

ALERT

Insured v. Insured Exclusion Does Not Preclude Advancement of Defense Costs in Failed Bank Litigation

April 2, 2014

Applying Puerto Rico law, the United States Court of Appeals for the First Circuit has held that an insured v. insured exclusion does not preclude an insurer's obligation to advance defense costs for the former directors and officers of a failed bank in a claim asserted by the Federal Deposit Insurance Corporation (FDIC) as receiver for the bank. *W Holding Co., Inc., et al. v. AIG Ins. Co. – Puerto Rico*, 2014 WL 1280246 (1st Cir. Mar. 31, 2014).

The FDIC, as receiver for a failed Puerto Rican bank, filed an action against the bank's former directors and officers in connection with a pattern of allegedly recklessly underwritten loans. The insurer for the bank and the directors and officers denied coverage and refused to advance costs based on the policy's insured v. insured exclusion, which precludes coverage for claims against an insured "brought by, on behalf of or in the right of, an Organization or any Insured Person." According to the insurer, the FDIC, as receiver for the bank, had stepped into the shoes of the bank and thus was asserting the claim on behalf of or in the right of an insured against other insureds. In response, the directors and officers argued that the insurer had an obligation to advance defense cost because there was a "remote possibility" that the insured vs. insured exclusion did not apply. The directors and officers contended that the exclusion did not, or at minimum might not, apply because the FDIC was also purporting to assert claims on behalf of non-insureds, including the bank's third-party creditors and depositors.

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The district court ruled in favor of the directors and officers and directed the insurer to advance defense costs. The appellate court affirmed, holding that Puerto Rico law requires an insurer to advance defense costs if there is a “remote possibility” of coverage. Here, the court found, there is at least a remote possibility that the FDIC is suing on behalf of depositors and accountholders in addition to the insured bank and thus the insured vs. insured exclusion might not apply. As such, the court held that the insurer had a duty to advance defense costs.