



Delaware Supreme Court Holds That Fraud Is Insurable Under D&O Policy

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The Delaware Supreme Court unanimously affirmed a trial court judgment requiring a directors and officers (D&O) excess insurer to pay a claim for losses predicated on fraudulent conduct of the director and CEO of a corporation, holding that such losses are insurable under Delaware law and coverage is not barred by Delaware public policy.

The Court also held that Delaware law applied to the insurance policy in the case, stating that a choice of law analysis for a D&O policy will most often reveal that a corporation's state of incorporation has the most significant relationship to the insurance policy.

Background

The insurance coverage at issue in *RSUI Indemnity Company v. Murdock* (March 3, 2021)¹ involved claims for breach of fiduciary duty and federal securities law violations under a \$10 million excess D&O liability insurance policy issued by RSUI Indemnity Company to Dole Food Company, Inc. In November 2013, affiliates of David Murdock, the CEO and a director of Dole, completed a transaction to take Dole private for \$13.50 per share. In 2015, the Delaware Chancery Court issued a memorandum opinion finding, among other things, that Murdock had breached his duty of loyalty and engaged in fraud in connection with the transaction, which drove down Dole's premerger stock price, undermining it as measure of value and affecting the Dole Special Committee's negotiating position. The Chancery Court awarded damages to unaffiliated stockholders in an amount equal to \$2.74 per share (approximately \$148 million in the aggregate). Dole then informed its insurers it was engaging in settlement negotiations, to which all responded by reserving their rights regarding coverage. Thereafter, Dole negotiated a settlement without further involvement of its D&O insurers, and Murdock paid the settlement amount in full.

In addition, a different group of former Dole stockholders brought a second suit in federal court alleging violations of the Securities Exchange Act of 1934 based on the findings of fraud and breach of loyalty in the Chancery Court's memorandum opinion. Before a decision was issued in the federal securities suit, the parties agreed to pursue mediation. After informing the insurers of

¹ <https://courts.delaware.gov/Opinions/Download.aspx?id=317480>. The Court's decision also addressed issues relating to the allocation provision of the insurance policy and claims by the insureds on cross-appeal, which are not the subject of this post.

the mediation, Dole negotiated and paid a settlement to end the suit without consent or confirmation of coverage from the insurers. Given the exhaustion of certain lower layers of excess coverage, the payment of the full amount of the settlement in the federal securities suit would have exhausted the entire amount of RSUI's coverage layer. All insurers, other than RSUI, settled or paid their policy limits. In subsequent litigation, the trial court ruled in favor of Dole and Murdock and ordered RSUI to pay to the insureds the full \$10 million limit on its policy, plus interest.

Delaware Supreme Court's Decision

On appeal, the principal issue before the Delaware Supreme Court was whether claims attributable to the fraud of a director or officer of a Delaware corporation were uninsurable as a matter of Delaware public policy. Reaffirming its respect for the right of sophisticated parties to enter into insurance contracts that they deem appropriate, other than contracts against public policy, the Court noted that the definition of "Loss" in the D&O policy was expansive and that allegations of fraud fit within the terms defining scope of coverage. The policy included an exclusion for losses arising from intentional fraudulent acts but only if established by a final and non-appealable adjudication in the underlying action.² The Court held that the public policy of Delaware does not vitiate the parties' right to freedom of contract to insure losses attributable to fraud.

In its analysis, the Court considered the language of Section 145 of the Delaware General Corporation Law (DGCL). Specifically, the Court noted that while Section 145(a) provides that a corporation can indemnify a director or officer if the person "acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation," Section 145(g) provides that a corporation may purchase insurance to indemnify against any liability asserted against its directors and officers "whether or not the corporation would have the power to indemnify such person against such liability" under Section 145. In light of this language in the DGCL, the Court reasoned that corporations have "statutory authority to obtain D&O insurance for liabilities arising from bad-faith conduct." Ultimately, the Court stated that its ruling was, in effect, deferring to the rights of private parties to provide exclusions in D&O insurance policies for fraud-based conduct and to the prerogatives of the Delaware legislature to otherwise provide "clear guidance" as to a public policy that would void an insurer's obligations for fraud-based claims on public policy grounds, which the legislature has not done to date.

