# Insights: The Delaware Edition

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Contents

1 / *Presidio* Shines Light on Key Delaware Deal Litigation Trends and Topics

6 / Delaware Courts Expand Plaintiffs' Rights in Section 220 Cases

9 / *Caremark* Update: Delaware Court of Chancery Dismisses Two 'Oversight' Derivative Actions Arising From Government Investigations

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

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

This issue covers important, developing areas of Delaware corporation law and deal litigation, including two recent Court of Chancery opinions discussing *Caremark* claims, Delaware's expansion of plaintiffs' rights in Section 220 lawsuits, the Delaware Supreme Court's guidance about directors' and officers' liability insurance coverage, and Vice Chancellor Laster's notable opinion in *Presidio*.

## *Presidio* Shines Light on Key Delaware Deal Litigation Trends and Topics

Contributors

**Edward B. Micheletti,** Partner

**Bonnie W. David,** Counsel

**Ryan Lindsay**, Associate

**> See page 4 for key takeaways**

In *Firefighters' Pension System of the City of Kansas City, Missouri Trust v. Presidio, Inc.*, Vice Chancellor Laster of the Delaware Court of Chancery dismissed claims against directors of Presidio, Inc. (Presidio) and Presidio's controlling stockholder arising out of the sale of Presidio, while sustaining claims against Presidio's Chairman/CEO, the buyer (Buyer) and Presidio's financial advisor. The case is notable for the stockholder plaintiff's allegation of an undisclosed "tip" from the financial advisor to the buyer that purportedly allowed the buyer to strategically increase and structure its offer and close the deal.

The decision — which the court labeled as an "Opinion," indicating it was intended to cover significant or novel issues — addresses several deal litigation topics and is worthy of analysis by M&A practitioners. The court discusses (i) the applicable standard of review for the sale of a controlled company to a third party, and the applicability of the "*Synthes* safe harbor"; (ii) potential liability for financial advisors premised on a "fraud-on-the-board" theory; and (iii) the continuing trend of breach of fiduciary duty claims against officers, who are not protected by exculpation provisions in a corporation's certificate of incorporation.

### Background

The case arose from the acquisition of Presidio in December 2019. Approximately seven months earlier, in May 2019, Presidio's controlling stockholder began exploring a sale of the company, assisted by financial advisor LionTree Advisors, LLC (LionTree). The controller and LionTree held early exploratory meetings with a potential financial buyer, and Clayton Dubilier & Rice, LLC (CD&R), a potential strategic buyer. In June 2019, LionTree and Presidio's chairman/CEO met with CD&R about a possible transaction with Presidio. CD&R allegedly suggested to the chairman/CEO that it desired a merger of equals with a portfolio company, in which his continued employment would not be guaranteed.

According to the plaintiffs, neither LionTree nor the chairman/CEO disclosed the meeting with CD&R to Presidio's board until several weeks later. The plaintiffs further alleged that when the meeting was disclosed, LionTree characterized it as "a casual discussion of the landscape" and told the board that CD&R had been "in no rush to consider strategic options."



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In early July 2019, the Buyer contacted LionTree to discuss a potential acquisition of Presidio. The plaintiffs alleged that at a meeting on July 8, 2019, during which Presidio's board considered whether to engage with the Buyer and/or solicit interest from CD&R, LionTree told Presidio's board that CD&R conveyed it was "focused on closing [a] pending acquisition" and was "not focused on a strategic transaction in the near term." According to the plaintiffs, in fact, CD&R's "pending" acquisition had already closed, and CD&R had expressed interest to LionTree in pursuing a transaction with Presidio. The plaintiffs further alleged that based on LionTree's advice, which the chairman/CEO did not contradict, the board directed LionTree to engage with the Buyer, and elected not to contact CD&R.

