

Silence is Golden? Delaware Court Applies Larger Settlement Rule in D&O Allocation Dispute

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When a D&O claim settles, one question often decides how much of that settlement a policyholder actually recovers: how do you account for parts of the case the policy covers and the parts it may not? Insurers and policyholders often answer that question very differently. In *Hemisphere Media Group, Inc. v. Fair American Select Insurance Co.*, the Delaware Superior Court delivered a clear and policyholder-friendly answer for the situation that arises most often in practice—a policy that says a great deal about trying to agree on allocation but is silent about what allocation standards control when the parties cannot.

The court’s message was simple, at least in Delaware: where a D&O policy does not actually prescribe an allocation method, the so-called “larger settlement rule” fills the gap and tilts the scales in the policyholder’s favor.

The Disputed Class Action Settlement and Allocation of Loss

A publicly traded media company carried a \$25 million tower of D&O coverage. Former stockholders filed a class action lawsuit challenging a buy-out transaction and a related divestiture. The complaint named two sets of defendants: the company’s directors, whose alleged fiduciary breaches fell within the D&O policies’ coverage, and controller entities that were not insured. When the case settled for \$15 million, some insurers paid while one excess insurer did not. Coverage litigation followed.

The parties agreed that the settlement covered a mix of insured and uninsured claims. What they contested was the method for dividing the \$15 million under the policies’ allocation provision, which is where the “larger settlement rule” took center stage.

What the Larger Settlement Rule Does and Why

The larger settlement rule is a court-created methodology to allocate risk. It says that a “loss is fully recoverable unless the insurer can show that the liability for non-covered conduct increased the insurer’s liability.” Applied to a settlement resolving claims against both insured and uninsured parties, settlement amounts are uncovered “only if the acts of the uninsured party are determined to have increased the settlement.”

The rule is not an accident. Delaware adopted it in the seminal *Murdock* litigation because it protects the policyholder’s economic expectations of the insured, preventing “the deprivation of insurance coverage that was sought and bought.” Stated differently, because the policyholder paid for broad D&O protection, the presence of uninsured co-defendants should not quietly erode it.

Why the Insurer's Allocation Provision Did Not Override the Larger Settlement Rule

When parties bring a coverage dispute to the court, the court must first decide what allocation method applies. Where a policy does not set out an allocation method that governs, the Delaware Supreme Court has held that the larger settlement rule applies. In the *Hemisphere* dispute, the D&O insurer argued that its policy supplied an allocation method that displaced the larger settlement rule.

That allocation provision required the parties to “use their best efforts” to reach a “fair and appropriate allocation” that took into account “the relative legal and financial exposures” and “relative benefits obtained” by the insureds and others. Where an allocation agreement could not be reached, the provision’s “disagreement clause” required the insurer to advance the undisputed portion of loss until a final amount was “determined pursuant to the provisions of this Policy and applicable law.”

The court was not persuaded, concluding the policy “lack[ed] language mandating an allocation method” that governed in lieu of the larger settlement rule. The “relative exposures and benefits” language, the court explained, described only what the parties consider *while trying to agree*; it was silent on what allocation methodology applied when they could not.

The disagreement clause supplied no method of its own because it pointed back to “the provisions of this Policy” (the whole policy) and to “applicable law.” No policy provision required application of the insurer’s preferred “relative exposures and benefits” approach.

What the policy required was that the insurer provide “broad coverage” for settlements that any insured is “legally obligated to pay.” Conversely, the policy did not exclude coverage “where a settlement also relate[d] to conduct by an uninsured person,” nor did it “mandate a particular allocation method.”

Because the allocation provision defaulted to “applicable law,” and Delaware’s applicable law for an unallocated settlement was the larger settlement rule, the policy’s own text ultimately points toward the default, not away from it.

Language Matters: Unpacking Delaware’s Allocation Case Law

Perhaps the most valuable part of the opinion was the Superior Court’s bright-line rule drawn from three Delaware cases (*Murdock*, *Verizon*, and *Calamos*). The distinction is whether the policy contains a mandatory directive that a particular allocation *shall* apply regardless of agreement, or whether it merely lists factors the parties weigh while trying to agree.

- **Larger settlement rule controls.** In *RSUI Indemnity Co. v. Murdock*, the policy directed the parties to use best efforts while “tak[ing] into account the relative legal and financial exposures.” The *Hemisphere* court agreed with the Delaware Supreme Court’s view that the language “speaks only” to where the insurer and policyholder are working together to negotiate and did not establish what happens when that negotiation fails, defaulting to the larger settlement rule. The policy in *Hemisphere* fell squarely within that rubric.
- **A “specific directive” for allocation controls.** In *Verizon Communications Inc. v. Illinois National Insurance Co.*, the policy provided that “there shall be a fair and equitable allocation” accounting for relative exposures and benefits, which the court described as “unambiguously provid[ing] a method that is independent of an agreement.” The *Hemisphere* court recognized the language gave a “specific directive” mandating a different allocation method that controlled over the policy’s general grant of coverage and the larger settlement rule.
- **A federal decision not representative of Delaware law.** In *Calamos Asset Management v. Travelers Casualty & Surety Co. of America*, the District of Delaware had read a similar provision to mandate an allocation method, worrying that the contrary view created a “vicious cycle” of renewed best efforts and rendered the disagreement

clause meaningless. The Superior Court in *Hemisphere* respectfully disagreed: the “provisions of this Policy” refers to *all* of them, and if one provision directed a specific allocation method applied (like in *Verizon*), then it would control. But otherwise what controls is the policy’s broad coverage for settlements, which is best fulfilled by the larger settlement rule.

The resulting rule is that allocation factors made part of a “best efforts” duty to negotiate do not displace the larger settlement rule. Instead, the policy must provide a standalone command that a specified allocation “shall” be made where the parties disagree. And a disagreement clause that routes to the policy provisions and applicable law is neutral: it simply defaults to whatever the rest of the policy commands under governing law.

The Future of Allocation in Delaware and Beyond

The practical lesson is that the time to focus on allocation is at the time of placement, not at the point of claim or settlement. Two allocation provisions can look facially similar but produce opposite results. Small variations in language applied during negotiations and disagreement can either default to broad grants of coverage favoring the policyholder or hand the insurer a powerful tool to discount a settlement.

Looking ahead, this decision may also prompt insurers to revisit standard “best efforts” allocation wording. If courts continue to treat the common relative-exposure factors as pure negotiation tools that have no binding effect once the parties disagree, it may revert allocation discourse back to more policyholder-friendly common law doctrines like the larger settlement rule for settlements and the “reasonably related” rule for defense costs. Insurers may respond in turn by drafting more explicit provisions mandating a particular allocation framework. Policyholders should be wary of that shift because mandatory relative-exposure language can materially reduce recovery when the default in many jurisdictions, like Delaware, is to apply more favorable standards like the larger settlement rule.

For now, the recent decision decided only *whether* the larger settlement rule applied and not how the rule applied to the particular settlement before the court. Thus, the Superior Court expressly left for another day the factual question of whether the \$15 million settlement was in fact increased by the conduct of the uninsured parties. That other inquiry, on which the insurer bears the burden, remains open and warrants further monitoring as the litigation proceeds.

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