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Delaware court recognizes D&O coverage for non-cash settlements

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The trend of Delaware court decisions favoring policyholders continues with a favorable ruling in *AMC Entertainment Holdings, Inc. v. XL Specialty Insurance Company, et al.* (https://bit.ly/4c6dGDh). The Delaware trial court found that AMC's settlement payment, made in the form of AMC shares valued at $99.3 million, qualified as a covered "Loss" under its directors and officers (D&O) liability insurance policy.

This ruling is noteworthy for a variety of reasons, particularly because it establishes that non-traditional forms of currency, like stock, can be a covered "Loss" under D&O policies.

Background of the underlying action

AMC, the movie theater chain, was financially strained during the pandemic. It experienced a dramatic surge in stock price, turning into a "meme stock" due to retail investor activity. To take advantage of the situation, AMC sought to issue more common stock.

This led to a legal battle with shareholders, who filed lawsuits to prevent AMC's proposal to convert the APEs into common stock.

However, shareholder approval to increase the common stock issuance was blocked, prompting AMC to create a new security — the AMC Preferred Equity Units (APEs). These units carried voting rights similar to common stock and were intended to convert to common stock if authorized by shareholders.

This led to a legal battle with shareholders, who filed lawsuits to prevent AMC's proposal to convert the APEs into common stock. The suits were consolidated in Delaware's Court of Chancery.

AMC notified its D&O insurers of the shareholder claims, which proceeded to mediation. The day after mediation, AMC received a settlement offer and had discussions with its insurers about the proposed terms. A week later, AMC settled the litigation, agreeing to issue 6,897,018 shares of common stock and pay the plaintiffs' attorneys' fees. AMC recorded this settlement as a contingent liability and expense on its books and valued it at $99.3 million.

AMC's D&O insurers denied coverage. After AMC commenced coverage litigation, most insurers settled, except for one excess insurer that continued to refuse coverage. AMC and the insurer moved for summary judgment.

The parties' arguments

The insurer argued that there was no coverage for the settlement payment for three reasons. First, it argued that the settlement payment was not a "Loss" under the terms of the policy. The policy defined "Loss", in relevant part, as "damages ... settlements ... or other amounts ... that any Insured is legally obligated to pay." Further, the policy provides that the insurer will "pay 'Loss' on behalf of AMC."

The insurer contended that because the settlement involved the issuance of stock, not cash, and because the insurer could not pay the settlement on AMC's behalf, it was not a covered "Loss".

Second, the insurer argued there was no "Loss" because AMC did not suffer economic harm by issuing the stock. And third, even if settlement in the form of stock issuance was a covered "Loss," the insurer was not obligated to pay it because AMC did not receive the insurer's prior written consent.

AMC countered that the settlement met the policy's definition of "Loss", which is not limited to cash payments, because it was an amount that AMC was "legally obligated to pay." AMC also argued that it suffered an economic harm since it recognized a permanent loss in its accounting by issuing new shares and suffered an opportunity cost in providing the shares.

Finally, AMC believed it received the insurer's consent on a conference call about the anticipated settlement.

The decision

The court found in favor of coverage, granting AMC's motion.

As for the definition of "Loss," the court found that "Loss" was not limited to cash payments. It emphasized that, under Delaware law, stock is a form of currency that can be used for a variety of corporate purposes, including settling debts. Thus, AMC's issuance of stock was deemed a covered "Loss," which the court refused to limit in a way not explicitly provided for in the D&O policy.

In further support of AMC's covered "Loss," the court looked to the policy's bump-up exclusion, which uses the word "paid" twice. The court stated, "[t]his is exclusion is not applicable to the issue presented, but its use of the word 'paid' is relevant" because words used in different parts of a policy are presumed "to bear the same meaning throughout."

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The court reasoned that because under Delaware Law the bump-up exclusion, and its use of the word "paid," can apply to stock transfers, it is "necessarily implie[d] that stock can be an amount AMC 'pays' which creates a covered 'Loss'."

Bump-up exclusions are a common insurer defense and source of frequent coverage disputes, including in Delaware (https://bit.ly/41RM4x0), but here the insurer's bump-up wording ended up supporting the policyholder's position in favor of coverage.

The court disposed of the insurer's "economic harm" argument because the policy did not condition coverage on the existence of such harm. Once again, the court refused to "insert a restricting clause into the Policy."

