Some Words Are More Equal Than Others: BancInsure V. FDIC

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In George Orwell’s "Animal Farm", the governing principle that “all animals are equal” was revised by the pigs, who had ascended into power, to “all animals are equal, but some animals are more equal than others.” A recent decision by the Tenth Circuit (applying Kansas law), BancInsure Inc. v. Federal Deposit Insurance Corp., appears to apply a similar principle of insurance policy interpretation, finding that the plain meaning of one policy provision may trump the equally plain meaning of another conflicting provision. This is a departure from well settled rules governing how courts interpret insurance policies. Among those rules are that where there is no ambiguity, courts are to apply a provision’s plain and ordinary meaning. However, courts are to read the policy as a whole and cannot interpret one policy provision (even if it is clear) in a way that would render another provision meaningless (because all words in a policy are equal). Where the plain meaning of two or more policy provisions conflict, the policy is ambiguous and the court must adopt a reasonable reading that favors coverage. Instead of employing these rules to resolve an ambiguity in the directors and officers policy at issue, the court in BancInsure gave effect to one provision that excluded coverage, even though doing so required it to disregard another clear provision that would have allowed coverage — effectively deciding that “all words are equal, but some words are more equal than others.”

BancInsure is a failed bank case similar to a class of cases we wrote about earlier this year. As we discussed here, there is a growing consensus among courts finding that the insured versus insured exclusion in D&O policies does not bar coverage for claims brought by a receiver of a failed bank against the bank’s directors and officers. The cases involve a similar fact pattern. After a bank fails (as many did in the wake of the credit crisis), the FDIC is appointed as receiver. The FDIC then brings claims against certain officers and directors of the failed bank alleging mismanagement. When the officers and directors tender their claims to the bank’s D&O insurer, the insurers reflexively deny coverage based on the insured versus insured exclusion — a provision that, as its name suggests, precludes coverage for claims by one insured against another. The provision is intended to protect insurers from covering allegedly collusive suits where a company sues its own officers and directors for alleged poor business decisions in an attempt to recover its losses by tapping the proceeds of its D&O policies. In the failed bank cases, although the FDIC is not an insured, the insurers argue that the insured versus insured exclusion applies because the FDIC has “stepped into the shoes” of the failed bank. Courts increasingly have rejected such arguments and allowed coverage, finding the insured versus insured exclusion to be ambiguous with regard to claims brought by the FDIC.

In BancInsure, the Tenth Circuit appears — at least at first blush — to have bucked this trend, finding in
its Aug. 6, 2015, opinion that the insured versus insured exclusion in Colombian Bank & Trust’s D&O policy excluded coverage for the FDIC’s claim against three of the bank’s former directors. However, a closer inspection of BancInsure reveals that the Tenth Circuit relied on unique language in the particular insured versus insured exclusion at issue, which barred coverage for claims made against an insured person by “a receiver” of the bank. This is the very language that other courts have noted insurers could have included in their policies to clear up the ambiguity but did not. Thus, at least with respect to the Tenth Circuit’s interpretation of the language of the insured versus insured exclusion, BancInsure is not a departure from the trend in policyholders’ favor.

But, as alluded to at the beginning of this post, there is another problem lurking in the Tenth Circuit’s reasoning. The court bases its decision on what it refers to as the “plain meaning” of the insured versus insured exclusion. Yet in doing so, it ignores the plain meaning of another provision that directly contradicts the insured versus insured exclusion. The court recites the familiar rules of policy interpretation — that the primary rule in interpreting an insurance policy is to ascertain the intent of the parties; that in doing so, courts consider the policy as a whole, rather than viewing provisions in isolation; that where policy language is unambiguous, courts apply its plain and ordinary meaning; but where policy language is ambiguous, courts adopt the construction most favorable to the insured. Moreover, the court acknowledges that a policy is ambiguous if it “contains provisions” of “conflicting meaning.” In other words, even if the language of a particular provision is clear, ambiguity is created when another provision conflicts with it.

Against this backdrop, the Tenth Circuit’s decision denying coverage to Colombian Bank & Trust’s former directors is puzzling. The D&O policy originally included a so-called “regulatory exclusion” precluding coverage for any action brought by a regulatory agency or “deposit insurance organization” (i.e., the FDIC), including “any type of legal action which any such agency may bring as receiver.” However, the bank purchased an endorsement which amended the policy by deleting the regulatory exclusion and setting a $5 million sublimit for claims brought by “any federal or state regulatory or supervisory agency or deposit insurance organization.” Thus, the plain language of the endorsement expressly allowed coverage (subject to a sublimit) of claims brought by the FDIC (including “as receiver”), while the insured versus insured exclusion expressly barred claims by “a receiver of the company.” Because these two provisions conflict, the court should have found that the policy was ambiguous and adopted the construction most favorable to the insured. Instead, the court found that the plain language of the insured versus insured exclusion trumped equally clear language in the regulatory coverage endorsement, i.e., that some provisions are more equal than others. But giving effect to the plain language of one provision that excludes coverage when doing so requires a court to ignore the plain language of another provision that allows coverage is precisely the opposite of what the rules of policy interpretation require.

BancInsure serves as another reminder to policyholders to read their policies closely at the time of renewal and understand what they are buying. No doubt Colombian Bank & Trust believed when it purchased an endorsement removing the regulatory exclusion that it was buying coverage for claims by regulatory agencies such as the FDIC. Indeed, the BancInsure marketing materials provided to the bank explained that “there is full coverage for actions by regulatory agencies” under the regulatory endorsement. Nevertheless, a close reading of the policy at the time it was issued could have revealed the conflicting language in the insured versus insured exclusion. Although the rules of policy construction are supposed to resolve such a conflict in the policyholder’s favor, BancInsure highlights the point that it is better to clear up the ambiguity at the time the policy is issued than to hope that a court will clear it up in your favor later.