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Delaware Supreme Court Addresses Increasingly Common Choice of Law Issue in New Context — Directors' and Officers' Liability Insurance Policies

WRITTEN BY

Joanna J. Cline | Emily L. Wheatley

In a recent decision, the Supreme Court of the State of Delaware (Supreme Court) affirmed a ruling of the Superior Court of the State of Delaware (Superior Court) that Delaware has a more significant relationship than California to a directors' and officers' liability insurance policy (D&O policy), at least when the dispute involves a Delaware corporation and its directors and officers. This case is part of a continuing trend in the case law showing a growing tension between Delaware courts and other state courts regarding important and consequential choice of law issues.[1]

Specifically, in *RSUI Indemnity Company v. Murdock*, 2021 WL 305367 (Del. Mar. 3, 2021), the Supreme Court considered whether the D&O policy at issue, which insured the directors and officers of a Delaware corporation but was negotiated and issued in California, should be interpreted under Delaware or California law. Justice Traynor, writing for the Court, concluded that Delaware has the most significant relationship to D&O policy disputes involving Delaware companies, and therefore, the Court interpreted the policy in question under Delaware law.

Background

The Court's decision in *RSUI* arises out of an appeal from the Delaware Superior Court where the plaintiff, an excess liability insurer, sought a declaration from the Court that, under the terms of the D&O policy, it was not obligated to fund the settlement of two lawsuits — one in the Court of Chancery and another in the U.S. District Court for the District of Delaware. Resolution of this question required the Superior Court to determine whether Delaware or California law should be applied to interpret the policy. Ultimately, the Superior Court rejected the insurer's claim, finding that under Delaware law the conduct addressed by the settlements was indeed covered by the policy.

The underlying action arose out of a dispute between David H. Murdock (Murdock), director and CEO of Dole Food Company, Inc. (Dole) who took Dole private in 2013, and former Dole stockholders. The stockholders filed suit in the Court of Chancery challenging the fairness of the going private transaction and alleging breach of fiduciary duty against Murdock and another Dole executive, C. Michael Carter (Carter). At base, the stockholders claimed that Murdock and Carter manipulated the value of Dole's stock, allowing them to acquire the stock at an artificially low price. This lawsuit was later combined with another Court of Chancery action brought by other stockholders seeking appraisal of their shares of Dole. The Court of Chancery ultimately determined that Murdock and Carter had breached their fiduciary duties to the Dole stockholders by committing a series of intentional, unfair, and fraudulent actions related to the going private transaction. After learning of the court's ruling, the parties settled both the breach of fiduciary duty and appraisal actions. The Court of Chancery approved the settlement, which Murdock paid in full.

Before the Court of Chancery approved the settlement, a federal securities class action was filed in the U.S. District Court for the District of Delaware by a different set of former Dole stockholders who had sold their stock before the October 2013 sale and were not party to the Court of Chancery actions. Based on the prior rulings of the Court of Chancery, the stockholders claimed that they were entitled to recover for violations of the Securities Exchange Act. The parties eventually participated in mediation and settled the district court case as well.

As a result of these settlements, and in light of the Court of Chancery's findings that Murdock and Carter committed intentional, unfair, and fraudulent actions, several of Dole's excess policy insurers filed suit in the Superior Court to determine whether they had an obligation to fund the settlements. At the crux of the Superior Court suit was one essential question: whether Delaware or California law governed the interpretation of the D&O insurance contract. This question was important due to potential differences under California and Delaware law as to whether the conduct and the loss at issue in the underlying actions was insurable. The Superior Court determined that Delaware law applied. RSUI appealed this decision, along with several of the Superior Court's holdings flowing therefrom, to the Supreme Court.

