

Lawyer Insights

Del. Ruling Could Affect D&O Claims Beyond SPACs

By Geoffrey Fehling and Janine Hanrahan
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A Delaware court recently issued a significant opinion in a directors and officers liability claim involving a special-purpose acquisition company.

In an issue of first impression in Delaware, the Delaware Superior Court in [Clover Health Investments Corp. v. Berkley Insurance Co.](#) held that directors and officers of the post-merger entity were "insured persons" under the SPAC's D&O policy because they were acting in "functionally equivalent" roles to directors and officers of the SPAC when the alleged premerger wrongful conduct took place.

The court's pro-policyholder rulings on coverage for government investigations, based on an ambiguous definition of a claim, and allocation of defense costs under the "larger settlement rule" also have potential ramifications for future D&O claims in Delaware outside of SPAC deals.

Background

Social Capital was a publicly traded SPAC that merged with Clover Health, a private health insurance company. Shareholders of Clover Health, the go-forward company, elected certain individuals as directors or officers of the company.

Prior to the merger, Social Capital purchased six years of D&O tail coverage from Endurance Risk Solutions, which issued the primary tail policy, and two other insurers. Clover Health also purchased go-forward D&O policies from three insurers — Berkley, XL Specialty Insurance Co. and Allied World Specialty Insurance Co.

Following the merger, Clover Health became embroiled in multiple D&O claims, including a securities class action, various shareholder derivative suits, a complaint filed under Delaware General Corporate Law Section 220 and a [U.S. Securities and Exchange Commission](#) investigation.

Endurance denied coverage for certain named directors and officers under the tail policy, asserting that they were not insured persons. It also denied coverage for the SEC investigation against the de-SPAC company because it did not fall within the policy's definition of "claim."

Berkley denied coverage for similar reasons, arguing that the individual defendants did not qualify as insureds under the go-forward policies.

The Delaware Coverage Action and Ruling

Clover Health filed a declaratory judgment action in Delaware court seeking declarations that the go-

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forward insurers and tail insurers were obligated to pay Clover Health for losses incurred in connection with the SPAC-related claims, as well as a finding that the tail insurers breached the implied covenant of good faith and fair dealing.

The tail insurers filed a motion to dismiss, and Clover Health filed a motion for partial summary judgment on the tail insurers' duty to pay defense costs.

The court dismissed Clover Health's bad-faith claim, but issued several significant rulings favoring Clover Health on coverage for insured persons, coverage for the SEC investigation subpoenas and the tail insurers' obligations to advance all defense costs in the securities and derivative actions.

The ruling focuses on three principal issues — coverage for insured persons, coverage for government investigations conducted pursuant to a subpoena and the insurers' defense cost obligations based on the policies' allocation and advancement provisions.

Insured Persons Coverage

The court's analysis of insured person coverage in the context of Clover Health's SPAC transaction — an issue of first impression for the court — centered around the meaning of insured persons, which the policy defined as:

[A]ny one or more natural persons who were, now are or shall become duly elected or appointed directors, trustees, governors, Managers, officers, in-house general counsel, controller, risk manager, advisory director or member of a duly constituted committee or board of the Company or their functional equivalent[.]

The tail insurers argued that coverage was not available for any of the individuals involved in the underlying claims because they were not yet directors or officers of Social Capital at the time of the alleged wrongful conduct.

The court disagreed, finding that the plain language of the insured persons definition encompassed future directors and officers because insured persons "includes individuals that 'shall become duly elected ... directors ... [or] officers ... of the Company or their functional equivalent.'"

Because "functional equivalent" appears after "of the Company" in the definition, the court determined that the individuals did not need to be officers or directors of Social Capital at the time of the alleged wrongdoing.

Rather, the policy extends coverage to directors or officers of another entity so long as they were acting in a functionally equivalent role to directors or officers of Social Capital.

In the Clover Health SPAC transaction, the wrongful acts were purportedly committed by the individual defendants while they were still directors and officers of the legacy entity before the merger was consummated and they had assumed positions at the SPAC entity.

During that time period, however, the individuals were future directors and officers of Clover Health who were alleged to have held positions of power authority and control over Clover Health that allowed them to control that entity's filings and statements.

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In particular, the court noted that they had assisted with Social Capital's regulatory filings while they were still directors and officers of the legacy company.

Because Social Capital was set to become Clover Health at the time of the purported wrongdoing and the individual insureds allegedly committed wrongdoing concerning Social Capital's SEC filings while in a position of power as future directors and officers of Clover Health, the court found that they were acting in "functionally equivalent" roles to Social Capital's directors and officers.

As such, they were afforded coverage as insured persons under the tail policies.

SEC Investigation Coverage

The court next analyzed whether the SEC investigation of Clover Health constituted a "claim."

The relevant subparts of the definition covered: (1) any "formal administrative or regulatory proceeding, other than an investigatory proceeding, against any insured for a wrongful act, commenced by the filing of a notice of charge or similar document"; and (2) "a Formal Investigation of an Insured Person," with formal investigation being defined as:

[A] civil, criminal, administrative or regulatory investigation against an Insured Person for a Wrongful Act, commenced by the service upon or other receipt by the Insured Person of a formal investigative order, written notice, including a Wells Notice, target letter, subpoena, search warrant, or a similar document from the investigating authority identifying the Insured Person as an individual against whom a formal proceeding may be commenced.

