BANK DIRECTOR
4th Quarter 2010

# Do I Need to Get My Own Lawyer?

*There are times when directors and officers of a troubled financial institution facing an enforcement order should consider hiring counsel, separate and apart from bank counsel, to best protect their personal interest.*

by **SCOTT SORRELS**

Serving as a director or an officer of a financial institution in these troubled times is enough to cause anxiety even for those affiliated with a healthy institution. If you are an officer or a director of a troubled institution, such as a bank subject to an enforcement order from federal or state regulatory authorities, the danger zone may be too close for comfort. While it may not reduce your anxiety level, unfortunately you are not alone. The number of enforcement actions has continued to escalate. Since 2008, 261 banks have been closed, with 140 of those closures in 2009. Through August 2010, 96 banks have been closed. Current trends indicate that an even higher number of banks will close in 2010, surpassing the financial crisis of some 20 years ago.

Therefore, you may well be asking when and under what circumstances you should consider retaining your own counsel separate from the bank's regular outside counsel. Is it worth the expense? What value can separate counsel provide in this context? There are a number of steps that separate counsel can undertake to help you prepare for a receivership and any potential claims that may follow in the wake of a failure.

**The need for continuity and confidentiality**

Technically, bank counsel do not represent the directors and officers. Bank counsel represents the legal entity itself. While the institution acts and communicates with counsel through the actions and statements of its directors and officers, and bank counsel will in good faith rightfully consider the interests of the directors and officers to the extent they can, the fact remains that bank counsel do not normally represent you in a personal capacity. If conflicts develop between the interests of the institution and your personal interests, bank counsel will normally be constrained to represent the interests of the entity and not the individual. Even more troubling is that in the event of an FDIC receivership, the FDIC will likely succeed to the attorney-client privilege that the bank enjoyed with its bank counsel. Effectively, bank counsel will no longer have a client following a receivership. What this means is that the email you thought was a privileged communication with bank counsel analyzing aspects of your personal liability may instead be open to review by the FDIC as it investigates liability claims and seeks to recover losses to the Deposit Insurance Fund. As a result, what you thought was a privileged conversation could instead become an admission against interest that can be used against you in any subsequent litigation.

One practical solution to this dilemma is to utilize the service of counsel representing your interests solely, or the interests of you and those similarly situated. By doing so, you establish an attorney-client relationship that will normally survive the failure of the institution, and you can better position yourself to weather the investigation that follows each closing. The privileged communications that you share prior to the failure will continue to be protected as you and your counsel determine the best means of defending potential liability claims.

The question of when to hire separate counsel is to some degree a "facts and circumstances" analysis however, one truth remains—your interests are best served by hiring counsel as far in advance of a potential failure as reasonably possible. By doing so, you and your counsel have access to the documentary record that will be critical to your potential defense. Moreover, advanced planning can put you in a situation where you have counsel who is knowledgeable of the facts, circumstances, and documents leading to the failure.

**Build your record now, before it is analyzed later**

The hiring of separate counsel well in advance of a potential closure presents an additional opportunity to shape the record of the institution. In these challenging times, it may be that the most you can hope for is a regulatory "pat on the back" and that you did everything that was reasonably possible. That is well worth the effort even if you are not successful at saving the institution.

Experienced counsel can review the "record" as it exists at the time and offer suggestions and proactive ideas, in coordination with bank counsel, to build the best record possible under trying circumstances. Certain key documents are evaluated following a failure. These documents include board and key committee minutes, reports of examination, the loan policy (including the "ALLL" methodology), and the regulatory record. The regulatory record includes not just the examination reports but also all regulatory correspondence flowing from those examinations and any communication about threatened enforcement actions.

In general, we believe that the FDIC will likely pursue claims that meet some variation of the two-part test used in the savings and loan crisis, when the agency pursued claims against 24% of the institutions that failed between 1985 and 1992. In those cases, the FDIC pursued claims that it considered to be sound on the merits and judged as more than likely to succeed in any litigation. As a second part of the test, the action was evaluated to ensure that it would be cost-effective, taking into consideration liability insurance coverage and personal assets.

**Take early steps to maximize your protection**

It is still too early in this round of bank failures and follow-on liability claims to determine whether and to what extent the FDIC will seek recovery from the personal assets of officers and directors. The last round of failures in the early 1990s taught us that directors and officers liability Insurance (D&O) was a primary source of recovery by the FDIC and that as the circumstances became more egregious, the FDIC was more likely to pursue personal assets. At this point, it is clear that a prudent director or officer should act early to evaluate the coverage that is afforded by the D&O policy, and if possible, undertake all reasonable efforts to secure and maximize that coverage. The expiration of a policy for a troubled financial institution, for instance, provides the insurer with an opportunity to add exclusions that may take away the insureds' valuable protection.

The practical realities are that the more troubled the institution, the more difficult it is to improve or sometimes even preserve the coverage you thought you purchased in the first place. Whether you use bank counsel or special outside counsel, it is prudent to have someone analyze your D&O coverage early in your policy term, and work with specialists who truly understand the vagaries of the existing D&O insurance market, to address and hopefully perfect any issues that come to light. These issues might include: the early negotiation of new coverage; whether to purchase a discovery or "tail" period for your expiring policy; avoiding a regulatory exclusion that affords no liability or defense costs for claims asserted by regulators; tailoring exclusions to deal with the "insured v. insured" language so that claims by the FDIC and a bankruptcy trustee are covered and severs those who committed fraud from those who acted in good faith; coverage of defense costs; whether a Notice of Circumstances should be filed; and whether the policy has a payments priority provision that benefits the individual directors and officers.

**Conclusion**

Too often we have seen counsel retained only several weeks or even days before a bank failure. The unfortunate reality is that the late choice of separate counsel effectively hampers many of the benefits of hiring separate counsel in the first place. These benefits include:

- perfecting the record that will be the subject of the professional liability analysis;
- evaluating and perhaps improving D&O insurance protection, and the timely submittal of Notice of Circumstances and actual claims in order to preserve coverage;
- obtaining an understanding in a less frantic environment of the general liability risks that directors and officers may face from regulators, shareholders, a bankruptcy trustee for a holding company, and employees, and informing themselves of the issues confronting the bank, through a review of regulatory examinations and correspondence, third-party reports, and other relevant documents that are still available while the bank is open;
- privately communicating any concerns to your counsel in a privileged environment without the fear that the government regulators will be looking over your shoulder at that same communication at some time in the future; and
- preparing counsel in advance of a receivership to adequately represent your interests post-receivership, including during the closing weekend and subsequent investigations and possible litigation. **|BD|**

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**Scott Sorrels** is a litigation and regulatory partner with Sutherland Asbill & Brennan LLP and is part of one of the most dynamic and experienced regulatory enforcement practices in the country. The group represents directors and officers of financial institutions in regulatory investigations, and in doing so, brings together attorneys from banking, directors and officers, and regulatory and enforcement practices.