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NEWSLETTER

Insurer Properly Denied Coverage to Bank Directors Who Were Not Indicted "Soley" in Capacity As Directors

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In an unreported decision, a federal magistrate judge, applying Arkansas law, has held that a D&O insurer properly denied a defense to two bank directors who were indicted for various acts of self-dealing because the indictment involved allegations of misconduct that were not in their capacity as directors. *McAninch v. Kansas Bankers Sur. Co.*, 2005 WL 1244981 (W.D. Mo. May 25, 2005).

The plaintiffs in the coverage action were directors of an Arkansas-based bank to which the insurer issued a D&O policy for a one-year period spanning October 2000 to October 2001. In September 2001, the bank was closed by the Office of the Comptroller of the Currency.

The directors were subsequently indicted in September 2003, along with a co-conspirator who was not a director, for conspiracy, making false statements, illegal participation in the misapplication of bank funds and bank fraud. The insurer disclaimed coverage, citing to a policy exclusion barring coverage for any claim "by any State or Federal official or agency."

In December 2003, the first director died. In August 2004, the second director was acquitted on five counts charged in the indictment, but was convicted of conspiring to file a false statement and filing a false statement in connection with her application for a change in control of the subject bank.

The court awarded summary judgment to the insurer as to all the claims in a decision that turned on the use of the term "solely" in the insuring agreement and the definition of "wrongful act." The insuring agreement of the policy provided that each bank director, officer, or employee shall be indemnified "for personal Loss which the Director or Officer or Employee is legally obligated to pay by reason of any Wrongful Act solely in their capacities of Director or Officer or Employee of the Bank which is first Discovered during the Policy Period." The policy defined "Wrongful Act" to mean:

any actual or alleged: (1) error or misstatement; or (2) misleading statement; or (3) act of omission; or (4) breach of duty; or (5) breach of fiduciary duty; or (6) any other act by the Directors or Officers or Employees in the discharge of their duties, individually or collectively, which is claimed against them solely by reason of their being Directors or Officers or Employees of the Bank.

The court concluded that the insurer properly disclaimed coverage because the directors "were not indicted solely because they were directors" of the insured bank. The court reasoned that:

The indictments [against the directors] exist because grand juries in state and federal court found probable cause to believe that [the directors], along with a co-defendant who was not a Bank director, had committed crimes... . The fact that the crimes allegedly took place while [the directors] were directors is irrelevant... . [W]e must ask whether the plaintiffs sustained personal loss which they are legally obligated to pay by reason of an act in the discharge of their duties as directors... . The answer... is no... . The operative fact subjecting plaintiffs to loss in this case is the allegation of criminal conduct, not their status as Bank directors.

One of the directors argued that the term "solely" applied only to the sixth definition of "wrongful act." The court, however, rejected that argument, reasoning that the phrase "solely by reason of their being directors or officers" applied to each of the enumerated acts preceding that clause.

The court also rejected the first director's argument that the insurer waived, or was estopped from, asserting any defense to coverage on the ground that the insurer allegedly "insured over" certain memoranda of understanding (MOU) that the bank filed with federal regulatory agencies prior to the inception of the D&O policy when it previously applied for a crime bond policy. The court noted that the crime bond policy specifically excluded coverage for "any claims arising from the MOU or any facts or circumstances then known to the applicants." The court also explained that, under Arkansas law, the defense of non-coverage is waived "only when the insurer's conduct misleads the insured into believing that coverage exists and the insured takes action in reliance on that misrepresentation." In this case, the director had not even made an allegation that the insurer misrepresented the coverage offered under the D&O policy.

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