The tail insurers argued that Clover Health was not an insured person, and the subpoenas did not identify any insured persons, so the SEC investigation could not qualify as a claim.

They also asserted that the SEC's subpoena to Clover Health did not identify a wrongful act. Rather, the insurers said, the subpoenas were merely a "non-public, fact-finding inquiry."

Clover Health disagreed, arguing that the subparts to the definition of a claim were inconsistent and ambiguous, where one subpart removes investigatory proceedings while the other provides express coverage for formal investigations.

The company also asserted that the subpoenas identified insured persons because both Clover Health and Social Capital were defined in the subpoenas to include each entity's officers and directors.

The court agreed with Clover Health, finding that the definition of "claim" was ambiguous because of "directly contradictory language" in the two subparts.

As a result, the court denied the tail insurers motion to dismiss with respect to the SEC investigation and permitted additional discovery regarding the ambiguity.

Duty to Advance Defense Costs

The court also ruled in Clover Health's favor on the issue of allocation of defense costs.

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The primary tail policy contained a provision requiring the insurer and insured to use their "best efforts" to allocate costs between covered and noncovered losses.

Clover Health argued that the tail insurers were not entitled to allocation at all and that, even if they were, the entirety of the legal bill should be allocated to covered loss under the larger settlement rule.

The court explained that the larger settlement rule requires that an insurer pay all costs associated with settlement or defense, without allocating any costs to uninsured parties or matters, if (1) the settlement or defense resolves insured claims, (2) the parties cannot agree to allocation, (3) the allocation provision does not provide for a specific allocation method and (4) the defense or settlement costs were not higher than they would have been had only the insured claims been defended or settled.

Clover Health argued that because all the defendants in the securities litigation shared the same counsel and benefited from the same defense work, there was no basis for the defense costs to have increased.

The court found that because all disputed directors and officers are insured persons, the principal factor governing the issue is allocation of defense costs between the tail policies and go-forward policies.

Following the Delaware Supreme Court's 2021 analysis of the larger settlement rule in the seminal RSUI Indemnity Co. v. David H. Murdock & [Dole Food Co.](#) case, the Clover Health court found that all four of the factors were met.

Notably, the court concluded that the advancement and allocation provisions are "potentially contradictory and ambiguous" where the policies gave the insurers' authority to determine what constitutes covered defense costs under the advancement provision while simultaneously qualifying that authority in the allocation provision instructing the parties to use "best efforts" to arrive at an allocation between covered and uncovered loss.

Because the advancement and allocation provisions were ambiguous, Delaware law required construing them in favor of Clover Health and against the insurers. And because the provisions are unclear on allocation methodology, that element of the larger settlement rule was satisfied.

The court held that the tail insurers were required to advance all defense costs for the securities and derivative actions, subject to their respective retentions and limits.

Takeaways

The Clover Health opinion touches a number of important insurance issues. While certain issues are unique to D&O claims arising from SPAC transactions, others may have broader implications for D&O coverage in Delaware beyond SPAC deals.

First, the decision provides an expansive view of potential D&O coverage under policies issued to SPACs, including for wrongful acts allegedly committed by future directors and officers before the transaction as long as they were acting in a "functionally equivalent" role to that of a SPAC officer and director at the time of the alleged misconduct.

The court's view of coverage for insured persons is in line with the intent of D&O policies to provide broad

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protection for individual officers and directors, as well as with Delaware's leading role on issues of corporate law and governance, which includes many pro-coverage rulings protecting the interests of Delaware corporations and their officers and directors.

Second, the decision is another example of a Delaware court correctly adhering to basic principles governing insurance policy interpretation, including that courts should interpret insurance contracts according to their plain, ordinary meaning and resolve ambiguities in favor of coverage consistent with the reasonable expectations of the insured.

Where the insurers did not adequately confine the definition of insured person to fit their preferred interpretation, the court was right to apply the definition according to its plain meaning, even if it did not conform with the insurers' unstated intention.

Third, the ruling in the policyholder's favor on SEC investigation coverage based on the definition of "claim" may be even more impactful to future D&O coverage disputes beyond those involving SPAC transactions.

The pertinent subparts to the definition of "claim" addressing formal regulatory proceedings and formal investigations of insured persons are common in many D&O policy forms, so the court's finding that the definition was ambiguous because those terms are directly contradictory in the context of SEC subpoenas is significant.

The court allowed the parties to take discovery on the ambiguity, but there are many jurisdictions where the mere fact that the definition was ambiguous would control the policy interpretation question without regard to extrinsic evidence and require a ruling in favor of the policyholder.

Finally, the decision is yet another example of the potential long-standing impact of the pro-policyholder Murdock decision — this time on the critical issue of allocation using the larger settlement rule.

The Clover Health court not only adhered to the allocation framework set forth in Murdock but also clarified that the larger settlement rule applies to all loss, which includes defense costs in addition to settlements.

Given the prevalence of best-efforts allocation provisions like those in Murdock and Clover Health, future D&O coverage disputes involving allocation of defense costs may result in similar pro-coverage rulings as long as litigation costs were not higher due to the presence of uncovered claims.

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