FDIC.¹⁶²

155. *See id.* at (d)(2)(B)(iii). Thus, the FDIC acts in the name of the institution when it serves as receiver. *See id.*

156. *See Evanston*, 1988 U.S. Dist. LEXIS 16263, at *1 (providing example of typical IvI exclusion). The exclusion in *Evanston* applied to any claim made against defendant insureds “by or in the right of” the insured bank. *See id.*

157. *See* 18 U.S.C. § 1821 (d)(2)(A)-(B) (2012).

158. *See* 18 U.S.C. § 1821 (d)(2)(A) (2012). “The [FDIC] *shall*, as conservator or receiver, and by operation of law” *Id.*; *see Gary v. Am. Cas. Co.*, 753 F. Supp. 1547, 1555 (W.D. Okla. 1990) (rejecting argument claims not brought merely as successor, but for benefit of depositors and creditors).

159. *See* § 1821 (d)(2)(A); *Gary*, 753 F. Supp. at 1555. *Gary* effectively elaborated on this point when it addressed the FDIC’s argument that its claims were not brought merely in the capacity of successor to a failed bank, but for the benefit of various other stakeholders. *See* 753 F. Supp. at 1555. The *Gary* court discredited this argument because the FDIC is the assignee of the failed bank, so the FDIC’s asserted claims are just the claims of that failed institution. *See id.* Thus, it did not matter who benefited from the claims asserted. *See id.*

160. *See St. Paul Mercury Ins. Co. v. FDIC*, 774 F.3d 702, 707 (11th Cir. 2014); *W. Holding Co. v. AIG Ins. Co.*, 748 F.3d 377, 385 (1st Cir. 2014); *FDIC v. Zaborac*, 773 F. Supp. 137, 143-44 (C.D. Ill. 1991) (concluding FDIC does not merely stand in shoes of party under which assumed lawsuit); *Fid. & Deposit Co. v. Zandstra*, 756 F. Supp. 429, 432 (N.D. Cal. 1990) (reiterating multiple roles of FDIC as receiver). Although the *Zaborac* court should have applied the IvI exclusion to the FDIC, it was correct in rejecting *Zandstra*’s conclusion that the IvI only applies to collusive lawsuits. *See Zaborac*, 773 F. Supp. at 143. *Zaborac* rightly held the noncollusive purpose of a lawsuit alone is not enough to treat a party differently under the plain language of the exclusion. *See id.*

161. *See* 753 F. Supp. at 1555. It does not matter who indirectly or ultimately benefits from the recovery on a D&O policy by the FDIC because the FDIC’s claims are those of the “financial institution, which [it] acquired after failure of such financial institution by succession or purchase and are thus asserted in the capacity of assignee of the failed financial institution.” *Id.* Moreover, a noninsured—such as a creditor of a failed bank who claimed a director’s wrongful act harmed him—could pursue his own claim against the director and recover from the insurer. *Id.* The FDIC, however, can only assert the claim because it succeeds to the rights and assets of the bank. *See id.*

162. *See id.*

Additionally, of the courts that did not uphold the IvI exclusion against the FDIC, some found the exclusion ambiguous because other courts addressing similar exclusions had ruled differently.¹⁶³ In *Zandstra*, for example, the court viewed the existence of varying conclusions regarding similar provisions as evidence of ambiguity.¹⁶⁴ At first glance, this seems like a logical argument: if two courts could look at the same provision and decide differently, then the provision is indeed susceptible to two or more reasonable constructions.¹⁶⁵

This is not as foolproof as it seems.¹⁶⁶ First, a comparison of *similar* provisions—rather than provisions worded exactly the same—is too low of a standard.¹⁶⁷ It begs the question of what degree of similarity suffices so that different interpretations are viewed as evidence that the provision at issue is ambiguous.¹⁶⁸ The unique facts of each situation further weaken the logic of the comparison standard.¹⁶⁹ Factual differences could cause cases with the exact same wording in their respective IvI exclusions to result in different conclusions; saying the same thing in two different contexts could naturally lead to different results.¹⁷⁰

Second, there are interesting consequences to this ambiguity argument: if an IvI exclusion is ambiguous just because other courts have reached different conclusions on similar provisions, then the courts that had found the provision unambiguous are automatically wrong.¹⁷¹ The existence of courts that arrive at opposite conclusions would, in itself, indicate ambiguity and prevent the courts

163. See *St. Paul Mercury*, 774 F.3d at 710 (interpreting exclusion as ambiguous because no unanimity in Georgia); *Zandstra*, 756 F. Supp. at 433-34 (reasoning other courts reaching varying conclusions on similar IvI exclusions evidences ambiguity).

