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CORPORATE INSURANCE

Expert Analysis

# Delaware Courts Continue To Issue Insured-Friendly D&O Insurance Rulings

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In recent years, Delaware courts have issued several choice of law rulings applying Delaware law to insurance disputes involving directors and officers of companies that were incorporated in Delaware even where other factors, like the location of company headquarters or the place of policy negotiation, suggest that the company had more significant contacts in a different state.

Two decisions issued within the last month by Delaware courts demonstrate that, along with a preference for applying Delaware law to these cases, the Delaware courts are increasing leaning toward the insured's position in disputes over directors and officers (D&O) insurance coverage.

As a result, New York companies that were incorporated in Delaware should consider whether to file lawsuits concerning D&O insurance disputes in Delaware instead of New York. On the other hand, insurers may be wise to consider including choice of law provisions in certain D&O policies.

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## Choice of Law

Delaware courts address choice of law disputes in insurance cases in three steps. First, the court will determine if the insurance contract contains an effective choice of law clause. If not, the court will evaluate whether there is an actual conflict between the laws of the different states each party believes should govern. If there is an actual conflict, the court will apply the "most significant relationship test" to determine which law governs. *Pfizer v. Arch Insurance Co.*, 2019 WL 3306043 (Del. Super Ct. July 23, 2019).

Notably, in applying the most significant relationship test, the Delaware courts have accorded more significant weight to the state of incorporation where the claims involve directors and officers of a company incorporated in Delaware. The Delaware Superior Court has explained that "[w]hen the insured risk is the directors' and officers' 'honesty and fidelity' to the corporation, and the choice of law is between headquarters or the state of incorporation, the state of incorporation has the most significant relationship." *Mills Ltd. Partnership v. Liberty Mut. Ins. Co.*, 2010 WL 8250837, *6 (Del. Super Ct. Nov. 5, 2010).

In *Pfizer v. Arch*, this choice of law made all the difference, as the court applied Delaware's narrower view of related claims instead of New York's broader review, resulting in a favorable ruling for Pfizer on its motion for summary judgment. *Pfizer Inc.* v. *Arch Insurance Co.*, 2019 WL 3306043;

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"Delaware Courts Take Narrower View of Related Claims Than NY Courts," NYLJ, Vol. 262-No. 56 (Sept. 18, 2019).

### Dole Food Case

Earlier this month, in *RSUI Indemnity v. Murdock,* the Delaware Supreme Court reinforced this choice of law rationale, applying Delaware law based on the state of incorporation and affirming a ruling against an excess insurer regarding coverage with respect to the settlements of a breach of fiduciary duty action filed against the insured in the Court of Chancery and a subsequently filed securities class action filed in federal court. *RSUI Indemnity Company v. Murdock*, 2021 WL 803867 (Del. March 3, 2021) (*Dole Food*). In *Dole Food*, the Delaware Supreme Court ruled in favor of the insured CEO even though the Chancery Court had found in a post-trial opinion that the CEO engaged in fraudulent and dishonest conduct. Like the decision in *Pfizer,* the choice of law ruling adopting Delaware law, in this case instead of California law, may have made all the difference.

The dispute at issue in *Dole Food* arose out of a take-private merger transaction in which Dole Food's CEO acquired all of the company stock not previously owned by him. After the transaction closed, Dole Food stockholders filed a lawsuit challenging the fairness of the merger and alleging breach of fiduciary duty and duty of loyalty claims against the CEO and other officers. The plaintiff stockholders claimed that the CEO had manipulated the value of the Dole Food stock so that he could acquire it at an artificially low price.

After trial, the Court of Chancery determined that the merger was not a product of fair dealing and held that the CEO had engaged in fraud and breached his duty of loyalty. Following the ruling, the parties reached a settlement agreement. The plaintiffs in the separate federal securities class action cited to the Chancery Court's findings of fraud and breach of the duty of loyalty and that case was also resolved by settlement.

The excess insurer argued that California law applied to the insurance dispute and that it had no coverage obligation with respect to the settlements because the California Insurance Code bars coverage for loss arising out of the willful acts of an insured. The insurer contended that the most significant relationship test dictated that California law governed because, among other things, Dole Food's headquarters is in California, the negotiation and procurement of the policies took place in California through a California-based insurance broker and Dole Food's directors and officers lived and worked in California.

