IT IS ORDERED as set forth below:

Date: February 4, 2014

W. Homer Drake
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
NEWNAN DIVISION

IN THE MATTER OF:	:	**CASE NUMBER**
	:	
WILLIAM H. GAFFORD, JR.,	:	11-13490-WHD
	:	
	:	IN PROCEEDINGS UNDER
	:	CHAPTER 7 OF THE
DEBTOR.	:	BANKRUPTCY CODE

O R D E R

Before the Court is the Motion of the Federal Deposit Insurance Corporation (hereinafter the "FDIC"), as receiver for McIntosh Commercial Bank (hereinafter "MCB") to (a) reopen, if necessary, the bankruptcy case of William H. Gafford, Jr. pursuant to 11 U.S.C. § 350(b); and (b) modify the 11 U.S.C. § 524(a) discharge injunction to permit the FDIC to proceed against an available limit of liability insurance policy in accordance with 11 U.S.C.§ 524(e). Specifically, the FDIC

requests that the Court modify the discharge injunction so it can name William H. Gafford, Jr. (hereinafter the "Debtor") as a nominal defendant in a suit for the purposes of establishing and seeking payment from the insurer, St. Paul Mercury Insurance Company (hereinafter referred to as "Travelers"). The Debtor and Travelers oppose the Motion. This matter is a core proceeding, over which this Court has subject matter jurisdiction. See 28 U.S.C. §§ 1334; 157(b)(2)(O).

Introduction

On October 20, 2011, the Debtor filed a voluntary petition under Chapter 7 of the Bankruptcy Code. The Court granted the Debtor's discharge on September 11, 2012. Prior to the petition date, the Debtor was an officer of MCB, which failed. The FDIC, as receiver for MCB, intends to file a suit against the Debtor and other former officers and directors for negligence and gross negligence in their management of the bank. Travelers and the Debtor argue, however, that modifying the discharge in accordance with the FDIC's motion would infringe upon the Debtor's "fresh start" under 11 U.S.C. § 524 due to specific language in the insurance policy which places the responsibility to defend the claim on the Debtor, personally, rather than Travelers. Conversely, the FDIC argues that any obligations, established under the Policy, requiring the Debtor to incur expenses in defense of the claim or reimbursement of Travelers' defense of the claim was discharged in his

bankruptcy. The FDIC further asserts that because the Debtor, as a discharged debtor, cannot be personally liable for an adverse judgment or related defense costs, and because it is well established that Travelers, as a non-debtor, is not entitled to the protection of the permanent injunction, the FDIC's Motion should be granted in its entirety.

Findings of Fact

Travelers issued "SelectOne for Community Banks Policy No. EC06800686" (hereinafter the "Policy") to MCB Financial Group, Inc. (hereinafter MCB Financial) for the policy period from October 21, 2006 to October 21, 2009, later extended to October 21, 2010. MCB was the former subsidiary bank of MCB Financial. The Policy includes a Management Liability Insuring Agreement and Bankers Professional Liability Insuring Agreement, which in turn includes Lender Liability Coverage. In the declarations of the Policy, the parties agreed that it is the duty of the Insured to defend against any claims. Specifically, the policy provides:

> If the Duty of the Insureds to Defend is selected as set forth in the Declarations under an Insuring Agreement made part of this Policy, it shall be the duty of the Insureds and not the duty of the Insurer to select defense counsel and defend any Claim covered by this Policy. *** The Insurer shall advance, on behalf of the Insureds, Defense Costs which the Insureds have incurred in connection with Claims made against them, before disposition of such claims, provided that to the extent that it is finally established that any such Defense Costs are not covered under this Policy, the Insureds, severally according to their

respective interests, agree to repay the Insurer such Defense costs.

Travelers Resp., Ex. A. (Doc. No. 60).

The Policy includes a Bankers Professional Liability Insuring Agreement, under which the insurer has a duty to defend claims brought against an insured person for either a "Lending Act" or a "Professional Services Act." Specifically, the policy provides:

> If the Duty of the Insured to Defend is selected as set forth in the Declarations, then subject to the provisions of the Defense and Settlement section of the General Terms, Conditions, and Limitations, it shall be the duty of the Insureds and not the duty of the Insurer to select counsel and defend any claim covered by this Insuring Agreement.

