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Delaware Supreme Court on Costs in an Appraisal Proceedings

In a recent decision, the Delaware Supreme Court held that an appraisal proceeding did not involve a violation of any law or rule and therefore did not constitute a "Securities Claim" giving rise to coverage for losses under the terms of a directors' and officers' insurance policy. It provided guidance regarding how the Delaware courts will construe insurance policies in connection with coverage disputes.

By John Mark Zeberkiewicz and Robert B. Greco

In *In re Solera Insurance Coverage Appeals*,[1] the Delaware Supreme Court, in reversing the Superior Court's decision, held that an appraisal proceeding under Section 262 of the Delaware General Corporation Law did not involve a "violation" of any law or rule and therefore did not constitute a "Securities Claim" giving rise to coverage for losses under the terms of a directors' and officers' insurance policy. The opinion provides some guidance regarding the manner in which the Delaware courts will construe insurance policies in connection with coverage disputes.

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Background

In September of 2015, Solera Holdings, Inc. announced that it had agreed to be acquired by private equity firm Vista Equity Partners.[2] Not long after the announcement, a group of Solera stockholders filed a class action in the Delaware Court of Chancery against Solera's directors and officers for breach of fiduciary duty.[3] Although the class action claim was dismissed for failure to state a claim,[4] after the merger closed in March of 2016, several Solera stockholders filed a petition for an appraisal of the fair value of their shares under Section 262 of the DGCL. Following a trial in the appraisal action, the Court of Chancery determined that the fair value of the petitioners' shares was $53.95, far less than the $84.65 the petitioners had sought and slightly less than the merger consideration of $55.85 per share.[5] In accordance with Section 262, Solera was ordered to pay the amount determined to be the fair value, together with more than $38 million in interest on

that amount.[6] Solera also incurred more than $13 million in attorney fees and costs in defending the appraisal proceeding.[7]

In January of 2018, Solera notified the insurers of the appraisal action and requested coverage under its directors' and officers' insurance "tower," which involved a primary policy from XL Specialty Insurance Company providing for $10 million in coverage and an additional $45 million in excess coverage from other insurers (collectively, the Policy).[8] (Solera had made a prior claim in October 2015 in connection with the class action claims, but the claim was dismissed before the retention amounts were exceeded).[9] The Policy provided, among other things, that the insurers would pay any "Loss" resulting solely from any "Securities Claim" made against Solera during the policy period "for a Wrongful Act."[10] The term "Securities Claim" was defined in the Policy as a claim made against Solera for "any actual or alleged violation of any federal, state or local statute, regulation or rule or common law regulating securities" that was either brought by a person as a result of the purchase or sale of (or offer to purchase or sell) securities of Solera or that was brought by a holder of Solera securities with respect to its interest in such securities.[11] The term "Loss," in turn, was defined broadly to include, among other things, damages, judgments, settlements and pre-judgment interest as well as defense expenses, including attorney fees.[12]

Solera commenced an action against the insurers to enforce the Policy after they denied coverage for the appraisal proceeding.[13] The defendant insurers then moved for summary judgment, claiming that the appraisal action did not constitute a "Securities Claim" because it did not involve a violation of any law.[14] The defendant insurers' principal argument was that a "violation" must involve some form of wrongdoing—and an appraisal action, which provides dissenting stockholders a statutory right to have the fair value of their shares appraised by the Delaware Court of Chancery, does not require an allegation of wrongdoing.[15] The insurers also argued that the pre-judgment interest did not constitute a "Loss," since the underlying award—the payment of the amount determined to be the fair value of the dissenting shares—was not itself a covered Loss.[16] Finally, the defendant insurers argued that Solera's "defense expenses" were not covered, since they were incurred without the insurers' consent, in violation of the Policy.[17]

Solera argued that a "violation" had occurred in that Section 262 of the DGCL creates a legal standard essentially obligating the payment of fair value to the stockholders for their shares in a merger, and that the filing of the appraisal petition involved an allegation that such standard was violated.[18] Solera also argued that pre-judgment interest was specifically included in the list of items constituting a "Loss," without regard to whether the underlying award itself was a Loss.[19] Solera then argued that, although it had not provided notice of the appraisal action until January 31, 2018, despite the appraisal petition having been filed on March 7, 2016, coverage of the defense costs was not barred, as the Policy's notice provisions required the insurers to demonstrate that they had been materially prejudiced by an untimely notice to deny coverage on that basis.[20]

The Superior Court Decision

In denying the insurers' motion for summary judgment, the Superior Court proceeded from the premise that an insurance policy, like other contracts, should be construed under Delaware's objective theory of contract interpretation, under which the court first seeks to determine the parties' intent from the plain language of the instrument and will accord clear and unambiguous language its ordinary and usual meaning.[21] In this case, the Superior Court found that the language of the Policy was unambiguous.[22] Since the Policy did not define the term "violation," the Superior Court, with reference to Black's Law Dictionary, construed it to mean "a breach of the law and the contravention of a right or duty."[23] The Superior Court noted that the term "violation" requires no particular state of mind—and pointed to various laws that could be violated without scienter

or wrongdoing.[24] The Superior Court concluded that the appraisal action constituted a Securities Claim, because under Delaware law, stockholders have the right in certain mergers to receive "fair value" for their shares. "By its very nature," the Superior Court stated,

