Del. Solera D&O Decision May Have Limited Impact

By Geoffrey Fehling, Steven Haas and Syed Ahmad
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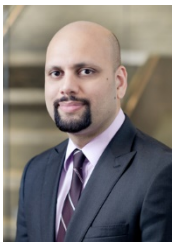

In a much-anticipated decision governing the rights of many Delaware companies to access insurance to protect against losses incurred in connection with stockholder appraisal proceedings, the Delaware Supreme Court reversed a lower court ruling and held that Solera Holdings Inc.'s $39 million insurance claim under directors' and officers' policies did not trigger coverage for securities claims.

The Oct. 23 decision can pose hurdles for policyholders attempting to secure securities-related D&O coverage in Delaware but highlights several issues suggesting that the result will not necessarily be followed in other jurisdictions evaluating similar coverage questions.

A private equity firm acquired Solera in 2016, giving rise to numerous legal proceedings, including an appraisal action initiated by several Solera stockholders pursuant to Title 8, Section 262 of the Delaware Code, seeking a determination of the fair value of their shares.

Solera sought coverage for the appraisal action under several D&O policies.

When the insurers denied coverage, Solera filed a coverage lawsuit in Delaware Superior Court for breach of contract and declaratory judgment, seeking coverage for reimbursement of legal fees and expenses incurred in the appraisal action and prejudgment interest on the amounts Solera ultimately was ordered to pay the stockholders for the fair value of their shares.

Solera argued that its losses were covered by the policies, which required the insurers to pay for loss "resulting solely from any securities claim first made against the company during the policy period for a wrongful act."

The policies defined "securities claim" in relevant part as an alleged "violation of any federal, state, or local statute, regulation or common law regulating securities."

Solera contended that the appraisal action was a securities claim because the stockholders alleged a violation of the Delaware appraisal statute, which is a law "regulating securities," and asserted a number of other wrongful acts in connection with the sale process.

Trial Court Proceedings

The primary insurer settled with Solera, but the excess insurers filed a motion for summary judgment, arguing that there was no coverage under the policies because appraisal actions are "neutral"

proceedings that do not involve any proof of wrongdoing by the company or its directors and, therefore, could not allege any violation of law necessary to trigger coverage as a securities claim.

The Superior Court denied the insurers' motion, holding that a Section 262 appraisal action constituted a securities claim within the meaning of the policy because the undefined policy term "violation" was commonly understood to mean, among other things, "a breach of the law and the contravention of a right or duty."[1]

As a result, the court rejected the insurers' argument that the policies limited coverage to violations of law alleging wrongdoing, stating "[b]y its very nature, a demand for appraisal is an allegation that the company contravened [the statutory right to receive fair value] by not paying shareholders the fair value to which they are entitled."

Delaware Supreme Court Opinion

On appeal, the Delaware Supreme Court reversed the trial court ruling and adopted the insurers' narrow view of securities claim in the D&O policies.[2]

The court took issue with the Superior Court's treatment of the undefined term "violation," acknowledging that one of many common dictionary definitions stated that violation includes "the act of breaking or dishonoring the law" or "the contravention of a right or duty" but ultimately concluding that the plain meaning of the term "suggests an element of wrongdoing."

Even if scienter is not required, the court reasoned, "contravention of a statute's prohibition is, nevertheless, a wrongdoing."

The court next supported its interpretation of violation requiring wrongdoing by discussing the historical background of the Delaware appraisal remedy, which is confined solely to "the value of the dissenting stockholder's stock."

Section 262 grants limited remedies to stockholders who perfect their appraisal rights and imposes several requirements on both the company and any dissenting stockholders seeking to challenge the value of their shares.

The court explained that the appraisal petition at issue alleged no violation by Solera of any requirements of Section 262, which Solera itself did not contend was violated.

The court also rejected Solera's argument that the appraisal action involved alleged wrongdoing related to the sale process leading up to the allegedly unfair share price, noting that "the valuation date under section 262 is as of the date of the execution of the merger, not the date the merger agreement is executed," which "further suggests that an appraisal action is not designed to address alleged wrongdoing in the merger process."