Id. The Policy defines "Claim" to include:

> (a) a written demand against any Insured for monetary damages or non-monetary relief; (b) a civil proceeding against any Insured commenced by the service of a complaint or similar pleading; (c) a criminal proceeding against any Insured commenced by a return of any indictment or information; (d) an arbitration proceeding against any Insured, or a formal administrative or regulatory proceeding against any Insured Person . . . ; (e) a written request received by any insured to toll or waive a statute of limitations, relating to a potential Claim described in (a), (b), (c), or (d) above; or (f) solely with respect to Fiduciary Act, any fact-finding investigation of any Insured by the Department of Labor or the Pension Benefit Guaranty Corporation; on account of a Wrongful Act.

Id. A "Wrongful Act" is defined to include certain acts covered by the various insuring agreements "but only to the extent that coverage is granted for such act

pursuant to an Insuring Agreement made part of" the Policy. Id.

The Policy also provides that the Insurer will pay "on behalf of the Insured Persons' Loss for which the Insured Persons are not indemnified by the Company and which the Insured Persons become legally obligated to pay on account of any Claim first made against them, individually or otherwise, during the Policy Period, the Automatic Discovery Period, or, if exercised, the Additional Extended Discovery Period, for a [Lending Act or Professional Services Act] taking place before or during the Policy Period." Travelers Resp., Ex. A. (Doc. No. 60). "Loss" is defined as:

> [T]he amount by which the Insureds become legally obligated to pay on account of each claim and for all Claims made against them during the Policy Period, the Automatic Discovery Period, or, if exercised, the Additional Extended Discovery Period, for Wrongful Acts for which coverage applies, including Damages, judgments, settlements and Defense Costs. Loss does not include: (a) any amount for which the Insureds are absolved from payment; (b) taxes, or fines or penalties impose by law . . . , (c) any unpaid, unrecoverable or outstanding loan, lease or extension of credit to any Affiliated Person or Borrower; (d) dividends or other distributions of corporate profits; (e) any amounts that constitute inadequate consideration in connection with the Company's purchase of securities issued by any Company; or (f) matters uninsurable under the law . . . .

Id.

CONCLUSIONS OF LAW

The filing of a bankruptcy petition prevents temporarily the litigation of

prepetition claims against a debtor. See 11 U.S.C. § 362(a)(1). The entry of a discharge acts as a permanent injunction against litigation for the purpose of collecting a debt from the debtor or the debtor's property. 11 U.S.C. § 727(b). "A discharge in bankruptcy does not extinguish the debt itself, but merely releases the debtor from personal liability for the debt." In re Edgeworth, 993 F.2d 51, 53 (5th Cir. 1993). Following the discharge, section 524(a)(2) enjoins "actions against a debtor,"[1] Owaski v. Jet Florida Sys., Inc. (In re Jet Florida Sys., Inc.), 883 F.2d 970, 972 (11th Cir. 1989), but section 524(e) "specifies that the debt still exists and can be collected from any other entity that might be liable." In re Edgeworth, 993 F.2d at 53; see also In re Jet Florida, 883 F.2d at 973 ("However, a discharge will not act to enjoin a creditor from taking action against another who also might be liable to the creditor."). Therefore, a creditor may establish the debtor's nominal liability for a claim solely for the purpose of collecting the debt from a third party, such as an insurer or guarantor. Id.; see also In re Walker, 927 F.2d 1138, 1142 (10th Cir. 1991) ("It is well established that this provision permits a creditor to bring or continue an

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[1] Section 524(a)(2) provides as follows: "A discharge in a case under this title . . . operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, to collect, recover, or offset any such debt as a personal liability of the debtor, or from property of the debtor . . . ." 11 U.S.C. § 524(a)(2).

action directly against the debtor for the purpose of establishing the debtor's liability when, as here, establishment of that liability is a prerequisite to recovery from another entity."); In re Hendrix, 986 F.2d 195 (7th Cir. 1993) (citing In re Shondel, 950 F.2d 1301 (7th Cir.1991)); In re Doar, 234 B.R. 203, 207 (Bankr. N.D. Ga. 1999) (Kahn, J.).

Procedurally, courts generally have considered this issue in the context of a motion to reopen a case or a motion for modification of the discharge injunction. While the cases are not consistent as to whether the actual modification of the discharge injunction is a prerequisite to the continuation of the action, relief can be granted by either a declaration that the injunction does not prevent the naming of the debtor as a nominal defendant or by the actual modification of the discharge injunction. In re Hendrix, 986 F.2d at 198.

