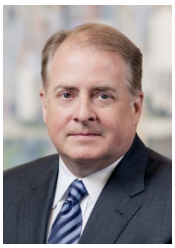
Lawyer Insights

Protecting Delaware Insureds: Recent Decisions Highlight Importance of State Law, D&O Policy Provisions Governing Coverage, Forum, and Applicable Law

By Geoffrey Fehling and Lawrence J. Bracken II
Published in Business Law Today | November 18, 2020

In three recent opinions, the Delaware Superior Court upheld the rights of companies and their officers and directors under directors and officers (D&O) liability policies in insurance claims involving a variety of disputed issues of state law. The disputed issues—ranging from jurisdiction over insurers under Delaware's long-arm statute to the timing of declaratory judgment actions and indemnification of legal fees—highlight favorable principles under Delaware law and underscore the importance of choice-of-law and forum selection provisions in insurance policies.

INSURER MUST REIMBURSE LEGAL FEES INCURRED BY COMPANY IN DEFENDING AGAINST FORMER EMPLOYEE'S COUNTERCLAIMS

In *Legion Partners Asset Management, LLC v. Underwriters at Lloyd's London*, the Delaware Superior Court granted a policyholder's motion for partial summary judgment, holding that Lloyd's was required to reimburse the company under a D&O policy for legal fees relating to an employee's counterclaim in a company-initiated arbitration proceeding.

A former employee of Legion Partners filed a lawsuit in California state court against Legion and two of its principal officers, alleging breach of fiduciary duty, wrongful termination, and violation of California's whistleblower statute. That same day, Legion filed its own arbitration demand, asserting that the employee violated his employment agreement. After the state court lawsuit was stayed in favor of the arbitration, the former employee asserted counterclaims against Legion in the arbitration that largely repeated the allegations in his original lawsuit.

Legion sought coverage from its D&O insurer, Lloyd's of London, for legal fees and expenses incurred in both the state court lawsuit and in the arbitration. Lloyd's denied coverage except with respect to the fiduciary duty claims brought against the officers in the state court lawsuit. Legion filed suit against Lloyd's and moved for summary judgment, arguing that Lloyd's had wrongfully refused to reimburse the legal fees incurred by the company and the two officers in defending the arbitration counterclaims.

At the outset, the court recognized that even where the insurer had a "duty to advance" rather than a "duty to defend," Delaware courts construe both duties "broadly in favor of the policyholder" and

that the insurer's duty to advance defense costs was triggered where a claim "*could* result in indemnity." Moreover, under Delaware law, the court was not constrained by how the claims are "characterized or formally titled in the pleadings." Rather, it considered both the facts alleged "and the reasonable inferences to be drawn" from those facts to determine whether the allegations as a whole "assert a risk within the policy's coverage."

Applying these principles, the court held that the allegations of the counterclaims asserted a risk within the policy's coverage under two separate insuring agreements; therefore, Lloyd's was required to reimburse all legal fees incurred in defending against the former employee's counterclaims. The court first found that the D&O policy's coverage for loss arising from claims against the company was triggered because the former employee alleged that Legion, acting through the two officers, breached fiduciary duties. In addition, looking beyond the employee's "characterizations of his claims," the court could "reasonably infer" that Legion, through its officers, also allegedly acted against its investors' interests and violated federal laws by leaking nonpublic information.

The court also broadly construed the phrase "for a Wrongful Act," recognizing that a claim "need only arise from Wrongful Acts" such that the claim need not "request certain relief that would impose legal liability on the Insureds for the Wrongful Act." Noting that Lloyd's "cannot avoid either the broad definition" of "Wrongful Acts" nor the broad causation between wrongful acts and the claim, the court held that the alleged acts by the company, through its officers, triggered coverage under the policy.

Next, the court found that the arbitration counterclaims also triggered the policy's insuring agreement for payment of loss that the company pays as indemnification to individual insureds. Because the counterclaim was a "Claim" and alleged that the two officers breached their fiduciary duties and violated federal law, the "allegations and the inferences to be drawn from them" constitute "Wrongful Acts" as defined in the policy.

For these reasons, the counterclaim was one for a "Wrongful Act" by insured persons, even though those persons were not named as defendants in the arbitration, meeting all requirements to trigger coverage.

