

IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

ERNESTO RODRIGUEZ and)
ALAN HALL,)
)
Plaintiffs,)
)
v.) **C.A. No. N21C-11-051 JRS**
)
GREAT AMERICAN INSURANCE)
COMPANY,)
)
Defendant.)

Date Submitted: December 22, 2021
Date Decided: February 23, 2022

OPINION

Upon Consideration of Defendant’s Motion to Dismiss
GRANTED

Seth D. Rigrodsky, Esquire, Herbert W. Mondros, Esquire and Gina M. Serra, Esquire of Rigrodsky Law, P.A., Wilmington, Delaware; Donald J. Enright, Esquire and Elizabeth K. Tripodi, Esquire of Levi & Korsinsky, LLP, Washington, DC; and Gustavo F. Bruckner, Esquire and Samuel J. Adams, Esquire of Pomerantz LLP, New York, New York, Attorneys for Plaintiffs Ernesto Rodriguez and Alan Hall.

Bruce E. Jameson, Esquire and John G. Day, Esquire of Prickett, Jones & Elliott, P.A., Wilmington, Delaware and Edward C. Carleton, Esquire and Juan Luis Garcia, Esquire of Skarzynski Marick & Black LLP, New York, New York, Attorneys for Defendant Great American Insurance Company.

SLIGHTS, J.¹

¹ Sitting by designation of the Chief Justice of the Supreme Court of Delaware pursuant to Del. Const. art. IV, § 13(2).

The issue presented in this insurance coverage action is whether stockholder plaintiffs who obtained a default judgment in class action litigation against defendant fiduciaries may assert a claim for coverage directly against the defendants' director and officer liability ("D&O") insurer to collect on the default judgment. The insurer has moved to dismiss the plaintiffs' prayers for declaratory relief on the grounds that the plaintiffs lack standing to sue both as a matter of common law and under the express terms of the D&O policy. As for common law standing, the insurer points to the general rule in Delaware that an injured third-party may not bring a direct claim against a tortfeasor's insurer. As for standing under the policy, the insurer points to the policy's so-called "No Action Clause," which provides that "no action shall be taken against [the insurer] unless, as a condition precedent thereto, there shall have been full compliance with all terms of this Policy. . . ." According to the insurer, the insureds failed to comply with their obligations under the policy in several respects, which ultimately led to the court's entry of a default judgment against them. The plaintiffs disagree and maintain they have standing to sue both as a matter of common law and under the terms of the D&O policy.²

Under Delaware law, the plaintiffs could attain common law standing to bring a direct action against the insurer under an express assignment of the claim from the

² While the insurer has previewed other defenses to coverage in its motion, the focus for now is on standing to sue.

insured, as an intended third-party beneficiary of the insurance policy, or as a matter of subrogation. There is no express assignment here and the plaintiffs have not well-pled a basis for the Court reasonably to infer that they are intended third-party beneficiaries of the D&O policy. Whether standing exists under a theory of subrogation is more complicated.

As will be explained below, the traditional bases to invoke subrogation rights are not present here. But there is authority, including Delaware cases and declarations in authoritative insurance law treatises, that supports the proposition that an injured third-party may have standing to bring a direct action against a liability insurer after a liability judgment has been entered against the insured. Unfortunately, the authority is neither well-developed nor well-explained, and it would appear the legal foundation for these declarations of standing under a modified notion of subrogation inevitably trace back to cases interpreting so-called “direct action statutes” that authorize third-party direct actions against the insurer, or cases interpreting language within an insurance policy that expressly reveals the insurer’s intent to allow third-party direct actions. Neither circumstance exists here.

Ultimately, the question of whether Delaware recognizes (or should recognize) a third-party’s right to pursue coverage directly against an insurer under a common law theory of subrogation need not be resolved here. Even if the plaintiffs were subrogated to the rights of the insureds, and could attain standing on that basis,

their standing falls away under the express terms of the D&O policy given the insureds' clear violations of their contractual obligations to the insurer. The insureds were required to defend themselves in the underlying litigation but failed to do so, resulting in material prejudice to the insurer. Since coverage would not be available to the insureds, it is not available to the plaintiffs. The insurer's motion to dismiss, therefore, must be granted.

I. BACKGROUND

I have drawn the facts from well-pled allegations in the Verified Complaint (the "Complaint"), documents incorporated by reference or integral to that pleading and documents subject to judicial notice.³ For purposes of the motion, I accept as true the Complaint's well-pled factual allegations and draw all reasonable inferences in the plaintiffs' favor.⁴

A. Parties and Relevant Non-Parties

Plaintiffs, Ernesto Rodriguez and Alan Hall, are former stockholders of Zhongpin, Inc. On October 11, 2019, Plaintiffs were certified as class representatives on behalf of Zhongpin stockholders in a class action against

³ See Verified Compl. ("Compl.") (D.I. 1) (filings in this action will be referred to by docket item entry as "D.I. __"); *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 860 A.2d 312, 320 (Del. 2004) (noting that on a motion to dismiss, the court may consider documents that are "incorporated by reference" or "integral" to the complaint).

⁴ *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896–97 (Del. 2002).

Zhongpin fiduciaries, litigated over several years in the Delaware Court of Chancery (the “Class Action”).⁵ That action ended when Plaintiffs obtained a default judgment against several of the defendant fiduciaries.⁶

Defendant, Great American Insurance Company (“GAIC”), is an Ohio-based insurance company that issued a D&O policy (the “GAIC Policy”) to Zhongpin.⁷ For purposes of this Opinion, I assume the GAIC Policy provided coverage to Zhongpin and other defined insureds for the claims asserted in the Class Action, subject to the policy’s express terms, conditions and exclusions.