Thereafter, an agreement was reached for the Buyer to acquire Presidio for $16.00 per share in cash. During a subsequent go-shop period, CD&R submitted a topping bid of $16.50 per share. Pursuant to the merger agreement, Presidio notified the Buyer the following day that CD&R was defined as an "Excluded Party," which meant that CD&R would be permitted to pay a discounted termination fee. However, the plaintiffs alleged that nearly two hours before that official notice was sent, LionTree shared CD&R's offer with the Buyer and, inferably, informed the Buyer of its price. Later that evening, the Buyer submitted a revised offer to LionTree at $16.60 per share, which contained a 24-hour deadline, and provided for an amended merger agreement (AMA) that would strip CD&R's ability to pay a discounted termination fee. Presidio's board directed LionTree to tell CD&R that it had until 5 p.m. the following day to submit a revised offer.

CD&R again topped the Buyer's bid with a nonbinding indication of interest at $17.00 per share, but rejected the increased termination fee and threatened to walk away if Presidio signed the AMA. Presidio signed the AMA and CD&R disengaged.

Post-closing, the plaintiff, a former Presidio stockholder, filed suit against (i) Presidio's controlling stockholder for breach of fiduciary duty or, in the alternative, aiding and abetting breaches of fiduciary duty; (ii) the members of the Presidio board for breaches of fiduciary duty; (iii) Presidio's chairman/CEO for breaches of fiduciary duty in his capacities as both a director and an officer; (iv) the Buyer for aiding and abetting; and (v) LionTree for aiding and abetting breaches of fiduciary duty. The court dismissed the claims against Presidio's controller and directors, but sustained the claims against Presidio's chairman/CEO, LionTree and the Buyer.

## Standard of Review and the *Synthes* Safe Harbor

The *Presidio* decision is notable for its analysis of the applicable standard of review for the sale of a company with a controlling stockholder to a third party, as well as the applicability of the "*Synthes* safe harbor."

In *In re Synthes, Inc. Shareholder Litig.*, 50 A.3d 1022 (Del. Ch. 2012), former Chief Justice, then-Chancellor Leo Strine held that entire fairness would not apply to the sale of a company to a third party, notwithstanding the presence of a controlling stockholder, where the controller did not engage in self-dealing and received the same consideration in the sale as the company's unaffiliated stockholders. In that circumstance, the court explained that "pro rata treatment remains a form of safe harbor under our law." Moreover, because 65% of the consideration paid in the sale at issue in *Synthes* consisted of stock, the deferential business judgement rule — rather than enhanced scrutiny under *Revlon* — applied and supported dismissal of the claims.

In *Presidio*, the defendants argued that the merger was subject to the business judgment rule, under either the Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC* — which held that in the absence of a conflicted stockholder, the fully informed vote of disinterested, uncoerced stockholders will extinguish breach of fiduciary duty claims, leaving only claims for waste — or the "*Synthes* safe harbor," since Presidio's controller received the same consideration in the transaction as the company's unaffiliated stockholders.

As an initial matter, the court rejected the plaintiff's argument that the controller was conflicted in the sale due to an alleged need for liquidity, and acknowledged that the controller received the same consideration as all other stockholders and did not secure any nonratable benefits for itself. Although this satisfied one requirement of *Corwin* — the absence of a conflicted controller — the court found that *Corwin* could not apply in these circumstances because, accepting plaintiff's allegations as true, the stockholder vote was not fully informed, since the proxy disseminated to stockholders in connection with the merger failed to disclose the facts and circumstances surrounding LionTree's alleged tip to the Buyer.

The court then rejected the defendants' reading of *Synthes* as requiring automatic application of the business judgment rule any time a controlling stockholder receives the same consideration in a sale as the unaffiliated stockholders do. In particular, Vice Chancellor Laster noted that "[t]he *Synthes* decision stands in contrast with *McMullin v. Beran*, 765 A.2d 910 (Del. 2000), in which the Delaware Supreme Court applied enhanced scrutiny" under *Revlon* — rather than the business judgment rule — "to the sale of a company by a controlling stockholder in which all of the company's stockholders received the same per-share consideration in cash."

