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Client Alert

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Delaware Court Rejects Insurer Public Policy Defense, Permits Bad Faith Counterclaim, Despite Allegations of Fraudulent and Intentional Conduct

A Delaware court recently refused to grant summary judgment to insurers seeking to avoid covering Dole Food Company and two of its officers and directors for amounts Dole paid to settle two shareholder lawsuits, notwithstanding that the underlying claims involved alleged intentional and fraudulent conduct. Dole was able to avoid summary judgment on the insurers' declaratory judgment claims and its own bad faith counterclaim by citing favorable state law and raising numerous questions of fact regarding the insurers' purported coverage defenses. The opinion serves as a reminder that policyholders should hold insurers to their burden of proving all coverage defenses and underscores the significant divergence on state law regarding the insurability of certain conduct at issue under many common insurer defenses for allegedly fraudulent or intentional acts.

Background

In *Arch Insurance Company v. Murdock*, No. N16C-01-104 EMD CCLD (Del. Super. Ct. Mar. 1, 2018), Dole and its insurers dispute whether Dole is entitled to coverage under a directors and officers insurance policy for over $200 million in settlements Dole paid to resolve two stockholder lawsuits alleging that Dole engaged in a scheme to manipulate its stock price leading up to a 2013 deal. Prior to settlement of the first lawsuit, the trial court found breaches of the duty of loyalty due to fraudulent acts of Dole and its officers and assessed liability of more than $148 million, which led to Dole paying 100% of the award plus interest in lieu of an appeal. In both underlying claims, Dole provided notice of potential settlement to its insurers, requested that the insurers fund the settlements, and provided updates on the progress of negotiations, but failed to receive written consent prior to finalizing the settlements.

The insurers sought a declaration that they had no duty to fund the underlying settlements due to Dole's alleged breaches of the applicable insurance policies. Dole countered by asserting counterclaims that the insurers acted in bad faith by refusing to cover the settlements and are subject to punitive damages. On summary judgment, the insurers raised three arguments against coverage for Dole's claims:
(1) indemnification for the settlements was against public policy; (2) the insureds failed to cooperate with the insurers; and (3) the insureds failed to obtain written consent.

Delaware Public Policy Does Not Prohibit Indemnification for Intentional or Fraudulent Conduct

The court first addressed the insurers' defense that there could be no coverage for the stockholder settlements due to the trial court's findings that Dole's officers breached their duty of loyalty because doing so would violate public policy. The court performed a choice of law analysis given that the parties disagreed over whether the action was governed by Delaware or California law, which conflicted on whether an insurance policy covers a director or officer's willful or wanton actions—California insurance regulations bar indemnification for loss caused by the willful act of the insured's agents or others, while Delaware law has no such prohibition.

The insurers argued that California applied because Dole's management and board, as well as the other Dole officers named as individual defendants, are located in California and that the conduct at issue in the underlying stockholder litigation occurred in California. Dole, on the other hand, argued that Delaware law applied because Dole is a Delaware corporation and the individual defendants were directors and officers of Dole. Dole also argued that Delaware had a direct interest under a Delaware statute authorizing Dole to obtain the insurance policies at issue and that Delaware law ultimately determines whether an officer or director violated his or her fiduciary duties.

Applying Delaware's choice-of-law rules under the Restatement's "most significant relationship test," the court found that Delaware law governed. The court explained:

> In this case, the Policies covered directors, officers and corporate liability. The Policies do not contain a choice of law provision. In addition, Dole is a Delaware corporation and [the Dole individual defendants] are directors and officers of a Delaware corporation. The suit was brought by stockholders of Dole in the Chancery Court. The situs of Dole's stock is Delaware. The Chancery Court applied Delaware law in holding that the duty of loyalty had been breached and that the value of Dole's stock had been artificially decreased due to fraudulent conduct. Under these facts, Delaware and not California has the more significant interest and Delaware law will apply in this civil action.

Citing to prior Delaware Supreme Court authority recognizing the absence of Delaware public policy prohibiting broad indemnification of directors and officers for punitive damages awards, the court noted that it would not void an otherwise valid insurance provision in "the absence of clear indicia that such a policy actually exists." Given the absence of any Delaware public policy precluding coverage for the alleged fraud at issue, the court denied the insurers' motion on a claim that indemnification would violate Delaware public policy.

