SHAREHOLDER "APPRAISAL" ACTION CAN TRIGGER D&O INSURANCE COVERAGE, ACCORDING TO DELAWARE COURT

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By: Steven L. Caponi, Lucas J. Tanglen

In a significant ruling of first impression, *Solera Holdings, Inc. v. XL Specialty Insurance Co.* ("*Solera*"), the Delaware Superior Court recently held that a corporation might find coverage in its directors and officers ("D&O") liability insurance for defense costs and prejudgment interest in a statutory shareholder "appraisal" lawsuit. [1] *Solera* strongly supports policyholders' arguments for coverage of appraisal actions under key D&O policy provisions and confirms that D&O insurance may be a valuable asset in the event of a merger that results in appraisal litigation by dissenting shareholders seeking "fair value."

THE DELAWARE APPRAISAL STATUTE

Some context regarding appraisal proceedings is helpful in understanding the significance of the *Solera* ruling. Appraisal rights, also known as dissenter's rights, allow shareholders to file suit seeking a judicial determination of the "fair value" of shares subject to divesture by merger or otherwise. Appraisal proceedings are most commonly filed after a "cash out" merger, when the stockholder would prefer to retain a position in the company or believes the merger price is inadequate. Following consummation of the transaction, stockholders may be able to initiate a legal proceeding in which a court will value their shares or other securities. The shareholders will then receive an amount equal to the valuation per share determined by the court, whether this amount is lower or higher than the merger consideration. As the "corporate capital" of the world, it is not surprising that Delaware is the epicenter for appraisal proceedings, which are governed by Section 262 of the Delaware General Corporation Law ("DGCL").

While the primary goal of an appraisal action is generally to obtain a ruling that "fair value" was greater than the merger price, there has been a growing tendency of institutional investors to initiate appraisal proceedings as a form of arbitrage. Under Section 262(h) of the DGCL, shareholders are generally entitled to prejudgment interest on the appraisal award at a rate equal to the Federal Reserve discount rate plus 5% (compounded quarterly), regardless of whether the appraisal decision is greater or less than the merger price. The availability of interest provides shareholders an opportunity to generate substantial returns and offset any illiquidity pending a resolution of the proceeding.

Under the Delaware appraisal statute, if various procedural requirements are satisfied, a shareholder may institute an appraisal proceeding by filing suit in the Delaware Court of Chancery. The court will determine the fair value of the shares, exclusive of any element of value arising from the accomplishment or expectation of the merger. In determining such fair value, the court will take into account "all relevant factors." Notably, Delaware appraisal courts consider evidence related to the merger process, including whether there was an arms-length

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transaction or any misconduct. Appraisal claimants often allege specific misconduct before and during trial, and appraisal courts typically consider such evidence when determining “fair value.” The court will also award prejudgment interest where appropriate, determine which shareholders are entitled to appraisal rights, and apportion the costs of prosecuting the appraisal proceedings among the parties as the court deems appropriate.

The above overview of the Delaware appraisal process is provided as context for the below analysis of *Solera* and its impact on the availability of D&O coverage for appraisal proceedings.

THE *SOLERA* APPRAISAL ACTION

In March of 2016, a majority of shareholders in the publicly traded software company Solera Holdings, Inc. (“Solera”) approved its merger with another company for an agreed price of $55.85 per share. A few days later, some Solera shareholders filed suit against it under the Delaware appraisal statute, claiming that the fair value was $84.65 per share. [2] After a trial, the Delaware Court of Chancery ruled that the fair value of the shares at the time of merger was $53.95 (an amount less than the actual merger price that the petitioning shareholders had challenged). The court ordered Solera to pay the petitioners the fair value of $53.95 per share and prejudgment interest of more than $38 million. In addition, Solera incurred attorneys' fees and other defense costs of more than $13 million in connection with the appraisal action. [3]

INSURANCE DISPUTE AND THE DELAWARE COURT'S RULING

After Solera's primary D&O insurer denied coverage for the appraisal action, Solera filed a coverage lawsuit in Delaware Superior Court against its primary and excess D&O insurers, seeking coverage for (1) its defense expenses and (2) prejudgment interest.

