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UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

**CIVIL MINUTES - GENERAL**

Case No.	SACV 13-0424 AG (RNBx)	Date	October 8, 2014
Title	ST. PAUL MERCURY INS. CO. v. MICHAEL S. HAHN, et al.		

Present: The Honorable ANDREW J. GUILFORD

Lisa Bredahl	Not Present	
Deputy Clerk	Court Reporter / Recorder	Tape No.
Attorneys Present for Plaintiffs:	Attorneys Present for Defendant:	

**Proceedings: [IN CHAMBERS] ORDER CONCERNING CROSS MOTIONS FOR SUMMARY JUDGMENT**

The parties to this case dispute whether an insurance policy issued by Plaintiff St. Paul Mercury Insurance Company (which the parties refer to as “Travelers”) requires Travelers to cover certain expenses of the insured. Travelers and FDIC-R have filed cross motions for summary judgment. (“Travelers’ Motion,” Dkt. No. 39; “FDIC-R’s Motion,” Dkt. No. 106.) FDIC-R’s Motion was joined by the other defendants. Travelers’ Motion is DENIED, And FDIC-R’s Motion is GRANTED.

**BACKGROUND**

In November 2012, FDIC-R sued the Bank’s former directors and officers Michael S. Hahn, Colin M. Forkner, Michael V. Cummings, Richard S. Grinyer, Stanley M. Cruse, and David L. Adams (the “D&Os”) for negligence, gross negligence, and breaches of fiduciary duty. *FDIC as Receiver for Pacific Coast National Bank v. Hahn, et al.*, Case No. 12-cv-1938-AG (C.D. Cal.) (the “Underlying Case”). (FDIC-R’s Statement of Genuine Disputes in Opposition to Plaintiff’s Motion for Summary Judgment, “FDICR’s SGD,” Dkt. No. 109, ¶¶ 17, 20.) In November 2009, the Office of the Comptroller of the Currency closed the Bank and appointed FDIC-R as receiver for the Bank. (*Id.* ¶ 18.)

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The complaint in the Underlying Case describes various loans made by the Bank that allegedly resulted in millions of dollars of losses to the Bank. (*Id.* ¶¶ 21-22.)

Travelers issued an insurance policy (the “Policy”) to the Bank. (*Id.* ¶ 1.) The Management Liability Insuring Agreement in the Policy states:

The Insurer shall pay on behalf of the Insured Persons Loss for which the Insured Persons . . . become legally obligated to pay on account of any Claim . . . for a Management Practices Act.

(*Id.* ¶ 3.) “Insured Persons” include Directors or Officers. (*Id.* ¶ 4.) “Loss” is defined as

[T]he amount which the Insureds become legally obligated to pay on account of each Claim . . . for Wrongful Acts for which coverage applies, including Damages, judgments, settlements, and Defense Costs. Loss does not include . . .

- (c) any unrepaid, unrecoverable or outstanding loan, lease or extension of credit to any Affiliated Person or Borrower.

(*Id.* ¶ 9.) The parties refer to subsection (c) from the definition of “Loss” as the “Unpaid Loan Carve-Out.” An “Affiliated Person” under subsection (c) includes “any Director, Officer or Employee.” (*Id.* ¶ 11.)

A “Management Practices Act” under the Policy includes “any error, misstatement, misleading statement, act, omission, neglect, or breach of duty actually or allegedly committed or attempted by any Insured Person in their capacity as such.” (*Id.* ¶ 12.)

The Policy further includes the following exclusion (the “Insured v. Insured Exclusion,” or the “IvI Exclusion”):

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The Insurer shall not be liable for Loss [including Defense Costs] on account of any Claim made against any Insured . . .

4. brought or maintained by or on behalf of any Insured or Company [including the Bank] in any capacity, except:
  - (a) a Claim that is a derivative action brought or maintained on behalf of the Company by one or more persons who are not Directors or Officers and who bring and maintain such Claim without the solicitation, assistance or active participation of any Director or Officer.

(*Id.* ¶ 13.)