Applying enhanced scrutiny under *Revlon*, the court found it reasonable to infer that Presidio's directors breached their duty of care by failing to provide "active and direct oversight" of LionTree. Such breaches of the duty of care were exculpated pursuant to the 102(b)(7) provision in the company's certificate of incorporation, and the court therefore dismissed the fiduciary duty claims against the directors. However, the court found that the directors' underlying duty of care breaches supported aiding-and-abetting claims against LionTree and the Buyer.

## 'Fraud-on-the-Board' Claims

In addition to addressing the applicable standard of review, the *Presidio* decision hints at other important doctrinal developments.

Notably, in two footnotes, the court suggested, in the context of analyzing the plaintiff's aiding-and-abetting claim against LionTree, that pleading a "fraud on the board" claim against a financial advisor that is not predicated on a breach of fiduciary duty may be possible.

Specifically, the court noted that even if the "business judgment rule governed the Merger such that it was not reasonably conceivable that the fiduciary defendants committed a breach of duty, the complaint still would state a claim for relief against LionTree." The court explained that, "[r]ather than a claim for secondary liability under a theory of aiding and abetting, the pled facts would support a claim for primary liability under a theory of fraud on the board." The court stated that the complaint pled all of the necessary elements of the equitable claim of "fraud on the board," which, unlike a claim for aiding and abetting, would not require the plaintiff to plead an underlying breach of fiduciary duty.

## Officer Liability

The *Presidio* decision is also significant as another recent example of stockholder plaintiffs' increased pursuit of claims against officers.[1]

Despite dismissing the claims against Presidio's nonexecutive directors, the court sustained claims against Presidio's chairman/CEO, concluding that it was "reasonably conceivable that [the chairman/CEO] tilted the sale process in favor of the Buyer and steered the Board away from a deal with CD&R for self-interested reasons." In doing so, the court remarked that "[the chairman/CEO's] obvious reasons for preferring a transaction with [the Buyer] make it reasonably conceivable that he was interested in the transaction," and the pleaded facts supported an inference that he "worked closely with LionTree to steer the deal in [the Buyer's] direction."

[1] *See Skadden Insights — The Delaware Edition*, "Recent Trends in Officer Liability," December 18, 2020.

## Takeaways

- This opinion demonstrates that the court continues to actively evaluate core Delaware law principles in the M&A context, such as the applicable standard of review for a sale transaction, and the allegations necessary to state an actionable post-closing "*Revlon*" claim. Notably, the primary focus of the opinion is not on whether, as alleged, a majority of the Presidio board was considered disinterested and independent, or "consciously disregarded" or "utterly failed" to satisfy its duties. Both of these concepts have historically played a significant role in post-closing decisions analyzing *Revlon*, such as the Delaware Supreme Court's decisions in *Malpiede and Lyondell*, where the plaintiffs' failure to plead a majority of conflicted directors or a "bad faith" claim resulted in dismissal of all claims, including against directors who may have been alleged to be conflicted. Instead, the court's focus in *Presidio* centered more on whether board oversight of certain alleged aspects of the process — such as the purported "tip," the buyer's go-shop bid maneuvering and the CEO's interests post-closing — fell outside a range of reasonableness. The result of that shift in focus is that, rather than dismissing all claims, the court sustained claims against purportedly conflicted fiduciaries (who breached a duty of loyalty) and conflicted advisors (that aided and abetted such breaches of loyalty), but dismissed claims against unconflicted directors who at most breached their duty of care for grossly negligent conduct.
- *Presidio* reaffirms the central holding in *Synthes* that entire fairness will not apply to the sale of a controlled company to a third party if the controller does not negotiate nonratable benefits for itself and receives the same consideration as the affiliated stockholders. The holdings in both *Synthes* and *Presidio* are premised on the notion that a sale to a third party in which a controller does not receive unique benefits is not a "conflicted controller" transaction and, accordingly, entire fairness should not apply. The difference in outcome, therefore, appears at least in part to be a function of the form of consideration paid in the transaction — mixed consideration with a majority being stock in *Synthes*, and cash in *Presidio* — rather than any radical shift in Delaware law. Ultimately, *Presidio* reaffirms that adequate disclosures (under *Corwin*) and the form of consideration (under *Revlon* and its progeny) remain critical factors in determining the standard of review applicable to a merger transaction.
- Financial advisors should be aware that *Presidio*'s recognition of a potential new "fraud on the board" claim may encourage plaintiffs to reframe claims that historically have been pled as aiding and abetting breaches of fiduciary duty. It remains to be seen whether such a fraud claim — which still must be pled with particularity under Court of Chancery Rule 9(b), and would require facts demonstrating scienter — will be more attractive to stockholder plaintiffs than traditional aiding-and-abetting claims, which also require a