Several of the excess insurers moved for summary judgment against Solera. [4] In denying the insurers' motion, the court engaged in a straightforward analysis of the pertinent policy wording and expressly refused to rewrite the policies to favor the insurers.

The Appraisal Action Was a “Securities Claim”

The insurance policies at issue covered in part “Loss resulting solely from any Securities Claim first made against [Solera] during the [p]olicy [p]eriod . . . .” [5] The insurers argued that the underlying appraisal action was not a Securities Claim and, thus, denied coverage for Solera's claim for defense costs and for prejudgment interest. Solera's policy defined “Securities Claim” as, in relevant part, a claim “for any actual or alleged **violation** of any federal, state or local statute, regulation, or rule or common law regulating securities.” [6]

Solera's insurers asserted that the appraisal action was not a “Securities Claim,” because an appraisal action does not require any showing of wrongdoing, and therefore the action alleged no “violation.” Solera argued in part that an appraisal action “inherently alleges a violation of the statutory obligation to provide shareholders fair value for their shares.”

The court agreed with Solera, reasoning that the term “violation” is “not limited to wrongdoing,” but rather “means, among other things, a breach of the law and the contravention of a right or duty.” The court held: “Under Delaware law, shareholders have the right to receive 'fair value' for their shares . . . . By its very nature, a demand for appraisal is an allegation that the company contravened that right by not paying shareholders the fair value to

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which they are entitled." The court held that, "[a]ccordingly, the Appraisal Action is a claim against Solera for a violation of law and therefore is a Securities Claim." [7]

The court explained that its analysis of the "violation" issue was rooted in the policy wording: "If [the insurers] intended to limit coverage to claims alleging wrongdoing, the Policy could have used limiting language. Their choice to use a broader word, like violation, must be given effect by this Court." [8] The court noted that Solera had made alternative arguments based on specific allegations related to the merger process made by the appraisal claimants, but the court stated that, based on its broad ruling, it need not reach this issue.

Having determined that the appraisal action was a potentially covered "Securities Claim," the court considered the two categories of costs for which Solera sought coverage — defense costs and prejudgment interest — and made rulings permitting Solera to pursue recovery for both amounts.

Defense Costs

Solera's $13 million claim for defense coverage demonstrates that the costs of defending appraisal actions can be substantial. The *Solera* court's reasoning provides a roadmap to coverage for policyholders seeking coverage for appraisal defense costs under common D&O policy provisions. Like many D&O policies, Solera's policy required its insurers to cover its reasonable defenses expenses for a "Securities Claim." *Solera*'s determination that an appraisal action was a "Securities Claim," with the apparent consequence that appraisal defense costs were covered (subject to consideration of other relevant policy terms and conditions), strongly supports policyholders' arguments for defense coverage of similar claims. [9]

Note that many D&O policies contain so-called "bump-up" exclusions that can provide further support for defense cost coverage of appraisal actions, such as the following:

> In the event of a Claim alleging that the price or consideration paid or proposed to be paid for the acquisition or completion of the acquisition of all or substantially all the ownership interest in or assets of an entity is inadequate, Loss with respect to such Claim shall not include any amount of any judgment or settlement representing the amount by which such price or consideration is effectively increased; **provided, however, that this paragraph shall not apply to Defense Costs** or to any Non-Indemnifiable Loss in connection therewith. (Emphasis added.)

While the application of any bump-up exclusion in the appraisal context may turn on the specific facts and policy language at issue, it is plainly significant that a common exclusion upon which insurers may rely in attempting to avoid covering an appraisal award expressly preserves coverage for defense costs.

