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D&O coverage dispute? Don't forget about the Delaware option

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Corporations embroiled in coverage disputes with their D&O insurers may be in the unenviable position of having to bring a lawsuit to enforce their rights. One of the first considerations the corporation faces is where it should file its coverage action. Some may assume that they are limited to the jurisdiction where the corporation principally operates or is headquartered, where its D&O policy was "issued" (often the same jurisdiction as it principal place of business), or where the underlying insured matter is centered. But if the corporation is incorporated in Delaware (which many obviously are), then bringing the action in Delaware is an important additional option that the corporation would be well-advised to consider. Of course, this option begs some important questions.

Why would a corporation principally operating outside of Delaware want to bring its coverage action in Delaware, particularly when that may mean giving up its "home field advantage" or incurring additional costs to litigate in a distant jurisdiction? This answer is easy—Delaware law on a number of key D&O coverage issues is simply more favorable for policyholders than the law of many other jurisdictions. Indeed, differences between Delaware coverage law and the law of other jurisdictions may be outcome-determinative. Just a few examples include:

- **"Bump-Up" Exclusion.** D&O insurers regularly assert this exclusion as a defense to claims by shareholders involving the value they received in corporate transactions. Delaware courts have interpreted this exclusion narrowly, most notably with respect to mergers. *See Northrop Grumman Innov. Sys. v. Zurich Am. Ins. Co.*, No. N18C-09-210, 2021 Del. Super. LEXIS 92 (Del. Super. Ct. Feb. 2, 2021), at *43-47.

- **Governmental investigations.** D&O insurers regularly assert that they are not required to cover the often substantial costs of responding to government subpoenas and civil investigation demands issued before formal proceedings are initiated. Delaware courts have broadly interpreted D&O insurers' obligations to cover the costs of pre-litigation subpoenas and CIDs. *See Conduent State Healthcare, LLC v. AIG Specialty Ins. Co.*, No. CVN18C12074MMJCCLD, 2019 WL 2612829, at *5 (Del. Super. Ct. June 24, 2019); *Guaranteed Rate, Inc. v. ACE Am. Ins. Co.*, No. N20C-04-268 MMJ CCLD, 2021 WL 3662269, at *2 (Del. Super. Ct. Aug. 18, 2021).

- **Allegations of fraudulent conduct.** Claims covered by D&O policies often involve allegations of fraud against a corporation and/or its officers and directors. D&O insurers regularly assert that such claims are not covered by virtue of: (i) so-called "fraud exclusions" in their policies or (ii) because covering fraud would violate public policy. Delaware courts have made clear that: (i) settlement of a claim alleging fraud is not a "final adjudication" as required by most fraud exclusions; and (ii) insuring against fraudulent conduct does not violate Delaware public policy. *See RSUI Indem. Co. v. Murdock*, 248 A.3d 887, 903-07 (Del. 2021).

- **Broad scope of insurable losses.** Some jurisdictions limit or preclude the insurance for certain types of loss, including disgorgement of allegedly ill-gotten gains, punitive damages, and civil penalties—purportedly on public policy grounds. Delaware courts, on the other hand, have indicated that insuring these types of losses does not violate Delaware public policy. *See Gallup, Inc. v. Greenwich Ins. Co.*, C.A. No. N14C-02-136FWW, 2015

WL 1201518, at *9-10 (Del. Super. Feb. 22, 2015) (disgorgement has not been, and is unlikely to be, deemed uninsurable by Delaware courts); *Whalen v. On-Deck, Inc.*, 514 A.2d 1072, 1073-74 (Del. 1986) (Delaware public policy does not preclude coverage for punitive damages); *Wilson v. Chem-Solv, Inc.*, No. 85C-MY-1, 1988 WL 109375, at *1 (Del. Super. Oct. 14, 1988) (Delaware public policy does not preclude coverage for civil penalties).

- **Larger Settlement Rule.** Insurers often point to so-called "allocation" provisions in D&O policies as a basis for covering only a portion of settlements involving both insured and non-insured claims. At least one Delaware court has held that, even where the policy at issue contains an allocation provision, the insured's entire settlement is covered where it "resolves, at least in part, insured claims" and "the allocation provision does not provide for a specific allocation method" as between covered and non-covered claims. *See Arch Ins. Co. v. Murdock*, 2020 Del. Super. LEXIS 156, at *18-23 (Del. Super. Ct. Jan. 17, 2020).

Of course, any policyholder considering bringing a D&O coverage action would be well-advised to research the law governing the key coverage issues in dispute with its insurer in of each of the jurisdictions it is considering—including Delaware—before filing its action.

Can a corporation bringing a coverage action in Delaware get Delaware law applied to its dispute, even if the only connection to Delaware is that the policyholder is incorporated there, especially where the underlying dispute is centered elsewhere? Simply put, if the coverage action is initially filed in Delaware, then the answer is probably yes. In conducting choice of law analyses, Delaware courts have repeatedly held that a corporation's place of incorporation is its "center of gravity" for determining which state's law applies to a D&O coverage dispute. Therefore, Delaware law ordinarily applies to D&O coverage disputes where the policyholder is a Delaware corporation. These courts have further held that Delaware has a substantial public interest in application of Delaware law to such disputes so that directors and officers have a consistent body of caselaw upon which they can rely to make informed decisions about protections available to them in performing their corporate functions. *See Murdock*, 248 A.3d at 900, 907; *Calamos Asset Mgmt., Inc. v. Travelers Cas. & Surety Co. of Am.*, No. CV 18-1510 (MN), 2020 WL 3470473, at *4 (D. Del. June 25, 2020).

What if the coverage action gets transferred out of Delaware before a choice of law determination is made? As an initial matter, a Delaware state court is not likely to dismiss a coverage action filed in Delaware on forum *non conveniens* grounds because, as discussed above, Delaware has a stated public interest in having D&O coverage disputes involving Delaware corporations decided in Delaware courts. In most cases, this interest is likely to overcome considerations of convenience to the parties.

As to Delaware coverage actions filed in state court and removed to federal court, it probably makes little practical difference whether or not the action stays in the Delaware courts as long as it is initially filed there. The Third Circuit (which includes Delaware) recognizes that the insured plaintiff's choice of forum is a "paramount consideration" in determining whether the insurance company is entitled to have the action transferred to another jurisdiction. *See Shutte v. Armco Steel Corp.,* 431 F.2d 22, 25 (3rd Cir. 1970). But even if the insurer is successful in having the action transferred, federal caselaw is clear that the choice of law rules applied by the jurisdiction in which the action was initially filed (including its interpreting caselaw) apply to any choice of law determinations made by the transferee court. See *Van Dusen v. Barrack*, 376 U.S. 612, 635-37, 84 S. Ct. 805, 11 L. Ed. 2d 945 (1964). Because Delaware's choice of law decisions so heavily favor application of Delaware law to D&O coverage disputes, the transferee court is likely to be constrained to apply Delaware coverage law to the action.

In sum, when deciding where to file a D&O coverage action, a Delaware corporation should carefully consider and research all of its options, including—perhaps most importantly—Delaware.

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