As this Court outlined in In re Hayden, "[a] request for declaratory relief must be brought by complaint, rather than by motion." In re Hayden, 477 B.R. 260, 265 FN.3 (Bankr. N.D. Ga. 2012) (Drake, J.). In the present case, however, the FDIC requests modification of the discharge by means of a motion rather than seeking declaratory relief and commencing an adversary proceeding. All parties have since filed numerous briefs with the Court. In the interest of judicial economy and because declaratory relief is not being requested, the Court will address the issue as

a modification of the discharge by means of a motion.

Assuming that modification is required, courts generally grant modification of the discharge injunction to allow a plaintiff to name the debtor if such a suit would not interfere with the debtor's fresh start. "A suit against the debtor will generally be permitted if: (1) naming the debtor as a nominal defendant is "necessary to establish liability against a third party"; (2) "the debtor bears none of the expense of the defense"; and (3) "most important," the plaintiff may not collect any judgment from the debtor personally or from his assets." In re Hayden, 477 B.R. 260, 265 (Bankr. N.D. Ga. 2012) (Drake, J.); (citing In re Catania, 94 B.R. 250, 253 (D. Mass. 1989)).

I. The Debtor is a Necessary Party to the Litigation

To determine whether the debtor is a "necessary party" to the litigation, the bankruptcy court typically considers whether: "'1) in the [party's] absence complete relief cannot be accorded among those already parties; and 2) the [party] claims an interest relating to the subject of the action and is so situated that the disposition of the action in the [party's] absence'" will either impair or impede the party's ability to protect its interest or "'leave anyone already a party subject to a substantial risk of incurring double, multiple or otherwise inconsistent obligations by reason of the [absent party's] claimed interest.'" In re Hayden, 477 B.R. 260, 265 (Bankr. N.D. Ga.

2012) (Drake, J.); (quoting In re Loewen Group, Inc., 2004 WL 1853137 at *25 (E.D. Pa. Aug. 18, 2004)).

Here, the FDIC submits that the Debtor, as former Chief Executive Officer of MCB, is a necessary party to the suit. The FDIC cites In re Grove in support. In In re Grove, the FDIC filed a motion to modify the injunction arising from the debtors' bankruptcy discharge for the purpose of recovering under a directors' and officers' liability insurance policy. In re Grove, 100 B.R. 417, 418 (Bankr. C.D. Ill. 1989). The In re Grove court held that the relief sought by the FDIC did not adversely affect the debtors' fresh start, and that a failure to modify the 11 U.S.C. § 524(a) injunction to allow the FDIC to proceed against the debtors nominally would allow other defendants to point to an "empty chair" at trial for the purposes of attributing liability, thus placing the FDIC at a "tactical disadvantage" and creating the possibility that the FDIC would "lose the potential benefit of $1,000,000.00 of insurance coverage." Id. at 419-20. In the context of the Debtor's being a necessary party, the Court finds In re Grove both factually similar and persuasive. If the FDIC pursues this action without nominally naming Mr. Gafford, who was the Chief Executive Officer of MCB, as a defendant, the FDIC would be placed in the same "tactical disadvantage" as in In re Grove. Accordingly, the Court finds that the Debtor is a necessary party to the litigation.

II. The Debtor bears none of the expense of the defense.

Travelers and the Debtor both argue that a modification of the discharge injunction would prejudice the Debtor's economic "fresh start." Travelers argues that its only defense obligation under the Policy is that it shall "advance" defense costs which the Debtor has "incurred," "provided" that he agrees to repay Travelers if it is later established that there is no coverage for such defense costs under the Policy, which would result in the placement of a burden on the Debtor. Travelers, Supp. Br. pg 2. However, this "burden" cannot be felt by the debtor due to his Chapter 7 discharge.

The FDIC argues that this case is controlled by the precedent set forth in In re Jet Florida Sys., Inc., 883 F.2d 970 (11th Cir. 1989). Specifically, the FDIC suggests that any obligation by the Debtor to reimburse defense costs under the Policy was discharged in his bankruptcy. As the Eleventh Circuit observed in In re Jet Florida, the specter of defense costs is not a basis to deny modification of the section 524 discharge injunction.