plaintiff to plead scienter (in the form of "knowing participation" of a fiduciary breach), and for that reason have been described as "among the most difficult to prove."[1] Whether the Delaware Supreme Court will recognize an independent cause of action for "fraud on the board" is also unclear.

- Stockholder plaintiffs challenging merger transactions continue to pursue claims not only against directors, but also against officers. The Delaware courts, particularly in the last two years, have repeatedly noted that officers owe the same fiduciary duties as directors, but are not entitled to the benefit of exculpation from money damages for breaches of the duty of care that directors benefit from pursuant to Section 102(b)(7) exculpatory charter provisions. Officers of Delaware companies should understand and recognize the potential for claims against them for breach of the fiduciary duty of care or loyalty.

[1] *RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816, 866 (Del. 2015).

# Delaware Courts Expand Plaintiffs' Rights in Section 220 Cases

Contributors

**Edward B. Micheletti,** Partner

**Elisa Klein,** Associate

**Stefania A. Rosca,** Associate

> See page 8 for key takeaways

The rise in Section 220 demands (and related lawsuits) has resulted in several recent opinions that continue a trend in favor of greater access for stockholders to corporate books and records. These decisions, which are analyzed below, will likely impact how companies respond to Section 220 demands, the types of defenses that can be raised in response to a Section 220 lawsuit, and how companies maintain their books and records.

## Curtailing Merits-Based Defenses

### AmerisourceBergen[1]

In the wake of multiple government investigations and lawsuits concerning its role in the national opioid crisis, AmerisourceBergen was served with a Section 220 demand requesting to inspect board materials regarding the same issues. The demand indicated several purposes for inspection, including to investigate possible breaches of fiduciary duty and to evaluate potential litigation. The company rejected the demand entirely, and the stockholders filed an action in the Court of Chancery to compel production of the documents.

AmerisourceBergen moved to dismiss the action, arguing — despite the multiple purposes for the requested documents stated in the demand — that the stockholders' only purpose was to file a *Caremark* claim for lack of oversight and that they had not presented evidence demonstrating a credible basis to suspect an actionable claim. This argument was based on AmerisourceBergen's Section 102(b)(7) charter provision, which bars money damages for breaches of the duty of care. The Court of Chancery rejected this defense for several reasons, including that (i) stockholders may investigate wrongdoing without needing to identify how specifically they intend to use the fruits of their investigation, and (ii) stockholders do not need to provide evidence of actionable wrongdoing to state a proper purpose for an information request.[2]

The Delaware Supreme Court affirmed. First, the court agreed that "a stockholder is not required to state the objectives of his investigation" because "corporate wrongdoing is, as the Court of Chancery noted, in and of itself 'a legitimate matter of concern that is reasonably related to [a stockholder's] interest[ ] as [a] stockholder[ ].'"[3] While corporations may still "challenge the *bona fides* of a stockholder's stated purpose and present evidence from which the court can infer that the stockholder's stated purpose is not its actual purpose," stockholders are nevertheless "not required to specify the ends to which [they] might use the books and records."[4]

[1] *AmerisourceBergen Corporation v. Lebanon County Employees' Retirement Fund*, 243 A.3d 417 (Del. 2020).

[2] *Lebanon County Employees' Retirement Fund v. AmerisourceBergen Corporation*, 2020 WL 132752, at *13, *20 (Del. Ch. Jan. 13, 2020).