Insurers often argue that public policy prohibits insurance for intentional and fraudulent conduct or other types of losses, such as disgorgement. In several recent decisions, however, courts are realizing that closer review is required to see whether the relevant public policies actually prohibit such insurance under applicable state law. Where no such public policy exists, courts are rightfully rejecting "uninsurability" defenses.[1] Such was the case in *Dole*, where the court explained "[a]lthough it may strain public policy to allow a director to collect insurance on a fraud," the court recognized, "it does not appear to be explicitly prohibited by Delaware statutory law." Thus, in the absence of Delaware public policy barring indemnification for fraudulent or intentional conduct, the insurers were not entitled to summary judgment on the insurability of allegedly fraudulent conduct at issue in the underlying settlements.

Lack of Prejudice, Fact Question on Substantial Breach, Preclude Summary Judgment on Insurer Cooperation and Consent Defenses

The court quickly dispatched the insurers' remaining cooperation and consent defenses.

With respect to alleged failure to cooperate, the court recognized that cooperation clauses are "material to the insurance contract and a substantial breach of the provision by the insured provides a legitimate defense to the insurer if factually proven," but ultimately held that the "record is not clear whether there

[1] *See, e.g.*, *William Beaumont Hosp. v. Fed. Ins. Co.*, 552 Fed. App'x 494, 500-01 (6th Cir. 2014) (rejecting public policy defense where insurer "ha[d] not identified any cases in the Sixth Circuit holding that disgorgement is not insurable" and that the "public policy" cases cited by the insurer were limited to claims involving "intentional tortious or criminal acts"); *U.S. Bank Nat'l Ass'n v. Indian Harbor Ins. Co.*, 68 F. Supp. 3d 1044, 1049 (D. Minn. 2014) (insurers "have failed to cite, and the Court cannot locate, any Delaware authority deeming restitution uninsurable"), *amended*, 2015 WL 12778848 (D. Minn. Mar. 19, 2015); *see also J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 992 N.E.2d 1076, 1081 (N.Y. 2013) (denying insurers' motion to dismiss coverage for settlements labeled as "disgorgement" on public policy grounds, noting that "our cases . . . have recognized" only two narrow public policy exceptions to freedom of contract, namely, punitive damages and conduct "with the intent to cause injury").

was substantial breach." Due to this material issue of fact regarding the purported lack of cooperation forming the basis of the insurers' defense, summary judgment was denied on that issue.

Similarly, on alleged lack of consent to settle, the court emphasized that "[c]onsent to settle provisions do not provide an insurer an absolute right to veto a reasonable settlement. Rather, the main purpose of the consent provision is to protect the insurer from prejudice." Therefore, the insurers could not prevail on their consent defense absent a showing that Dole's breach caused them to suffer prejudice.

The court found that the insurers demonstrated that Dole did not obtain prior written consent to the underlying settlements. Summary judgment was inappropriate, however, where the insurers failed to establish prejudice and "there may be a factual issue as to whether prior written consent was unreasonably withheld."

Notably, the court refused to accept the insurers' argument that Dole's settlement of the claim for 100% of the value of the case established prejudice per se where the insurers "have not shown how they would have settled the case differently or what they would have changed if they had been involved in the case from the beginning." The fact that the insurers were on notice and chose not to take any action relating to the underlying litigation and settlements precluded summary judgment.

Ruling on Dole's Bad Faith Counterclaim Is Premature

Notwithstanding allegations of fraud and intentional acts on the part of the insureds, the insurers were unable to get Dole's bad faith counterclaim dismissed on summary judgment. The court found that the insurers' motion on bad faith was "pre-mature" at this early stage of the litigation where discovery had just begun and Dole needed "some time to develop this claim."

It will be interesting to see what record Dole develops during discovery to sustain its bad faith counterclaim, as the parties will surely address the issues raised in the court's opinion with respect to the insurers' conduct in denying the claim, the validity of the denial, and other circumstances addressing whether the insurers acted with "reckless indifference or malice toward the plight of the insured." Given the early stage of litigation and the numerous open issues following the summary judgment ruling, further motions practice seems likely.

The authors will continue to monitor this litigation and report on future developments.

Authors

Michael S. Levine
mlevine@hunton.com

Geoffrey B. Fehling
gfehling@hunton.com

Contacts

Walter J. Andrews
wandrews@hunton.com

John C. Eichman
jeichman@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Lorelie S. Masters
lmasters@hunton.com

Lawrence J. Bracken II
lbracken@hunton.com

Sergio F. Oehninger
soehninger@hunton.com