

Georgia Bankruptcy Court: FDIC May Sue Officer of Failed Bank, Notwithstanding His Bankruptcy, If Defense and Recovery Limited to D&O Insurance

September 2012

A federal bankruptcy court in Georgia has held that notwithstanding the discharge of an individual in his individual bankruptcy proceeding, the Federal Deposit Insurance Corporation (FDIC) may file suit against the individual as a former officer of a failed bank so long as the applicable D&O policy covers defense costs and the FDIC's recovery is limited to insurance proceeds. *In re Hayden*, 2012 WL 3597422 (Bankr. N.D. Ga. July 6, 2012).

The relevant insurance policy included a duty to defend the insured persons for bankers professional liability claims. The policy also provided indemnity coverage in relevant part for Loss "which the Insured Persons become legally obligated to pay on account of any Claim" In addition, the policy specified that it "shall afford coverage for Claims for the Wrongful Acts of Insured Persons made against the estates, heirs, legal representatives, or assigns of Insured Persons who are incompetent, insolvent or bankrupt to the extent that in the absence of such death, incompetence, insolvency or bankruptcy, such Claims would have been covered by this Policy."

The court reasoned that an individual discharged in bankruptcy may still be named as a nominal defendant in a suit against a third party if his presence in the suit is necessary to establish liability, he bears none of the expense of the defense of the suit and the plaintiff may not collect any judgment from the discharged individual or his assets. The court found that all three factors were met with respect to the FDIC's proposed suit.

The discharged individual argued that because he had been discharged in bankruptcy, he could never be "legally obligated to pay" any judgment, such that the FDIC's proposed suit would not seek covered Loss. The court rejected that argument, holding that the bankruptcy discharge "does not eliminate the debtor's legal obligation for the debt," but "simply enjoins collection activity if that collection activity is targeted at the Debtor, the Debtor's property, or property of the Debtor's bankruptcy estate." The court also noted in a footnote that the policy language regarding coverage for bankruptcy estates suggested that the parties

intended the “legally obligated to pay” language to include liability discharged in bankruptcy.

Accordingly, the court entered an order stating that the FDIC was permitted to file suit against the individual to seek insurance policy proceeds so long as any judgment was not collectible from the individual.