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Duty To Advance Defense Expenses Should Mean What It Says Under D&O Policies

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When an insurance policy has a “duty to advance,” rather than a “duty to defend,” is it appropriate for an insurer to wait until the conclusion of a claim to advance defense costs? This issue has arisen with more frequency in connection with directors and officers (D&O) liability insurance policies. D&O insurance policies often require insurers to, among other things, advance defense expenses on a current basis before disposition of a claim for which the policy provides coverage.

Notwithstanding this language, certain insurance companies have been taking an aggressive position, saying they cannot know if a claim is “covered” until the final disposition of a claim. They have asserted they do not need to pay defense costs until the claim has been resolved.

Duty to Advance as a Restriction on Coverage?

It is not appropriate, in our view, for insurance carriers to rely on the duty to advance as a reason to refuse to advance defense costs. Traditionally, the

duty to advance was an enhancement to coverage for corporate policyholders, allowing them to pick their defense counsel of choice. Lately, insurance companies have argued that the duty to advance is a restriction on coverage, and does not provide the broad protections attributed to policies with a duty to defend.

This position is a narrow interpretation of coverage and, in our view, not supported by the policy language. As a preliminary matter, the express contractual language of D&O policies generally requires insurers to advance defense expenses on a current basis (i.e., before conclusion of a claim). Consistent with this, multiple decisions from courts in California have refused to ignore D&O insurers' contractual promise to advance defense costs before disposition of a claim. Courts around the country, including in New York, Delaware, and Ohio have ruled the same way.

In fact, rather than evaluating the obligation to advance defense expenses based upon an actual coverage standard, many courts have determined that a "potentiality" for coverage standard applies to a D&O insurer's obligation to advance defense costs. That is, if the claim or lawsuit pending against the insured contains allegations that could be covered, the insurance carrier has to advance defense costs on a contemporaneous basis. Because D&O policies generally cover alleged wrongful acts, insurers' duty to advance defense expenses is likewise subject to the potential for coverage.

Like other defense obligations, the duty to advance defense costs would be illusory if the insured had to wait for a determination of actual coverage to obtain the necessary funding for its defense. Otherwise, an insurer could refuse to advance defense costs unless and until a court determines that the costs are "covered," which would effectively render the advancement obligation worthless.

Further highlighting insurers' duty to advance defense costs before final disposition of a claim, D&O policies generally contain allocation and reimbursement provisions should a claim allege both covered and non-covered matters.

How to Address a Refusal to Advance Defense Costs

What should an insured do if an insurance carrier refuses to advance defense costs on a contemporaneous basis? If faced with an insurer's position that a duty to advance does not require it to advance defense expenses before the conclusion of a claim, a best practice is not to take the insurer's position at face value. A best practice is to review the insurance carrier's position letter and respond in a manner that accounts for the obligation to advance defense costs as they are incurred, rather than reimburse them after the conclusion of a matter.