

CORPORATE INSURANCE LAW

Expert Analysis

Defense Costs Coverage 101

Upon receipt of a claim, the risk manager or in-house counsel should coordinate with the company's insurance broker to make sure notice is submitted to the insurer. However, even earlier, in anticipation of claims, counsel should review the terms of the relevant insurance policies and develop an understanding of the defense cost coverage provisions.

An insurance company's obligation to pay defense costs incurred by its insured in response to a claim typically falls into one of two categories: (1) a duty to defend or (2) a duty to advance defense costs. The duty to defend is most often included in general liability (GL) policies while the duty to advance is more likely to be included in directors' and officers' liability (D&O) policies. Policy forms can vary, however, and a GL or D&O policy may contain either type of defense obligation. In addition, specialty insurance policies covering, for example, employment practices or pollution liability risks may contain either a duty to defend or duty to advance clause.

Regardless of the type of insurance policy, an insurer may be willing to consider including either defense clause if



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requested by the broker or the insured. While each of these clauses provides insurance for defense costs incurred by the insured, there are distinctions worth considering which may dictate which clause is preferable for a given insured.

Duty to Defend

While case law varies to some degree from state to state, the duty to defend is broader than the duty to advance under New York law and the law of the majority of other jurisdictions. It is also well-settled that the duty to defend is broader than the insurer's duty to indemnify for loss under a policy. The duty to defend is triggered "whenever the allegations in a complaint against the insured fall within the scope of risks undertaken by the insurer, regardless of how false or groundless those allegations may be." *Seaboard Surety Company v. Gillette Company*, 64 N.Y.2d 304, 486 N.Y.S.2d 873 (1984). Even where some asserted claims fall outside the scope of covered risks, as long as some of the claims are within the scope of coverage, the insurer will have a duty to defend. Once triggered,

the insurer is required to pay defense costs on behalf of the insured.

While the duty to defend is broader than the duty to advance, it also gives the insurer control over the defense of the claim. Typically, where a policy contains a duty to defend, the insurer will have the right to appoint defense counsel. Thus, with a duty to defend policy, the insured gets the benefit of broad defense coverage but gives up the right to choose defense counsel and, effectively, control of the defense.

An exception to this rule, in most jurisdictions including New York, is that where there is a conflict of interest between the insured and the insurer, the insured is entitled to select indepen-

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dent defense counsel. *Public Service Mut. Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 442 N.Y.S.2d 422 (1981). In the case of such a conflict, the insurer is responsible to pay the reasonable defense fees of independent counsel.

Duty to Advance Defense Costs

In contrast to the duty to defend, the duty to advance merely requires

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the insurer to reimburse the insured for costs incurred in defense of claims. Moreover, while the duty to defend requires the insurer to pay defense costs on behalf of an insured whenever the claims alleged fall within the scope of the risk insured, the duty to advance only requires the insurer to advance defense costs for covered claims.

Policies that contain a duty to advance clause generally require the insurer to advance defense costs on an unspecified “timely basis” or within a specified period of time that can range from 30 to 120 days after submission of invoices. Such policies also typically permit the insurer to allocate defense costs to covered and uncovered claims and thus, in some cases, provide a basis for the insurer to advance only a percentage of the defense costs. In addition, a duty to advance is conditional—in the event that it is subsequently determined that there is no coverage for the claims, the insurer may have a right to seek recoupment of the defense costs from the insured.

On the other hand, in the context of a duty to advance, the insured is typically entitled to select its own defense counsel and has control of the defense as well as the responsibility to defend the claim. In addition, a duty to advance will typically be triggered by a written demand seeking monetary relief whereas a duty to defend, in some policies, will only be triggered by an actual suit.

Key Considerations

Whether a duty to defend or duty to advance is a better fit for a particular insured may depend on several factors including the insured’s profile and the types of potential claims. For example, a cost-conscious insured may prefer a duty to defend because defense costs will be paid directly by the insurer and

because the insurer is more likely to pay 100 percent (or close to 100 percent) of the defense costs above the applicable deductible or retention. In contrast, under a policy with a duty to advance, there is likely to be considerable lag time between the submission of legal invoices and payment by the insurer, and there is also a stronger possibility that the insurer will pay less than 100 percent of the invoices—either based on an allocation between covered and uncovered claims or persons or based on the insurer’s defense counsel guidelines.

Where choice of counsel is important to the insured, a duty to advance will likely be the preferred option. Choice of counsel may be of primary importance to an insured if the insured has a relationship with counsel in whom they have developed confidence. Similarly, if the claims at issue require a particular expertise or in-depth understanding of a specific industry, the insured may believe it is better positioned to select counsel than the insurer. Likewise, where the claims asserted threaten the continued viability of the insured’s business, the insured will likely prefer to retain counsel with whom they have substantial experience or counsel with a reputation for expertise in the relevant area.

While a duty to advance clause typically grants the insured the right to select counsel, in some cases selection of counsel will be subject to insurer approval, such approval not to be unreasonably withheld. In the case of either a duty to defend or advancement policy, it may also be possible to negotiate pre-approval of defense counsel.

Where control of the defense is the primary concern, a duty to advance policy will likely be a better fit for the insured. Control may be the primary

concern where the insured is involved in a regulated industry and where it may be the subject of investigations or claims by government agencies. Similarly, where the insured operates in an industry in which litigation is relatively common or routine, the insured may prefer to have control over its defense. Likewise, where a claim concerns private, confidential or even potentially embarrassing issues, the insured will likely prefer to have control of the defense.

Timely Notice and Tender

In any event, regardless of the type of defense obligation, the risk manager or in-house counsel should be sure to give timely notice of claim in order to avoid jeopardizing the right to coverage. In addition, it is crucial to give notice as soon as possible because an insurer’s obligation to pay defense costs is not typically triggered until notice has been submitted. So while a couple of weeks’ delay in providing notice may not jeopardize coverage, the defense costs incurred prior to the notice will not be recoverable from the insurer. Further, to the extent that an opportunity for early settlement negotiations may arise, it will be necessary to coordinate those discussions with the insurer. Consequently, notice should always be provided before any significant defense costs are incurred.

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