Travelers filed this action seeking a declaratory judgment that the Policy does not cover the claims against the D&Os in the Underlying Case.

**PRELIMINARY MATTERS**

Travelers submits evidentiary objections to two categories of evidence submitted by FDIC-R: (1) testimony of Travelers' employees, and (2) expert testimony. ("Objections," Dkt. No. 118.) Travelers objects that this testimony is "irrelevant and immaterial to insurance policy interpretation." (*Id.*) FDIC-R argues that the evidence is relevant. (Dkt. No. 123.)

These objections seemingly ignore that a court can grant summary judgment only when there is no genuine issue of *material* fact. *See* Fed. R. Civ. P. 56(a). Because the Court can't rely on irrelevant facts, objections based on relevancy are redundant. *See generally*

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*Burch v. Regents of the Univ. of Cal.*, 433 F. Supp. 2d 1110, 1119 (E.D. Cal. 2006) (noting that parties may simply *argue* that certain facts are not relevant, instead of objecting to them on relevance grounds). Thus the Court considers Travelers' position in evaluating the evidence, but the Objections as stated are **OVERRULED**.

**ANALYSIS**

**1. LEGAL STANDARDS**

In deciding these Motions, the Court must apply the legal standards for summary judgment and for interpreting insurance policies under California law.

**1.1 Summary Judgment**

Summary judgment is appropriate where the record, read in the light most favorable to the nonmoving party, indicates "there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24 (1986). In deciding a motion for summary judgment, courts believe the nonmovant's evidence and draw all justifiable inferences in the nonmovant's favor. *Id.* at 269. The burden is initially on the moving party to demonstrate the absence of a genuine dispute of material fact. *Celotex*, 477 U.S. at 322-23. If the moving party meets its burden, the nonmoving party must produce enough evidence to rebut the moving party's claim and create a genuine dispute of material fact. *Id.* If the nonmoving party meets this burden, summary judgment is inappropriate. *Nissan Fire & Marine Ins. Co. v. Fritz Co., Inc.*, 210 F.3d 1099, 1103 (9th Cir. 2000).

In reviewing cross-motions for summary judgment, a court should review each motion separately, drawing all reasonable inferences in favor of the nonmoving party on each motion. *Ctr. for Bio-Ethical Reform, Inc. v. Los Angeles Cnty. Sheriff Dep't*, 533 F.3d 780, 786 (9th Cir. 2008).

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## 1.2 Interpreting Insurance Policies

In California, courts interpret insurance policies as a matter of law. *Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th 1, 18 (1995). “While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply. . . . The fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties.” *Powerine Oil Co. v. Superior Ct.*, 37 Cal. 4th 377, 390 (2005) (quoting *Bank of the West v. Superior Court*, 2 Cal. 4th 1254, 1264 (1992)). When interpreting a policy, the court will “look first to the language of the contract in order to ascertain its plain meaning or the meaning a layperson would ordinary attach to it.” *Waller*, 11 Cal. 4th at 18 (citing Cal. Civ. Code § 1638). “[L]anguage in a contract must be interpreted as a whole.” *Id.*

If the contractual language is “clear and explicit,” contractual language should govern. *Bank of the West*, 2 Cal. 4th at 1264-65. Policy provisions that are capable of two or more reasonable constructions are ambiguous and must be interpreted to protect “the objectively reasonable expectations of the insured.” *Id.* at 1265. Thus courts interpret insurance coverage broadly to give the insured the “greatest possible protection.” *MacKinnon v. Truck Ins. Exch.*, 31 Cal. 4th 635, 648 (2003). On the other hand, “exclusionary clauses are interpreted narrowly against the insurer.” *Id.* Exclusionary clauses “must be *conspicuous, plain and clear*,” especially where “the coverage portion of the insurance policy would lead an insured to reasonably expect coverage for the claim purportedly excluded.” *Id.* (emphasis in original). The burden is on the insured to show that the claim is within the basic scope of coverage and on the insurer to establish that the claim is specifically excluded. *Id.*