> a demand for appraisal is an allegation that the company contravened that right by not paying shareholders the value to which they are entitled.[25]

Next, the Superior Court addressed whether the pre-judgment interest constituted a Loss under the Policy. The Superior Court noted that the parties had agreed that the Chancery Court's award of "fair value" for the dissenting shares did not constitute a Loss under the Policy.[26] The Superior Court found, however, that the insurers' argument in favor of excluding the claims—that is, the pre-judgment interest only constituted a Loss if payable in connection with an underlying Loss—was not tethered to the language of the Policy.[27] The Superior Court noted that the Policy separately enumerated pre-judgment interest as an item that could be claimed as a Loss, but did not (as in one example the Superior Court noted) expressly provide for the coverage of pre-judgment interest only when payable on a judgment covered as a Loss.[28] Finally, the Superior Court declined to rule on the question of whether Solera had breached the provision of the Policy requiring the insurers' consent to the incurrence of defense costs. The Superior Court found that the "prejudice" requirement in the Policy's notice provision operated to create a presumption that the insurers were prejudiced by the delay, which presumption Solera would have an opportunity to rebut.[29]

"Implying the prejudice requirement," the Superior Court stated,

> protects an insured who has breached a consent provision from the harsh result of forfeiture, but only if the insured can prove by competent evidence a lack of prejudice to the insurer.[30]

The Supreme Court's Reversal

The insurers submitted an application to certify the Superior Court's opinion for interlocutory appeal. The Superior Court agreed that a decision as to whether an appraisal action constitutes a "Securities Claim" would be case dispositive, and the Supreme Court accepted the request for certification.[31] The three issues presented on appeal were: (1) whether the Superior Court erred in determining that the appraisal action involved a "violation" of law; (2) whether the Superior Court erred in holding that pre-judgment interest constitutes a loss when payable in connection with an amount that is not a covered loss; and (3) whether the consent provision included an implied prejudice requirement.[32]

The Supreme Court reached the conclusion that "violation" involves some element of wrongdoing, even if scienter is not required.

Reviewing the denial of the motion for summary judgment and the interpretation of the Policy *de novo*, the Supreme Court reversed the lower court's decision, reaching the contrary conclusion that the appraisal action did not involve a "violation" for purposes of the Policy's definition of Securities Claim.[33] The Supreme Court stated that its conclusion was "compelled by the plain meaning of the word 'violation,' which involves some element of wrongdoing, even if done with an innocent state of mind."[34] As with the Superior Court, the Supreme Court, in ascertaining the meaning of "violation" in the context of the Policy, looked to *Black's Law Dictionary*.[35] The Supreme Court pointed to the elements of the

definition construing a violation as an "infraction," "transgression," or "contravention." The Supreme Court then reviewed the definitions of those terms and reached the conclusion that "violation" involves some element of wrongdoing, even if scienter is not required.[36]

The Supreme Court then summarized the history of Section 262 of the DGCL, noting that it was added to Delaware corporation law in 1899 to allow for the sale of a corporation upon majority approval, rather than the unanimous approval that was required at common law, as a means of compensating stockholders for the loss of their right to prevent a merger from being consummated.[37] The Supreme Court also observed that a long line of cases holds that the remedy provided under Section 262 does not involve a determination of wrongdoing but is instead limited to a determination of fair value, and pointed to language in its own opinions stating that the only matter at issue in an appraisal trial is the value of the petitioner's shares.[38]

The Supreme Court then noted that Section 262 imposes only limited duties on the corporation, including the duty to provide specified notices and statements to stockholders.[39] The Supreme Court noted that the underlying petition in the appraisal action did not allege a violation of any of Solera's duties under Section 262, nor did it contain any other allegations of wrongdoing.[40] In support of its conclusion that appraisal actions do not involve wrongdoing, the Supreme Court noted that the fair value of the dissenting shares is determined at the time of the merger, not at the time the merger agreement is executed, thus suggesting that the appraisal action is not designed to address wrongdoing related to the merger process.[41] Moreover, the remedy is directed against the surviving corporation—not the target board's directors and officers who negotiated and approved the merger—further indicating that the action is not designed to address breach of fiduciary duty or other wrongdoing.[42]

The Supreme Court rejected Solera's argument that, in recent years, appraisal proceedings have evolved such that petitioners must show that there were deficiencies in the process leading up to the merger in order to overcome the contention that the deal price reflects the fair value.[43] While the Supreme Court noted that the deal price resulting from a robust market check is probative of fair value, it has "also emphasized that there is no presumption that the deal price reflects fair value" in an appraisal proceeding.[44] After determining that the appraisal claim did not constitute a Securities Claim under the Policy, the Supreme Court found that the remaining questions were moot and accordingly declined to reach those issues.