[3] 243 A.3d at 427-28.

[4] 243 A.3d at 429-30.

Second, the court affirmed that, even where follow-on derivative litigation is the stockholders' sole purpose in investigating wrongdoing, they do not need to present evidence that the wrongdoing could support claims raised in a subsequent action that are capable of surviving a motion to dismiss. The court examined several recent Court of Chancery opinions, noting an apparent divide in willingness to entertain merits-based defenses to Section 220 demands. However, observing that Section 220 proceedings are intended to be "summary," and thus "managed expeditiously," the court stated that "[i]t has become evident that the interjection of merits-based defenses — defenses that turn on the quality of the wrongdoing to be investigated — interferes with that process."[5]

The court then clarified the credible basis standard that courts are to apply going forward:

> To obtain books and records, a stockholder must show, by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement or wrongdoing warranting further investigation. The stockholder need not demonstrate that the alleged mismanagement or wrongdoing is actionable.[6]

However, the court left open the possibility for companies to raise certain defenses "[i]n the rare case in which the stockholder's sole reason for investigating mismanagement or wrongdoing is to pursue litigation." If "a purely procedural obstacle, such as standing or the statute of limitations, stands in the stockholder's way such that the court can determine, without adjudicating merits-based defenses, that the anticipated litigation will be dead on arrival, the court may be justified in denying inspection."[7]

[5]243 A.3d at 437.

[6]243 A.3d at 437.

[7]243 A.3d at 437.

## Permitting Access Beyond Formal Board Materials

### Facebook[8]

Following a data breach involving the unauthorized release of confidential user data to a data analytics firm, Facebook, Inc. (Facebook) faced investigation from the Federal Trade Commission (FTC) regarding potential violation of a consent decree entered in 2012 over previous data privacy breaches. The company settled with the FTC in 2019 for a record-breaking $5 billion, and the settlement included a release for Facebook's CEO, Mark Zuckerberg. Shortly thereafter, a stockholder served a demand to inspect Facebook's books and records to investigate whether the company had overpaid in the settlement to protect Mr. Zuckerberg from personal liability.

Facebook responded to the demand by agreeing to provide certain categories of documents, and produced over 30,000 pages. However, Facebook resisted the stockholder's request for board-level emails and text messages concerning its settlement negotiations with the FTC. When the stockholder filed a suit to obtain the communications, Facebook objected, arguing that the additional documents were not necessary and essential to establish the stockholders' stated purpose for inspection.

Vice Chancellor Slights rejected Facebook's arguments. First, the court explained that the stockholder had not

> forfeit[e]d its statutory inspection rights by candidly describing the strength of its potential claims. That a stockholder plaintiff believes it has a basis in facts already known to pursue claims of wrongdoing against company fiduciaries does not mean the stockholder should be denied use of the "tools at hand" to

[8]*Employees' Retirement System of Rhode Island v. Facebook, Inc.*, 2021 WL 529439 (Del. Ch. Feb. 10, 2021).

> develop those facts further so that it can well-plead its claims in a complaint, particularly a derivative complaint.[9]

Second, the court determined that the materials Facebook had already provided "do not allow [the plaintiff stockholder] to engage in the kind of investigation contemplated by Section 220."[10] The court noted that the board and special committee minutes were "heavily redacted[,] providing only a basic outline of the Board's process and the resulting negotiations with the FTC leading to the 2019 Settlement."[11] The court described the documents as "bereft of any information concerning the substance of Facebook's nonprivileged discussions with the FTC,"[12] and added, "[t]he fact that Facebook's more traditional Board materials reveal little or nothing of the Board's thinking with respect to the negotiations and decision to enter the 2019 Settlement indicate strongly that, if such information exists, it will be in the nonprivileged electronic communications … ."[13]

On a separate note, Vice Chancellor Slights signaled that he agrees with Chancellor McCormick regarding how corporations ought to approach Section 220 demands and litigation. In a footnote, he "commend[ed] the parties" for focusing the trial on the scope of documents to be produced, rather than the propriety of the stockholder's stated purpose, and noted that their conduct stood "in marked contrast to the tactics that have prompted expressions of concern by this court regarding 'overly aggressive' Section 220 litigation."[14]

[9] 2021 WL 529439, at *6.
[10] 2021 WL 529439, at *6.
[11] 2021 WL 529439, at *7.
[12] 2021 WL 529439, at *7.
[13] 2021 WL 529439, at *8.
[14] 2021 WL 529439, at *2 n.11 (citing *Gilead Sciences*).

