

Delaware Supreme Court Rejects "No Loss" Argument Even Though Directors Indemnified by Uninsured Shareholder

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The Delaware Supreme Court, applying California law, has held that directors incurred "Loss" despite full indemnification of the insureds by a company's controlling shareholder. *AT&T v. Clarendon Am. Ins. Co.*, 2007 WL 1892240 (Del. July 2, 2007).

After the policyholder, a cable Internet provider, filed for bankruptcy, several shareholder lawsuits were brought against the policyholder's directors and their employer, the controlling shareholder of the policyholder. The policyholder's D&O insurers did not advance defense costs for the underlying actions or fund the settlement at issue. Rather, the majority shareholder indemnified the directors for the costs of defense and funded the settlement. The directors ultimately assigned their rights under the D&O policies issued to the Internet provider to the controlling shareholder.

The policies defined "Loss" as an amount an insured is either "financially liable" or "legally obligated" to pay. With respect to defense costs, the Delaware Supreme Court concluded that the directors incurred liability to pay as soon as their counsel performed services on their behalf. With respect to the settlement at issue, the court determined that California law did not require the directors formally to incur an obligation to pay the settlement or to incur a consent judgment for the settlement to constitute "Loss." As a result, the Delaware Supreme Court held that the directors had a cognizable legal claim against the insurers that the controlling shareholder, as their assignee, became entitled to enforce.

Finally, the court held that the majority shareholder had standing to sue the insurers as an equitable subrogee. The Delaware Supreme Court held that although the majority shareholder was not "legally obligated to indemnify" the insureds, it had interests that, "as a reasonable member of the business community, [it] was entitled to protect." According to the court, under California law, such an interest is sufficient to create standing as an equitable subrogee.