Non-party, Zhongpin (or the “Company”), was a corporation organized and existing under the laws of Delaware.⁸ The Company’s principal corporate offices were located in China.⁹

⁵ See Compl. ¶ 9; Chancery D.I. 130 (order granting class certification). I refer to filings in the Court of Chancery action, *In re Zhongpin Inc. S’holder Litig.*, C.A. No. 7393-VCS, by docket item entry as “Chancery D.I. ___.” As the underlying proceedings before the Court of Chancery are integral to Plaintiffs’ Complaint, I may refer to them in deciding the motion *sub judice*. See *Wal-Mart Stores, Inc.*, 860 A.2d at 320. The filings in the Chancery action are also properly subject to judicial notice. See D.R.E. 202(d)(1)(c).

⁶ Chancery D.I. 138 (order granting Plaintiffs’ Motion for Default Judgment).

⁷ Compl. ¶ 10.

⁸ Compl. ¶ 13.

⁹ *Id.*

Non-party, Xianfu Zhu (“Zhu”), a resident of China, was the *de facto* controlling stockholder of Zhongpin.¹⁰ As discussed below, in the Class Action, the stockholder plaintiffs alleged that Zhu and members of the Zhongpin board of directors (the “Board”) breached their fiduciary duties when Zhu acquired Zhongpin in a going-private transaction that was the product of an unfair process resulting in an unfair price.¹¹

B. The Class Action

On March 27, 2012, Zhongpin announced that its controlling shareholder, Zhu, had proposed to acquire the shares of the Company he did not own for \$13.50 per share.¹² The Class Action complaint alleged that Zhu caused the Board to reject superior acquisition proposals from third-parties, without due deliberation, in favor of his own deal.¹³ The Company entered into a definitive merger agreement with Zhu and Zhu-related entities on November 26, 2012, at the \$13.50 per share price (the “Merger”).¹⁴

¹⁰ Compl. ¶¶ 2, 20.

¹¹ Compl. ¶¶ 2, 14.

¹² Compl. ¶¶ 15–16.

¹³ *Id.* One of the proposals opened with an offer of \$15 per share. *Id.* According to the Class Action complaint, under Zhu’s direction, the Board did not even consider it. *Id.*

¹⁴ Compl. ¶ 15.

Several putative class actions challenging the Merger were filed throughout 2012, some pre-closing and some post-closing. The actions were consolidated on July 25, 2013.¹⁵ The defendants moved to dismiss the operative Class Action complaint on September 27, 2013,¹⁶ and the court denied that motion by memorandum opinion dated November 26, 2013.¹⁷ That decision was reversed, in part, by the Supreme Court of Delaware on interlocutory appeal, after which certain defendants were dismissed from the case with prejudice.¹⁸

Just before the motion to dismiss was briefed, on April 7, 2014, the law firm of Skadden, Arps, Slate, Meagher & Flom LLP (“Skadden”) entered its appearance on behalf of the defendants and thereafter vigorously defended the claims, including by prosecuting the motion to dismiss and the related appeal.¹⁹ The road to default judgment began on October 12, 2018, when Skadden moved to withdraw as counsel following the clients’ failure to meet their financial obligations to the firm.²⁰ The court granted that motion by order dated February 6, 2019, and directed defendants

¹⁵ Chancery D.I. 13.

¹⁶ Chancery D.I. 21.

¹⁷ Chancery D.I. 44.

¹⁸ *See Leal v. Meeks*, 115 A.3d 1173 (Del. 2012); Chancery D.I. 69.

¹⁹ Chancery D.I. 57.

²⁰ Chancery D.I. 114.

within sixty days either “to engage and cause new counsel to appear for them,” or to “notify the Court that they wish to represent themselves *pro se*.”²¹ The defendants failed to comply with either direction.

With the defendants refusing to comply with the court’s order and no longer participating in the litigation, on May 14, 2019, Plaintiffs moved for a default judgment.²² The defendants were noticed on the motion for default judgment but failed to respond to it, either in writing or by appearing at the hearing.²³ The court granted the motion on April 14, 2020, and entered final judgment against the defendants in the amount of \$41,282,758, plus pre- and post-judgment interest (the “Default Judgment”).²⁴ To date, Plaintiffs have been unable to execute on the Default Judgment with respect to any of the defendants, presumably because they all reside in China.²⁵

²¹ Chancery D.I. 122. Withdrawing counsel at Skadden sent the court’s order to their clients, copied to the court, at the addresses the clients had provided to their attorneys. Chancery D.I. 123.

²² Chancery D.I. 125.

²³ Chancery D.I. 126.

²⁴ Chancery D.I. 138.

²⁵ Compl. ¶ 10.

C. The GAIC Policy

The GAIC Policy, spanning the period of March 24, 2011 to March 24, 2012, covers losses resulting from certain claims, including securities claims, made against “Insured Persons” within Zhongpin during the policy period (“Losses”).²⁶ “Insured Persons” is defined in Section III as “Directors and Officers and all past, present and future Employees of the Company other than Directors and Officers.”²⁷ The policy sets a \$10 million limit, subject to a \$300,000 cost of defense retention.²⁸

As is typical, the GAIC Policy imposes certain conditions to coverage upon the insureds. Two, in particular, are relevant here.