Those limited remedies, combined with the "neutral" purpose of the appraisal statute and an "unbroken" line of cases holding that Section 262 "does not involve any inquiry in claims of wrongdoing," led the court to conclude that Solera's claim did not involve violation of any laws.

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Discussion

While a blow for Delaware companies seeking protection for Section 262 appraisal proceedings, the Solera decision poses several issues regarding the court's reasoning in adopting the insurers' narrow view of violation, as used in the D&O policies' definition of securities claim.

Protecting policyholders' reasonable expectations.

In addition to proper interpretation of myriad definitions of violation, discussed more below, courts should consider Solera's reasonable expectations in being protected by D&O insurance when faced with costly appraisal actions demanding recompense due in part to alleged wrongful acts in the sale process giving rise to the transaction determining fair value.

Delaware, like many jurisdictions, follows the "reasonable expectations" doctrine, which states that coverage language is "interpreted broadly to protect the insured's objectively reasonable expectations."[3]

This means that, when considering whether policy terms are ambiguous, confusing or misleading, courts "should interpret contract language as it 'would be understood by any objective, reasonable third party.'"[4]

Both the Superior Court and the Supreme Court went to great lengths to navigate the varied meanings of violation in the context of appraisal proceedings to arrive at the "plain" meaning of the policies.

What is a common purchaser of corporate D&O insurance to think upon receipt of a stockholder demand letter for fair value of stock (i.e., securities) due to allegedly unfair valuation when the company paid substantial premium for D&O policies addressing claims for violations of laws or statutes regulating securities?

One reasonable view, it seems, is that such policies would respond to appraisal proceedings.

There are two other important considerations.

First, most appraisal demands are premised on the notion that the directors did not discharge their fiduciary duty to obtain the best price reasonably available — so-called Revlon duties.

They may also challenge the quality of the corporation's disclosures to stockholders.

Therefore, in most appraisal proceedings, it would seem that there is an alleged violation of law, including common law.

Second, appraisal proceedings can give rise to separate fiduciary duty claims, as was the case with in the Solera acquisition and many others.[5]

Thus, even if individual directors and officers are not parties to the appraisal proceeding, the proceeding may lead to discoverable evidence or judicial findings of fact that could give rise to such liability.

Absent clear and unambiguous language, Delaware courts construe unclear policy provisions in favor of policyholders.

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In Delaware and elsewhere, courts have long followed the basic insurance tenet that ambiguous policy language must be construed against the insurer that drafted the policy and in favor of coverage.[6]

Moreover, as the Solera court recognized, an undefined term like violation need only be "reasonably or fairly susceptible of different interpretations" or "have two or more different meanings" to be ambiguous under Delaware law.[7]

Having examined three different dictionaries and multiple iterations of the meaning of violation and its constituent parts — ranging from a transgression or to defy to misdemeanor or to violate or infringe — the Solera court found that the term "suggests an element of wrongdoing."

Concluding that one particular view only suggests a particular interpretation is a far cry from the language being clear and unambiguous, which is what is required for a court to follow the plain language without construing undefined terms in favor of the policyholder.[8]

The Superior Court's view that one definition — the "contravention of a right" — satisfied the plain meaning of violation shows one reasonable interpretation of the policy, which is all that should be required for the policyholder to prevail.

The fact that the court cited multiple definitions of a single word, several of which used language, like transgress or contravention, that in turn had to be traced back to their own multiple meanings indicates that violation is at least unclear as applied to appraisal actions.

In addition, at the conclusion of the discussion of the plain meaning of violation, the Court states that "appraisal actions are not proceedings that adjudicate wrongdoing," which is a different concept than what was required under Solera's D&O policies.

There, the definition of securities claim requires only a claim "made against [Solera] for any actual or alleged violation," so requiring an adjudication of wrongdoing as an element of the statutory appraisal remedy arguably construes the pertinent language in favor of the insurers and not Solera.

Giving policyholders fair value in future appraisal coverage disputes.

The Solera decision, while arguably in conflict with the principles described above, now provides a more limited view of public-company D&O coverage for securities claims arising from statutory appraisal proceedings in Delaware.