164. See 756 F. Supp. at 433-34 (declaring policy provision ambiguous when reasonably susceptible to two or more constructions).

165. See *St. Paul Mercury*, 774 F.3d at 709; *Zandstra*, 756 F. Supp. at 434.

166. Cf. *Nat'l Union Fire Ins. Co. v. Seafirst Corp.*, 1986 U.S. Dist. LEXIS 28065, *13-14 (W.D. Wash. Mar. 18, 1986) (requiring preliminary review of policy language according to plain meaning before determining ambiguity). A court should not hunt for ambiguity when a policy's language "clearly points to only one reasonable interpretation." *Id.* at *14.

167. See Hanekamp & Formeller, *supra* note 7 (declaring "precise language in . . . particular exclusion cannot be overemphasized"); see also Sousa, *supra* note 15, at 404 (noting applicability of IvI exclusion in particular case depends on specific language of policy). The insertion of just one word can change the outcome of a case. See *Fid. & Deposit Co. v. Zandstra*, 756 F. Supp. 429, 433 (N.D. Cal. 1990) (examining particular words used in IvI exclusion at issue). In *Zandstra*, for example, the court explained that the exclusion's omission of language indicating an intent to include the banks' successors within the exclusion makes the exclusion ambiguous. See *id.* Likewise, in *Zaborac*, the court noted the failure to include the term "FDIC" contributed to the IvI exclusion's inapplicability to the FDIC. See *FDIC v. Zaborac*, 773 F. Supp. 137, 143 (C.D. Ill. 1991).

168. Cf. *Zaborac*, 773 F. Supp. at 143 (disagreeing with *Zandstra's* holding regarding similarly worded exclusion).

169. See Sousa, *supra* note 15, at 404 (acknowledging unique facts of circumstance impacts applicability of IvI exclusion).

170. See *id.*

171. Cf. *Zandstra*, 756 F. Supp. at 434 (using division of judicial opinion as evidence of exclusion's ambiguity).

from concluding the provision in question was unambiguous in the first place.¹⁷² Following that line of reasoning, every court would have to conclude the provision was ambiguous.¹⁷³

If, however, the court still finds that ambiguity exists using this corrected view, it should construe the ambiguity against the insurer.¹⁷⁴ This rule advances the purpose of D&O policies—to protect directors and the corporation (which must indemnify its directors) from losses arising out of claims made against them.¹⁷⁵ Since insurers are the creators of D&O policies and their limitations, exceptions, and exclusions, insurers undertake the duty to define any limitations clearly and unequivocally.¹⁷⁶ The insurer is the *least cost avoider*, meaning it is in the best position to resolve ambiguities beforehand.¹⁷⁷

A more frequent application of the IvI exclusion provision to FDIC claims against a failed bank, enables insureds, insurers, and bank depositors to benefit in the long run.¹⁷⁸ As demonstrated during the D&O crisis, when coverage requirements expand, insurers search for other ways to reduce coverage.¹⁷⁹ Thus, if courts do not apply the IvI exclusion to the FDIC's claims, insurers will create new exclusions to counteract courts' decisions.¹⁸⁰ Insurers may even raise the price of D&O policies in order to recoup the costs of increased payouts.¹⁸¹

If D&O policies become more expensive than ever before, or if costs go up to remove insurers' newly-created exclusions, banks may be forced to purchase less comprehensive D&O policies or forego them altogether.¹⁸² Directors'

172. Compare *Zandstra*, 756 F. Supp. at 429, with *Gary v. Am. Cas. Co.*, 753 F. Supp. 1547 (W.D. Okla. 1990).

173. Cf. *BancInsure v. McCaffree*, 3 F. Supp. 3d 904, 906 (D. Kan. 2014) (applying IvI exclusion to FDIC), *aff'd*, *BancInsure, Inc. v. FDIC*, No. 14-3063, No. 14-3064, 2015 U.S. App. LEXIS 13764 (10th Cir. Kan., Aug. 6, 2015).