²⁶ Compl. ¶¶ 19, 21; Opening Br. in Supp. of Def.’s Mot. to Dismiss (“OB”) Ex. B (“GAIC Policy”) at I (“The Insurer shall pay on behalf of the Insured Persons all Loss which the Insured Persons shall be legally obligated to pay as a result of a Claim (including an Employment Practices Claim or a Securities Claim) first made against the Insured Persons during the Policy Period or the Discovery Period for a Wrongful Act, except for any Loss which the Company actually pays as indemnification.”). Zhongpin purchased a “Discovery Period” rider extending coverage through March 23, 2013, for claims made against an Insured Person for a Wrongful Act allegedly committed on or before March 24, 2012. *See* GAIC Policy at III(K); Compl. ¶ 21.

²⁷ GAIC Policy at III(K).

²⁸ *Id.* I note that GAIC sent a letter to Zhongpin informing it that GAIC was declining coverage for the Class Action because the Loss occurred outside the policy period. Compl. ¶ 22. While Plaintiffs dispute this ground for denial, I need not address it here because, as stated, the focus of GAIC’s motion to dismiss is standing. *See* Compl. ¶¶ 22–23 (characterizing GAIC’s denial of coverage as “wrongful”).

First, Section VII(A) reads:

The Insureds shall not incur Costs of Defense, or admit liability, offer to settle, or agree to any settlement in connection with any Claim without the express prior written consent of the Insurer, which consent shall not be unreasonably withheld. The Insureds shall provide the Insurer with full cooperation and all information and particulars it may reasonably request in order to reach a decision as to such consent. Any Loss resulting from any admission of liability, agreement to settle, or Costs of Defense incurred prior to the Insurer's consent shall not be covered hereunder.

Notwithstanding the foregoing, if a Claim can be resolved in which all Loss, including Costs of Defense, does not exceed the applicable Retention, then the Insurer's consent shall not be required, provided, however, the Insureds agree to notify the Insurer of the disposition and provide the Insurer with all information and particulars it may reasonably request about the Claim and its disposition as soon as practicable and in no event later than the expiration of this Policy.²⁹

Second, Section VII(B) provides: "The Insureds, and not the Insurer, have the duty to defend all Claims, provided that the Insureds shall only retain counsel as is mutually agreed upon with the Insurer."³⁰ As is clear from the language, this provision placed the obligation to defend Claims squarely on the Insureds.

Additionally, the GAIC Policy contains a so-called "No Action Clause," at Section IX, which reads, in relevant part:

No action shall be taken against the Insurer unless, as a condition precedent thereto, there shall have been full compliance with all the terms of this Policy, and until the Insured's obligation to pay shall have

²⁹ GAIC Policy at VII(A).

³⁰ GAIC Policy at VII(B).

been finally determined by an adjudication against the Insured or by written agreement of the Insured, claimant and the Insurer.³¹

According to GAIC, this No Action Clause bars Plaintiffs' claim for coverage since the Insureds failed to comply with the obligations to defend the Class Action and cooperate with the Insurer, and thereby allowed the Default Judgment to be taken against them.³²

D. GAIC Denies Coverage to Plaintiffs

According to the Complaint, the Default Judgment represents a Loss covered by the GAIC Policy.³³ Specifically, Plaintiffs allege they gave GAIC notice of the motion for default judgment when it was filed, spoke with GAIC's counsel in advance of the hearing on the motion, and "provided GAIC with a copy of the relevant pleadings."³⁴ Upon obtaining the Default Judgment, Plaintiffs made a demand for coverage upon GAIC but GAIC "has refused to honor its coverage obligations and has flatly denied coverage."³⁵

³¹ GAIC Policy at IX(C)(1).

³² GAIC also contends that the Default Judgment is not an "adjudication" that "finally determined the Insured's obligation to pay," as required by the No Action Clause. For reasons explained below, I do not reach that argument here.

³³ Compl. ¶ 24.

³⁴ Compl. ¶ 25.

³⁵ Compl. ¶ 24.

E. Procedural History

Plaintiffs initiated this declaratory judgment action in the Court of Chancery on May 20, 2020.³⁶ GAIC moved to dismiss on July 21, 2020,³⁷ and that motion was presented to the court on May 13, 2021.³⁸ After oral argument, I raised, *sua sponte*, the question of whether the Court of Chancery could exercise subject matter jurisdiction over Plaintiffs' claims.³⁹ The parties submitted supplemental letter memoranda on the jurisdictional question and, on October 20, 2021, I issued a letter opinion dismissing the matter for want of subject matter jurisdiction.⁴⁰ In doing so, I granted leave to Plaintiffs to transfer the case to the Superior Court under 10 *Del. C.* § 1902.⁴¹ Plaintiffs filed their election to transfer on November 1, 2021.⁴²

³⁶ D.I. 1, 9.

³⁷ D.I. 13.

³⁸ D.I. 35–36.

³⁹ D.I. 37.

⁴⁰ D.I. 40–42.

⁴¹ D.I. 42.

⁴² D.I. 43.

I was designated to sit as Superior Court judge *pro tempore* on December 22, 2021.⁴³ Thereafter, I deemed the motion to dismiss—as filed, briefed and argued in the Court of Chancery—submitted for decision in this Superior Court action as of December 22, 2021.

II. ANALYSIS

While a challenge to a plaintiff’s standing to sue traditionally is regarded as a challenge to the court’s exercise of subject matter jurisdiction under Rule 12(b)(1), “where, as here, the issue of standing is so closely related to the merits, a motion to dismiss based on lack of standing is properly considered under Rule 12(b)(6) rather than Rule 12(b)(1).”⁴⁴ Because the availability of coverage under the GAIC Policy presents quintessentially merits-based questions, this matter will be resolved under Rule 12(b)(6).