The Delaware Supreme Court rebuffed this argument, citing to *Mills* with approval and reiterating that "the state of incorporation is the center of gravity of the typical D&O policy." Id. at 9. The court went on to hold that "when we balance the California contacts against Delaware's interest in protecting the ability of its considerable corporate citizenry to secure D&O insurance and thereby attract talented directors and officers … we find that Delaware has the most significant relationship to the Policy and the parties." Id. at 10.

Reviewing the parties' positions under Delaware law, the court found that Delaware does not have a public policy against insuring loss arising from fraudulent conduct. In so doing, the court referenced §145 of the Delaware Code, which permits Delaware companies to purchase D&O insurance to insure their directors and officers "whether or not the corporation would have the power to indemnify such person against such liability under this section." 8 Del. C. §145(g).

Since Delaware corporations are authorized to indemnify their directors and officers for expenses incurred as a result of good faith conduct, the Court explained that it is implicit that a corporation is authorized to obtain insurance for loss arising out of bad faith conduct.

The court emphasized that it was not condoning fraud but merely finding that there was no public policy against insuring loss arising out of fraudulent conduct. Nonetheless, the court avoided any discussion of whether permitting insurance for loss arising from fraud might encourage wrongful behavior.

### Sycamore Partners

In another recent insurance case decided just before *Dole Food*, after

ruling that Delaware law governed the issue in dispute, the Delaware Superior Court held that restitution and disgorgement are not uninsurable as a matter of public policy under Delaware law. *Sycamore Partners Management, L.P. v. Endurance American Insurance Company*, C.A. No. N18C-09-211 AML CCLD (Del. Super. Ct. Feb. 26, 2021).

In *Sycamore Partners*, the court was presented with an insurance dispute concerning an underlying suit filed by a company's bankruptcy estate against the private equity funds that had allegedly stripped it of its high-performing assets and sold those assets off for profit prior to the bankruptcy. The estate sued the investment funds and their managers for fraudulent conveyance, breach of fiduciary duty and related claims. The funds settled the case for $120 million before any final court rulings and sought to recover a portion of the settlement and their defense costs from their insurers.

The insurers denied coverage on several grounds including that the policies' definition of loss excluded coverage for "amounts which are uninsurable under the law most favorable to…insurability." According to the insurers, the loss at issue was uninsurable as a matter of public policy because it represented disgorgement or restitution of ill-gotten gains obtained by the private equity funds through the pre-bankruptcy asset sales.

The plaintiff insureds moved for partial summary judgment contending that the "law most favorable" provision constitutes an enforceable choice of law clause that permits application of Delaware law and that Delaware law has no public policy against insuring restitution or disgorgement payments. The Delaware Superior Court agreed with the plaintiff funds.

As the court held that the "law most favorable" clause is a choice of law clause, it did not need to perform the most significant relationship test to conclude that Delaware law governed. Moving to the coverage issue, the court explained that public policy is the domain of the legislature and, therefore, it would not find loss uninsurable due to public policy unless that policy was articulated by a Delaware statute. Finding no Delaware statute that barred insurance for restitution or disgorgement payments, the court ruled that the settlement at issue was insurable and granted the insureds' motion for partial summary judgment.

Given these rulings, New York-based businesses that were incorporated in Delaware should consider whether these recent decisions provide justification for filing D&O insurance-related lawsuits in Delaware instead of New York.

## Looking Forward

Issued within a few days of each other, the *Dole Food* and *Sycamore Partners* rulings continue to solidify Delaware's growing reputation as an insured-friendly forum for D&O insurance coverage disputes. In *Dole Food*, the Delaware Supreme Court reaffirmed the justification for applying Delaware law to the vast majority of D&O insurance disputes involving a company incorporated in Delaware. In both *Dole Food* and *Sycamore*, the courts declined to find that Delaware has a public policy against insuring bad faith conduct including fraudulent behavior and disgorgement of ill-gotten gains.

Given these rulings, New York-based businesses that were incorporated in Delaware should consider whether these recent decisions provide justification for filing D&O insurance-related lawsuits in Delaware instead of New York. Similarly, insurance companies that have been reluctant to include choice of law provisions in their policies may wish to reconsider their use in certain D&O insurance policies.

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