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The Advancing Majority: A Sensible Answer to Disputes over D&O Defense Costs

By **WILLIAM G. PASSANNANTE, ESQ.**

You are a director of BigCorp Inc. Due to the botched acquisition of a major subsidiary, the plaintiff's class-action bar is circling like a hungry shark. The fall in BigCorp's stock price is the blood in the water. You get sued. Personally.

BigCorp refuses to indemnify you because of unresolved allegations of bad faith and self-dealing. Thank goodness you have the protection of the D&O liability insurance policy sold to you by the Really Big Insurance Group (RBIG). You ask them to pay your legal fees. They refuse to advance defense costs pending the final outcome of the matter.

D&O Insurance Companies Are Required to Advance Defense Costs

When faced with a wrongful failure to advance defense costs, a policyholder may need to seek court intervention to compel the proper advancement of fees. Summary judgment is particularly appropriate to determine an insurance company's duty to defend or advance defense costs in a D&O matter.

For example, in June the Delaware Superior Court stated unequivocally that an excess D&O insurance company following the form of a primary policy requiring the advancement of defense costs must also advance defense costs once the underlying limits are exhausted. *Sun-Times Media Group, Inc. v. Royal & SunAlliance Ins. Co. of Canada,* C.A. No. 06C-11-108 RRC, 2007 WL 1811265 (Del. Super. June 20, 2007).

In awarding the plaintiff policyholder's partial summary judgment motion on the issue of advancement of defense costs, the *Sun-Times* court dismissed each of the insurance company's coverage defenses holding that

> [T]here is no genuine issue of material fact regarding choice of law that precludes summary judgment as to defense costs. In addition, the Court has determined that, at this juncture, there has been no showing by Defendants that the personal conduct exclusions have been violated so as to preclude the advancement of defense costs. Furthermore, this Court has also determined that, at this juncture, Defendants have not made a sufficient showing that either the cooperation clause or the consent-to-settle provision have been violated, so as to preclude advancement of defense costs. Lastly, the Court has determined, on the present record, that the priority-of-payment clause does not prevent the present advancement of defense costs. Therefore, Plaintiffs' motion is GRANTED.

Sun-Times, 2007 WL 1811265, at *1.

Courts have found that an insurance company may not invoke an exclusion as the underlying litigation progresses unless every allegation of the underlying complaint falls solely and entirely within specific and unambiguous exclusions from coverage.

Moreover, an insurance company cannot escape its duty to advance and reimburse defense costs by merely contesting coverage *Fed. Ins. Co. v. Kozlowski,* 792 N.Y.S.2d 397 (App. Div. 2005.) In *Kozlowski*, the insurance company unpersuasively argued that a coverage dispute over the application of an exclusion excused the insurance company from its duty to advance defense costs. In rejecting this argument the court stated

> This court has recognized that under a directors and officers liability policy calling for the reimbursement of defense expenses as in *Gon* and *Okada* "insurers *are required to makes contemporaneous interim advances of defense expenses where coverage is disputed*, subject to recoupment in the event it is ultimately determined no coverage was afforded."

Id. at 403 (*quoting Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Ambassador Group, Inc.* 556 N.Y.S. 2d 549, 553 (App. Div. 1990) (emphasis added).

Other courts agree. In 2004, *Brown* v. *AIG, Inc., et al.* reiterated the rule that D&O liability insurance companies should be required to advance defense costs during the defense of a D&O claim. In *Brown*, the insurance companies attempted to avoid advancing defense costs by relying on an exclusion for "related acts." The *Brown* court concluded that the insurance company failed to prove the applicability of the exclusion. The court thus required advancement of defense costs.

If the insurance company arguments were legitimate, the D&O policy itself would be "rendered a nullity," and the coverage it supposedly provided would be completely illusory. *See United States v. Weissman, (S.D.N.Y. 1997).* Furthermore, a policyholder may seek a ruling on the duty of an insurance company to provide defense costs even if the total amount of liability for those defense costs is not

yet ascertainable. *See General Accident Insurance Co. of America v. Allen* (1997). Directors and officers should receive the fair protection and compensation they are entitled to under the D&O policies. *See In re Adelphia Communications Corp.* (Bankr. S.D.N.Y. 2002):

> In many cases, officer or director insureds might be severely prejudiced by a refusal to grant relief from the stay to recover defense costs. ... D&O policies are obtained for the protection of individual directors and officers...

Advancement of Defense Costs Is Consistent with the Purpose and Language of the D&O Policy

In *Adelphia*, the court considered the directors and officers' requests for advancement of defense costs from a D&O policy. The court found that

> [W]here the debtor has had a material interest in the proceeds of the D&O policy for its own economic exposure—e.g., by way of reimbursement for any indemnification payments it might make, or for "entity coverage," satisfying issuer obligations on account of securities fraud liability—courts have recognized the interest of the debtor in the policy proceeds as well as the policy itself, with the result that the proceeds are property of the estate.

Id. at 591. The Adelphia Creditors' Committee argued that defense costs constituted property of the estate because (1) the Adelphia policies reimburse the estate to the extent that the estate advances defense costs to directors and officers; and (2) the Adelphia policies contain entity coverage protecting the estate from securities claims. *Id.* The Creditors' Committee also argued that unfettered resort to the Adelphia policies would deprive a debtor trying to reorganize an asset it needs to secure independent directors who will not serve without insurance coverage. *Id.* at 592-93. The court agreed with the Creditors' Committee and held that

> [A]n important factor is whether the estate is worth more with the D&O policy than without it. Here the [Adelphia] estate is worth more with the D&O Policy than without it by reason of the entity coverage, and the [Adelphia] estate is worth more with the D&O Policy by reason of the amalgam of the entity coverage and the need for the policy itself to secure independent directors. Under the facts of these cases, then, the proceeds of the D&O Policies are, like the policies themselves, property of the estate, and requests by insureds to draw down on policy proceeds do indeed require motions for relief from the stay.

Id. at 593. In light of the court's discussion earlier in its opinion, as mentioned above, it appears that the reference to "entity coverage" may include the reimbursement coverage provided by the Adelphia policies.

The "advancing majority" of courts require that defense costs be paid as incurred in D&O matters. Make sure that you forcefully protect your right to this important insurance benefit.

Resolution

Armed with proper interpretation of provisions regarding defense costs advancement, you forcefully insist upon a current advancement of the defense costs from RBIG. RBIG hems and haws, but ultimately relents and agrees to advance all of your defense costs regarding the BigCorp share-price drop.

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