Delaware Supreme Court Provides Guidance Regarding D&O Liability Insurance Coverage

Contributors

Nicole A. DiSalvo, Associate

Daniel S. Atlas, Associate

> See page 4 for key takeaways

The Delaware Supreme Court has issued two decisions over the past year that provide important guidance about directors' and officers' (D&O) liability insurance coverage. In *RSUI Indemnity Company v. Murdock*, the Supreme Court affirmed decisions holding that losses due to the fraudulent actions of an officer or director of a Delaware corporation are insurable under Delaware law. As part of its analysis, the Supreme Court conducted and affirmed a choice-of-law analysis to determine that Delaware law applied even though the D&O policy was negotiated and issued in another state. In *In re Solera Insurance Coverage Appeals*, the Supreme Court reversed a lower court ruling, holding instead that an appraisal action was not a "Securities Claim" — and therefore, not a covered claim — under the at-issue D&O policy.

RSUI Indemnity Company

In November 2013, David Murdock — Dole Food Company, Inc.'s CEO, director and 40% stockholder at the time — engaged in a going-private transaction, resulting in class action litigation and an appraisal action in the Court of Chancery in which former Dole stockholders challenged the fairness of the transaction and alleged breaches of fiduciary duty by Mr. Murdock and Dole's president, COO and general counsel, Michael Carter. The court held in its post-trial opinion that Mr. Murdock and Mr. Carter breached their fiduciary duty of loyalty and "engaged in fraud" by, among other things, intentionally depressing Dole's premerger stock price.[1]

Before the Court of Chancery approved a settlement of the class action litigation, different stockholders, who had sold their stock in Dole before the going-private transaction, brought a federal securities class action in the District of Delaware. Before both the federal class action was settled and the Court of Chancery approved the settlement of the Delaware class action litigation, several of Dole's D&O insurers who issued primary and excess directors' and officers' insurance policies, including RSUI Indemnity Company, filed an action against Dole and Mr. Murdock in the Delaware Superior Court seeking a declaratory judgment that they had no obligation to fund the settlement.

In seeking a declaratory judgment, RSUI and other insurers alleged that favorable California law — specifically California Insurance Code Section 533, which bars insurance coverage for willful acts — should apply because the D&O policies were negotiated and issued in California and Dole is headquartered in California. During the course of the Superior Court litigation, all D&O insurers — except for RSUI — settled their claims and voluntarily dismissed them with prejudice. Following the Superior Court's ruling on cross motions for summary judgment, the court entered final judgment in favor of Dole and Mr. Murdock and against RSUI in the amount of $10,000,000 — its policy limit — plus $2,321,095.90 in prejudgment interest. RSUI subsequently appealed the final judgment to the Delaware Supreme Court.

The Delaware Supreme Court affirmed the Superior Court's holding that RSUI's D&O policy should be interpreted under Delaware law and that losses resulting from fraudulent actions under the policy are insurable. The court began by reviewing the often cited Restatement (Second) Conflict of Laws' "most significant relationship test" for determining which state's law to apply, including Sections 188 and 193, which discuss

[1] *In re Dole Food Co., Inc. Stockholder Litigation*, 2015 WL 5052214, at *26, *38 (Del. Ch. Aug. 27, 2015).

choice-of-law questions involving insurance coverage disputes and contract disputes more broadly. After reviewing the various factors in the Restatement, the court noted that the "most significant relationship" test does not yield precise results depending on the type of insurance coverage; therefore, parties applying the same test and factors can reach different conclusions.

Relying on a prior choice-of-law analysis by the Superior Court in *Mills Ltd. Partnership v. Liberty Mutual Insurance Co.*,[2] the Delaware Supreme Court held that "[w]hen the insured risk is the directors' and officers' 'honesty and fidelity' to the corporation," including to its stockholders and investors, "and the choice of law is between headquarters or the state of incorporation, the state of incorporation has the most significant interest."[3] In reaching this determination, the court focused on several factors, including (i) the D&O policy's title of "Directors, Officers and Corporate Liability"; (ii) Dole's position, as the policyholder, as a Delaware corporation at all relevant times; (iii) the fact that the D&O policy insures Dole's duly elected or appointed directors and officers; and (iv) RSUI's obligation to pay for "wrongful act[s]" committed by directors and officers "*in their capacity* as such."[4] Additionally, the court noted that because Delaware law generally governs the duties of the directors and officers of Delaware corporations, such corporations must assess their need for D&O coverage with reference to Delaware law. The court thus held that Delaware was the appropriate law to apply to the dispute, and that the California location of Dole's physical headquarters did not alter this conclusion.

Next, the Delaware Supreme Court analyzed the D&O policy under Delaware law, affirming the Superior Court's holding that losses resulting from fraud are insurable. The court determined that Dole's typical D&O policy had an expansive definition of covered losses; thus, "[a]llegations of fraud fit comfortably within these terms defining the scope of coverage."[5] Despite RSUI's arguments to the contrary, the court further held that Delaware does not have a public policy against the insurability of losses occasioned by fraud so strong as to vitiate the parties' freedom of contract because, among other reasons, Section 145 of the Delaware General Corporate Law directly authorizes corporations to purchase D&O insurance "against any liability" asserted against their directors and officers. Accordingly, the court affirmed the Superior Court's final judgment ordering RSUI to pay Dole and Mr. Murdock their policy limit plus prejudgment interest.

In re Solera Insurance Coverage Appeals

In March 2016, an affiliate of Vista Equity Partners acquired Solera Holdings, Inc., resulting in several stockholders objecting to the merger. These stockholders filed appraisal petitions under Title 8 of Delaware Code § 262, seeking a determination of the fair value of their shares. In January 2018, after the appraisal trial concluded, Solera notified its D&O insurers of the appraisal action and requested coverage under the insurance policies.