In addition, because there was no choice of law provision in the D&O policy, the Court considered a choice of law issue prior to its ruling on the validity of claims predicated on fraud. RSUI argued that the law of California—the state where Dole was headquartered, where its officers and directors lived and worked and where Dole's D&O insurance policies were negotiated, issued and delivered—should apply. If the Court had decided that California law applied, that holding may

² One of the other issues addressed in the Court's ruling was RSUI's argument that because the Chancery Court issued a memorandum opinion finding that Murdock had engaged in fraud, the insurance policy's exclusion for claims based on intentional fraudulent acts as found in a final and non-appealable adjudication of the underlying action would apply and RSUI would have no liability in connection with the Delaware fiduciary duty suit or the federal securities suit. Applying a rule of strict construction with respect to insurance contract exclusions, the Court did not address whether the Chancery Court's decision in the fiduciary duty suit was a final non-appealable adjudication satisfying the requirements of the exclusion but, instead, ruled that with respect to the federal securities suit, there was no adjudication of the underlying action because the case was settled before the court rendered a decision in the case and the amount to be paid by RSUI in the federal securities suit alone was sufficient to fully exhaust RSUI's coverage limit.

have been dispositive because the California Insurance Code prohibits insurance coverage for wilful acts. Applying the “most significant relationship” test from the Second Restatement, which Delaware has adopted for choice of law analysis, and relevant Delaware precedent, the Court held that Delaware law applied to the D&O policy. In its analysis, the Court stated that because Delaware law will govern the duties of directors and officers of a Delaware corporation, the corporation must assess its need for insurance with reference to Delaware law. The Court acknowledged the significant contacts with California in this case, but went on to state that in the context of a D&O policy, the interest of Delaware corporations to obtain D&O insurance and thereby attract talented directors and officers resulted in Delaware having the most significant relationship to the D&O policy and the parties to the litigation.

Observations and Practice Points

1. *No Delaware Public Policy Against Insuring D&O Fraud.* The most significant implication of the case is that the Court has made clear that Delaware public policy does not prohibit D&O policies from insuring against the fraudulent conduct of a corporation’s directors and officers. D&O policies typically have very broad definitions of the types of losses that are covered and then carve out certain losses by providing for express exclusions. Therefore, absent an express exclusion covering the type of fraudulent conduct at issue, the typical D&O policy for a Delaware corporation would cover losses for fraudulent conduct, and Delaware public policy does not provide a separate backstop that D&O insurers can fall back on to deny coverage. In this case, while there was an exclusion for fraud, the Court ruled that the exclusion did not apply because the federal securities suit was settled before being adjudicated. It remains to be seen whether this decision will drive insurers to try to broaden the fraud exclusion or insureds to seek broader coverage for fraud claims. This holding is also likely to apply to settlements of claims seeking to recover losses from insureds receiving remuneration to which they were not legally entitled, the other common policy exclusion conditioned on establishment of a final and non-appealable adjudication.
2. *D&O Indemnity in Merger Agreements.* Typically, target companies in merger transactions require that, after the closing, the surviving corporation will, among other things, indemnify the target company’s directors and officers for claims attributable to pre-closing conduct. In addition, for transactions structured as triangular mergers (which is the typical public company acquisition structure), some target companies negotiate for the acquiring company to also indemnify the target company’s directors and officers for claims attributable to pre-closing conduct. While the surviving corporation’s obligations would be limited by the provisions of Section 145 of the DGCL, the acquiring company’s obligations would not be so limited and might only be limited by Delaware public policy. The holding of the Court in this case illustrates that the Delaware courts will distinguish between the types of claims for which a corporation cannot indemnify and the types of claims for which a third-party indemnitor, contracting freely, can indemnify.
3. *Choice of Law.* The Court’s holding seems to provide a strong presumption that Delaware courts will find that D&O policies for Delaware corporations are to be governed by Delaware law, absent a choice of law provision that would result in the application of the law of a different state.³ Given that the application of California law may have been

³ Under the D&O policy in this case, RSUI was not liable for losses that were uninsurable under the law applicable to the policy, except that the law of the jurisdiction most favorable to the insurability of such matters would be

dispositive in this case because of the difference between California's and Delaware's public policies applicable to the insurability of claims predicated on fraud under D&O policies, insurers in the future might consider hard-coding the choice of law applicable to the policy generally or specify certain provisions subject to law that is different from the law that the policy is subject to generally. The absence of a choice of law or venue provision may also lead to a rush to the court house to pursue a favorable forum for the choice of law analysis.

applied if, among other things, it is the law of the state of incorporation of the insured. This type of provision is typical in D&O policies and favors the insured and, in this case, Dole argued that such provision was a means for Dole to obtain Delaware law treatment for the claims predicated on fraud; however, the Court did not address this provision because of its finding that Delaware law applied generally to the D&O policy.