Analysis

With respect to the choice of law analysis, the D&O policy did not specify a certain state's law to govern the agreement. Therefore, both the Supreme Court (and the Superior Court) applied the familiar "most significant relationship" test. After examining two previous opinions on the question, the Supreme Court noted that the framework laid out in various sections of the *Restatement Second* should guide the Court's analysis. The Court also noted, however, that the *Restatement Second* framework is imprecise and that reasonable minds may differ as to its exact application. For example, the parties here applied the same framework, but arrived at opposite conclusions regarding which state's law should apply. According to RSUI, California had the closest relationship to the D&O policy, as that is where the policy was negotiated and issued and where Dole's headquarters and executives are located. The insureds, on the other hand, argued that, as the state of incorporation, Delaware had the most significant relationship.

After a close review of the parties' contentions, the Supreme Court looked to a previous Superior Court decision, *Mills Ltd. Partnership v. Liberty Mutual Ins. Co.,* to guide its analysis. In *Mills,* the court found that "[w]hen the insured risk is the directors' and officers' 'honesty and fidelity' to the corporation, and the choice of law is between headquarters or the state of incorporation, the state of incorporation has the most significant relationship."[2] Following *Mills'* logic, and given that the underlying case concerned Dole executives' intentional, unfair, and fraudulent actions related to the going private transaction, the executives' "honesty and fidelity" to the corporation was certainly at issue. Therefore, the Supreme Court concluded that Delaware, as the state of incorporation, had the most significant relationship. As further support for this point, the Court highlighted that in the vast majority of cases related to obligations under a D&O policy, Delaware law governs the directors' and officers' fiduciary duties to the corporation and its stockholders. This fact, combined with the reasoning of the prior case law noted above, led the Court to hold that "the state of incorporation is the center of gravity of the typical D&O policy."[3]

As additional support for finding that Delaware bore the most significant relationship to the D&O policy, the Court connected Delaware's relationship to the D&O policy to the general advancement and indemnification obligations contained within Section 145 of the Delaware General Corporation Law (DGCL). The Court noted that it makes sense to apply Delaware law to the D&O policies that actually cover the advancement and indemnification costs, and that doing so will advance the relevant policies underpinning advancement and indemnification.

Despite finding these strong ties to Delaware at the outset, the Court went on to analyze the California contacts that could potentially tip the balance to favor application of California law. The main California contacts were that (1) Dole is headquartered in California, and (2) the Dole directors and officers live and work in California. The Court was unpersuaded that these factors altered the analysis, reasoning that a shift in focus to physical location would underrate the significance of Dole's status as a Delaware corporation. Is essence, the legal ties to Delaware were stronger than the physical ties to California. As such, Delaware law applied to the D&O policy at issue. However, the Court was careful not to overstate its holding: "[t]o be clear, we do not ignore the California contacts and acknowledge that they might be dispositive were we addressing an insurance policy covering a different subject matter and insured with a more tenuous connection to Delaware than a Delaware corporation and its officers and directors have."[4]

Takeaway

The *RSUI* decision again underscores the Court's balanced approach to choice of law issues and provides clarity in an area where choice of law issues are relatively likely to come up on a regular basis — D&O policies. In the eyes of the Supreme Court, Delaware has the most significant relationship to a D&O policy when the dispute covered by the policy involves a Delaware entity and its directors and officers. However, the Court was quick to temper this holding by stating that where the D&O policy at issue covered different subject matter or involved an insured with a more attenuated connection to Delaware, the outcome may be different.

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[1] Christopher B. Chuff, et al., *Delaware Court of Chancery Tells California To Get Off Its Lawn*, Troutman Pepper Insights, https://www.troutman.com/insights/delaware-court-of-chancery-tells-california-to-get-off-its-lawn.html (last updated Aug. 17, 2020); Joanna J. Cline, et al., *Court of Chancery Speaks on an Increasingly Common Choice of Law Issue*, Delaware Business Court Insider, https://www.law.com/delbizcourt/2020/11/25/court-of-chancery-speaks-on-an-increasingly-common-choice-of-law-issue/ (last updated November 25, 2020).

[2] 2010 WL 8250837, at *6 (Del. Super. Ct. Nov. 5, 2010).

[3] *RSUI,* 2021 WL 803867 at *9.

[4] *Id.* at *10.

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