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Delaware Court Concludes Shareholder Appraisal Action Is a "Securities Claim" Under a D&O Policy

In what appears to be a ruling of first impression, a Delaware Superior Court has held that a dissenting shareholders' appraisal action constitutes a "Securities Claim" for purposes of coverage under a directors and officers (D&O) insurance policy.

While this ruling was issued at the motion stage of the case and may yet find its way to appeal, this decision appears to provide companies with expanded protection under their D&O coverages when dissenting shareholders bring appraisal actions after acquisitions. This apparent expanded protection, however, may be fleeting if, upon renewal, D&O insurers seek to tighten up the definition of Securities Claim to avoid covering appraisal proceedings.

In *Solera Holdings, Inc. v. XL Specialty Insurance Co.*, No. N18C-080315 AML CCLD (DE Super. Jul. 31, 2019), the policyholder, a publicly traded company, was acquired by an affiliate of a private equity company. A shareholder class action was dismissed and a majority of the company's shareholders approved the merger. Several shareholders, however, filed an appraisal action under Delaware law, claiming that the fair value for their shares was some US$30 more per share than the agreed upon merger price. After trial on the appraisal action, the court found that the fair value of the shares was actually a few dollars less than the agreed upon merger price. Nevertheless, the company incurred more than US$13 million in attorney and other fees and costs defending the appraisal action.

When the company notified its insurers of the appraisal action – after a substantial portion of the litigation, including the trial, was complete – the primary insurer denied coverage. The company then brought an action for breach of contract and a declaratory judgment.

While there were several questions before the court on the insurance companies' motion for summary judgment, the key question was whether an appraisal action qualified as a covered Securities Claim under the D&O policy. In denying summary judgment, the court concluded that the appraisal action did indeed qualify as a Securities Claim based on the lack of an express limitation in the definition to claims of wrongdoing.

The terms of the relevant D&O policy provided coverage for loss resulting solely from any Securities Claim for a wrongful act. Securities Claim was defined by the policy as a claim made against the company "for any actual or alleged violation of any federal, state or local statute, regulation or rule or common law regulating securities, including but not limited to the purchase or sale of or offer to purchase or sell securities."

The court found that the D&O policy did not define the term "violation," but the insurers contended that a violation required allegations of wrongdoing. The court held that the policy language was unambiguous and because the D&O policy did not define violation, the court looked to the plain and ordinary meaning of the term.

Holding that "[n]othing in the Policy's use of the word "violation" purports to limit coverage only to claims containing allegations of wrongdoing because the common meaning of the word "violation" in this context is not limited to a wrongdoing," the court concluded that a Securities Claim was not limited under the D&O policy to violations of law alleging wrongdoing. "Violation," said the court, "simply means, among other things, a breach of the law and the contravention of a right or duty."

The court applied its interpretation to the appraisal action and held it to be a Securities Claim under the D&O policy because the appraisal petition necessarily alleged a violation of a law or rule. In this case, under Delaware law, shareholders have the right to receive "fair value" for their shares when they are cashed out of their positions through an acquisition. Thus, held the court, the appraisal action is a claim against the company for a violation of law and, therefore, a Securities Claim under the D&O policy.

Notably, the court stated that the insurers could have limited coverage to claims of alleged wrongdoing by using limiting language. Because the insurers chose to use the broader word – "violation" – the court held that it must give effect to that choice.

The court's analysis is interesting given that, in a footnote, the court recognized that the term "wrongful act" was contained in the coverage grant. The court stated that the parties, "[f]or reasons that are not clear," did not argue that the limitation of coverage to claims made for a wrongful act precluded coverage for an appraisal action, so the court did not address this issue. Instead, the court focused on the parties' argument about the meaning of the word violation. Nevertheless, the term wrongful act appears in the coverage grant and insurers may choose to either argue this point in the future or make sure that the definition of Securities Claim makes clear reference to the requirement of a wrongful act.

Public companies seeking coverage for appraisal actions in the context of a potential exit transaction should be alert to changing language in their policies at the time of policy renewal. Insurers are likely to seek to either eliminate this apparent expansion of coverage or charge an enhanced premium to provide for it.

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