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NEWSLETTER

Law Firm Has No Rights Under D&O Interim Funding Agreement

May 2005

In an unreported decision, the United States District Court for the Southern District of New York has held that a law firm representing a director of a company insured under a D&O policy could not require the insurer to continue paying its fees after the insurer denied coverage to the director. *Litman, Asche & Gioiella, LLP v. Chubb Custom Ins. Co.*, 2005 WL 926925 (S.D.N.Y. Apr. 20, 2005). The court rejected the defense counsel's argument that it was entitled to recover some of its legal expenses under theories of breach of implied contract, unjust enrichment or promissory estoppel.

The insured, a fund manager company, purchased a D&O policy from the insurer. Subsequently, the president and the general counsel of the fund manager company were indicted on charges relating to a scheme to bribe a state official. After the officers were indicted, the insured company sought payment of defense costs from the insurer.

The insurer initially advanced defense costs, subject to a reservation of rights to disclaim coverage and seek recoupment of payments. Later, a dispute arose regarding the insurer's willingness to advance defense costs, and in June and July 2002, the insurer entered into two defense cost reimbursement agreements, one with the company and another with one of the indicted former officers. The June 2002 agreement, which was entered into between the insurer and the company, provided that the insurer would advance those defense cost funds that the insurer "believes ... reimbursable" under the policy. Under the June 2002 agreement, the insurer also expressly reserved "the right to determine whether [expenses incurred after February 28, 2002] are reimbursable."

The general counsel then entered into an agreement with the insurer in July 2002, after retaining new defense counsel. According to the court, the July 2002 agreement "modified" the June 2002 agreement and was negotiated on the general counsel's behalf by his new defense counsel. Under the July 2002 agreement, the insurer agreed to pay the defense counsel's fees without scrutinizing them for reasonableness. The court stated that defense counsel "in return" agreed to a specific budget, payment schedule and limit on overall fees. The agreement stated that the insurer's obligations remained subject to the terms of the D&O policy and the insurer's ongoing "reservations of rights ... including the right to seek recoupment from the insureds of advanced defense costs if it ultimately determines that there is no coverage under the Policies for the criminal action." The insurer additionally agreed to pay the law firm directly.

The general counsel was subsequently convicted at trial of several crimes. Based on the conviction, the insurer concluded that an exclusion in the D&O policy for claims based on receipt of illegal profits or advantages by the insured relieved it of any obligation to pay general counsel's defense costs. Accordingly, the insurer ceased defense cost payments. The insurer also sued the general counsel in Massachusetts state court, seeking recoupment of amounts previously advanced. The defense firm continued providing services to the general counsel and filed suit in the District Court for the Southern District of New York, claiming breach of implied-in-fact contract, unjust enrichment and estoppel.

The district court rejected all three of the law firm's arguments. First, the court rejected the defense firm's claim of unjust enrichment, noting that the law firm was not a party to the July 2002 defense cost reimbursement agreement, which was signed by the general counsel and the insurance company. The court also reasoned that the July 2002 agreement had expressly stated that the agreement "shall not be construed or interpreted to create any contractual relationship or obligations between [the insurer] and [defense counsel]."

Second, the court rejected the law firm's argument for unjust enrichment, reasoning that the law firm "conferred no benefit on Chubb," since the beneficiary of the legal services was the general counsel, not the insurer. The court explained that, under the policy, the insurer was obligated to reimburse the general counsel for his legal fees, "not to get him a lawyer."

Finally, the court dismissed defense counsel's argument based on promissory estoppel, explaining that a key element of such a claim is justifiable reliance. The court concluded that the insurer, by virtue of both the June and July 2002 agreements, had "unequivocally" put the insureds and their defense counsel on notice that it had reserved the right to disclaim coverage and that it had not yet determined whether it was obligated to pay defense costs. The court additionally noted that any "promises" that the insured had made in the July 2002 agreement had been "expressly hedged" by its reservation of rights.

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