The issues, however, are likely to arise again in the future, in Delaware and other jurisdictions.

Among other things, different results might be obtained based on the petitioner's allegations or pleadings and governing law.[9]

While each insurance claim depends on the particular facts and policy language at issue, proper policy interpretation and analysis, particularly of undefined terms in light of the reasonable expectations of the average policyholder-consumer, should lead to different results in subsequent coverage litigation for appraisal proceedings.

Coverage implications for the company aside, directors and officers should be keenly aware of possible

collateral effects of appraisal proceedings.

Despite the Delaware Supreme Court characterizing appraisal as a neutral process focused solely on fair value, those proceedings — or more specifically appraisal discovery related to sale process and conduct of the directors — can lead to (or bolster existing) fiduciary duty claims based in whole or in part on evidence obtained in appraisal proceedings.

Notes

1. Solera Holdings, Inc. v. XL Specialty Ins. Co., 213 A.3d 1249, 1256 (Del. Super. Ct. 2019), rev'd sub nom. In re Solera Ins. Coverage Appeals, No. 413, 2019, 2020 WL 6280593 (Del. Oct. 23, 2020).

2. Solera Ins. Coverage Appeals, 2020 WL 6280593, at *9.

3. Arch Ins. Co. v. Murdock, No. CVN16C01104EMDCCLD, 2019 WL 2005750, at*9 (Del. Super. Ct. May 7, 2019) (citing AT&T Corp. v. Clarendon Am. Ins. Co., No. CIV.A.04C-11-167(JRJ, 2006 WL 1382268, at *9 (Del. Super. Ct. Apr. 13, 2006), rev'd in part on other grounds, 918 A.2d 1104 (Del. 2007)).

4. Legion Partners Asset Mgmt., LLC v. Underwriters at Lloyds London, No. CVN19C08305AMLCCLD, 2020 WL 5757341, at*7 n.63 (Del. Super. Ct. Sept. 25, 2020) (quoting Salamone v. Gorman, 106 A.3d 354, 367-68 (Del. 2014)); see also Steigler v. Ins. Co. of N. Am., 384 A.2d 398, 401 (Del.1978) ("[A]n insurance contract should be read to accord with the reasonable expectations of the purchaser so far as the language will permit.").

5. See, e.g., In re Xura, Inc., Stockholder Litig., No. CV 12698-VCS, 2018 WL 6498677, at *1 (Del. Ch. Dec. 10, 2018) ("What began as an appraisal case has become, with the benefit of appraisal discovery, a breach of fiduciary duty case.").

6. See Apotas v. Allstate Ins. Co., 246 A.2d 923, 924 (Del. 1968) (where ambiguous, "the language of insurance contracts is always construed against the insurance company which has drafted it").

7. Solera, 2020 WL 6280593, at *8 (quoting E.I. du Pont de Nemours & Co. v. Allstate Ins. Co., 693 A.2d 1059, 1061 (Del. 1997).

8. See id. at *8 (courts follow ordinary meaning of a policy when its language is "clear and unambiguous" (quoting AT&T Corp. v. Faraday Capital Ltd., 918 A.2d 1104, 1108 (Del. 2007))); see also Hallowell v. State Farm Mut. Auto. Ins. Co., 443 A.2d 925, 926 (Del. 1982) (courts will follow the plain language only "when the language of an insurance contract is clear and unequivocal"); Legion, 2020 WL 5757341, at*7 n.63 ("If the language is 'clear and unequivocal,' the Court will read the terms of the policy in accordance with their plain meaning." (quoting E.I. du Pont de Nemours & Co. v. Admiral Ins. Co., No. CIV. A. 89C-AU-99, 1996 WL 111205, at *2 (Del. Super. Ct. Jan. 30, 1996)).

9. See, e.g., CEC Entertainment, Inc. v. Travelers Cas. & Surety Co. of Am., No.3:16-cv-02493, 2016 WL 4575700 (N.D. Tex. filed Aug. 29, 2016) (addressing insurer's denial of coverage for stockholder appraisal action instituted under Kansas appraisal statute, K.S.A. §17-6712).

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