

The Need To Advance Advancement: Lessons for New York From Delaware

Advancement is often the nail that will determine whether the kingdom is lost.

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When companies and individuals purchase insurance they are typically concerned not only with protecting themselves from any liabilities, but in assuring that they are afforded a vigorous defense should a claim be brought against them. This right to be provided a defense is called “advancement” and requires that insurers (or other parties such as employers) fund the defense of the insured through the life of the litigation. That is in contrast to “indemnification,” which only requires payment upon the resolution of the underlying dispute.

Advancement is available under a wider range of circumstances and is considered a far broader right than indemnification, as it often requires that an insurer provide a defense in situations where an unfavorable result at trial would negate a claim for indemnification. Accordingly, the quality of the defense for the underlying claim will influence both the findings on liability for the claim and whether the insured can qualify for indemnification. Therefore, advancement is often the nail that will determine whether the kingdom is lost.

While an insured may ultimately have an obligation to reimburse defense costs if they are not entitled to indemnification, often if the underlying matter has gone poorly the insured may not have the funds available to cover the underlying judgment and reimbursement of defense costs. Insurance is intended to shift the risk of collection to the insurer in these circumstances. In light of this, at times insurers may be incentivized to deny advancement claims in the hope that a decision in the underlying matter will obviate their need to pay at all.

In these circumstances, insureds find themselves in the difficult position of facing a serious claim without the benefit of coverage and then having to pursue a separate suit against their insurer. This can be an expensive endeavor with an insured having to unexpectedly fund not just one case, but two. Furthermore, added coverage litigation shifts the insured’s focus from defending the underlying claim to funding their defense—adding complications to the insured’s relationship with

their attorney. Even for well-funded insureds, the reality of paying for two lawsuits can be daunting and will usually mean tough strategic decisions based on associated costs.

Advancement Through Temporary Restraining Orders

Making matters worse, New York's state and federal courts provide no clear process to expediate resolution of advancement claims arising from insurance contracts. Instead, claimants typically seek advancement against insurers by attempting to squeeze through the rubric of a temporary restraining order (TRO). This generally requires the showing of "irreparable harm", a term that is often interpreted as requiring that the movant show that their injury cannot be addressed through an award of money damages (*Forest City Daly Hous. v. Town of North Hempstead*, 175 F.3d 144, 153 (2d Cir.1999)). This can be a subtle argument for insureds to make considering they are asking the court to order the insurer to pay money.

In *In re WorldCom Securities Litig.*, 354 F. Supp. 2d 455, 463 (S.D.N.Y. 2005) (*WorldCom*) the district court appeared to take a step forward by holding that whether the individual *WorldCom* directors had sufficient funds should not be part of the analysis in determining if they were entitled to a TRO requiring their D&O insurer advance costs. *Id.* at 463. As stated by the *WorldCom* court: "The issues here surmount whether an individual director has or does not have sufficient funds to pay counsel when confronted with litigation stemming from service as a corporate director. In some cases the litigation will be minor; here it is massive. In some cases a director will have great personal wealth; in other cases she will not. The issue here is whether every director protected by a policy [] is entitled to ongoing payment of defense costs until there is a judicial determination that that right does not exist." *Id.* at 470.

While the *WorldCom* court seemingly recognized that the TRO irreparable harm analysis was not appropriate in determining an insured's right to advancement, it still explained the serious harm associated with proceeding to litigation without the benefit of fully funded counsel. As the opinion noted, "[i]t is impossible to predict or quantify the impact on a litigant of a failure to have adequate representation []. The ability to mount a successful defense requires competent and diligent representation. The impact of an adverse judgment will have ramifications beyond the money that will necessarily be involved. There is the damage to reputation, the stress of litigation, and the risk of financial ruin—each of which is an intangible but very real burden." *Id.* at 469.

Despite the *WorldCom* holding on the immateriality of an individual's ability to finance a litigation, that has not stopped other courts from continuing to require that individual insureds establish irreparable harm by proving that they are unable to fund their defense and that, without funding, their counsel would withdraw. See *Kaloyeros v. Ft. Schuyler Mgt.*, 49 N.Y.S.3d 867 (N.Y. Sup. 2017), *aff'd*, 69 N.Y.S.3d 739 (3d Dept. 2018). Even when courts find irreparable harm, they still often focus on factors such as the insured's financial status that should not affect their

contractual right to a defense. See, e.g., *In re Platinum-Beechwood Litig.*, 378 F. Supp. 3d 318 (S.D.N.Y. 2019) (“manager’s pro se status during much of one third-party action supported need for advance”).

Moreover, corporations are held to a higher standard than individuals despite bargaining for the same advancement protections. Courts have recently held that for a corporation to demonstrate the necessary irreparable harm it must show (1) it cannot afford to pay legal fees in the underlying litigation absent insurance coverage; (2) absent payment of those legal fees, its current counsel will withdraw; and (3) a significant proceeding, such as a trial, is imminent in the underlying litigation. *Rochester Drug Co-Operative v. Hiscox Ins. Co.*, 6:20-CV-06025 EAW, 2020 WL 906872, at *2 (W.D.N.Y. Feb. 25, 2020).

As a result, we are left with a system that requires insureds to prejudice their defense and come to the edge of ruin before their claims for advancement can be expedited. Moreover, by requiring parties seek advancement through the TRO irreparable harm rubric, the same contractual provisions are being given different force and effect depending on the financial status of the party bringing the claim. Neither of these results is desirable.

Separating Advancement From Irreparable Harm

Thankfully there is a simple solution. New York’s state and federal courts can adopt procedures similar to those in place in Delaware to address advancement of officers and directors by a company. Pursuant to Del. Code Ann. Title 8, §145, the Court of Chancery is vested with exclusive jurisdiction to hear all claims regarding the advancement of costs and subsequent indemnification claims brought against a company.

In order to go before the Court of Chancery, one files a petition for advancement. *Danenberg v. Fitracks*, 2012 WL 11220 at *4 (Del. Ch. Jan. 3, 2012). The proceeding that takes place is summary in nature and is limited to determining the issue of entitlement in accordance with a corporation’s advancement provisions. *Homestore v. Tafeen*, 888 A.2d 204, 213 (Del. 2005), citing *Kaung v. Cole Nat’l*, 884 A.2d 500, 510 (Del. 2005). These summary proceedings determine advancement, whereas a determination on the right to indemnification is stayed until the conclusion of the matter. *Kaung*, 884 A.2d at 509. The proceedings are structured in this way specifically to make advancement more accessible. See *Homestore*, 888 A.2d at 211.

While New York has not defined the procedure as well as Delaware, it too has granted its courts the authority to order the advancement of defense costs of officer and directors by their employer, “if the court finds that the defendant seeking advancement has raised genuine issues of fact or law.” N.Y. Bus. Corp. Law §724(c). However, in both New York and Delaware these statutory advancement provisions are in the context of corporate advancement rather than by an insurer.

Despite this statutory limitation, there is no compelling reason why the two should be treated differently.

Accordingly, New York should put in place clear statutory authority and processes to allow for all applications for advancement to be addressed at a summary hearing without the need for an insured to seek a TRO or demonstrate irreparable harm. This would assure that claimants receive the benefit of the insurance they purchased without requiring them to exhaust their saving, potentially alienate their counsel, and limit their defense. It is imperative that defendant insureds be allowed to determine quickly and efficiently from the onset whether they are entitled to a funded defense. Otherwise, our system is allowing insurers to convert their advancement obligation to potential indemnification obligations, forever depriving the insured of the very coverage they purchased.

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