

## Officers Denied Preliminary Injunction to Require Insurer to Advance Defense Costs

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The federal court in Manhattan recently denied two former officers' motion for a preliminary injunction requiring their D&O insurer to advance defense costs despite the insurer's denial of coverage as a result of a misrepresentation in the application process. *Gaon v. Twin City Fire Ins. Co.*, No. 1:05-CV-04477-KMW (S.D.N.Y. Jun. 3, 2005). The court held that the officers failed to satisfy the last two prongs of the Second Circuit's preliminary injunction standard, which required the officers to demonstrate "sufficiently serious questions going to the merits to make them a fair ground for litigation" and "a balance of hardships tipping decidedly in [their] favor." Wiley Rein & Fielding LLP represented the insurer in the case.

The former chief executive officer and chief financial officer of a bankrupt corporation sought coverage for two securities lawsuits under a D&O insurance policy. The policy contained a representation and severability provision, which provides that, if "the particulars and statements contained in the Proposal are untrue," there is no coverage for "any Director or Officer who knew as of the Inception Date of this Policy the facts that were not truthfully disclosed in the Proposal" whether or not such director or officer "knew of such untruthful disclosure in the Proposal." The insurer denied coverage based on the representation and severability provision because the two former officers had knowledge of a misrepresentation of fact in the application for the policy.

After filing a coverage action, the former officers sought a preliminary injunction requiring the insurer to advance defense costs pending resolution of the coverage litigation. The former officers argued that, because the policy provides for the advancement of defense costs as they are incurred, the insurer was required to advance all of their defense costs for the underlying litigation. Moreover, the officers maintained that they would be irreparably harmed if they were not awarded defense costs because they would be unable to fund the ongoing litigation. With respect to the balancing of the hardships, the officers claimed that the insurer would not be harmed by advancing defense costs because it was obligated to do so under the policy and the officers would agree to repay the defense costs if the court ultimately determined that there was no coverage.

The insurer responded that it was obligated under the policy to advance only those defense costs incurred in connection with covered matters. Thus, because there was no coverage for the securities litigation under the representation and severability provision, the insurer maintained that it had no duty to advance costs and therefore the officers could not show a substantial likelihood of success on the merits. The insurer also noted

that the insureds' position was inconsistent with the policy's allocation provision, which obligated the insurer to advance only those defense costs that it believes to be covered until a different allocation is negotiated, arbitrated or judicially determined. The insurer also contended that the officers would not suffer irreparable harm if the court denied the motion because any defense costs incurred could be addressed by requiring the insurer to pay monetary damages if the officers were to prevail on the merits in the coverage action.

The court denied the motion for a preliminary injunction based on the officers' failure to prove that "sufficiently serious questions going to the merits" existed. The court found that the evidence produced by the insurer strongly suggested that both officers had knowledge of the truth of the fact misrepresented in the application. The court also held that the balance of hardships did not tip decidedly in the officers' favor. The court opined that the insureds' argument concerning the balance of the hardships was inconsistent. On the one hand, the officers claimed that they would be irreparably harmed if the court did not order the insurer to advance their defense costs because they could not afford to pay the defense costs. On the other hand, however, the officers argued that the insurer would not be harmed if the court granted the motion because the officers could be ordered to repay the defense costs if the insurer were successful on the merits. The court opined that if the officers could not afford the defense costs now, then they likely could not repay the insurer at a later time. For purposes of the ruling, however, the court assumed that the officers would suffer irreparable harm, but concluded that that factor alone was not sufficient to support the issuance of the injunction.

For more information, please contact us at 202.719.7130.