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Client Alert

Insurance Recovery

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Delaware Trial Court Rules Appraisal Action is a 'Securities Claim' and Leaves Door Open to Order D&O Insurers to Pay Prejudgment Interest and Defense Costs Despite Lack of Insurer Consent

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What You Need To Know:

- **Appraisal actions may be covered by D&O policies.**
- **Prejudgment interest may be covered even if the basis for awarding the interest is not.**
- **Noncompliance with a consent clause in a D&O policy may not be fatal if the insurer was not prejudiced by delayed notice and/or lack of consent.**

Introduction

Recently, the Delaware Superior Court issued an opinion that has far-reaching consequences for directors' and officers' liability ("D&O") policyholders and insurers. *Solera Holdings, Inc. v. XL Specialty Insurance Company, et al.*, C.A. No. N18C-08-315 AML CCLD, 2019 WL 3453232, at *1 (Del. Super. Ct. July 31, 2019) (*Solera*).

The court held that the definition of "Securities Claim" in a D&O policy includes a shareholder appraisal action. The court also held that prejudgment interest can be covered "Loss" even if the policy does not provide coverage for the loss giving rise to the prejudgment interest, i.e., merger value consideration. Finally, the court held that the policy's requirement that the insured obtain the insurer's consent before incurring defense costs (the "Consent Clause") included an implied prejudice requirement, i.e., a breach is immaterial if it does not prejudice the insurer.

Background

In March 2016, an affiliate of the private equity firm Vista Equity Partners acquired the formerly publicly traded company Solera Holdings, Inc. (the "Insureds") for an agreed merger price of $55.85 per share, or approximately $6.5 billion. At the time of the merger, the Insureds had a $10 million primary D&O policy (the "Policy") and $45 million of excess follow-form policies sold by various insurance companies (the "Insurers").

Four days after the merger, several of the Insureds' previous shareholders (the "Petitioners") filed an appraisal action (the "Appraisal Action") in the Delaware Court of Chancery, seeking a merger valuation of $84.65 per share. The Insureds did not notify the Insurers of the Appraisal Action until January 2018, after much of the litigation, including trial, was complete. In April 2018, the Insurers denied coverage for the Appraisal Action. Then, in July 2018, the Chancery Court determined that the fair value of the

Petitioners' shares was $53.95 per share (less than the merger price) and ordered the Insureds to pay the Petitioners approximately $38.4 million in prejudgment interest. The Insureds incurred more than $13 million defending the Appraisal Action.

Coverage Issues

The issues presented in Solera were threefold: (i) whether the Appraisal Action must allege wrongdoing to qualify as a "Securities Claim" as defined in the Policy; (ii) whether the Policy covered prejudgment interest on the Chancery Court's determination of the fair value of the Petitioners' shares, even though the Policy did not cover the value of the shares; and (iii) whether the Insureds' breach of the Consent Clause, stemming from their delayed notice, caused material prejudice to the Insurers such that coverage for the Insureds' defense costs was precluded.

The Court's Analysis, Findings, and Holdings

Regarding the first issue, the Insurers argued that the Appraisal Action was not a "Securities Claim" under the Policy because the definition required an "actual or alleged violation" of a securities law. Specifically, the Insurers contended that "violation" requires wrongdoing and an appraisal action does not require an allegation of wrongdoing. The court, however, relied on long-established rules of insurance contract interpretation and stated that courts must "first seek to determine the parties' intent from the language of the insurance contract itself." The court then found that the plain meaning of the undefined term "violation" in the Policy was broader than "wrongdoing" and that the Appraisal Action was inherently an allegation of the Insureds' violation of the Petitioners' right to receive the fair value of their shares. Therefore, the court held that the Appraisal Action qualified as a "Securities Claim" under the Policy.

Next, the court considered whether the prejudgment interest award was a "Loss" as defined in the Policy. The Insurers argued that the interest could not be a "Loss" because the underlying amount on which the interest accrued was not a covered "Loss." Again, the court looked to the plain meaning of the Policy, which defined "Loss" to include "pre-judgment interest . . . that [the Insureds are] legally obligated to pay." The court readily held that the Policy covered prejudgment interest because the Policy did not limit "pre-judgment interest" in any way, such as by excluding coverage for interest awarded for an uncovered loss, e.g., the Chancery Court's determination of the fair value of the Petitioners' shares. Notwithstanding this finding, the court did not award summary judgment to the Insureds because it noted factual issues remained with respect to whether the Insureds could have mitigated the prejudgment interest incurred and whether the Insureds actually paid all the awarded prejudgment interest.

The last issue before the court was whether the Insureds' nearly two-year delay in giving notice of the Appraisal Action materially prejudiced the Insurers. Notably, the Insurers did not advance a late notice argument on this summary judgment record because the Policy contained an explicit material prejudice requirement in the notice provision. Therefore, the Insurers sought to bar coverage for the prenotice defense costs by relying on the Consent Clause, which stated that the Insureds could not incur any defense costs without the Insurers' prior consent (which consent could not be unreasonably delayed or withheld). The Insureds argued that the same material prejudice requirement that applied to the notice provision of the Policy was implied in the Consent Clause. The court agreed that a prejudice requirement must be implied in the Consent Clause to protect policyholders from the harsh result of forfeiture of coverage when an insurer is not actually harmed by delayed notice. However, the court also made clear that policyholders bear the burden of demonstrating lack of prejudice when they have breached the Consent Clause. The court admitted that the Insureds successfully defended the Appraisal Action, but it determined that summary judgment in the Insureds' favor was premature because factual questions regarding prejudice required additional evidence to determine.

Key Takeaways

The *Solera* court's broad interpretation of "Securities Claim" to include an appraisal action that contains no explicit alleged wrongful conduct is favorable to D&O policyholders but also may lead insurers to modify the definition on future D&O policy forms. Therefore, it is critically important for policyholders to remain diligent in carefully reviewing renewal terms and conditions with qualified coverage counsel. In the same vein, policyholders should be aware of changes being made to the definition of "Loss" to address the court's determination that prejudgment interest may be covered even if the basis for the interest award is not. Indeed, the Solera opinion includes language that could have been, but was not, used in the Policy to foreclose the Insureds' ability to recover prejudgment interest. Finally, notwithstanding the court's favorable finding that a material prejudice requirement applies to the Consent Clause, policyholders are still best served by providing immediate notice of claims in order to avoid the burden of explaining delay and demonstrating that insurers have not been prejudiced by it.

Contacts

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