> "We can determine no effective means of determining at this stage whether the bankrupt or the insurance company will pay the cost of the litigation. To have our ruling premised on that determination would provide an incentive for the debtor to claim to assume the burden. If that simple fact barred the plaintiff from going forward on his claim, there would exist no adversarial relationship between the bankrupt and the insurer so that we could actually resolve this crucial question,

> because both of those parties would have an obvious interest in demonstrating that the debtor was liable for litigation costs."

In re Jet Florida, 883 F.2d at 976.

In In re Jet Florida, an employee sued his employer for defamation, and the employer subsequently filed Chapter 11 bankruptcy. Id. at 971. The Eleventh Circuit held that allowing the employee to pursue his defamation action for purposes of recovering under an insurance policy did not thwart Jet Florida's "fresh start." The Eleventh Circuit further observed that:

> "[T]he practical and economic realities compel the *insurance company* to defend the underlying action. The insurance company may be responsible pursuant to a contract with the bankrupt, in which case it is in their direct interest to defend the action. On the other hand, if there is a dispute between the bankrupt and the insurer as to the applicability of coverage, it remains in the interest of the insurer to defend the suit. In the situation such as the one at bar, the debtor would be free to default because the Plaintiff cannot recover directly from the bankrupt estate. In that scenario, we recognize that the insurance company would be compelled to litigate its responsibility under the insurance contract in order to avoid payment. It seems clear that the relationship between the parties in this action-Plaintiff, bankrupt, and insurer-virtually requires that Air Florida will be represented in the defamation action with no cost to it. In short, we find that the possibility that the debtor will be responsible to pay any amount associated with defending this action is so remote that the fresh-start policy is not defeated."

In re Jet Florida, 883 F.2d at 976 (internal citations omitted).

Travelers suggests that the present case involves an insurance policy that creates an exception to the general rule. Specifically, Travelers and the Debtor argue

that the language of the Policy explicitly excludes any coverage for any action involving Insured vs. Insured. Travelers sets forth this argument based on the decision entered by Judge Story in Federal Deposit Insurance Corp. v. Charles M. Miller, et al., No. 2:12-CV-0225-RWS (N.D.Ga. August 19, 2013) (Story, J.). In Miller, Judge Story concluded that the "Insured v. Insured" language of the insurance policy expressly excludes from coverage suits brought by an insured against another insured. Miller, at 11. In Miller, the court held that under the terms of the Insured v. Insured exclusion in the policy, the insurance company was under no duty to provide coverage for the suit instituted by the FDIC against the officer of the bank because the FDIC stood in the shoes of the bank as an "Insured". See Miller at 15.

Travelers argues that the purpose of a section 524(e) action is to ensure that the carrier's liability remain consistent with the policy. Traveler's Supp. Br. at 7. Travelers contends that In re Jet Florida is distinguishable from the case at bar because the insurance policy in In re Jet Florida is different than the instant Policy, in that the In re Jet Florida policy states that it is the duty of the insurer to defend the action. Travelers further attempts to distinguish the present case by noting that in In re Jet Florida the court states:

"The insurer is not considered to be "prejudiced" under section 524

> when the permanent injunction is modified to permit a pending action to continue for the purpose of seeking recovery from the debtor's insurer, because the insurer's obligation remains commensurate with the underlying insurance contract."

In re Jet Florida, 883 F.2d at 975. Travelers insists that because the underlying contract that makes up the Policy included specific language excluding "Insured v. Insured" from Travelers' liability in defending lawsuits, the bargained for Policy should control, which would create financial liability on the debtor, contrary to the fresh start policy of section 524. However, Traveler's argument relies upon the presumption that any litigation between Travelers and the Debtor would result in the same outcome as the Miller decision.

Travelers fails to distinguish the present case from In re Jet Florida because this Court, just as the In re Jet Florida court, has no "effective means" in determining whether the Debtor or Travelers will pay the cost of litigation. While the Miller decision appears to be similar to the issue here, the underlying coverage issue is not before the Court, and the Court cannot "predict" the potential outcome of future litigation. Additionally, this Court agrees with the reasoning in In re Jet Florida, in that the practical and economic realities compel the "insurance company" to defend the underlying action. In re Jet Florida, 883 F.2d at 976. The Eleventh Circuit further reasoned in In re Jet Florida that "if there is a dispute between the bankrupt

and the insurer as to the applicability of coverage, it remains in the interest of the insurer to defend the suit." Id. Accordingly, the Court finds the instant case comparable to In re Jet Florida.