The standards for deciding a motion to dismiss under Rule 12(b)(6) are well-settled, and have been summarized by our Supreme Court as follows:

(i) all well-pleaded factual allegations are accepted as true; (ii) even vague allegations are “well-pleaded” if they give the opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the non-moving party; and (iv) dismissal is inappropriate unless the plaintiff would not be entitled to recover

⁴³ D.I. 7.

⁴⁴ *Appriva S’holder Litig. Co., LLC v. EV3, Inc.*, 937 A.2d 1275, 1286 (Del. 2007).

under any reasonably conceivable set of circumstances susceptible of proof.⁴⁵

As noted, GAIC challenges Plaintiffs' standing to sue on two grounds: (A) lack of standing as a matter of common law; and (B) lack of standing under the terms of the GAIC Policy. I address both challenges in turn.

A. Common Law Standing

In Delaware, as a general rule, an injured third-party may not bring a direct cause of action against a tortfeasor's insurer.⁴⁶ "The rationale behind this rule appears to be simply that the courts feel that it would not be sound public policy to permit an insurer to be joined as a defendant in an action grounded upon the acts of the insured."⁴⁷ More to the point, courts "do not want an insurer to be prejudiced by a jury's tendency to find the insured negligent or inflate damages based upon an insurer's deep pockets."⁴⁸ To eliminate this risk, most jurisdictions, including

⁴⁵ *Savor*, 812 A.2d at 896–97 (citation omitted).

⁴⁶ See *Walden v. Allstate Ins. Co.*, 913 A.2d 570 (Del. 2006) (TABLE) ("[A]n injured third party may not prosecute a direct action against a liability insurer on the basis of the alleged negligence of an insured before a determination of the insured's liability."); *Kaufmann v. McKeown*, 193 A.2d 81, 83 (Del. 1963) (recognizing the general rule); *Delmar News, Inc. v. Jacobs Oil Co.*, 584 A.2d 531, 534 (Del. Super. Ct. 1990) (same); *Jones v. State Farm Fire & Cas. Ins. Co.*, 1997 Del. Super. LEXIS 201, at *6 (Del. Super. Ct. Apr. 14, 1997) (case not reported in Westlaw) [hereinafter *Jones I*], *aff'd in part rev'd in part on other grounds*, *Jones v. State Farm Fire & Cas. Ins. Co.*, 1997 WL 702570, at *1 (Del. Nov. 4, 1997) (same) [hereinafter *Jones II*].

⁴⁷ *Delmar News*, 584 A.2d at 534.

⁴⁸ *Jones I*, 1997 Del. Super. LEXIS 201, at *4.

Delaware, have determined that an injured plaintiff “does not have standing to bring an action against the tortfeasor’s liability insurer.”⁴⁹

In Delaware, this general rule regarding standing is not absolute.⁵⁰ Our courts have recognized three theories upon which an injured third-party may pursue its claim for coverage directly against a tortfeasor’s insurer: (1) where the third-party has received a valid assignment of the claim for coverage from the insured, (2) where the third-party is an intended third-party beneficiary of the insurance contract, or (3) through subrogation.⁵¹ Plaintiffs maintain they have standing under the latter two theories.⁵² I address them *seriatim*.

⁴⁹ 16A *Couch on Insurance* § 227:43 (Dec. 2021 Update).

⁵⁰ *See Jones I*, 1997 Del. Super. LEXIS 201, at *5 (“[T]his Court finds an injured third-party, after obtaining judgment against the insured, may directly sue the insurer.”); *Jones II*, 1997 WL 702570, at *1 (affirming trial court’s finding that injured party “had standing to assert this claim [for coverage]” against the insurer); *see also* 16A *Couch on Insurance* § 104:41 (Dec. 2021 Update) (explaining that many jurisdictions allow an “injured claimant” to bring a claim directly against the insurer under limited circumstances).

⁵¹ *Lewis v. Home Ins. Co.*, 314 A.2d 924, 925 (Del. Super. Ct. 1973) (“The right of an injured third-party to recover from a liability insurer upon a judgment obtained against an insured has been upheld either on the basis of subrogation or on the basis of third-party beneficiary.”); *Jones I*, 1997 Del. Super. LEXIS 201, at *5 (recognizing third-party’s standing to pursue claim for coverage under both assignment and subrogation theories).

⁵² The parties agree the insureds did not assign any claims for coverage to Plaintiffs.

1. Third-Party Beneficiary Standing

“As a general matter, only a party to a contract has enforceable rights under, and may sue for breach of, that contract.”⁵³ With that said, “[i]t is settled law in Delaware that a third-party may recover on a contract made for his benefit.”⁵⁴ To confer such rights on a third-party, the contracting parties together must have intended to enter the contract for the benefit of that third-party (or a similarly situated class of third-parties).⁵⁵ “[I]f the promisee did not intend to confer direct benefits upon a third person and instead the third-party happens to either coincidentally or indirectly benefit from the performance of the promise, then the third-party is deemed an incidental beneficiary and has no right to enforce the contract.”⁵⁶

⁵³ *Madison Realty P’rs 7, LLC v. AG ISA, LLC*, 2001 WL 406268, at *5 (Del. Ch. Apr. 17, 2001).

⁵⁴ *Delmar News*, 584 A.2d at 534; *see also Royal Indem. Co. v. Alexander Indus., Inc.*, 211 A.2d 919, 920 (Del. 1965) (“A third party beneficiary may recover on a contract made for his benefit . . .”).

⁵⁵ *Delmar News*, 584 A.2d at 534; *see also Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver Inc.*, 312 A.2d 322, 326 (Del. Super. Ct. 1973) (“The application of the creditor beneficiary rule depends on whether the third-party is in fact a creditor beneficiary, a status which in turn depends on the intention of the parties to the contract as expressed therein.”); *Madison Realty P’rs*, 2001 WL 406268, at *5 (“To qualify as a third-party beneficiary of a contract, (i) the contracting parties must have intended that the third-party beneficiary benefit from the contract . . .”).

