Delaware General Corporation Law Amended To Authorize Use of Captive Insurance for D&O Coverage

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On February 7, 2022, Delaware's governor signed a bill amending the Delaware General Corporation Law (DGCL) to expressly authorize Delaware corporations to purchase and maintain directors' and officers' (D&O) liability insurance by or through captive insurance companies. This amendment, described further below, permits coverage for liabilities incurred by a corporation's directors, officers, employees and agents, even in certain situations where the corporation would not be permitted to indemnify for such liability.

Background

When directors and officers face claims in their capacity or status as such, their defense costs generally will be indemnified or advanced by the corporation. However, there are certain limits on a corporation's power to indemnify directors, officers and other indemnifiable persons. Under the DGCL, when the claim has been brought by or in the name of the corporation (including derivative claims), the corporation does not have the power to indemnify its directors, officers employees or agents for judgments against them or for amounts paid in settlement. D&O insurance tradition ally has played a critical role in protecting directors and officers (and their personal assets) from exposure to such liability. In recent years, though, corporations seeking D&O coverage have faced increasing challenges in the D&O insurance market, including significant increases in premiums and retention amounts, coupled with less favorable coverage terms. In certain instances, policyholders have been unable to obtain from traditional third-party insurers the policy limits desired to meet the corporation's risk management goals, or such limits have proven to be cost-prohibitive. Against this backdrop, corporations have explored alternatives to traditional third-party D&O insurance, including through captive insurance, to obtain adequate D&O coverage at affordable costs.

Captive Insurance Companies

The amendments to Section 145(g) make clear that Delaware corporations are authorized to purchase and maintain insurance on behalf of their directors, officers, employees and other indemnifiable persons by or through a "captive insurance company" — generally, an insurer directly or indirectly owned, controlled and funded by the corporation. The captive insurance company must be regulated as such, licensed in Delaware or another jurisdiction and, like third-party insurance, may provide coverage for liabilities incurred by directors, officers, employees and others regardless of whether the corporation itself could indemnify them for such amounts under DGCL Section 145. The amendments also permit a corporation to obtain captive D&O coverage under a "fronting" arrangement, in which a third-party insurance company is the insurer, but the funds to pay claims are "fronted" to the insurance company by the corporation.

The amendments include certain "guardrails" intended to provide reasonable limitations and exceptions to such captive D&O insurance policies. First, they must exclude coverage for any personal profit or financial advantage to which the covered person was not legally entitled, such as a self-dealing transaction. Similarly, the policies must exclude coverage for deliberate criminal or fraudulent acts, as well as for knowing violations of law by the director, officer or other covered person. In each instance, for the exception to apply, the proscribed conduct must have been established by a final, nonappealable adjudication in the underlying proceeding in respect of the claim in question (which does not include an insurance coverage action). Subject to these mandates, and to the other terms and conditions of the policies, coverage may be provided for both expenses (such as attorneys' fees) and for judgments and amounts paid in settlement. These exclu-

sions would not apply to the extent the corporation is otherwise entitled to indemnify the director, officer or other covered person under the existing provisions of Section 145, and the corporation is permitted to prescribe additional exclusions and limitations to coverage beyond the scope of the restrictions described above.

Moreover, any determination to make a payment under such a captive insurance policy must be made by a third-party administrator or in accordance with Section 145's existing requirements (*e.g.*, by the board or a board committee, in each case, by directors not subject to the claims at issue, by independent legal counsel if no such directors exist or by stockholders). This restriction is intended to ensure that persons making claims under these policies are not the same persons making the decision whether to pay claims under the policy.

Finally, if a payment is to be made under a captive insurance policy in connection with the dismissal or compromise of an action, suit or proceeding in which the corporation is otherwise required to provide notice to stockholders (such as would be the case in the settlement of derivative claims), such notice must state that a payment is proposed to be made under the captive insurance policy in connection with such dismissal or compromise. Courts and stockholders, therefore, would have an opportunity to consider the captive insurance company's use of corporate assets to provide insurance coverage for such claim in connection with the dismissal or compromise. There is no requirement that a court make any specific determination with respect to payments by captive insurance companies.

The amendments became effective immediately upon the governor's signing of the bill.