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Year End Update

2022

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CASES OF INTEREST

Delaware Chancery Court Brings the Structure of SPACs Into Focus

Almost a year to the day after issuing the *In re Multiplan Corp. Stockholders Litigation* opinion, Vice Chancellor Will followed it up with another decision buttressing the conclusions reached therein. In doing so, the specter of litigation challenging the typical structure of SPACs may have greatly increased.

By way of background, the January 3, 2021 opinion in *Multiplan* held that shareholders could assert direct claims against the sponsor of a SPAC arising out of conflicts of interest as they relate to misleading proxy disclosures. While the mismatched incentives were disclosed to investors, fiduciary duties of the SPAC sponsor mandated all material information be disclosed in advance of the shareholder vote on whether to consummate the de-SPAC transaction. Vice Chancellor Will found the claims to be direct in nature, not derivative. This is based on the harm experienced by shareholders individually when deciding whether to redeem their shares or to allow their investment to flow to the de-SPAC entity surviving the transaction. “Delaware courts regard a wrongful impairment by fiduciaries of the stockholders’ voting power or freedom as causing a personal injury to the stockholders, not the corporate entity...Stockholders harmed through the impairment of their redemption rights personally lost the opportunity to recover $10.04 before the merger closed and any reduction in enterprise value occurred.”

The opinion goes on to reject defendants’ position that the claims being asserted were ‘holder’ claims, whereby a person is wrongfully induced to hold stock instead of selling it. Making short work of these arguments, she held the defendants cannot escape liability for fiduciary duty breaches by characterizing it as a passive holder decision. The other important aspect of the decision was to apply the entire fairness standard of review.

Finding that the controlling stockholder engaged in a conflicted transaction, coupled with the lack of director independence as well as the sponsor gaining a unique benefit rendered the business judgment rule standard inappropriate.

Turning to the January 4, 2023 opinion in *Delman v Gigaquisitions3, LLC et. al.,* Vice Chancellor Will reiterated many of the same findings contained in the *Multiplan* decision. She again rejected defendants' contentions the claims at issue were 'holder' claims and found the entire fairness standard of review applied. The analysis here differed slightly from the prior case based on differences in the way each handled the de-SPAC transaction. Unlike in *Multiplan* where the court took issue with a fairness opinion being authored by an entity controlled by defendants, no fairness opinion was obtained by the SPAC sponsor here. The fact that the IPO underwriters agreed to defer two-thirds ($8 million) of their fees until a merger was accomplished was also explicitly noted in the discussion of whether the incentives of the sponsor and shareholders were aligned.

In the end, after detailing the share structure, warrants and PIPE funding that accompanied the de-SPAC transaction, Vice Chancellor Will came to the same conclusion as in *Multiplan*. "The right to redeem is the primary means protecting stockholders from a forced investment in a transaction they believe is ill conceived. It follows that a SPAC's fiduciaries must ensure that right is effective, including by disclosing fully and fairly all material information that is reasonably available about the merger and target to inform the redemption decision. To hold otherwise would lead to the illogical outcome that SPAC directors owe fiduciary duties in connection with the 'empty' vote on the merger, but not the redemption choice that is of far greater consequence to stockholders. Lastly, the court took issue with the financial projections relied upon by the SPAC sponsor as not being impartial and should have been viewed with greater scrutiny. "The nature of [the target's] business model was 'knowable' through the sort of diligence and analysis expected of the board of a Delaware corporation undertaking a major transaction It can be inferred that the defendants knew (and should have disclosed) or should have known (but failed to investigate) that [the target's] Delaware Chancery Court Brings the Structure of SPACs Into Focus production would be difficult to scale in the manner predicted."