## 2. FDIC-R’S MOTION

The Court first considers FDIC-R’s Motion (Dkt. No. 106), drawing all reasonable inferences in favor of Travelers. The D&Os join in FDIC-R’s Motion. (Dkt. Nos. 113-14.) Because FDIC-R’s Motion is a cross motion, its arguments largely respond to

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Travelers' arguments, and its structure largely follows Travelers'. Travelers argues that the Policy's IvI Exclusion and Unrepaid Loan Carve-Out bar coverage for the Underlying Case. (*See generally* Travelers' Motion.) Thus FDIC-R argues that neither the IvI Exclusion nor the Unrepaid Loan Carve-Out bars coverage. The Court analyzes each.

## 2.1 Whether the IvI Exclusion Bars Coverage

Travelers argues that the IvI Exclusion bars coverage for the Underlying Case because FDIC-R brings the claims "on behalf of" the Bank. Travelers says that FDIC-R is asserting claims that originally belonged to the Bank, and that the Underlying Case exists only because FDIC-R "stands in the shoes" of the Bank to bring the claims. FDIC-R argues that it is not bringing claims "by or on behalf of any Insured or Company in any capacity" for various reasons, including (1) that the Bank failed more than three years before the Underlying Case was brought, and (2) that the FDIC-R is a unique entity created and empowered by statute to act in multiple capacities, not just on behalf of banks.

### 2.1.1 By or On Behalf Of . . . In Any Capacity

Travelers asserts that FDIC-R brings its claims "on behalf of" the Bank, thus falling within the IvI exclusion. Because the phrase "on behalf of" is ambiguous when applied to the FDIC, this argument fails.

As noted in a similar case decided in this district, "[t]hat the Insured v. Insured Exclusion is ambiguous when applied to the FDIC is evidenced by the fact that courts considering this exclusion have reached varying conclusions." *FDIC v. BancInsure*, No. CV 12-09882, 2014 U.S. Dist. LEXIS 82892, at \*26 (C.D. Cal. June 16, 2014). Indeed, the question presented in this case has been litigated numerous times over many years in courts across the nation. *Compare Progressive Cas. Ins. Co. v. FDIC*, 926 F. Supp. 2d 1337, 1339-40 (N.D. Ga. 2013) (holding IvI Exclusion ambiguous as to the FDIC); *W. Holding Co., Inc. v. Chartis Ins. Co. - Puerto Rico*, 904 F.Supp. 2d 169, 182-84 (D.P.R.

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2012) (same); *American Cas. Co. v. Baker*, 758 F. Supp. 1340 (C.D. Cal. 1991) (same); and *Fid. & Deposit Co. of Maryland v. Zandstra*, 756 F. Supp. 429, 433-34 (N.D. Cal. 1990) (same) with *St. Paul Mercury Ins. Co. v. Miller*, 968 F. Supp. 2d 1236, 1243-44 (N.D. Ga. 2013) (holding exclusion applies) and *Fid. & Deposit Co. of Maryland v. Conner*, 973 F.2d 1236, 1244-45 (5th Cir. 1992) (same). See also Peter D. Rosenthal, *Have Bank Regulators Been Missing the Forest for the Public Policy Tree? The Case for Contract-Based Arguments in the Litigation of Regulatory Exclusions in Director and Officer Liability Policies*, 75 B.U. L. Rev. 155, 173-174 (1995) ("A majority of better-reasoned opinions holds that the 'insured v. insured' exclusion does not unambiguously exclude suits by the FDIC from coverage." (collecting cases)). There can be little doubt that repeated disputes over the IvI Exclusion have placed insurers on notice that it is ambiguous.

California law mandates that "any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer." *Harris v. Glens Falls Ins. Co.*, 6 Cal.3d 699, 701 (1972). "The purpose of this canon of construction is to protect the insured's reasonable expectation of coverage in a situation in which the insurer-draftsman controls the language of the policy." *Reserve Ins. Co. v. Pisciotta*, 30 Cal.3d 800, 808 (1982). At least one reason for this rule is apparent: The insurance company has the ability, as a repeat party to these contracts, to ensure that ambiguities are eliminated over time. The insured, lacking the experience of an insurance company, is in a worse position to recognize ambiguities in its policy. Construing ambiguities to benefit insurers would thus create perverse incentives. It would encourage insurers to build ambiguities into their policies to defeat claims.

