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Guest Post: Court Requires Insurers to Advance Insureds' Defense Costs

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In the following guest post, Syed Ahmad, Brittany Davidson, and Andrea DeField of Hunton & Williams LLP take a look at a very interesting New York trial court decision relating to D&O insurers' duty to advance defense costs. I would like to thank the authors for their willingness to allow me to publish their article as a guest post on my site. I welcome guest post submissions from responsible authors on topics of interest to this site's readers. Please contact me directly if you would like to submit a guest post. Here is the authors' guest post.

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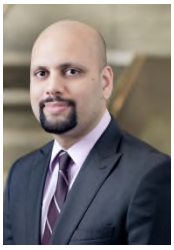

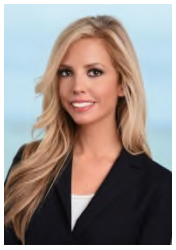

A New York trial court recently ruled against D&O insurers who refused to advance defense costs prior to the resolution of a criminal prosecution and civil enforcement action against their insureds. The Court granted the insureds' preliminary injunction motion and directed the insurers to advance defense costs explaining that without preliminary injunctive relief, the insureds would be irreparably harmed because they would be unable to mount adequate defenses and potentially face serious criminal and civil charges. Given the importance of ensuring that an insured's defense is funded timely, this recent ruling provides a helpful framework that insureds can rely on when insurers refuse to advance defense costs as required under insurance policies.

The insureds, Platinum Management (NY) LLC and its various officers and directors (the "Insureds"), were the subject of a criminal prosecution by the United States Attorney for the Eastern District of New York, a civil enforcement action by the Securities and Exchange Commission in the same court, and a parallel civil action in Texas state court. At this time, the Insureds had coverage under a tower of D&O policies. The primary and first level excess D&O policies provided coverage and were exhausted by payment of defense costs. The insurers providing the three layers above the exhausted policies (the "Excess Insurers"), however, disclaimed all coverage and filed suit seeking to have the D&O policies deemed void or have the Court find that they owed no coverage. Based on these defenses, the Excess Insurers refused to advance defense costs.

The Insureds moved for an injunction requiring the Excess Insurers to advance defense costs. The Insureds argued that they were suffering from the Excess Insurers' position because they were unable to

retain expert witnesses whose testimony was essential to refuting the Government's allegations. The Insureds also sought an order staying discovery pending resolution of the underlying lawsuits.

In response, the Excess Insurers argued that all coverage—including coverage for defense costs—was precluded for two reasons. First, the policies were void based on the Insureds' alleged breach of warranty statements signed at policy procurement stating that "no Insured has knowledge…of any wrongful act of any Insured," or any "fact, circumstances or situation which (s)he has reason to suppose might result in a claim being made against any of the Insureds." The Excess Insurers argued that this was a misrepresentation and, thus, a breach of the warranty statements because the Insureds did not disclose information contained in the criminal indictment and SEC proceeding. The Excess Insurers further argued that the Insureds received a subpoena in May 2015 from the U.S. Attorney for the Southern District of New York relating to an investigation into a bribery scheme by a non-insured third-party, but failed to disclose the subpoena in the insurance applications. The Insureds countered that the 2015 subpoena did not concern any of the wrongful acts alleged in the pending criminal indictment or SEC proceeding, and that no Insured was charged with wrongdoing in the S.D.N.Y. action. Therefore, the S.D.N.Y. subpoena did not result in a "Claim" against an Insured sufficient to trigger the warranty statement language.

Second, the Excess Insurers asserted that their policies provided no coverage by operation of the "Prior or Pending Demand or Litigation" ("PPL") exclusion. They argued the PPL exclusion precluded coverage because the pending actions "share a common nexus of facts and circumstances" to the S.D.N.Y. investigation into the non-insured third-party's bribery scheme.

The Court disagreed with the Excess Insurers. At the outset, the Court stated that under the D&O coverage, the Excess Insurers were required to make contemporaneous interim advancement of defense expenses where coverage is disputed, subject to recoupment if it is later determined that there is no coverage.

The Court held that the Insureds had not been found guilty of any charges in the pending criminal indictment or SEC proceeding and, therefore, the D&O policy still remained in effect. The Court further disagreed with the Excess Insurers' coverage defenses. The Court held that the Insureds did not breach the warranty statements because the undisclosed S.D.N.Y. subpoena involved alleged conduct that was distinct from the conduct alleged in the criminal indictment and SEC proceeding. The Court likewise held that the Excess Insurers failed to prove that the PPL exclusion applied because the Excess Insurers "made no attempt to compare the facts and circumstances as alleged in the SDNY investigation commenced during the prior policy period with those alleged in the [criminal indictment and SEC proceeding], both of which were commenced during the policy period."

Importantly, the Court found that the Excess Insurers' failure to advance defense costs constituted a "direct, immediate and irreparable injury" warranting a preliminary injunction. The Court reasoned that if the Excess Insurers failed to advance defense costs, then the Insureds would be unable to provide adequate defenses in connection with the criminal indictment when key pre-trial motions were already due, the Government had already produced over 15 million of pages of documents in ongoing discovery, and the Insureds were in need of funds to pay for expert witnesses and consultants necessary to mount an adequate defense. In contrast, the Excess Insurers would only face the economic risk of having to

advance defense costs but could then seek recoupment of such funds if the Insureds were ultimately not entitled to coverage.

Furthermore, the Court granted the Insureds' stay on discovery. The Court held that it would be premature to determine if there was coverage at this time where the Excess Insurers' coverage defenses were dependent on the outcome of the pending criminal indictment and SEC proceeding. The Court noted that the "purpose of D&O insurance is to provide advancement of defense fees and costs to directors, officers, and employees in the event claims are made against them for alleged wrongful acts." The Court held that "a declaratory judgment action cannot be used to conduct discovery regarding the very facts at issue in the [criminal indictment and SEC proceeding]. Discovery aimed at establishing non-coverage must await outcome of the underlying criminal and civil proceedings."

This ruling is consistent with an earlier New York court decision requiring D&O insurers to advance defense costs to their insureds pending a final resolution of the matter, subject to recoupment in the event of an ultimate determination of no coverage. See Li v. Certain Underwriters at Lloyd's, London, et al., No. 15 CV 06099 (E.D. N.Y. filed Apr. 27, 2016) (granting insured's request for preliminary injunction ordering D&O insurers to advance defense costs pending final resolution of an indictment for an alleged intentional racketeering conspiracy).

The Platinum Management case is a helpful decision for insureds facing underlying claims and simultaneously dealing with insurance coverage disputes. The case provides a good framework for insureds seeking expedited relief through a preliminary injunction. This route is a good alternative to allowing the coverage dispute to be litigated in the normal course because that can take longer than resolution of the underlying claims. To the extent funding the defense of the claims an insured faces is an important concern, Platinum Management is an important ruling to consider. The case is Freedom Specialty Ins. Co., et al. v. Platinum Mgmt. (NY), LLC, et al., 2017 BL 468437 (N.Y. Sup. Ct. filed Dec. 21, 2017).

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