

ALERT

Allegations of General Misconduct by CEO Do Not Arise from Same “Interrelated Wrongful Acts” as Specific Allegations of Fraud

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The United States District Court for the Southern District of New York, applying New York law, has held that FDIC demands against a failed bank’s directors for their failure to act on allegations of improper conduct by the former CEO did not arise from the same Interrelated Wrongful Acts as a later lawsuit attacking the directors’ oversight of the CEO in a specific fraud. *Glasscoff v. OneBeacon Midwest Ins. Co.*, 2014 WL 1876984 (S.D.N.Y. May 8, 2014).

The insureds, directors of a failed bank, sought coverage under a claims made professional liability policy for a demand the FDIC made against them during the policy period. The FDIC asserted that the directors had committed breach of duty, negligence and gross negligence in connection with their roles in the failure of the bank, generally arising from their failure to oversee the bank to ensure compliance with the law and all regulatory authorities. The FDIC focused primarily on the directors’ deficient policies, internal controls, and practices that ultimately led to the bank’s failure, such as inadequate loan approval and monitoring policies and failure to establish adequate collection procedures and oversee employee compensation. The FDIC also alleged that the directors failed to act on allegations of improper conduct made against the former president and CEO of the bank.

After the policy period expired, individuals sued the directors under state securities laws for control person and indirect liability in connection with the former CEO’s fraudulently inducing the plaintiffs to invest money with two customers of the bank, while actually using the investments to fund the CEO’s self-dealing “round trip” transactions.

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The securities lawsuit alleged that the directors were liable for lax oversight of the CEO and for the bank's lack of sound corporate governance.

Under the policy, multiple claims arising out of Interrelated Wrongful Acts were deemed a single claim made at the time of the earliest claim. "Interrelated Wrongful Acts" was defined as "Wrongful Acts which have as a common nexus any fact, circumstance, situation, event, transaction or series of related facts, circumstances, situations, events or transactions." The directors contended that the FDIC demand and the securities lawsuit arose from the same Interrelated Wrongful Acts and therefore constituted a single claim made during the policy period. Accordingly, the securities lawsuit would be deemed made during the policy period.

The court disagreed. The court noted that, in prior cases with similar definitions of Interrelated Wrongful Acts, courts have required that claims share a "sufficient factual nexus" to be deemed a single claim. The court observed that "[w]hen courts have found a sufficient factual nexus, the two claims had specific overlapping facts." Here, the court considered the factual overlap between the two claims to be "tenuous at best." According to the court, "[i]f painted in broad strokes, the two Claims may arise out of the same deficient corporate structure or Plaintiffs' lack of oversight." However, the court concluded that references in the FDIC claim to the former CEO's "general misconduct" did not sufficiently overlap with "specific allegations of his fraud" by the securities plaintiffs. Accordingly, the court found that the FDIC demand and the securities lawsuit did not share a sufficient factual nexus and that no coverage was available for the securities lawsuit under the claims made policy.

The opinion is available [here](#).