Under the primary D&O policy, XL Specialty Insurance Company agreed to pay for any "Loss resulting solely from any Securities Claim first made against an Insured during the Policy Period for a Wrongful Act." The primary policy defined "Securities Claim" to include a claim "made against [Solera] for any actual or alleged violation of any federal, state or local statute, regulation, or rule or common law regulating securities, including but not limited to the purchase or sale of, or offer to purchase or sell, securities … ."

[2] 2010 WL 8250837 (Del. Super. Ct. Nov. 5, 2010).

[3] *RSUI Indem. Co. v. Murdock*, 2021 WL 803867, at *8 (Del. Mar. 3, 2021).

[4] *Id.* (emphasis in original).

[5] *Id.* at *10.

XL denied Solera's coverage request. As a result, Solera filed an action in Superior Court against its insurers for breach of contract and a declaratory judgment, seeking coverage for the interest and expenses it incurred in the appraisal action. Solera alleged that, pursuant to its primary policy, the appraisal action constituted a Securities Claim because, among other things, petitioners had alleged a "violation" of Section 262 and purported securities violations in connection with the sales process.

A motion for summary judgment crystalized the issue before the Superior Court. The court denied the motion, holding that an appraisal action under Section 262 constituted a Securities Claim. The court further held that a "violation" under the primary policy did not require an allegation of "wrongdoing." Rather, the court found that a violation (undefined under the policy), "simply means, among other things, a breach of the law and the contravention of a right or duty."[6] The court held that "the appraisal petition necessarily alleges a violation of law or rule" because "[b]y its very nature, a demand for appraisal is an allegation that the company contravened [stockholders'] right[s] by not paying stockholders the fair value to which they are entitled" under Section 262.[7]

Thereafter, the Delaware Supreme Court agreed to hear an interlocutory appeal of the decision. Ultimately, the court reversed the decision, holding that an appraisal action did not fall within XL policy's definition of a Securities Claim because no "violation" occurred. The court began by analyzing the plain meaning of the word "violation," reviewing various definitions of the term in such dictionaries as Black's Law and Webster's and concluding that a "violation" suggests an element of wrongdoing. The court held that "[s]cienter may not be required, but contravention of a statute's prohibition is, nevertheless, a wrongdoing."[8]

To determine whether appraisal actions are proceedings that adjudicate wrongdoing (including breaches of fiduciary duty), the court reviewed the historical background of the appraisal remedy, reiterating that the only issue in an appraisal trial is the fair value of the company's stock. Turning to the text of Section 262, the court noted that the appraisal statute affords only a limited remedy to stockholders who exercise their appraisal rights. The court observed that the appraisal petition in this case, as is typical, contained no allegations of actual wrongdoing. "Rather, any such alleged wrongdoing is frequently addressed, as it was here, in a separate stockholder fiduciary litigation brought by stockholders against the target board's directors."

The court held that the purpose of an appraisal proceeding is "neutral," and unlike in most other proceedings, both sides bear the burden of proving their respective valuation positions by a preponderance of evidence. The court further determined that appraisal proceedings are neutral because the Court of Chancery makes an "independent" assessment of a company's fair value by considering "all relevant factors." For all of these reasons, the court held that an appraisal action did not constitute a "Securities Claim" as defined by the insurance policy at issue, mooting the remaining issues on appeal.

[6] *Solera Holdings, Inc. v. XL Specialty Ins. Co.*, 213 A.3d 1249, 1256 (Del. Super. Ct. 2019), *rev'd sub nom. In re Solera Ins. Coverage Appeals*, 240 A.3d 1121 (Del. 2020).

[7] *Id.*

[8] *In re Solera Ins. Coverage Appeals*, 240 A.3d at 1133

Takeaways

- D&O policies, at least those issued domestically in the U.S., are typically silent as to choice of law. *Solera* serves as an important reminder that in the D&O insurance context, absent a choice of law provision in the policy, Delaware courts typically will apply the law of a company's state of incorporation, while other jurisdictions may reach a different choice-of-law determination. Therefore, where a coverage action is filed can determine its outcome.
- As with other insurance policies, D&O policies are creatures of contract, and their terms and conditions (*e.g.*, the specific definition of "Securities Claim" and the exact contours of the fraud exclusion) — which can vary widely from policy to policy — will control whether a particular claim is covered.
- Delaware corporations seeking coverage from losses arising from an appraisal action should seek to ensure that their policies cover at least defense costs arising from such proceedings.

Contacts

Litigation

Cliff C. Gardner
302.651.3260
cliff.gardner@skadden.com

Edward B. Micheletti*
302.651.3220
edward.micheletti@skadden.com

Robert S. Saunders
302.651.3170
rob.saunders@skadden.com

Paul J. Lockwood
302.651.3210
paul.lockwood@skadden.com

Jenness E. Parker
302.651.3183
jenness.parker@skadden.com

Jennifer C. Voss
302.651.3230
jennifer.voss@skadden.com

Mergers & Acquisitions

Faiz Ahmad
302.651.3045
faiz.ahmad@skadden.com

Steven J. Daniels
302.651.3240
steven.daniels@skadden.com

Allison L. Land
302.651.3180
allison.land@skadden.com

Corporate Restructuring

Anthony W. Clark
302.651.3080
anthony.clark@skadden.com

Joseph O. Larkin
302.651.3124
joseph.larkin@skadden.com

Carl Tullson
302.651.3142
carl.tullson@skadden.com

*Editor

Special thanks to **Stephen F. Arcano** and **Peter Luneau**.

One Rodney Square / 920 N. King St. / Wilmington, Delaware 19801 / 302.651.3000

One Manhattan West / New York, NY 10001 / 212.735.3000