DELAWARE COURT HAS JURISDICTION OVER INSURERS INSURING PERSONS LOCATED IN DELAWARE WHO SEEK COVERAGE FOR INSURED RISKS IN DELAWARE

The Delaware Superior Court in *Energy Transfer Equity, L.P. v. Twin City Fire Insurance Co.* issued two separate decisions, both in favor of the policyholder, in a suit filed by Energy Transfer, one of the largest midstream energy companies in the United States. Energy Transfer was sued in a class action lawsuit (the "*Dieckman* Action") alleging breach of a partnership agreement of an affiliated entity, Regency.

The *Dieckman* Action sought $2 billion in damages and alleged that Energy Transfer's acquisition by merger of Regency violated the Regency partnership agreement due to undisclosed conflicts of

interest, inadequate negotiations, and other issues with the transaction. A trial in the *Dieckman* Action took place in December 2019, and the parties submitted their final post-trial briefings on September 15, 2020.

Energy Transfer notified its D&O insurers of the *Dieckman* Action and sought coverage under 17 different policies providing $170 million in coverage. The insurers agreed to pay defense costs, but disputed obligations to indemnify the insureds. Energy Transfer filed suit against the insurers, seeking a declaration that the insurers had a duty to indemnify the insureds and demanding damages for the insurers' anticipatory breach of the D&O policies. Certain insurers filed two separate motions to dismiss—one on jurisdictional grounds and one on ripeness of the prospective duty to indemnify. The court denied both motions, each of which is discussed below.

The insurers' jurisdictional motion to dismiss contended that the court lacked personal jurisdiction over them. The insurers also argued that Delaware's long-arm statute did not apply and that exercising jurisdiction would violate the insurers' due process rights. Energy Transfer responded that the court had personal jurisdiction over the insurers because the insured persons were located in Delaware and sought coverage for risks located in Delaware.

The court agreed with Energy Transfer and dismissed the motion. The court recognized that, even if it is "tempting" to argue lack of personal jurisdiction, the facts supported jurisdiction. First, the Delaware statute conferring personal jurisdiction over nonresidents in cases involving insurance contracts applied where: (i) the insurers issued insurance contracts to the insureds; (ii) the insureds are located in Delaware and are organized under the laws of Delaware; and (iii) the policies are D&O policies "insuring the actions of officers and directors of Delaware corporate entities." The court held that the insurers were defendants who issued "contracts to insure" persons (i.e., the insured entities and their officers and directors) located in and to be performed in Delaware, which was sufficient to confer personal jurisdiction over Energy Transfer's claims.

Second, the court determined that exercising personal jurisdiction over the insurers would not offend due process. Longstanding Delaware authority has held that nonresident insurers issuing policies for Delaware corporations "must have foreseen the possibility that [they] could be haled into court in this forum." Citing this "guiding precedent," the court found that the Energy Transfer insurers had sufficient minimum contacts with the forum by entering into D&O insurance contracts with Delaware corporations that provided coverage for their officers and directors.

Practically speaking, the court further noted that "rarely are officers and directors of a Delaware entity sued for a breach of fiduciary duty outside of Delaware." The court reasoned that the duty to defend and indemnify "would likely be in Delaware," as in the pending *Dieckman* Action, and that "any coverage dispute litigation would be in Delaware." Therefore, the court saw "no reason" why the insurers should not be required to remain in Energy Transfer's coverage action.

Protecting Delaware Insureds: Recent Decisions Highlight Importance of State Law, D&O Policy Provisions Governing Coverage, Forum, and Applicable Law
By Geoffrey Fehling and Lawrence J. Bracken II
Business Law Today | November 18, 2020

DUTY TO INDEMNIFY CLAIM PRESENTS JUSTICIABLE CONTROVERSY UNDER DELAWARE LAW, EVEN BEFORE THE AWARD OF DAMAGES OR SETTLEMENT IN THE UNDERLYING ACTION

The second motion to dismiss ruling in the Energy Transfer coverage dispute concerned the justiciability of the insureds' request for declaratory relief under the D&O policies regarding the insurers' duty to indemnify. The insurers argued there was no "ripe controversy" for adjudication because, even though the *Dieckman* Action trial had concluded and the parties submitted post-trial briefings, the claim had not resulted in any award of damages or settlement invoking the duty to indemnify. Energy Transfer opposed the motion, arguing that the complaint "establishe[d] a sufficient basis to conclude that the relevant Policies are implicated" and met all requirements for declaratory relief under Delaware law.

