

The Delaware Supreme Court's *Murdock* Coverage Ruling is a Challenge for D&O Insurers

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On March 3, 2021, the Delaware Supreme Court issued a unanimous decision in *RSUI Indemnity Company v. David H. Murdock & Dole Food Company* that affirmed all of the trial court's pro-insured coverage rulings relating to choice of law, insurability of fraud-based claims and allocation between covered and non-covered losses. This decision resolves several frequently debated coverage disputes in the directors and officers (D&O) insurance context. Insurers of Delaware corporations must take heed of this outcome, and consider revisiting policy forms as the D&O insurance market continues to harden.

Choice of Law Favors Delaware for Claims against Fiduciaries of Delaware Corporations

In this instance, the insurance contract did not specify which state's laws applied. The court therefore looked to the Restatement (Second) Conflict of Laws' "most significant relationship test" to determine the applicable state law – which it acknowledged is a test often without a precise answer. Several factors pointed to application of California law, including that the insurance program was negotiated and policies were issued by and among parties in California. The court was however most persuaded by the rationale that claims involving the conduct of fiduciaries of Delaware corporations should be decided under Delaware law. This aspect of the ruling accordingly suggests that absent an enforceable choice of law provision in an insurance policy, Delaware law will likely apply to coverage disputes over D&O claims against fiduciaries of Delaware corporations.

Delaware Does Not Prohibit Coverage for Fraud

The application of Delaware law instead of another state's laws may have significant consequences for coverage under a D&O policy. In this instance, the application of Delaware law was outcome-determinative given that California law prohibits coverage for fraud-based claims. Unlike California, Delaware does not expressly prohibit insurability of fraudulent conduct. Indeed, the Delaware General Corporation Law allows a company to insure its directors and officers against *any liability* – even if the company is otherwise not permitted to indemnify them for such liability. The court also observed that the applicable coverage grant in the policy was worded broadly enough to afford coverage for fraudulent conduct. While the policy included a fraud exclusion, the exclusion (as is typical) only applied to a final adjudication of fraud. Since the fraud-based claims were settled prior to final adjudication, the exclusion was not triggered. Thus, there was neither a public policy, statutory nor contractual basis from which to find that coverage for fraud-based claims was uninsurable once Delaware law was deemed to apply.

Allocation Unaffected if Non-Covered Losses or Uninsured Claimants do not Increase the Settlement Value

Insurers frequently argue that settlements should be allocated between covered and non-covered losses, as did the insurer in *Murdock*. The court concluded that the "larger settlement rule" captured the extent to which the insurer's indemnity obligations might be reduced by an allocation of a portion of the settlement to non-covered losses or uninsured parties. Under the rule, "responsibility for any portion of a settlement should be allocated away from the insured party only if the acts of the uninsured party are determined to have increased the settlement." There were simply insufficient facts from which to conclude that a non-covered loss or uninsured party

caused an increase in the settlement value to prejudice the insurer. The court accordingly rejected the insurer's effort to reduce its exposure to only indemnity owed for allegedly covered losses.

What Can Insurers Do?

Given the often outcome-determinative nature of what state's laws apply, insurers might consider contractual choice-of-law provisions. Otherwise, the choice of law will be left to the imprecise most significant relationship test, which for claims against fiduciaries of Delaware corporations will likely result in application of Delaware law. And, Delaware law is, as the *Murdock* outcome reflects, not often friendly to D&O insurers.

Insurers also might consider tightening policy language to address overly broad coverage grants, holes in exclusionary provisions and to better control allocation between covered and non-covered losses to address the issues resulting in the pro-insured rulings in *Murdock*. Although not addressed in *Murdock*, the pro-insured views underlying the decision signal how the court might favor insureds for other D&O coverage issues, such as coverage for disgorgement or bump-up claims. The D&O coverage market is becoming increasingly hard, and this could afford insurers an opportunity to implement certain policy language protections for these issues.

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