Whether the denial of defendants' Motions to Dismiss in these cases will lead to litigation challenging de-SPAC transactions generally remains to be seen. Some commentators have indicated their belief this will open the floodgates however, the uniqueness of each SPAC deal and very detailed specifics on why the structure of these two were found to be problematic seems to indicate otherwise. Nevertheless, when the Delaware Chancery Court points out glaring issues in the makeup and incentives of SPAC sponsors versus public shareholders, legal and finance practitioners would be wise to take note. If SPACs are to continue as a viable means for companies to access public equity markets, the way in which they are structured is likely in need of modification.

In re Multiplan Corp. Stockholders Litigation, 268 A.3d 784 (Del. Ch. 2022); *Delman v Gigacquisitions3 LLC et. al.,* 2023 WL 29325 (Del. Ch. January 4, 2023).

Conviction and Sentencing Constitute Final Adjudication, Barring Coverage for Costs of Appeal

It is now fairly typical for directors and officers (D&O) liability insurers to include a 'final judgment' or 'final adjudication' qualifier within certain conduct exclusions. Absent explicit policy language ensuring that such exclusions will not be triggered until all available appeals have been denied, insureds run the risk of being deprived coverage for defense costs once sentencing takes place. This issue took center stage in a recent New York insurance coverage dispute.

The coverage litigation arose following a criminal conviction on two counts of accepting a gratuity in violation of federal law. The individual's D&O insurer covered the defense costs at trial and agreed to advance his fees on appeal under a 'reservation of rights'. The insurer then filed a declaratory judgment action seeking a declaration that coverage did not exist for the costs of his appeal. The policy in question excluded claims based upon any deliberately dishonest, fraudulent, intentional or willful misconduct, but only after a 'final adjudication' established such conduct was committed by the insured.

In spite of 'defense costs' explicitly including the 'cost of any appeals' in the policy, the court found the imposition of a sentence to constitute final judgment. The court explained that New York courts use the terms 'final judgment' and 'final adjudication' interchangeably, rendering the conduct exclusion applicable. The court rejected the insured's contention that the phrase was ambiguous as well as his contention that the definition of 'defense costs' that included 'appeals' was superfluous since other exclusions did not contain the same wording, meaning that the policy would cover the cost of certain appeals, just not those involving acts of dishonesty or ill gotten gains.

As always in this arena, the devil is in the details. Even when a policy reads as if it includes the most policyholder friendly terms available in the market, insurance buyers must remain ever vigilant for the omission of highly important qualifiers that could end up depriving one of coverage unexpectedly.

Cumis Specialty Insurance Co. v. Kaufman, 2022 WL 4534459 (September 28, 2022, S.D.N.Y.)

Warranty Letter Bars Coverage Under D&O Policy Even if Insurer Cannot Prove Actual Knowledge

The Chief Legal Officer of a bankrupt cyber security company was left without D&O coverage based on a warranty letter signed by the company's CEO. In March of 2019 the company was only able to obtain excess coverage if a warranty letter was executed by the CEO on behalf of himself and all insureds representing that no insureds had knowledge or information of any act, error or omission that might give rise to a claim. By November 2019 the Securities and Exchange Commission commenced an investigation into the company's operations, which led to civil and criminal suits being filed by the SEC and DOJ the following year. Allegations in the SEC lawsuit alleged the fraud began in 2018 prior to the time the warranty letter was executed.

The excess insurer initiated coverage litigation based on the representations contained in the warranty letter. During the pendency of the litigation, the former CEO pleaded guilty to one count of securities fraud In agreeing with the insurer, the court found the warranty letter's language to unambiguously encompass the CLO. But for the fraud of the CEO, the breach of fiduciary duty claims being asserted against the CLO would never exist. While noting that the allegations leveled against him were separate and distinct from those made against the former CEO, the fact that they arose from the CEO's actions brought them within the scope of the exclusion set forth in the warranty letter. The court went on to reject the argument the insurer must prove actual knowledge or information by the CLO to invoke the warranty letter. Because the letter did not explicitly require actual knowledge, the court would not impute such a requirement. Lastly, the court also rejected the CLO's reliance on a non imputation clause contained within the policy because no such limitation existed in the warranty letter itself. As such, the non imputation clause was inapplicable to the terms of the warranty letter.

