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WHITE PAPER

Held Captive: The DGCL § 145 Amended

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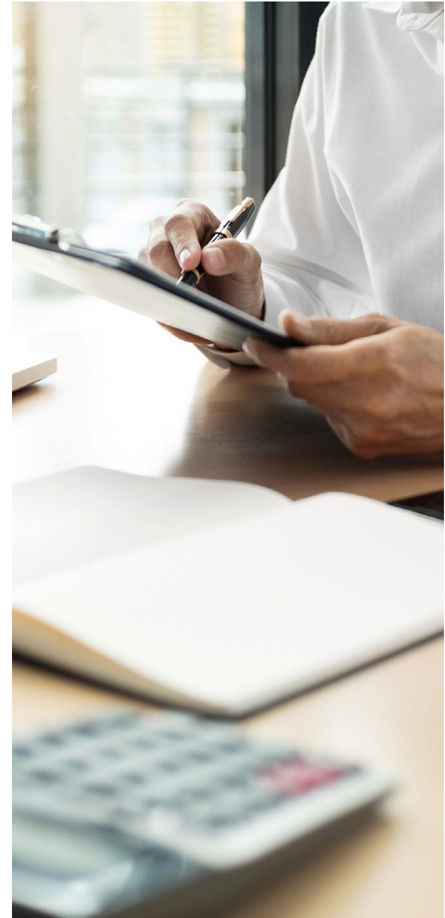
Introduction

On February 7, 2022, Delaware Governor John Carney signed Senate Bill No. 203 (“the Bill”), which provided pertinent amendments to Section 145 (“§ 145”) of the Delaware General Corporation Law (“DGCL”). The amendments allow Delaware corporations to purchase and maintain executive liability insurance, encompassing directors’ and officers’ and fiduciary liability, via captive insurance companies, regardless of their domicile. § 145 gives Delaware corporations the right to utilize a captive insurance company to provide coverage for both indemnifiable and non-indemnifiable losses.

What Is Captive Insurance?

Defined by the synopsis supplementing the Bill, a captive insurance company is “an insurer, directly or indirectly owned, controlled and funded by the corporation,” which may, but does not have to be, licensed within the jurisdiction of Delaware. The Bill explains that choosing to establish or maintain a captive insurer does not alone subject the corporation to the Delaware Insurance Code. A captive insurer, a subsidiary funded by the corporation, may provide liability coverage for current and former directors, officers, employees and other indemnifiable individuals.

Senate Bill No. 203 and DGCL § 145



DGCL § 145 as it was:

Preceding the passing of the amendments to §145, directors and officers could not be indemnified by Delaware corporations for derivative suits pertaining to breaches of fiduciary duties or bankruptcy-related litigation. Many corporations sought to purchase Side A D&O liability insurance to ensure coverage for otherwise non-indemnifiable exposures in response to this dilemma.

DGCL § 145 as amended:

As amended, DGCL § 145 provides that, like third-party commercial insurance, a captive insurance policy may indemnify indemnifiable individuals "whether or not the corporation would have the power to indemnify them under § 145." In addition, DGCL § 145(g) provides specific authorization for Delaware corporations to utilize a captive for protection from fines, judgments and amounts paid to settle claims brought either by or in the right of the corporation.

Limitations to DGCL § 145 as amended:

The Bill includes a series of limitations imposed upon a Delaware corporation's utilization of a captive insurance policy. The exclusionary limitations provision within § 145(g)(1) provides that the captive, should it be used, may not allocate payments in connection with losses related to the following:

- Personal profit the indemnifiable individual was not legally entitled to
- Deliberate criminal or fraudulent acts
- Knowing violations of the law

Notwithstanding these exclusions, a captive insurer can cover certain liabilities otherwise not exculpable under DGCL § 102(b)(7), including liability for Caremark or oversight claims where directors did not knowingly lead the corporation to violate the law. In addition, because oversight claims usually go hand-in-hand with fiduciary claims for ERISA violations, § 145 may implicate a corporation's fiduciary coverage, not just its D&O coverage.

The Bill also includes procedural requirements. § 145(g)(2) requires any determination to allocate payment by a captive insurer to be made by an independent claims administrator or in accordance with § 145(d).[1] Finally, § 145(g)(3) requires stockholders to be provided with notice before a captive policy allocates any payment in connection with a dismissal or compromise of a suit that has been brought either by or in the right of the corporation. Notice must serve to notify that the captive is to make the proposed, allowing stockholders and a reviewing court the scope to appraise the utilization of the captive insurer's assets.

These exclusions and limitations are a minimum checklist. They do not address obtaining any independent director or stockholder approval before entering into an insurance transaction with an owned captive, resulting in some potential for circularity of the transaction, which has typically been a stumbling block to captives writing certain types of risk. DGCL § 145 does not prohibit any additional exclusions or limitations a Delaware corporation may impose at its discretion.

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1 8 Del. C. 1953, § 145(d) requires such determination to be made by: (1) a majority of directors not party to the action, (2) a committee of directors designated by a majority of directors not party to the action, (3) independent counsel, or (4) stockholders.

Remaining Directors and Officers Risk Exposures Under DGCL § 145

In deciding whether to utilize a captive insurer, a company board must consider the exposures that a commercial D&O policy would provide coverage for and a captive policy may not. Because of the § 145 stockholder notice requirement, companies maintaining solely captive coverage run the risk of stockholder or presiding court disapproval, halting any settlement in its tracks. Stockholders seek liability coverage to efficiently insulate themselves from the actions of the company's directors and officers. In using captive assets to pay for derivative settlements, stockholders would ultimately be assuming the very financial burden they were striving to avoid. Naturally, they would be neither pleased nor eager to allow such action and would more than likely object. § 145 allows stockholders or a court to raise objections, alleging using the captive policy to cover the settlement equates to moving the company's assets in a purely annular manner. Whether stockholders are victorious in their objection, or a reviewing court abstains from providing approval of a final settlement agreement, directors and officers of the defendant company could find themselves without the financial protection necessary to resolve the derivative action adequately.

A chief concern for many companies – losses stemming from actual violations of federal securities laws – will likely be non-indemnifiable by a captive insurer under § 145. A D&O loss stemming from a real finding of a federal securities law violation, or any related securities action rooted in the same offense, is not indemnifiable as a matter of federal law. Because of this, a company's directors and officers will most likely be forced to bear the financial loss from such exposures should the company choose to forego commercial D&O insurance in favor of solely seeking coverage under a captive policy.

Other instances under which a captive policy would likely be unable to indemnify directors and officers include the following:

- Protection against various penalties under the Foreign Corrupt Practices Act (FCPA) and Investment Company Act
- Losses resulting from the Racketeer Influenced and Corrupt Organizations Act (RICO)

A commercial D&O policy would also be necessary to mitigate potential losses under Title VII as they relate to claims of sexual discrimination.

Conclusion

When deciding whether to utilize a captive insurance policy as now permitted by the amended DGCL § 145, a company's board must take heed and fully understand how gaps within the law may affect its ability to mitigate risks stemming from various non-indemnifiable losses. Purchasers of D&O insurance coverage must also be diligent when conducting their risk exposure assessments because, for many companies, it may prove detrimental to abandon their commercial D&O insurance policies in favor of a captive insurer, which will provide such companies and boards with limited protection for assorted non-indemnifiable losses.

About the Authors

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