## Takeaways

- In light of *AmerisourceBergen*, the Delaware courts are no longer likely to entertain merits-based defenses to Section 220 demands, whether or not a stockholder has identified any particular intended use for the documents it is seeking to inspect. However, other defenses, such as standing or scope-based defenses, may be applicable.
- Even where corporations voluntarily produce formal board records in response to a demand, that will not necessarily defeat a demand for informal board materials or emails, particularly if the formal board records are lacking in substance.
- Based on another recent case, when a court views a particular defense against a Section 220 demand as overly aggressive, it may entertain plaintiff fee-sharing demands.[15]
- Boards should seek legal guidance upon receipt of a Section 220 demand to ensure that they are considering the most recent case law developments before responding.

[15] *Pettry v. Gilead Sciences, Inc.*, 2020 WL 6870461 (Del. Ch. Nov. 24, 2020).

# *Caremark* Update: Delaware Court of Chancery Dismisses Two 'Oversight' Derivative Actions Arising From Government Investigations

Contributors

**Art Bookout,** Counsel

**Michelle L. Davis**, Associate

**Joe Gadberry**, Law Clerk

**> See page 11 for key takeaways**

The Delaware Court of Chancery recently issued two opinions — *Richardson v. Clark (MoneyGram)*[1] and *Fisher v. Sanborn* (*LendingClub*)[2] — that dismissed stockholder derivative claims for breach of directors' oversight duties (so-called *Caremark* claims).

*Caremark* claims comprise a two-part test. The first part asks whether the board "completely failed" to implement board-level reporting or control systems. The second part asks whether, once such a system is in place, the board failed to properly monitor it. In several recent opinions, derivative claims alleging the failure of directors to effectively exercise their oversight duties in connection with government investigations or litigation have survived motions to dismiss.[3] In contrast to those cases, in both *MoneyGram* and *LendingClub*, the Delaware Court of Chancery applied *Caremark*'s long-standing requirements to plead particularized facts showing bad faith and dismissed the claims. In both cases, the Court of Chancery held, despite the companies' alleged past and current regulatory compliance issues and significant governmental litigation, that the plaintiffs failed to plead particularized facts demonstrating that a majority of the board faced a substantial likelihood of liability.

## MoneyGram

MoneyGram is a money transfer company that operates in a business environment that the court described as an "attractive vehicle[]" for money laundering and in which implementing effective controls to prevent wrongdoing is difficult. Federal prosecutors alleged in 2012 that MoneyGram violated anti-money laundering laws and aided and abetted wire fraud. MoneyGram entered into a deferred prosecution agreement (DPA) that obliged the company to dedicate $100 million for restitution to injured customers and to take specific remedial actions over the next five years. MoneyGram established a compliance committee and took steps to comply with its obligations under the DPA. When those efforts failed, to avoid prosecution, the company agreed to pay $125 million more in restitution and to extend the DPA through 2021.

The plaintiff in the 2020 case asserted *Caremark* claims against MoneyGram's directors and officers and alleged that demand upon the board was excused because a majority of the directors faced a "substantial likelihood of liability" in the lawsuit. The court noted that the facts pleaded showed that the board "ignored warnings from its DPA-imposed monitor" about compliance failures, responded to government mandates with "insufficient speed and skill," and "did a poor job applying its discretion to act" in attempting to comply with the DPA.