Ironshore Indemnity Inc. v. Kay, 2022 WL 4239790 (September 16, 2022, D. Nevada)

Claim by Liquidator Made After Policy Expiration Entitled to Coverage

This matter involved an insolvent insurer for whom a liquidator was appointed under state law. A Petition for an Order of liquidation was filed on June 12, 2018. The Order was issued on June 27, 2018, wherein a liquidator was appointed to prosecute any action on behalf of the creditors, members, policyholders, or shareholders of the insurer against any of its officers or directors. An extension of coverage for three additional years was purchased for the primary D&O policy in effect however, one was not procured for the excess policy. Under its terms, the excess policy expired on July 18, 2018. In November of the same year, the liquidator provided notice of a claim to both the primary and excess D&O insurers. The primary carrier did not contest coverage, but the excess carrier took the position the claim was outside of the policy period and therefore not covered.

Relying on the state statute authorizing the appointment of a liquidator when faced with an insolvent insurance company organized under state law, the court found the notice to be timely.

The excess D&O insurer took the position that state statutes cannot be used to extend the period of coverage. The insurer further sought to make the distinction between 'claims made and reported' policies versus 'occurrence' policies since the former were not in use at the time the state statute was enacted. Finding no claims made exception in the statutory language, the court found in favor of the liquidator. Noting that both the petition for liquidation and the order initiating the process were entered prior to expiration of the policy period, it held the statute granted the liquidator an extension of time within which to provide notice regardless of what type of policy coverage was sought under.

While this case represents a somewhat odd result, the regulation of insurance providers are governed by state law and are intended to afford maximum recovery for claimants harmed by an insolvent insurer. As such, the excess insurer was forced to provide coverage for claims being made in the liquidation proceedings.

Dieter v. XL Specialty Insurance Co., 488 F.Supp.3d 881 (September 21, 2022 D. South Dakota)

Moving coverage from one carrier to another during ongoing claims can be fraught with peril. A recent North Carolina case is a prime example of why insureds need to be exceedingly cautious in such situations. Back in 2012 the insured acquired a competitor. Anti-trust claims were filed in the wake of this transaction, alleging the insured conspired with its only remaining competitor to inflate prices. Following the settlement of the anti-trust claims, shareholders brought a securities class action against the insured in 2020.

While the opinion is somewhat unclear on the notice given to the insured's D&O insurers prior to the securities class action being filed, notice was given under its 2018-2019 policy as well as the 2019-2020 policy. The lineup of carriers on both programs was the same except for the fourth and final excess insurer. Coverage was accepted under the 2019-2020 program, presumably based on the date the case was filed. (It's unclear if any attempt was made by the insureds or their broker to have the claim accepted under the 2018-2019 program.)

The settlement to resolve the securities class action resulted in all underlying insurers paying their policy limits. The final excess insurer, however, declined coverage and brought this coverage action.