⁵⁶ *Scott v. Moffit*, 2019 WL 3976068, at *3 (Del. Super. Ct. Aug. 20, 2019).

Although relegated to a footnote in their brief, Plaintiffs do argue that they qualify as third-party beneficiaries of the GAIC Policy.⁵⁷ According to Plaintiffs, the parties to the policy understood and agreed that coverage was intended for the benefit of those injured by the insured's covered wrongdoing, like the wrongdoing at issue in the Class Action. While Plaintiffs' claim to third-party beneficiary status might have more weight if the coverage at issue was mandated by statute for the benefit of a class of putative claimants, such as Delaware's mandatory automobile liability coverage or mandatory worker's compensation coverage,⁵⁸ the argument has no persuasive force with respect to D&O insurance.

⁵⁷ Pls.' Br. in Opp'n to Def.'s Mot. to Dismiss the Verified Compl. for Declaratory J. ("AB") at 18 n.8 (Chancery D.I. 15).

⁵⁸ See, e.g., *Ferrari v. Helmsman Mgmt. Servs., LLC*, 2020 WL 3444106, at *3 (Del. Super. Ct. June 23, 2020) (observing that Delaware courts have recognized an injured party's third-party beneficiary status with respect to insurance policies mandated to be carried for their benefit by statute, such as "workers' compensation insurance policies and automobile insurance policies"); *Swain v. State Farm Mut. Auto. Ins. Co.*, 2003 WL 22853415, at *2 (Del. Super. Ct. May 29, 2003) (emphasizing the statutory mandate that all motorists in Delaware carry minimum liability insurance coverage for the benefit of fellow motorists in holding that an injured party is "a third-party beneficiary to the automobile insurance contract entered into by [the tortfeasor] and State Farm"). But see *Brown v. Allstate Ins. Co.*, 1997 WL 129345, at *4 (D. Del. Feb. 27, 1997) (holding, under Delaware law, that injured plaintiff was not an intended third-party beneficiary of tortfeasor's liability insurance policy); *Hostetter v. Hartford Ins. Co.*, 1992 WL 179423, at *7 (Del. Super. Ct. July 13, 1992) (rejecting plaintiff's argument that because consumers buy liability insurance "mainly to benefit third-parties injured by the insured's negligence" she must be deemed a third-party beneficiary of tortfeasor's liability insurance since there was no indication that the parties to the contract expressly intended to confer third-party beneficiary status), *abrogated sub. nom. on other grounds, Connelly v. State Farm Mut. Auto. Ins. Co.*, 135 A.3d 1271 (Del. 2016).

Delaware encourages, but does not require, its business citizens to procure D&O insurance,⁵⁹ not for fear that the company or its fiduciaries will be unwilling or unable to pay a judgment, but “to encourage capable persons to serve as officers, directors, employees or agents of Delaware corporations, by assuring that their reasonable legal expenses will be paid.”⁶⁰ With this animating public policy in mind, it is difficult to view Plaintiffs here as anything more than incidental beneficiaries who would benefit from the D&O coverage to the extent the Zhongpin insureds were found liable to Plaintiffs and elected to pay the judgment with proceeds from the GAIC Policy.⁶¹ Because it is not reasonable to infer that the parties to the GAIC Policy at the time of contracting mutually intended for that coverage to benefit stockholder claimants, including Plaintiffs, either as a matter of contract or as a

⁵⁹ Contrary to Plaintiffs’ argument that “Delaware corporations are required by law to carry D&O coverage,” no Delaware law imposes that requirement. *See* AB at 18. Instead, “Section 145(g) of the [Delaware] Corporation Law provides that a corporation *may* obtain directors’ and officers’ insurance” 1 R. Franklin Balotti et al., *The Delaware Law of Corporations & Business Organizations*, Directors and Officers § 4.13 (4th ed. 2021) (explaining that the DGCL “*allows* the corporation to insure for potential liability”) (emphasis added).

⁶⁰ *Mayer v. Exec. Telecard, Ltd.*, 705 A.2d 220, 223 (Del. Ch. 1997); *see also* *RSUI Indem. Co. v. Murdock*, 248 A.3d 887, 900 (Del. 2021) (observing that the statutory grant of authority to corporations to acquire D&O Insurance, per 8 *Del. C.* § 145(g), reflects Delaware’s public policy to “minimize[e] the downside risks of serving as a director or officer through D&O insurance, [which in turn] will enhance the ability of Delaware corporations to attract talented people to fill those roles”).

⁶¹ *Delmar News*, 584 A.2d at 534 (“Delmar is an indirect beneficiary of the insurance contract in that if Jacobs is eventually found to have been negligent, Delmar may have the right to receive payment for its losses from MCC.”).

matter of statutory mandate, Plaintiffs cannot obtain standing as intended third-party beneficiaries.

2. Subrogation Standing

Delaware’s approach to subrogation standing is well defined in certain aspects, yet unclear in others. In general terms, as relevant here, subrogation allows a third-party to replace one of the parties to a contract and then assume the rights of that contracting party to sue the counterparty.⁶² The right of subrogation takes one of three forms: contractual, statutory or equitable.⁶³

Contractual subrogation, or conventional subrogation, “involves subrogation rights that are *expressly* provided for in the provisions of a contract or agreement between the parties. . . . [For instance], the terms of [an insurance] policy often will include a provision that expressly grants the insurer right to pursue recovery from a responsible third-party to the extent of its payment to the insured.”⁶⁴ Here, Plaintiffs

⁶² *Chittick v. State Farm Mut. Auto. Ins. Co.*, 170 F. Supp. 276, 279 (D. Del. 1958) (describing subrogation as “an equitable assignment” and “a substitution [of parties,] leav[ing] no right in the party whose interest is subrogated”).

