

# Resisting Insurer Attempts to Recoup D&O Defense Costs

by William G. Passannante

**D**&O liability insurance is specifically designed to protect individual directors and officers from crushing defense costs related to claims made against them. The D&O liability insurance protection works alongside the usual “corporate indemnity” protection available to many directors and officers, but attempts by insurance companies at recoupment can greatly tarnish that protection.

Courts have often ruled that some of the ways that insurers have tried to recoup D&O costs are not permitted. Insurance companies sometimes wrongfully attempt in their “reservation of rights” letters to create a new contract under which they argue that they have a right to attempt to recoup defense costs. Other cases have found that insurers cannot recoup defense costs absent an explicit policy provision authorizing the recoupment. Courts have also held that a policyholder’s express rejection of a reservation purporting to reserve a right to recoup defense costs prevents recoupment. In essence, the average insurance purchaser would not expect to be able to change the terms of the insurance policy purchased after the fact, and neither should insurance companies.

In other cases, some insurance companies have argued that “improper” advancement of defense costs by the corporation pursuant to corporate indemnity statutes permits the insurer to “recoup” defense costs they previously advanced by re-litigating the policyholder’s entitlement to defense costs even after a successful defense. In one recent case, in which the author represented the insureds, the insureds under a D&O liability insurance policy asserted that under Delaware law, since their defense had been “successful on the merits or otherwise,” that corporate indemnification was beyond being second-guessed by the D&O liability insurance company. This inquiry involves a determination of whether the advancement of defense costs would be “permissive indemnification” as opposed to “mandatory indemnification” under corporate indemnification statutes.

A policyholder may request a threshold legal determination regarding whether the directors and officers were entitled to mandatory indemnification because they have “been successful on the

merits or otherwise in defense of” the underlying matter within the meaning of Section 145(c) of Delaware state code. Under Section 145 and established Delaware practice, that determination is to be made by the court as a threshold matter, prior to discovery, because “this approach...avoids, where possible, prolonged and expensive discovery into the facts behind a particular dismissal, settlement, or plea.” Thus, if the court determines that the directors and officers are entitled to mandatory indemnification, then none of the extensive litigation on permissive indemnification issues is necessary. Under Section 145(c), “any result other than conviction must be considered success in a criminal action.” Thus, the phrase “successful on the merits or otherwise” permits indemnification if a defendant is successful on a “technical” defense even if that does not involve the defendant being adjudged “innocent.” In a situation in which the directors and officers were acquitted, or had charges dismissed—even on supposedly “technical grounds”—Delaware law mandates indemnification of their defense costs, and the insurance company argument that the corporation “improperly” advanced defense costs must fail.

Moreover, if a D&O case is “successful on the merits or otherwise” under Section 145(c), the director or officer is entitled to indemnification without the necessity of any analysis of the requirements of Section 145(a).

Corporate indemnification statutes that largely favor the ability to protect individual directors and officers via advancement of defense costs also may put to rest recent creative insurance company arguments regarding attempted “recoupment” of defense costs. Similarly, improper attempts at recouping defense costs paid by insurance companies generally are against legal precedent on the issue. ■

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