New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 263—NO. 21
FRIDAY, JANUARY 31, 2020

CORPORATE INSURANCE LAW

Expert Analysis

Securing Insurer Advancement Of Defense Costs Under D&O Policies

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Very soon after counsel is retained with respect to a new matter, counsel should discuss with the client whether there is potential insurance coverage and whether the appropriate insurers have been notified. This is true whether the new matter concerns a lawsuit, a threatened claim or a regulatory investigation or inquiry. But providing timely notice to the insurers is just the first step. There are a number of other issues that outside counsel should consider in order to protect the client's right to advancement of defense costs under the client's directors and officers (D&O) liability insurance policies.

Defense Obligations 101

Most insurance policies that provide coverage for defense costs include either a duty to defend clause or a duty to advance provision. Under New York law, and the law of most states, the duty to defend is broader than the duty to advance and is triggered whenever the allegations in a complaint fall within the scope of risks covered by the policy. However, while the duty to defend is broader, it also typically gives the insurer the right to control the defense and often to select defense counsel.

> Given the increasing costs associated with defending lawsuits and regulatory investigations, clients are rightfully interested in maximizing their right to insurance coverage for legal defense fees.

Most D&O policies instead impose an obligation to advance defense costs on the insurer. These policies require the insurer to reimburse the insured for costs incurred to defend covered claims subject to a right to recoup the costs if it is ultimately determined that the claim is not covered. Typically, such policies require the insured to defend the claim and the insurer is obligated to reimburse reasonable and necessary defense costs on an unspecified "timely basis" or within a specified period of time that can range from 30 to 120 days.

In some cases, the insured will pay the legal invoices and seek reimbursement from the insurer. In other cases, the insurer will pay defense counsel's invoices directly. We will focus here on the situation where the insurer pays defense counsel directly and the practices defense counsel should follow to protect the client's right to advancement.

Notice Requirements

D&O policies are typically written on a claims-made basis providing coverage for claims arising out of a wrongful act that are first made against the insured during the policy period. The insured is required to report the claim during the policy period or possibly within a tail period

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of 30-90 days that follows the end of the policy period. The notice obligation will also typically require the insured to provide notice of claim as soon as practicable after receipt of the claim. While D&O policies require the insured to provide timely notice of claim, most policies also permit the insured to voluntarily provide notice of circumstances that may give rise to a claim. Where a notice of circumstances is submitted and accepted by the insurer, a future claim arising out of such circumstances will be adjusted under the policy in which the original notice was submitted.

Coordinate With the Broker

Upon receipt of a new matter, counsel should consult with the client regarding the status of any insurance claim—whether there is potential insurance coverage and whether notice has been submitted to all of the appropriate insurers, including excess insurers. This is not only in the best interest of the client, but counsel arguably has an obligation to advise the client about the potential availability of insurance. *Soni v. Pryor*, 139 A.D.3d 841, 842 (2d Dept. 2016); *McGlynn v. Burns & Harris*, 170 A.D.3d 1162 (2d Dept. 2019).

If the insurer has not yet been notified, or even if it has, it is a good idea to coordinate with the client's insurance broker with respect to providing notice as well as ongoing communications with the insurer. The broker can fill a valuable role as a point of contact between the insured and the insurer, providing guidance with respect to the tone of communications and facilitating negotiations through the broker's contacts, relationships with the insurer representatives and familiarity with insurer customs and practices.

Keep Your Insurer Contact In the Loop

It is also important to make contact, through the broker or otherwise, with the insurance claims adjuster or in-house claims counsel. To some degree, this is necessary to satisfy the duty to cooperate contained in most D&O policies. More important, however, is that keeping your insurer claims contact informed regarding the status of the claim will facilitate discussions regarding payment of defense invoices as well as, ultimately, settlement negotiations. Try to avoid surprising the insurer with respect to developments in the case as well as the pace of defense costs and you are likely to find that it is easier to resolve disputed issues that arise during the course of the claim.

> Privilege issues can be exacerbated where the insurer has retained a third-party contractor to review and recommend deductions with respect to defense counsel invoices.

Pre-Tender Costs and Consent Requirements

In addition to the notice obligations discussed above, the other crucial reason for providing prompt notice of claim is that the insurer will not reimburse defense costs incurred by the insured prior to the date of notice, known as pre-tender costs, even if the defense costs are legitimate. Further, most policies provide that the insured may not incur defense costs without the consent of the insurer. As a practical matter, this provision does not necessarily require a specific request and a specific response before the insured can begin incurring costs to defend a lawsuit. But it does require the insured to submit notice of claim, advise the insurer that it has retained counsel, identify that defense counsel and advise the insurer that it expects to begin incurring costs to defend the claim. The key is to provide that information to the insurer and give the insurer the opportunity to respond—and to avoid surprising the insurer with unexpected defense cost invoices.

This is the preferred practice even where the policy is subject to a significant retention or deductible. In that case, the insurer may not appear particularly interested until defense costs start approaching the retention amount. Nevertheless, it is still in the best interest of the client to make sure any consent obligation is satisfied at the outset by identifying

defense counsel and clearly informing the insurer that the insured is beginning to incur defense costs that will erode the retention. It is also a good idea to keep the insurer in the loop as matters progress—or at least give the insurer the opportunity to be kept informed. More critically, give the insurer advance warning when the invoice amounts become significant, offer to provide copies of the invoices and make sure the insurer understands when exhaustion of the retention is imminent.

In addition, it is important to bear in mind that most D&O policies prohibit commencement of settlement negotiations without the consent of the insurer. Again, the key is to avoid surprising your claims contact—best practice is to not make a settlement offer without first running it by the insurer, particularly if you are looking for insurer contribution.

Guidelines and Time Entries

In response to the notice of claim, the insurer should issue an acknowledgment followed later by a position letter confirming its obligation to advancement defense costs, often subject to a reservation of rights. Counsel should ascertain whether the insurer has issued any defense counsel guidelines, which would typically be referenced in or attached to the insurer's correspondence. It is important to keep these guidelines in mind when recording time entries. Some insurer guidelines prohibit block billing and require the time for each task to be separately noted. Others will not reimburse the insured for interoffice conferences or when multiple attorneys attend events without prior consent. Whether these and other restrictions are reasonable is a question for another day. However, it is important that defense counsel be cognizant of the guidelines so that neither counsel nor the client are surprised if certain invoiced amounts are not reimbursed.

Privilege Issues and Outside Reviewers

Defense counsel must also consider privilege issues when preparing or submitting invoices to an insurer who has issued a reservation of rights. While the insurer will need a sufficient task description to ascertain that the defense costs incurred are reasonable and related to the claim, counsel needs to be careful not to disclose privileged information that could potentially be discovered by a third party. See *Kingsway Financial Services v. Pricewaterhouse-Coopers*, 2008 WL 4452134 (S.D.N.Y. 2008). This creates some tension and may require careful redaction of invoices before submission to the insurers.

Privilege issues can be exacerbated where the insurer has retained a third-party contractor to review and recommend deductions with respect to defense counsel invoices. Our experience is that third-party contractors often seek unnecessarily specific descriptions of attorney tasks. Counsel should be prepared to address this issue through the appeals process which gives counsel an opportunity to respond and push back on inappropriate deductions or requests for descriptions that would require disclosure of privileged information.

Looking Forward

Given the increasing costs associated with defending lawsuits and regulatory investigations, clients are rightfully interested in maximizing their right to insurance coverage for legal defense fees. By considering the issues and following the practices discussed above, counsel can help protect their clients' right to advancement of defense costs under D&O insurance policies.

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