⁶³ *See, e.g.*, 13 Steven Theesfeld & Marie Cheung-Truslow, *New Appleman on Insurance Law Library Edition* § 158.05 (2021); 7A *Couch on Insurance* § 104:41 (Dec. 2021 Update); *E. Sav. Bank, FSB v. Cach, LLC*, 124 A.3d 585, 590 (Del. 2015).

⁶⁴ 13 Steven Theesfeld & Marie Cheung-Truslow, *New Appleman on Insurance Law Library Edition* § 158.05 (2021) (emphasis added).

do not assert subrogation rights as a matter of contract, presumably because no language in the GAIC Policy extends those rights to them.

Statutory subrogation is available when a statute expressly grants subrogation standing to third-parties.⁶⁵ Here again, Plaintiffs do not assert subrogation rights as a matter of statute, presumably because no Delaware statute extends those rights in this context.

As for equitable subrogation, in Delaware, a party must satisfy five elements to acquire rights as an equitable subrogee:

(1) *payment* must have been made by the subrogee to protect his or her own interest; (2) the subrogee must not have acted as a volunteer; (3) the debt *paid* must have been one for which the subrogee was not primarily liable; (4) the entire debt must have been *paid*; and (5) subrogation must not work any injustice to the rights of others.⁶⁶

Once again, Plaintiffs do not seek classic equitable subrogation because they cannot satisfy the requisite elements. Indeed, the Default Judgment has yet to be paid by anyone; yet payment (by someone) is a factual predicate of equitable subrogation. Even so, say Plaintiffs, that does not end the inquiry.

There is a “modern trend [that] allow[s] a [third-party] action against a tortfeasor’s insurer, once a judgment is obtained,” under a general notion of

⁶⁵ 7A *Couch on Insurance* § 104:41 (Dec. 2021 Update) (discussing statutory subrogation).

⁶⁶ *E. Sav. Bank*, 124 A.3d at 590 (emphasis added).

subrogation.⁶⁷ I say “general notion of subrogation” because the circumstances giving rise to the third-party’s “subrogation” claim against the insurer do not squarely fit within “a traditional use of the word.”⁶⁸ It is unclear doctrinally where this modern trend comes from or whether Delaware law embraces it.

Several Delaware cases have suggested that an injured third-party may sue an insurer directly once the injured third-party has received a judgment against the insured tortfeasor.⁶⁹ These cases, however, all appear to rely on decisions from other

⁶⁷ 13 Steven Theesfeld & Marie Cheung-Truslow, *New Appleman on Insurance Law Library Edition* § 160.4 (2021); *see also* 8 J. Appleman, *Insurance Law and Practices* § 4831 (1981) (“An injured third-party who has recovered a judgment against the insured generally has been held to be subrogated to the rights of the latter and he can maintain an action directly against the liability insurer.”); 7A *Couch on Insurance* § 104:41 (Dec. 2021 Update) (“In some instances, the status of the injured claimant after the necessary judgment against the insured is obtained has been described in terms of subrogation.”); *Jones I*, 1997 Del. Super. LEXIS 201, at *6 (recognizing third-party’s right to bring direct action against the insurer on a theory of subrogation); 16 *Couch on Insurance* § 222:100 (Dec. 2021 Update) (“In some instances, the term ‘subrogation,’ applied technically to the broad concept of a legal authorization to stand in the place of another, is used to describe the rights of injured third parties to proceed directly against the insurer of the entity that caused the injury.”).

⁶⁸ 7A *Couch on Insurance* § 104:41 (Dec. 2021 Update) (“While the use of the term ‘subrogation’ in this connection conveys the meaning of a derivative right arising by operation of law rather than by express assignment, it must be recognized that it is not an accurate or traditional use of the word and should not be carried beyond the aspect which the situation here considered has in common with subrogation: that of a claimant’s standing in the position of the insured.”).

⁶⁹ *E.g.*, *Chittick*, 170 F. Supp. at 280 (“An injured third party who has recovered a judgment against the insured generally has been held to be subrogated to the rights of the latter and he can maintain an action directly against the liability insurer.”) (quoting 8 J. Appleman, *Insurance Law and Practices* § 4831 (1981)); *Lewis*, 314 A.2d at 925 (“[A]n injured third party [may] recover from a liability insurer upon a judgment obtained against an insured”); *Jones I*, 1997 Del. Super. LEXIS 201, at *6 (“It has been held that an

jurisdictions, or treatises citing such decisions, where the third-party attained standing by statute or by the express terms of the insurance contract.⁷⁰ In other words, the source of the authority cited by the Delaware decisions recognizing a right (or standing) to pursue a direct action against the insured was either statutory subrogation (through so-called “direct action statutes”) or contractual subrogation (through the express terms of the insurance policy).⁷¹

injured third-party may recover from a liability insurer after recovering judgment against the insured on a theory of subrogation, it being stated that the injured party is then subrogated to the rights of the insured.”); *Delmar News*, 584 A.2d at 534 (observing that third-party may be able to bring a direction action against the insurer upon obtaining a judgment against the alleged tortfeasor); *Walden*, 913 A.2d at 570 (“[A]n injured third party may not prosecute a direct action against a liability insurer on the basis of the alleged negligence of an insured *before a determination of the insured’s liability.*”) (emphasis supplied).