Here, Travelers had the opportunity to make clear in the Policy that the IvI exclusion applied to FDIC-R, and it could have done so with a simple statement. Indeed, Travelers provides an optional regulatory exclusion—not included in the policy here—that explicitly names the FDIC. (Plaintiff's Statement of Genuine Disputes, Dkt. No. 116, ¶ 15.) It could have included similarly clear language in the IvI exclusion. Having failed to meet its burden "to phrase exceptions and exclusions in clear and unmistakable

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language,” Travelers cannot now benefit from the ambiguity. *State Farm Mut. Auto. Ins. Co. v. Jacober*, 10 Cal.3d 193, 201-02 (1973).

In making its argument, Travelers relies heavily upon *O’Melveny & Myers v. FDIC*, 512 U.S. 79 (1994). But just as the court in *FDIC v. BancInsure*, this Court finds the reliance upon that case to be misguided. 2014 U.S. Dist LEXIS 82892 at \*24-25. Although the Supreme Court held in *O’Melveny & Myers* that the FDIC as a receiver “steps into the shoes” of a failed bank when pursuing tort claims that belonged exclusively to the bank, its holding did not concern insurance or an insured v. insured exclusion. 512 U.S. at 86. The latter issues require interpretation of the Policy and specifically the phrase “on behalf of.” *O’Melveny & Myers* doesn’t tell us whether “on behalf of” means the same thing as “steps into the shoes,” or whether FDIC-R, who represents a number of interests, even steps into the shoes of the Bank for these particular claims. It is the “mutual intention of the parties at the time the contract is formed that governs [the] interpretation.” *Palmer v. Truck Ins. Ex.*, 21 Cal. 4th 1009, 1114 (1999). As to the meaning of “on behalf of,” *O’Melveny & Myers* offers little guidance.

Neither is the Court persuaded by Travelers’ reliance on *Biltmore Associates, LLC v. Twin Fire Insurance Co.*, 572 F.3d 663 (9th Cir. 2009). In *Biltmore Associates*, the Ninth Circuit held that a similar IvI exclusion barred coverage for mismanagement claims brought initially by the corporation as debtor and debtor in possession. 572 F.3d at 666. As the Ninth Circuit noted, the “bankruptcy code defines a Chapter 11 debtor in possession as the debtor.” *Id.* at 671. And rightly so. The debtor in possession is the same entity. Thus the claims in *Biltmore Associates* were initiated directly by the insured corporation itself. Needless to say, it is unambiguous that claims brought directly by the corporation are “on behalf of” the corporation. The FDIC, on the other hand, is a separate entity that represents a variety of interests in its receiver role. Thus *Biltmore Associates* says little about the ambiguity of the IvI Exclusion as applied to the FDIC.

### 2.1.2 The Shareholder Exception to the IvI Exclusion

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Even if the IvI Exclusion did apply to FDIC-R when bringing claims on behalf of the bank, it still would not bar the claims in this case. FDIC-R also represents the interests of the Bank's shareholders, whose claims are covered under the Policy's Shareholder Exception.

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), the FDIC as a receiver succeeds to the rights not only of the failed bank, but also "of any stockholder, member, [or] accountholder . . . of such institution." 12 U.S.C. § 1821(d)(2)(A)(i). As such, "the FDIC differs from other receivers insofar as it is given the exclusive authority to bring claims to recover losses by shareholders." *BancInsure*, 2014 U.S. Dist. LEXIS 82892 at \*20.

The Policy at issue here provides coverage for claims by shareholders, even for derivative actions brought by the shareholders *on behalf of the Bank*. Indeed, the Shareholder Exception to the IvI Exclusion applies to any "Claim that is a derivative action brought or maintained on behalf of the Company by one or more persons who are not Directors or Officers and who bring and maintain such Claim without the solicitation, assistance or active participation of any Director or Officer." (FDICR's SGD, ¶ 13.)

