AKO EXECUTIVE INSURANCE ALERT

ANDERSON KILL & OLICK, P.C.
Attorneys and Counsellors at Law

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D&O Liability Insurance Companies Must Advance Defense Costs

By William G. Passannante

You are Ms. Big, a director of BigCorp Inc., a New York Stock Exchange listed company. On account of an acquisition of a major subsidiary (now gone sour) the plaintiff's class-action bar is circling like a school of hungry piranhas. The fifty-percent drop in BigCorp's stock price is the blood-in-the-water. You get sued. Personally.

On account of allegations of bad faith self-dealing, BigCorp refuses to indemnify you. Thank goodness you have the protection of the D&O liability insurance policy sold to you by the Really-big Insurance Group ("RIG"). You send them the civil and criminal complaints against you and ask them to pay for your lawyer. They refuse to advance defense costs pending the final outcome of the matter. Ms. Big has a major problem.

"D&O policies are obtained for the protection of individual directors and officers..."

Most Courts Require Advancement of Defense Costs.

A recent case, *Brown v. AIG, Inc., et al.*, (Oct. 19, 2004) has 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 upon 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. This is a story oft-repeated.

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 though the total amount of the liability for those defense costs may not yet be ascertainable. *General Accident Insurance Co. of America v. Allen* (1997). Directors and officers, should receive the fair protection and compensation they paid for 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.

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We hope you have found this issue of the Executive Insurance Alert informative. We invite you to contact the Editor, William G. Passannante at (212) 278-1328 or wpassannante@andersonkill.com with your questions or comments.

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Defense Costs Must Be Advanced Despite Rescission Claims

Simply declaring "rescission" (as has become popular lately) does not end the obligation to advance defense costs under the D&O liability insurance policy. In one case seeking rescission of an errors and omissions policy, the court held that the insurance company's "attempt to unilaterally rescind the policy was ineffective, absent resolution by the court through either a declaratory judgment proceeding or equity action." *Colonial Valley Abstract Co. v. Homestead Ins. Co.* (1993). The Court also cited to a prior decision, *Prudential Ins. Co. of America v. Ptohides*, which held:

> Repudiation is … *an act too uncertain* … to be accepted as the equivalent of ordered battle in the courts. . . . A [valid] contest [of liability] begins when the insurer avoids, or seeks to avoid, the obligation of the contract by action or defense. [emphasis added].

Every Court Which Has Considered the Issue has Concluded That Defense Costs Must be Advanced Pending a Resolution of the Rescission Claim

Every court which has considered the issue of advancement of defense costs in the context of a rescission claim has concluded unequivocally that defense costs must be advanced until there is a final judicial determination of rescission. Though they continue to make the same arguments, D&O liability insurance companies, do not offer any persuasive arguments against these rulings.

Resolution

Now, armed with proper interpretation of provisions regarding defense costs advancement, Ms. Big forcefully insists upon a current advancement of the defense costs from RIG. RIG hems and haws, but ultimately relents and agrees to advance defense costs. Perhaps the dispute is over, and all of Ms. Big's defense costs regarding the BigCorp share-price drop will be covered. When last seen, Ms. Big's attorney and RIG's claims unit were discussing RIG's "litigation guidelines." ■

Regarding D&O Liability and Insurance Events

Thank you to all those who attended our October 13th and December 7th D&O Liability Insurance luncheon seminars. We appreciate your interest in our seminars and welcome any suggestions or requests you may have for future programs. Anderson Kill's D&O Practice Group looks forward to seeing you at our next D&O Liability and Insurance Seminar in the Spring of 2005.

For a listing of our upcoming seminars, please visit us at www.andersonkill.com.

—Bill Passannante