Prejudgment Interest

The *Solera* court also held that the policyholder was potentially entitled to recover for the $38 million in pre-judgment interest that it was ordered to pay in addition to "fair value." [10]

The policy defined covered "Loss" to include "damages, judgments, settlements, **pre-judgment and post-judgment interest** or other amounts . . . that [S]olera is legally obligated to pay . . . ." [11] The insurers argued that the "fair value" amount at issue in the case was not a covered loss and, therefore, it followed that the pre-

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judgment interest also was not covered. The insurers conceded that this was a mere “logical” argument and that they were not citing any policy language to support this position. [12]

The court rejected the insurers' argument, reasoning that the insurers' position was “untethered to the language in the Policy” and noting that the policy broadly covered all prejudgment interest. Based on this reasoning, the court denied the insurers' motion for summary judgment as to prejudgment interest. [13]

CONCLUSION

Solera provides strong support for corporate policyholders seeking coverage for “appraisal” actions under D&O insurance policies. Companies that have been required to respond to “appraisal” actions would be well advised to review their D&O policies and consider providing notice to appropriate primary and excess insurers.

The *Solera* court's analysis suggests that the wording of the particular D&O policy may be significant. Policyholders that wish to insure against the risk of an appraisal action in Delaware or other jurisdictions with comparable procedures might consider reviewing the terms of their existing D&O policies to confirm appropriate wording. It may be possible to obtain enhanced policy wording in the renewal process or from other underwriters.

Steven L. Caponi is a litigation Partner at K&L Gates in Wilmington, Delaware. His practice covers all facets of corporate litigation, including matters involving alleged breaches of fiduciary duties, and appraisal actions, and he frequently appears in the courts of Delaware, including the Court of Chancery.

Lucas J. Tanglen is an insurance coverage Associate at K&L Gates in Pittsburgh, Pennsylvania. He counsels corporate policyholders on claims and policy reviews with respect to D&O matters, along with many types of commercial insurance.

NOTES

[1] No. N18C-08-315 AML CCLD, 2019 WL 3453232 (Del. Super. Ct. July 31, 2019).

[2] Note that shareholder lawsuits alleging breach of fiduciary duty in the context of corporate mergers are a common subject of D&O insurance claims and disputes, and that such claims raise different issues from those presented by the appraisal claim considered in the *Solera* coverage action.

[3] *See id.* at *2-3.

[4] Solera settled with its primary D&O insurer while the summary judgment motion was pending.

[5] *Id.* at *1.

[6] *Solera*, 2019 WL 3453232, at *4 (emphasis added).

[7] *Id.* at *5.

[8] *Id.*

[9] In *Solera*, the court did not take the step of awarding Solera the defense costs for which it sought coverage, due to remaining issues related to the history of the claim and the course of dealing between Solera and its insurers with respect to a “consent” condition in the policy. It is notable that the court resolved a threshold “consent” issue in Solera's favor. The court held that a lack of consent by the insurers to Solera's defense costs

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would not automatically bar coverage in the absence of prejudice to the insurers, and Solera would have the opportunity to present evidence to rebut a presumption of prejudice. *Id.* at *7-8.

[10] The court “assume[d]” that Delaware law applied to the prejudgment interest issue. *Id.* at *6. Certain insurers argued that a choice-of-law analysis between Delaware and Texas law was needed. However, the court noted that the insurers failed to identify any conflict of laws and that the insurers did not explain how another state's law might require a different outcome.

[11] *Id.* at *6 (emphasis added).

[12] *Id.*

[13] The court's analysis of the prejudgment interest issue provides guidance for policyholders in other contexts beyond appraisal actions (*e.g.*, where an insurer contends that because the underlying amount on which interest is paid is not covered due to a policy exclusion, there is also no coverage for that portion of a judgment or settlement paid as prejudgment interest).

KEY CONTACTS



STEVEN L. CAPONI
PARTNER

WILMINGTON
+1.302.416.7080
STEVEN.CAPONI@KLGATES.COM



LUCAS J. TANGLEN
PARTNER

PITTSBURGH
+1.412.355.7479
LUCAS.TANGLEN@KLGATES.COM

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