Travelers points out that FDIC-R's action is not as a technical matter a derivative action, and it argues that the action cannot therefore fall under the Shareholder Exception. (Pl.'s Reply at 14:15-16 ("Judge Gee's opinion inaccurately refers to the 'shareholder's suit exemption' to the exclusion, when it is a 'derivative action exemption.'")) But this argument ignores the relevant question: On *whose behalf* does FDIC-R bring these claims? The Shareholder Exception "evidences an intent to place on insurer the risk for actions against the D&Os based upon allegations of mismanagement, waste, fraud, or abuse of the failed institution." *BancInsure*, 2014 U.S. Dist LEXIS 82892 at \*25. The Policy should therefore cover these claims if FDIC-R pursues them under its authority to recover losses on behalf of shareholders. This is true even if the procedure by which FDIC-R asserts the claims differs from the derivative action available to shareholders.

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In sum, Travelers failed to meet its burden of showing that the IvI Exclusion barred coverage of FDIC-R's claims. The IvI Exclusion is ambiguous as applied to FDIC-R, and has been for many years. Furthermore, the Court is unconvinced that the Shareholder Exception does not apply to FDIC-R's claims. Therefore, the Court construes the IvI Exclusion to allow coverage for the claims brought by the FDIC-R.

## 2.2 Whether the Unrepaid Loan Carve-Out Bars Coverage

Travelers next argues that the Unrepaid Load Carve-Out precludes coverage of FDIC-R's claims. This argument is also misguided.

The Policy's D&O coverage extends to Loss, defined as "the amount which the Insureds become legally obligated to pay on account of each Claim . . . for Wrongful Acts . . . , including damages . . . ." (FDIC-R's SGD, ¶¶ 8-9.) The Policy carves out six categories from the definition of "Loss," including unrepaid loans. (*Id.* ¶ 9.) But the Underlying Case concerns the alleged tortious conduct of the D&Os, and on its face the complaint seeks *compensatory damages* for that tortious conduct, not recovery of unrepaid loans. (Dkt. 110, Ex. 2 at ¶ 3.)

Travelers argues that the Carve-Out applies because the damages sought by FDIC-R are *in the amount* of unrepaid loans. But as three courts have already found, the Carve-Out does not unambiguously apply to cases where tortious conduct results in damages that might happen to be in the amount of unrepaid loans. *See St. Paul Mercury Ins. Co. v. Miller*, 968 F. Supp. 2d 1236, 1241 (N.D. Ga. 2013); *Progressive Cas. Ins. Co. v. FDIC as Receiver for Michigan Heritage Bank*, No. 11-CV-14816, 2012 U.S. Dist. LEXIS 188498, at \*9 (E.D. Mich. Sept. 24, 2012); *Progressive Cas. Ins. Co. v. FDIC as Receiver for Omni Nat'l Bank*, 926 F. Supp. 2d 1337, 1337 (N.D. Ga. 2013). The Court agrees with the reasoning of those decisions.

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Because Travelers failed to meet its burden of establishing that the Unrepaid Load Carve-Out unambiguously bars coverage for FDIC-R's claims, the Court construes the clause to permit coverage.

Therefore, in conclusion, the FDIC's Motion for Summary Judgment is GRANTED as to its claims that the IvI Exclusion and the Unrepaid Loan Carve-Out do not preclude coverage of in the Underlying Case.

**TRAVELERS' MOTION**

For the same reasons that the FDIC is entitled to summary judgment, Travelers is not. Viewing the evidence in the light most favorable to Plaintiff does not alter this result. Accordingly, Travelers' motion for summary judgment is DENIED.

**DISPOSITION**

Travelers' Motion is DENIED, And FDIC-R's Motion is GRANTED. The Court reaches these results after reviewing all arguments in the parties' papers. Any arguments not specifically addressed were either unpersuasive, not adequately developed, or not necessary to reach given the Court's holdings.

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