Additionally, the present case is very similar to the one before the Illinois bankruptcy court. See In re Grove, 100 B.R. 417 (Bankr. C.D. Ill. 1989). There, the court noted that the "usual situation of a discharge modification involves one in which a creditor seeks removal of the stay of section 524 in order to maintain a state court action against a debtor to establish liability where the insurance carrier has recognized its obligations under the policy to provide a defense and to pay if the debtor is found liable." Id. The situation in In re Grove involved the FDIC's motion to modify a debtor's section 524 discharge injunction in order to proceed with litigation against the debtors so that, if successful, the FDIC could then proceed against the insurance company on the directors' and officers' liability policy. See In re Grove, 100 B.R. at 418. The debtors in In re Grove opposed the FDIC's motion to modify the discharge on the grounds that the insurance policy would require that the debtors defend the underlying liability action and incur the costs for defense, including attorney fees. Id. at 419.

The In re Grove court reasoned that in the liability action, similar to the underlying liability action in this case, the real parties in interest, from a financial

perspective, would be the FDIC and the insurance company. See In re Grove, 100 B.R. at 421. Specifically the In re Grove court stated:

> "While it is apparent the FDIC will benefit from a successful pursuit of the [liability] action, it must also be recognized that American Casualty stands to benefit from the defense of the [liability] action. A successful defense equates to $1,000,000.00 not having to be paid on the claim. The true and ultimate adversaries, those who have something to win or lose, are the FDIC and American Casualty."

Id. at 421. The economic interests in the present case are the same as in In re Grove. In particular, Travelers stands to gain if it is ultimately held that there is no liability in the underlying action.

Moreover, the Debtor's fresh start will not be adversely affected by allowing the FDIC to pursue an action naming him as a nominal defendant, solely for the purposes of pursuing liabilty against Travelers on the Policy, because any claims against the Debtor for defense costs were discharged in bankruptcy pursuant to section 524 of the Bankruptcy Code. The court in In re Grove reached a similar conclusion:

> "The debtors have nothing to gain or lose monetarily in the [liability] action. They can do nothing and let judgment be entered against them as it is not recoverable from them. In so doing they do not have to be concerned with liability to American Casualty for failure to defend. For the reasons set forth above, the [liability] action and the obligation to defend all arose pre-petition and are dischargeable by their bankruptcy. In sum, the debtors are not forced to defend and incur defense costs. They are free to be the conduit through which the FDIC

> and American Casualty fight the battle. If American Casualty wants the [liability] action defended, it should pay for it."

Id.at 421.

Travelers argues that if the Court were to allow the Debtor to breach his duty to defend under the Policy, it would do so knowing that Travelers is essentially without process or remedy. Travelers Supp. Br., at 9. The Court disagrees. Travelers had the opportunity to object to the Debtor's discharge. Additionally, Travelers may seek post-discharge relief by filing a motion to reopen the case and file the appropriate pleadings.

Accordingly, the Court finds that naming the Debtor as a nominal defendant does not place a burden on the Debtor that would impact his fresh start in accordance with section 524. Additionally, the Court agrees with the reasoning in In re Jet Florida and In re Grove and finds that allowing the FDIC to nominally name the Debtor as defendant in a liability action would comply with the precedent set forth in those cases.

III. The FDIC will not collect from the Debtor personally or his assets.

The FDIC's motion is limited in scope and nature. Specifically, the motion requests that the Court modify the Debtor's discharge injunction in order for the FDIC to pursue a liability action against Travelers on the Policy. The FDIC

recognizes that any obligation by the Debtor under the Policy was discharged in his bankruptcy. The Court will allow the modification of the discharge injunction, provided that any judgment rendered against the Debtor shall not be collectible from and shall not be recorded against the Debtor or his property.

CONCLUSION

While it is not clear that modification of the discharge injunction is required, out of an abundance of caution, the Court will grant the relief requested. The Court does not find it necessary to reopen the bankruptcy case pursuant to 11 U.S.C. § 350(b). Accordingly, the Motion to Modify Permanent Injunction to Permit Suit to Available Liability Insurance Policy Limits, filed by the FDIC, is **GRANTED**.

IT IS ORDERED that the Debtor's bankruptcy discharge shall be modified so as not to preclude the FDIC from going forward against the Debtor, or his liability insurer, St. Paul Mercury Insurance Company, in another forum; provided, however, that any judgment obtained against the Debtor shall not be collectible out of any property of the debtor and shall not be recorded against him.

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