Client Alert

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Delaware Court Holds D&O Insurer Must Advance Defense Costs for Two Company Officers Involved in Fraudulent Transfer Litigation

A Delaware judge has ruled that an insurer was required to pay for the defense of two officers of a midstream crude oil transportation company involved in a dispute under a rail services agreement. In *Ferrellgas Partners, L.P. v. Zurich American Insurance Co.* (Del. Super. Ct. decided Jan 21, 2020), the court held that a D&O policy's narrow retroactive date exclusion for a single insured did not preclude coverage for the wrongful acts alleged against the individuals in their concurrent capacity as officers for a different entity. As discussed below, this decision highlights the steps that policyholders should consider following mergers, acquisitions, or other transactions to ensure their D&O coverage will apply in the event of a claim.

Background

The underlying lawsuit arises out of a 2013 rail services agreement between rail company Eddystone Rail Company and Bridger Transfer Services, LLC (BTS). In the agreement, Eddystone agreed to construct and operate a transloading facility on the Delaware River for the purpose of transferring crude oil from railcars to barges that would transport the oil downriver to Philadelphia-area refineries. Eddystone alleged that it entered into the agreement with BTS based on representations made by two BTS officers, Julio Rios and Jeremy Gamboa, regarding whether BTS was a bona fide company with substantial operations and capital.

In 2015, Ferrellgas Partners (FGP) acquired BTS, Bridger Logistics, and various other affiliated entities. Rios and Gamboa then joined FGP's general partner overseeing the rail services deal. Eddystone alleged that, as a result of the FGP transaction, in 2015 and 2016, Rios and Gamboa developed and implemented a plan to strip BTS of its assets to avoid payments under the rail agreement. The plan diverted all assets from BTS into the affiliated entities that FGP acquired in the BTS deal, which Eddystone referred to as the "Fraudulent Transfer Recipients." Eventually, BTS stopped delivering oil to the facility altogether in 2016 and failed to make the minimum payments to Eddystone required under the agreement. Eddystone secured an arbitration award for the current unpaid invoices and future payments due under the agreement. It then filed a federal lawsuit seeking to recover the award from Rios and Gamboa and affiliated BTS entities under theories of alter ego, fraudulent transfer, and breaches of their duties of care and loyalty to creditors.

Rios, Gamboa, FGP, and the BTS affiliates sought coverage under two separate D&O insurance policies. The FGP and BTS entities alleged to have received the fraudulently transferred assets from BTS sought coverage under a Zurich policy. Rios and Gamboa submitted an indemnification demand to FGP's general partner, which agreed and then sought advancement and reimbursement of the indemnified defense costs under a Beazley policy. Both Zurich and Beazley denied coverage.

Various corporate affiliates of FGP and BTS sued, seeking to enforce Zurich's and Beazley's obligations under their D&O policies and for advancement of defense costs in the Eddystone litigation, including for

reimbursement of indemnification paid to Rios and Gamboa. The parties filed competing motions for summary judgment.

The Delaware Court Ruling

The FGP and BTS entities argued that the Zurich policy covered the Eddystone litigation because they incurred reasonable defense costs in a civil proceeding alleging wrongful acts, namely, that they had made misleading statements to induce Eddystone to enter into the rail services agreement and then later fraudulently transferred property and forgave debt to shield the BTS affiliates from liability. In denying coverage, Zurich argued that the Eddystone litigation was a single claim barred under the policy's run-off exclusion, which precluded coverage for claims arising from acts occurring in whole or in part after June 24, 2015. In response, plaintiffs argued that the insurer had not met its burden of proof to show that the exclusion applied. First, they argued that the run-off exclusion applied (if at all) only to the subsequent allegations of *fraudulent transfers* in 2016. Second, they contended that alleged misrepresentations, which occurred prior to 2015, to *induce* Eddystone to execute the services agreement qualified as an independent category of wrongful acts not subject to the exclusion.

The court held that the Zurich policy provided no coverage, adopting the insurer's broad view of the run-off exclusion and the interrelated nature of the acts giving rise to the Eddystone claim. The court found that Eddystone's claim, which did not seek reformation or rescission, stemmed from the alleged 2016 breach of the contract and fraudulent transfer acts. Because Eddystone did not pursue a claim for the earlier acts related to inducement, the court, therefore, held that the exclusion applied to preclude coverage.

The court upheld coverage, however, for the claim for advancement of defense costs for Rios and Gamboa under the Beazley policy. That policy provided coverage for numerous corporate entities, including the entity indemnifying Rios and Gamboa, subject to a retroactive date exclusion precluding coverage for certain claims with respect to a single insured, Bridger Logistics. Beazley argued that, because the Eddystone litigation alleged wrongful acts by those individual insureds involving Bridger Logistics before the retroactive date, coverage did not apply.

The court disagreed, finding that the retroactive date exclusion clearly and unambiguously applied "solely with respect to Bridger Logistics," which a reasonable third party would interpret to apply solely to coverage for that named insured. As a result, the exclusion could not apply to the claim for Rios's and Gamboa's legal fees because it was made by a separate insured. In the alternative, the court concluded that, even if the exclusion were ambiguous, the ambiguity should be construed in favor of coverage, as the allegations in the Eddystone litigation were not "solely" against Bridger Logistics.

Takeaways

As shown by *Ferrellgas,* policyholders should consider several issues when evaluating the scope of D&O coverage and pursuing reimbursement of defense costs for complex claims against multiple insureds with acts taking place over a long period of time, both before and after a change in control of key entities.

First, policyholders should ensure continuity of D&O coverage after a merger, acquisition, or change in control. Potential coverage gaps arise when run-off or "tail" coverage of an acquired entity does not dovetail with the surviving company's D&O program. This disconnect can result in coverage disputes for "mixed" claims involving pre- and post-transaction alleged wrongful acts or for claims involving legacy entities and former executives. In *Ferrellgas*, the Eddystone litigation centered around the impact of the FGP acquisition on the parties' ongoing business relationship under the pre-acquisition rail services contract. In such situations, legacy and present-day insurers have the incentive to take inconsistent views on coverage for claims involving facts that arguably span policy periods, preventing insureds from obtaining the benefit of either D&O program as expected.

Second, policyholders should be wary of broad interrelated claim provisions and exclusions like those at issue in the Zurich policy. The interrelated acts provision there required only a common nexus of "any fact" to deem wrongful acts related, while the run-off exclusion barred coverage for any interrelated acts "taking place in whole *or in part*" after the policy expiration date. Regular policy audits—when procuring new coverage, approaching renewals, and assessing adequacy of coverage in an M&A deal—can identify potential pitfalls that may give insurers more latitude to refuse coverage.

Finally, policyholders should not assume that all claims for defense costs will be subject to the broad "potentiality" standard, which requires insurers to reimburse defense costs where the allegations potentially support a covered claim. The *Ferrellgas* court, interpreting recent Delaware Supreme Court precedent, distinguished an insurer's duty to advance defense costs from a traditional duty to defend, finding that the former asks whether the lawsuit states "a claim covered by the policy," while the latter arises when even one or a few factual allegations "potentially support a covered claim." Although the court's rationale runs contrary to other court rulings explicitly holding that the duty-to-defend and duty-to-advance standards are analogous and require only allegations giving rise to the potential for coverage, this determination often turns on applicable state law.

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