⁷⁰ *E.g.*, *Jones I*, 1997 Del. Super. LEXIS 201, at *6 (citing *Chittick*, 170 F. Supp. at 279) (“[T]here is no subrogation in the present case as that term is used in the law and I am referred to no other principle sustaining the present action.”). The cases referenced by the plaintiff in *Chittick*, in turn, granted the subrogation rights through express terms in the insurance policies. *Chittick*, 170 F. Supp at 279–80 (“[Those] courts considered the rights of the injured party to be contractual rights growing out of express terms of the policies”) (citing *Kleinschmit v. Farmers Mutual Hail Ins. Ass’n*, 101 F.2d 987 (8th Cir. 1939) and *Auto Mut. Indem. Co. v. Shaw*, 184 So. 852 (Fla. 1938)).

⁷¹ As noted, the Delaware decisions finding direct action standing on the basis of subrogation often point to insurance treatises and legal encyclopedias. These authorities exist and discuss subrogation at length. *E.g.*, 44 Am. Jur. 2d *Insurance* § 1449 (Jan. 2022 Update) (noting with respect to subrogation standing that, “if the policy is an indemnity policy against loss, the insured’s cause of action against the insurer does not arise until after the payment of the judgment recovered against the insured by the injured person”); 8 J. Appleman, *Insurance Law and Practices* § 4831 (1981) (“An injured third-party who has recovered a judgment against the insured generally has been held to be subrogated to the rights of the latter and he can maintain an action directly against the liability insurer.”); 7A *Couch on Insurance* § 104:41 (Dec. 2021 Update) (“In some instances, the status of the injured claimant after the necessary judgment against the insured is obtained has been

Upon careful review of the relevant Delaware authority, the best that can be said is that our law is unclear regarding whether a third-party may bring a direct action against an insurer for coverage on a theory of subrogation when equitable subrogation does not apply and the right cannot be traced to a statute or contract. For their part, Plaintiffs point to *Jones I* and declare that its holding represents the settled law of Delaware.⁷² But, as GAIC correctly observes, in *Jones II*, our Supreme

described in terms of subrogation.”); 16 *Couch on Insurance* § 222:100 (Dec. 2021 Update) (“In some instances, the term ‘subrogation,’ applied technically to the broad concept of a legal authorization to stand in the place of another, is used to describe the rights of injured third parties to proceed directly against the insurer of the entity that caused the injury.”). But a deeper dive reveals that the sources upon which these discussions of direct action standing rest inevitably are decisions interpreting either direct action statutes or insurance policies expressly authorizing direct actions. *E.g.*, 44 Am. Jur. 2d *Insurance* § 1449 (citing *Degnan v. R.I. Mut. Liab. Ins. Co.*, 154 A. 912, 913 (R.I. 1931) (holding that the third party could sue the insurer under the terms of the policy, which explicitly stated “[n]o action shall lie against the company *under this policy* unless brought . . . [after the] judgment against the insured after final determination of the litigation”) (emphasis added); *Smith Stage Co. v. Eckert*, 184 P. 1001, 1003 (Ariz. 1919) (“[W]e have concluded the company’s contract is not one of insurance, but one of conditional liability; the [*contract*] *condition* being that the injured party must first obtain a judgment against the assured stage company.”) (emphasis added)); *e.g.*, 7A *Couch on Insurance* § 104:41 (Dec. 2021 Update) (citing *N.J. Fid. & Plate Glass Ins. Co. v. Clark*, 33 F.2d 235, 236 (9th Cir. 1929) (“[T]he intent and purpose of [the Oregon] statute is to subrogate the injured party to the rights of the insured”); *Bourget v. Gov’t Emp. Ins. Co.*, 287 F. Supp. 108, 110 (D. Conn. 1968) (“[T]he language of [the Connecticut statute] clearly subrogates the injured person to all the insured’s rights against the insurer.”); *Guerin v. Indem. Ins. Co. of N. Am.*, 142 A. 268, 268 (Conn. 1928) (“[If] under chapter 331 of the Public Acts of 1919 . . . the judgment creditor is subrogated to the rights of the assured against his insurer.”); *Gen. Accident Fire & Life Assurance Corp. v. Mitchell*, 259 P.2d 862, 866 (Colo. 1953) (observing that “plaintiffs are subrogated to the rights of Greathouse under General’s policy”)).

⁷² AB at 15–16.

Court affirmed the trial court’s standing determination only on the basis of an express assignment.⁷³ The court did not address the trial court’s finding regarding subrogation standing.⁷⁴ Unfortunately, *Jones I* did not explain the basis of the subrogation right it found to exist, and the authority it cites rested on either statutory or contractual rights.

Having identified the uncertainty in our law, I have determined that I need not tackle the difficult task of attempting to provide clarity. Even if Plaintiffs are subrogated to the rights of the insureds, for reasons I explain below, standing does not exist under the GAIC Policy because the insureds were not in compliance with the GAIC Policy, and thereby forfeited coverage, at the time the Default Judgment was entered.

B. Standing Under the Policy

The “concept of subrogation,” even in Plaintiffs’ formulation, assumes “that the injured person stands in the shoes of the insured, with no greater and no lesser rights than the insured against the insurer. Consequently, if the insured cannot recover against the insurer, the injured person cannot do so.”⁷⁵ GAIC argues the

⁷³ *Jones II*, 1997 WL 702570, at *1.

⁷⁴ *Id.*

⁷⁵ 7A *Couch on Insurance* § 104:41 (Dec. 2021 Update); *see also id.* § 104:6 (observing that “a claimant seeking to bring a direct action against an insurer stands in the shoes of the insured against whom his or her claim arose; consequently, if the insured has breached the insurance policy, the insurer may assert this breach as a bar to the third-party claimant’s

Zhongpin insureds breached the GAIC Policy such that they, and in turn Plaintiffs, have forfeited their rights to seek coverage. I agree.