Conclusion

The Delaware Supreme Court's opinion in *In re Solera Insurance Coverage Appeals* demonstrates that the Delaware courts, when construing the scope of coverage under insurance policies, will employ the objective theory of contracts. The opinion makes clear that, in cases where policies require a "violation" of law as a condition to the invocation of coverage, the Delaware courts will assess whether there has been some "transgression" or "contravention" of a rule that involves some level of wrongdoing, even if not involving knowing or intentional wrongdoing.

Although the Supreme Court construed the Policy in a manner that barred coverage under the present facts, the Supreme Court's opinion suggested that any "Loss" related to a claim for a violation of the *requirements* of the appraisal statute (*e.g.*, the notice requirements) may have constituted a Securities Claim. Finally, although the Supreme Court was not required to reach the issues, the Superior Court's opinion suggests that pre- and post-judgment interest may constitute independent losses, regardless of the extent related to a covered loss, unless they are specifically tethered to the underlying covered loss. In addition, the Superior Court's opinion suggests that an insured's failure to provide notice or seek consent as required under a policy, in many instances, will create a presumption that the insurer was prejudiced by the delay, but may not result in an absolute

forfeiture of the claim provided the insured is able to rebut the presumption.

Notes

1. — A.3d —, 2020 WL 6280593 (Del. Oct. 23, 2020).
2. Solera Hldgs., Inc. v. XL Specialty Ins. Co., 213 A.3d 1249, 1253 (Del. Super. 2019), *rev'd sub nom*. In re Solera Ins. Coverage Appeals, 2020 WL 6280593.
3. *See* In re Solera Hldgs., Inc. S'holder Litig., 2017 WL 57839 (Del. Ch. Jan. 5, 2017).
4. *Id*. at *1 (dismissing the fiduciary claims "based on long-standing doctrine reaffirmed in *Corwin v. KKR Financial Holdings LLC* that the Solera board's decision to approve the transaction [wa]s subject to the business judgment presumption because, in a fully-informed and uncoerced vote, a disinterested majority of Solera's stockholders approved the merger," and the transaction did not constitute waste).
5. In re Appraisal of Solera Hldgs., Inc., 2018 WL 3625644, at *1 (Del. Ch. July 30, 2018). In the appraisal action, the Court of Chancery considered the Delaware Supreme Court's endorsement of efficient market principles and, finding that Solera was sold in an open process involving objective indicia of reliability, including outreach to multiple buyers, public disclosures that the company was for sale, reliance on outside legal and financial advisors, and a 28-day go-shop period that was conducted against the backdrop of an efficient market for Solera's stock, relied on the deal price less synergies to determine the fair value. *Id.*
6. *See* 8 *Del. C.* § 262(h) ("Unless the Court in its discretion determines otherwise for good cause shown, and except as provided in this subsection, interest from the effective date of the merger through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment. At any time before the entry of judgment in the proceedings, the surviving corporation may pay to each stockholder entitled to appraisal an amount in cash, in which case interest shall accrue thereafter as provided herein only upon the sum of (1) the difference, if any, between the amount so paid and the fair value of the shares as determined by the Court, and (2) interest theretofore accrued, unless paid at that time.").
7. *In re Solera Ins.*, 2020 WL 6280593, at *4.
8. *XL Specialty Ins. Co.*, 213 A.3d at 1251–1253.
9. *Id*. at 1251.
10. *Id*. at 1252.
11. *Id*.
12. *Id*.
13. *Id*. at 1251.
14. *Id*. at 1253. Certain of the insurers settled with Solera after the motion for summary judgment was filed. *Id.*
15. *In re Solera Ins.*, 2020 WL 6280593, at *5.
16. *Id*.
17. *Id*. The Policy provided that Solera "may not 'incur any Defense Expenses . . . or admit liability for, make any settlement offer with respect to, or settle any Claim without [the insurers'] consent, such consent not to be unreasonably delayed or withheld.'" *Id*. at *3.
18. *Id*. at *5.
19. *See id*. at *6.
20. *See id*. at *6.
21. *XL Specialty Ins. Co.*, 213 A.3d at 1255.
22. *Id*.
23. *Id*. at 1255-1256.
24. *Id*. at 1256.
25. *Id*.
26. *Id*. at 1257.
27. *Id*.
28. *Id*. (noting that, in Verizon Communications Inc. v. Illinois National Insurance Company, 2017 WL 1149118, at *2 n.13 (Del. Super. Mar. 2, 2017), the policy at issue defined loss to include "'judgments (including pre/post-judgment interest on a *covered* judgment)'").
29. *Id*. at 1258–1259.
30. *Id*. at 1259.
31. *In re Solera Ins.*, 2020 WL 6280593, at *7.
32. *Id*.
33. *Id*. at *8–9.
34. *Id*. at *9.
35. *Id*.
36. *Id*.
37. *Id*. at *10.

38. *Id.* The Supreme Court reviewed, among others, its opinion in Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017).
39. *In re Solera Ins.*, 2020 WL 6280593, at *11.
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.* at *13.
44. *Id.* (citing *Dell*, 177 A.3d at 21).