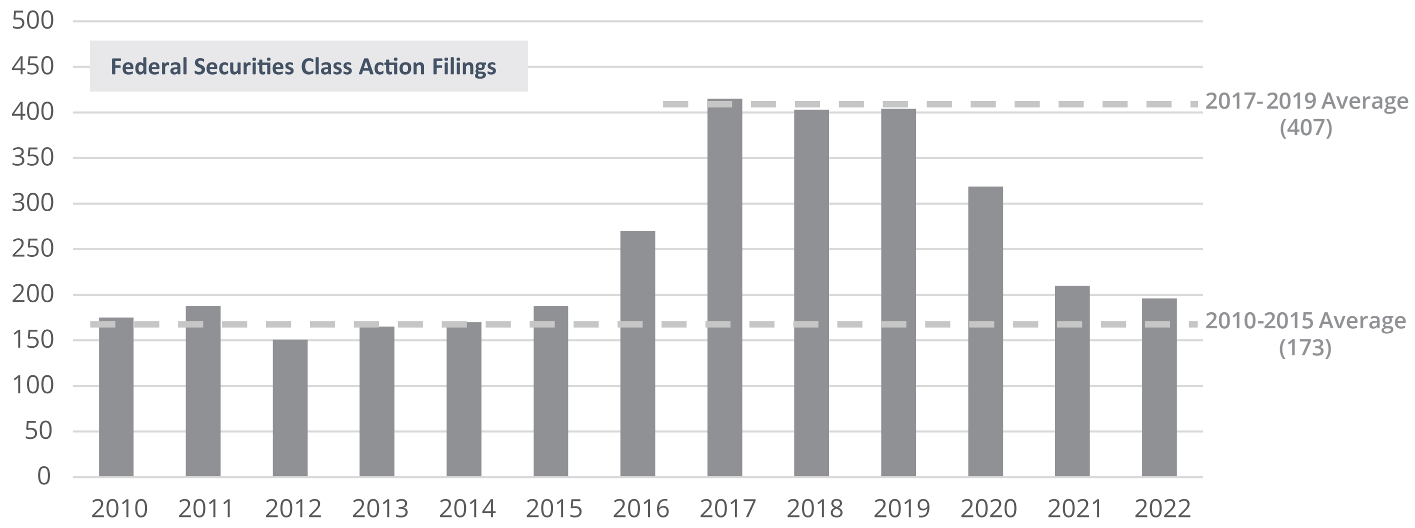
Relying on a preceding claims exclusion as well as the prior notice exclusion contained in the final excess insurer's policy, the court found both precluded coverage. After holding the exclusions to be unambiguous, it went on to find the anti trust and securities claims to be related because they built on one another and resulted in the accomplishment of a common goal In doing so, the court concluded that the anti-trust and securities claims involved inter related wrongful acts, meaning the claim was first made prior to the 2019-2020 policy period.

This case presents a stark example of what can happen when an insured moves coverage from one insurer to another. When insureds are contemplating changing the insurer in an insurance tower, it must be done with expertise to ensure the situation discussed herein does not occur. Whenever an insured is facing claims that implicate multiple different insurance policies, a careful review of the terms of coverage and pitfalls that could occur are absolutely necessary.

Travelers Casualty & Surety Co. of America v. Jeld-Wen Holding, Inc., 2022 WL 17095207 (November 21 2022 W.D. North Carolina)

D&O FILINGS

+ As we have previously reported, D&O Federal Securities Class Action Claims had been in decline for two straight years.
+ In 2022, filings declined again (although at a slower pace), with 197 total Federal Securities Class Action Claims.
+ The 2022 total represents a 6.2% YoY decrease. This does remain above the historical average of 173, but the gap is closing.



D&O PRICING AND OTHER DEVELOPMENTS

+ With D&O litigation having declined each of the last three years, dismissal rates remaining elevated, and new capacity having entered the marketplace, D&O pricing for recent renewals has consistently been more favorable than year ago levels.
    — Companies considering an IPO or de-SPAC transaction (congratulations!) can continue to expect elevated pricing and retentions, but both of these are also much more favorable than prior year levels.
    — D&O pricing is also still dependent on a company's specific situation, so messaging the risk profile in the right way to D&O underwriters remains crucial.
+ An additional contributing factor to the much improved pricing environment is the sharp decline in the number of IPOs and de-SPAC transactions in 2022, which has created additional D&O carrier competition for existing company business.
+ As we look forward into early 2023, we are optimistic that the trends we have seen over the last several months will continue to take hold, with additional pricing improvement and capital deployment.

Sources
Cornerstone Research; Stanford Law School; IMA proprietary database

MORE THAN JUST INSURANCE

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