174. See *St. Paul Mercury Ins. Co. v. FDIC*, 774 F.3d 702, 710 (11th Cir. 2014); *W. Holding Co. v. AIG Ins. Co.*, 748 F.3d 377, 386 (1st Cir. 2014) (carrying out obligation to resolve doubts in insured's favor); *Mt. Hawley Ins. Co. v. FSLIC*, 695 F. Supp. 469, 484 (C.D. Cal. 1987).

175. See *Mt. Hawley*, 695 F. Supp. at 484. In other words, these policies seek to protect directors from the costs of defending against claims commonly arising from the performance of their duties. See *id.*

176. See *St. Paul Mercury*, 774 F.3d at 710-11. "[T]he insurer, having affirmatively expressed coverage through broad premises assumes a duty to define any limitations on that coverage in clear and explicit terms." *Id.* at 709

177. See *St. Paul Mercury Ins. Co. v. Hahn*, No. SACV 13-0424 AG (RNBx), 2014 WL 5369400, at *3 (C.D. Cal. 2014) (stating insurer's failure to clearly apply IvI exclusion to FDIC prevents insurer from benefitting later).

178. Cf. *Adler*, *supra* note 102 (explaining some banks consider not purchasing D&O policies).

179. See *Romano*, *supra* note 70, at 1 (listing consequences of D&O crisis, including coverage reduction).

180. See *Rosenberg et al.*, *supra* note 128 (providing examples of various exclusions used to defeat coverage).

181. See *Romano*, *supra* note 70, at 6 (pegging increase in claims filed against directors as primary impetus for skyrocketing premiums).

182. See *Adler*, *supra* note 102 (recognizing banks conduct cost-versus-benefit analysis to determine level of insurance to purchase). Banks often consider that they may pay a substantial amount to purchase insurance

concerns about exposure to liability would grow, and their willingness to serve on bank boards would decrease.¹⁸³ It would become more difficult for banks to secure capable directors, thereby increasing the likelihood of bank failures and losses to depositors.¹⁸⁴ The FDIC considers the breadth of a failed bank's D&O policy and the proceeds that the FDIC could potentially collect in deciding whether or not to pursue claims against the bank's directors.¹⁸⁵ Thus, part of the solution lies in discouraging the FDIC from excessively filing lawsuits.¹⁸⁶ By applying IvI exclusions to FDIC claims, the FDIC's potential recovery would diminish, creating an effective disincentive to frequent lawsuits.¹⁸⁷

IV. CONCLUSION

While the IvI exclusion to D&O policies may have been a sound response to cases like *Seafirst*—to prevent coverage of collusive lawsuits—the need to prevent future collusion is shrinking in importance. When a government agency, like the FDIC, brings the lawsuit, the risk for collusion remains low. After all, the FDIC is an independent federal agency, establishing its claims as legitimate in that the FDIC has crucial, arms-length perspective when evaluating a failed bank's directors.

Even though one might argue that federal budgetary constraints continue to squeeze the economy today, and the FDIC has strangely not felt the belt-tightening effects, the agency's existence, no matter the state of the U.S. economy, is crucial. An overview of U.S. economic history shows that a lack of regulation is catastrophic. What happens, however, when the FDIC starts to go too far? When the agency begins to overstep its bounds and infringe on private enterprise? One answer is for courts to be less willing to find ambiguity when determining the applicability of the IvI exclusion to the FDIC as receiver. Through judicial action, courts can encourage the federal agency to rein it in.

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with certain exclusions removed yet the bank ends up ultimately not needing the insurance at all. *See id.* (discussing directors' reluctance to serve on bank boards for fear of personal liability).

183. *See supra* notes 17-19 and accompanying text.

184. *See Adler, supra* note 102 (emphasizing safety interest in good D&O policy).

185. *See supra* notes 21-23 and accompanying text (discussing consideration of D&O policy proceeds).

186. *See Adler, supra* note 102 (unveiling FDIC self-interest in lawsuits). The FDIC wants bank directors to have as much D&O as they can without exclusions, in part because of the FDIC's interest in policy proceeds. *See id.* Observers have argued that the consistent flow of FDIC lawsuits against bank directors has influenced the amount of insurance carriers provide. *See id.* In fact, David Baris, executive director of the AABD reflected, "There is a certain irony to this. Part of the reason, and it may be a large part, that some of the insurance carriers are balking at providing the regulatory coverage has to do with the fact that the FDIC has been aggressive in suing directors of failed banks." *Id.*

187. *Cf. Adler, supra* note 102.