However, the court held that the plaintiff failed to plead particularized facts showing "bad faith" oversight. The court found that, although the board failed to ensure compliance with the DPA, "bad oversight" — "feckless oversight and lack of vigor … wistless[ness] or [being] overly reliant on management" — is not bad faith oversight, even over a long period of time. Thus, a "failed attempt" to comply with a DPA, or an "unsuccessful program" that results in additional financial restitution and extended remedial obligations,

[1] 2020 WL 7861335 (Del. Ch. Dec. 31, 2020).

[2] 2021 WL 1197577 (Del. Ch. Mar. 30, 2021).

[3] *See, e.g., Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019); *In re Clovis Oncology Derivative Litigation*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

does not alone support a *Caremark* claim. To hold otherwise and penalize unsuccessful attempts to comply with regulators would create "a perverse incentive," the court determined.

## LendingClub

LendingClub operates an online lending marketplace that connects borrowers with investors. In 2016, the Federal Trade Commission (FTC) sent LendingClub a civil investigative demand regarding potential deceptive and unfair trade practices with consumers. The FTC filed suit against the company two years later. Based on the pending FTC complaint, the plaintiff in the 2021 case filed a derivative action alleging that the board (i) utterly failed to implement a board-level monitoring system, (ii) consciously disregarded its duty to oversee compliance with consumer protection laws, and (iii) knowingly made false and misleading statements.

The Court of Chancery dismissed each argument. First, the court found that the complaint conceded that the board had established a functioning Risk Committee, which received updates on consumer complaints and was aware of the FTC investigation, receiving detailed reports about it and routinely discussing them. The court compared the facts at issue with those in the recent *Marchand* case before the Delaware Supreme Court, where the court found that the board of an ice cream company had failed to implement a system to monitor food safety. By contrast, the facts alleged against the LendingClub board could not state a claim that the board "utterly failed," *i.e.*, "made no good faith effort to 'try,'" to monitor compliance with consumer protection laws. Thus, the facts alleged did "not come close to the allegations" in *Marchand*.

Second, the Court of Chancery concluded that the plaintiff failed to adequately plead the requisite "red flag" that was ignored in order to state a claim based on failure of oversight. The court stated that "[t]he issuance of a subpoena or the launch of a regulatory investigation does not 'necessarily demonstrate that a corporation's directors knew or should have known that the corporation was violating the law.'" The court explained that had there been "'strong factual allegations of board knowledge of ongoing legal violations in the wake of federal government enforcement proceedings,'" then the presence of an investigation "would take on more significance." However, the court found "no particularized factual allegations indicating that the FTC warned LendingClub it was violating the law" and credited an internal communication noting that the company was "surprised" to receive a complaint from the FTC.

Third, the Court of Chancery held that LendingClub's public disclosures concerning the FTC investigation did not demonstrate bad faith. For the same reasons that the plaintiff failed to plead particularized facts that the directors knew the company was violating the law, there were likewise no facts from which the court could reasonably infer that the "directors deliberately lied to investors about the FTC investigation."

## Takeaways

- The exacting standard to plead a *Caremark* claim has not changed, and particularized facts evidencing bad faith require showing that a board either utterly failed to implement a board-level monitoring system or that it was alerted to "red flags" of misconduct and consciously disregarded its duty to address them.
- The decisions in both *MoneyGram* and *LendingClub* reiterated that the mere presence of government investigations — whether ongoing or following actual findings of wrongdoing — is insufficient to sustain a *Caremark* claim.
- *Caremark* claims are rooted in a company's governance protocols: Maintaining a record of directors' engagement in oversight and compliance, especially regarding revenue drivers and operations that carry risks of misconduct, remains a critical tool in defending against *Caremark* claims.
- Directors should maintain regular contact with company compliance officials and counsel to ensure that appropriate governance protocols are in place and functioning effectively.

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

Contributors

**Nicole A. DiSalvo**, Associate

**Daniel S. Atlas**, Associate

**> See page 15 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.

[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).

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 … ."

[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

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

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

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

**Robert S. Saunders**
302.651.3170
rob.saunders@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

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

One Manhattan West / New York, NY 10001 / 212.735.3000