

Court Equates Insurer's Duty to Advance Defense Costs with Duty to Defend

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The United States District Court for the Central District of California, applying California law, has held that the duty to advance defense costs should be interpreted as broadly as the duty to defend. *Acacia Research Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. SA CV 05-501 (C.D. Cal. Feb. 8, 2008). The court also held that the allocation of defense expenses is inappropriate where a company and an officer present a joint defense to covered claims arising solely out of the officer's actions and for which the company indemnified the officer.

The insurer issued a D&O policy to a technology company that was sued for allegedly misappropriating trade secrets. The officer of the company had developed technology that led to two patents that were assigned to the company, but for which a previous employer of the officer claimed it had legal rights. The officer and the company presented a common defense that the technology had not been stolen. The company ultimately settled the litigation. Under the terms of the settlement, the plaintiff company acknowledged that the insured company owned the rights to the patents and technology.

The insured company gave notice of the claim to its D&O insurer shortly after the suit was filed. The insurer acknowledged receipt of the claim and, several months later, requested additional information. The company responded with additional information, litigation updates, and a request for the advancement of defense costs. The insurer, however, did not respond to the request for payment and issued its first coverage letter, denying coverage, almost three years after the company gave written notice of the claim and over a year after the settlement. The company then brought this coverage action for reimbursement of the settlement and defense costs.

Following trial, the court concluded that the company had properly given notice of a covered claim under the policy. The policy provided that after receipt of written notice of a claim, "the Insurer shall advance excess of the applicable retention...covered Defense Expenses every ninety (90) days." The insurer argued that the company failed to make a valid claim because it never notified the insurer that the retention had been exhausted. The court, citing case law from other jurisdictions, stated that "the duty to advance defense costs is as broad as the duty to defend" and determined that the insurer's duty to advance defense costs arose when the company tendered a potentially covered claim. The court concluded that the insurer, based both on this duty and its duty of good faith and fair dealing, was required to investigate the claim to determine whether it

was potentially covered and, in doing so, should have ascertained that the retention had been satisfied. The insured thus was not required to give a separate notice that the retention had been exhausted. The court stated that the insurer had put its own interests above those of the insured when it failed to respond to the company's request for defense costs and remained inactive with respect to the claim for several years. Therefore, the insurer could not "convincingly argue that [the insured] did not submit a valid claim under the Policy terms when [the insurer] failed its duties to [the insured] to act on [the insured's] claim."

The court then considered the issue of allocation. The policy provided entity coverage to the extent the company indemnified directors and officers for covered claims. The insurer, however, asserted that the policy afforded no coverage for the company directly, and thus, an allocation was required. In addressing the issue, the court first held that claims against the officer were covered under the policy and that the company was entitled to reimbursement for its indemnification of the officer. The court then determined that allocation of defense costs was inappropriate because all of the underlying claims arose out of the officer's alleged wrongful acts, and thus, all defense costs the company incurred arose out of the indemnification of the officer.

The court also determined that the settlement constituted a covered loss under the policy. Although the insured provided a transfer of stock and patent royalties to the other company under the terms of the settlement, the court determined that the settlement did not constitute restitution. The court concluded that evidence presented in the coverage action showed that the insured had not stolen any trade secrets. The court therefore distinguished cases in which the payment of patent royalties had been found uninsurable loss because the patent royalties in this case did not constitute ill-gotten gain.

After concluding that the policy provided coverage and that the insurer had acted in bad faith for unreasonably denying benefits, the court awarded the company the entire amount of the settlement (which exceeded policy limits), defense costs, and interest.