Finally, the court ruled that whether AMC sought the insurer's consent to settle, or waiver of consent, on a phone call was a factual issue to be decided by a jury. However, the court noted that Delaware law allows a policyholder that does not comply with consent requirements to obtain coverage by rebutting the presumption that the insurer was prejudiced by the breach and showing that the settlement was reasonable.

Discussion

This case has a has a variety of takeaways for policyholders.

Non-cash settlements: Non-cash settlement payments, including stock, may be covered as a "Loss" under D&O policies in Delaware.

While AMC's non-cash payment was in stock, the court's ruling may apply equally to a variety of other payment forms, such as cryptocurrency or other amounts that insureds are legally obligated to pay as damages or settlement.

Policyholders should carefully review policy language regarding the definition of "Loss" to determine if there is coverage for non-cash settlement payments.

Delaware coverage trends: Over the past few years, Delaware courts have issued several significant rulings, many in favor of policyholders. The court's decision in this case is yet another example of this.

Delaware's leadership in corporate governance and shareholder litigation also bleeds over into insurance disputes. In the recent decision, the court ruled in AMC's favor by relying on Delaware law recognizing that stock is a form of currency.

Insurers and policyholders will continue to pay attention to Delaware's developing role in issuing important coverage rulings.

Choice of law matters: In one such landmark decision, the Delaware Supreme Court (https://bit.ly/4cfQJOh) held that Delaware corporations and their insured officers and directors should be able to get the benefit of Delaware law governing their D&O coverage disputes. The *AMC* case exemplifies a Delaware policyholder reaping the benefits of Delaware law.

First, it was the Delaware's Chancery court's decision in a non-insurance suit determining whether a claim was a derivative or direct claim that the Superior Court used to support the conclusion that AMC's settlement was a covered "Loss" because "[s]tock is a form of currency." Other jurisdictions may not have similar law to support such a conclusion.

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Second, the *AMC* court held that if the company did not seek the insurer's consent to settle, it may still obtain coverage if it can rebut the presumption that the insurer was prejudiced and show that the settlement was reasonable. This is not true in all jurisdictions.[1] The point is that choice of law is significant, and Delaware policyholders may be able to leverage a growing body of favorable Delaware law on important coverage issues.

Conversely, the importance of what law governs an insurance policy makes choice-of-law, choice-of-forum, and similar policy provisions even more significant when insurers mandate application of another state's law. These provisions often go unnoticed but can have an outsized impact on coverage in the event of a dispute.

Policy drafting matters: The court's refusal to rewrite the policy highlights the importance of clear and unambiguous language. Insurers must ensure that policy's are drafted precisely, and policyholders must remain vigilant to ensure that insurers are not making inferences or interpreting policy language to support their preferred reading if it is not stated expressly

in the policy. It is the terms of the policy — not the insurer's unstated intentions — that controls.

Consider insurance ramifications in underlying litigation: Policyholders seeking defense and indemnity coverage under liability policies should be strategic in how they approach settlement in underlying litigations, keeping an eye towards potential coverage and ways to maximize recovery.

Small changes, like nuances in settlement agreements or accounting practices, can make or break claims for millions of dollars of potential coverage. In the *AMC* case, for example, the company recorded the settlement as a contingent liability and expense valued it at $99.3 million, which the court relied on to support a finding that the non-cash payment was covered loss.

Records of insurer communications: In the midst of high-stakes settlement negotiations and fast-paced litigation, it is not always feasible to document all communications with insurers. Nonetheless, this case shows the risks of not documenting what is said during conversations held in-person or via phone or video call. This is critical to avoid post-conferral disputes.

The *AMC* court was unable to resolve the question of whether the insurer consented to AMC's settlement because a factual dispute existed as to what was said during a phone call. It is unclear if a post-call confirmation email would have helped here, but, at a minimum, these kinds of written records can potentially minimize the risk of factual disputes.

Notes:

[1] *See, e.g.*, *Perini/Tompkins Joint Venture v. Ace Am. Ins. Co.*, 738 F.3d 95, 104-06 (4th Cir. 2013) (recognizing that, under Maryland and possibly Tennessee law, an insured's breach of a policy's consent to settle provision negates coverage without regard to whether the insurer was prejudiced by the breach).

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