The court declined to dismiss the action. Guided by Delaware Supreme Court precedent instructing courts to undertake "a common sense assessment" in balancing the interests of the party seeking relief against the need to postpone judicial review until the question presented arises in a more concrete and final form, the trial court found that Energy Transfer had met its burden to present a justiciable controversy.

The court found that a coverage determination was appropriate under the circumstances where the insureds were involved in active litigation, final briefing is complete after trial, and "a determination should be made soon" with respect to any ultimate liability in the *Dieckman* Action. Delaware law dictated that the court "take into consideration the legitimate interests of the Insureds in a prompt resolution, the hardship of delay, the prospective of future developments that might affect the determination made, and the need to conserve scarce resources."

All factors weighed in favor of the insureds, the court concluded, where the *Dieckman* Action was close to a decision on liability, the insurers had denied coverage on a claim that may soon impose liability on insureds under the policies, and judicial economy would not be preserved by dismissing the action without prejudice, only to have it refiled when a final decision is reached. Moreover, because not all insurers moved to dismiss, the civil action would still proceed regardless of the court's ruling on the pending motion. Thus, the controversy presented was "mature enough where judicial action is appropriate."

TAKEAWAYS

The three Delaware decisions in *Legion* and *Energy Transfer* highlight several key principles.

The first is that Delaware courts continue to uphold numerous principles favoring policyholders which protect Delaware corporations and their officers and directors in the event of a disputed insurance claim.

Duty to Advance Defense Costs. Delaware courts evaluate an insurer's "duty to advance" defense costs "broadly" under the more favorable "duty to defend" standard, where the insurer

must reimburse defense costs under D&O policies when there is even the potential for coverage that "could" result in indemnity. *See Hurley v. Columbia Cas. Co.*, 976 F. Supp. 268, 275 (D. Del. 1997) ("[T]here does not exist a significant difference between the duty to defend and the promise to advance defense costs, other than the difference between who will direct the defense."). The rule in Delaware is consistent with other jurisdictions that have interpreted the duty to advance defense costs broadly in favor of the policyholders seeking protection under D&O policies. *See, e.g.*, *Acacia Research Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. SACV 05-501 PSG MLGX, 2008 WL 4179206, at *12 (C.D. Cal. Feb. 8, 2008) ("as with a duty to defend, [insurer's] duty to advance defense costs arose on tender of a potentially covered claim"); *Liberty Mut. Ins. Co. v. Pella Corp.*, 650 F.3d 1161, 1170 (8th Cir. 2011) (recognizing that "the duty to reimburse defense costs and the duty to defend are different but 'similar in result' and concluding that, even though this case does not involve a duty to defend, the parameters of that duty, under Iowa law [which is materially similar to Minnesota law on the duty to defend], nevertheless guide our analysis of [the insurer's] duty to reimburse . . . defense costs"); *Aspen Ins. UK, Ltd. v. Fiserv, Inc.*, No. 09-CV-02770-CMA-CBS, 2010 WL 5129529, at *3 (D. Colo. Dec. 9, 2010) ("[T]here are no material differences between a duty to defend and a duty to advance Defense Expenses."); *Julio & Sons Co. v. Travelers Cas. & Sur. Co. of Am.*, 591 F. Supp. 2d 651, 660 (S.D.N.Y. 2008) (same); *Goldberg v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 143 F. Supp. 3d 1283, 1293 (S.D. Fla. 2015) ("Generally, courts have 'viewed an insurer's duty to advance defense costs as an obligation congruent to the insurer's duty to defend, concluding that the duty arises if the allegations in the complaint could, if proven, give rise to a duty to indemnify.'" (quoting *Fed. Ins. Co. v. Sammons Fin. Grp., Inc.*, 595 F. Supp.2d 962, 976–77 (S.D. Iowa 2009) and collecting cases)), *aff'd*, 861 F.3d 1335 (11th Cir. 2017).