The GAIC Policy’s No Action Clause provides, in part, that “[n]o action shall be taken against [GAIC] unless, as a condition precedent thereto, there shall have been full compliance with all terms of this Policy. . . .”⁷⁶ As Plaintiffs stand in the shoes of the insureds, and their standing to sue must be consistent with the terms of the GAIC Policy, Plaintiffs must well-plead that the insureds were in “full compliance with all terms of th[e] Policy” in order to have standing to sue for coverage. But the insureds’ “full compliance” with the GAIC Policy is not a reasonable inference that can be drawn from the Complaint.

I start with the obvious—the reason Plaintiffs possess the Default Judgment against the Zhongpin insureds is that the insureds failed to defend the claims asserted against them. That, in and of itself, violated the GAIC Policy.⁷⁷ In failing to defend,

recovery”); 44 Am. Jur. 2d, *Insurance* § 1450 (Jan. 2022 Update) (“If the insured has not complied with a clause in the policy requiring cooperation, the injured person cannot recover against the insurer . . . if the insurer has been prejudiced by the breach of the cooperation clause.”); *Jones I*, 1997 Del. Super. LEXIS 201, at *7 (holding that “regardless of whether Jones has a cause of action in subrogation or as a valid assignment, Jones will be subject to the insurance policy’s limitations and conditions”).

⁷⁶ GAIC Policy IX(C)(1).

⁷⁷ GAIC Policy VII(B) (providing that the “Insureds, and not the Insurer, have the duty to defend all Claims”). This provision obligated the insureds to defend any action against them that might implicate the policy. *See XL Specialty Ins. Co. v. Lakian*, 243 F. Supp. 3d

the Zhongpin insureds violated not only express provisions of their GAIC Policy but also an order of the court directing that they retain new counsel or defend the action *pro se*.⁷⁸

Moreover, the GAIC Policy required all insureds to avoid any admission of liability without GAIC's prior consent. Specifically, at Section VII(A), the policy provides in unambiguous terms that the "Insureds shall not . . . admit liability . . . in connection with any Claim without the express prior written consent of the Insurer, which consent shall not be unreasonably withheld."⁷⁹ The court's order granting the Default Judgment made clear that the Class Action defendants, by default, had admitted their liability on the breach of fiduciary duty claims asserted against them.⁸⁰ There is no allegation in the Complaint that GAIC gave its consent before the insureds made that admission.⁸¹

434, 440–41 (S.D.N.Y. 2017) (interpreting a similar provision and recognizing that a "[d]efault is undeniably a failure to defend").

⁷⁸ Chancery D.I. 122–23.

⁷⁹ GAIC Policy VII(A).

⁸⁰ Chancery D.I. 138.

⁸¹ GAIC also argues that the default judgment was not a "final determination [of liability] and adjudication against the Insured," as required by the No Action Clause to trigger coverage. OB at 35. Given my determination that the No Action Clause otherwise bars coverage, I decline to reach the "final determination" issue.

As a general matter, “an insured’s breach of [a] notice provision, without prejudice to the insurer, will not relieve the company of its liability under the contract.”⁸² Whether a showing of actual prejudice is required when an insured breaches a contractual duty to defend, as opposed to a requirement to give the insurer notice of a claim, has not been addressed by the parties, and the Court has found no cases directly on point. Assuming a showing of prejudice is required, the only reasonable inference to be drawn from the Complaint is that the showing has readily been made here.

The Zhongpin insureds failed to pay their lawyers, as required by the GAIC Policy, and then disappeared. When ordered to secure new counsel or proceed in the litigation *pro se*, the insureds elected to do neither and instead did nothing. When given notice of Plaintiffs’ intent to seek a default judgment, they sat silent and, by their silence, acknowledged liability. All the while, GAIC could do nothing to stop the defense train as it careened toward default judgment. This was not a case where the insured was an at-fault driver of an automobile who declined to participate in the defense of a personal injury claim brought against him. If that were the case, the insurer could engage counsel, admit fault and defend the claim (without the insured)

⁸² *State Farm Mut. Auto. Ins. Co. v. Johnson*, 320 A.2d 345, 346 (Del. 1974); *see also Jones II*, 1997 WL 702570, at *1 (holding that “an insurer must demonstrate actual prejudice before a forfeiture of coverage may be invoked by reason of the non-compliance of a notice requirement in an insurance policy”).

on causation or damages. Here, the Zhongpin insureds allegedly were conflicted fiduciaries who approved an unfair squeeze-out merger. Plaintiffs argued these insureds bore the burden of proving the entire fairness of the Merger, a burden that would require them to demonstrate the fairness of both the process leading to the Merger and the price ultimately paid.⁸³ This burden could not be sustained without the cooperation, indeed the full involvement, of the insureds. Rather than cooperate, though, the insureds disappeared, leaving GAIC to hold the bag. That was a material breach of the GAIC Policy that has resulted in obvious prejudice to GAIC. Under the No Action Clause, Plaintiffs cannot maintain their action for coverage under these circumstances.

III. CONCLUSION

Based on the foregoing, GAIC's motion to dismiss the Complaint must be GRANTED.

IT IS SO ORDERED.

⁸³ See *In re Zhongpin Inc. S'holders Litig.*, 2014 WL 6735457, at *6 (Del. Ch. Nov. 26, 2014) (outlining Plaintiffs' contentions in the Class Action, including that "the Merger should be reviewed under the entire fairness framework").