Broad Definition of "Wrongful Acts." Delaware courts have looked to the actual language of D&O policies, specifically the definition of "Wrongful Act," which in many cases includes a broad range of conduct (e.g., "acts," "omissions," "misrepresentations," "statements") that extends well beyond traditional alleged "breach of fiduciary duty." Despite the nomenclature in the defined term, many such definitions also do not even require the precise conduct by the insured officer or director to be "wrongful," only that the claim alleges an "act" committed or attempted by an individual insured in his or her capacity as an officer, director, or other insured. Policyholders can leverage expansive definitions to bring numerous insureds into coverage under a D&O policy, even if the insured is only alleged to have incidental involvement in the circumstances giving rise to the claim.

Looking Beyond Labels to Find Coverage. In construing allegations broadly in favor of policyholders, Delaware courts, like the court in *Legion*, do not rely solely on the "characterizations" of causes of action or remedies by the underlying claimant. Instead, focusing on the actual policy language used, they determine whether the facts alleged against the insureds trigger D&O policy insuring agreements, many of which require only "Claims" that "arise from" wrongful acts. As a result, policyholders may find coverage exists even where officers and directors are not named as defendants, but are nevertheless involved in the alleged wrongful conduct.

Utilizing Declaratory Relief to Protect Insureds Facing Exposure. Delaware courts also permit policyholders to protect themselves proactively from imminent potential exposure by seeking

declaratory relief, even where the adverse event has not yet occurred. Permitting "mature" D&O indemnification disputes to proceed allows officers and directors to seek protection from insurance without forcing them to wait until after an adverse judgment is entered.

Furthermore, Delaware corporations, and their officers and directors, should be able to take advantage of favorable jurisdictional law. As in *Energy Transfer*, insureds can rely on Delaware law to oppose jurisdictional challenges by insurers that attempt to move coverage actions to less favorable forums, which may apply different state law. Insurers issuing policies to Delaware entities and individuals to insure risks in Delaware or actions taken on behalf of Delaware corporations should foresee the possibility of being sued in Delaware.

To be sure, while the decisions above are favorable on several key coverage issues, not all Delaware insurance principles favor policyholders, as recent opinions by the Delaware Supreme Court overturning pro-policyholder rulings on several important D&O coverage issues have shown. *See, e.g.*, *In re Solera Ins. Coverage Appeals*, No. 413, 2019, 2020 WL 6280593 (Del. Oct. 23, 2020) (reversing Superior Court ruling that Delaware statutory appraisal action was a "Securities Claim" under D&O policy); *In re Verizon Ins. Coverage Appeals*, 222 A.3d 566, 577 (Del. 2019) (reversing lower court ruling that bankruptcy trustee suit constituted "Securities Claim"). Thus, careful analysis of applicable state law based on the particular facts and policy language at issue is required.

Finally, policyholders should carefully review their D&O insurance policies, both when placing the policies and when they receive a claim, for any choice-of-law or forum selection provisions that may affect the ability of insureds to choose their preferred forum or otherwise take advantage of the favorable principles described above. Even where policies are silent on these issues, policyholders should carefully consider choice-of-law and forum selection early in any claim scenario to account for variances in state law, court disposition, and judicial tendencies that could have significant impact in the event of litigation or arbitration.

Geoffrey B. Fehling *is Counsel in the firm's Insurance Coverage group in the firm's Washington D.C. office. Geoff represents corporate policyholders and their officers and directors in insurance coverage disputes involving directors' and officers' (D&O), errors and omissions (E&O), and other professional liability claims, cybersecurity and data breaches, representations and warranties, employee theft and fidelity claims, government investigations, breach of fiduciary duty, environmental liabilities, and property damage. He serves as the Vice Chair of the ABA Business Law Section D&O Liability Committee's Insurance Subcommittee and can be reached at +1 (202) 955-1944 or gfehling@HuntonAK.com.*

Lawrence J. Bracken II *is a partner in the firm's Insurance Coverage group in the firm's Atlanta office. Larry has more than 30 years of experience litigating and investigating insurance coverage, class action, technology, environmental and commercial matters. He can be reached at +1 (404) 888-4035 or lbracken@HuntonAK.com.*