IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE	)	C.A. No. 18604
DELTA HOLDINGS, INC.	)	

MEMORANDUM OPINION

Date Submitted: June 15, 2004
Date Decided: July 26, 2004

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CHANDLER, Chancellor

The Receiver of Delta Holdings, Inc., a Delaware corporation which has dissolved in accordance with the Delaware General Corporate Law (the "DGCL"), seeks Court approval of a plan of distribution to the corporation's stockholders. This plan involves the purchase of a directors' and officers' insurance policy (the "D&O Policy") for former directors and officers of a wholly owned subsidiary of Delta Holdings and the payment of certain other professional expenses. The three former directors and officers that the D&O Policy is intended to cover (the "Objectors") object to the plan of distribution on the ground that the plan does not make "reasonable provision" to cover their claims under Delta Holdings' indemnification provision. In this Opinion, the Court holds that the Objectors' claims under Delta Holdings' indemnification provision are present contingent contractual claims known to Delta Holdings requiring Delta Holdings to make reasonable provision for them under Section 281(b)(i) of the DGCL. The Court finds that Delta Holdings has failed to meet this requirement and, therefore, declines to approve the proposed plan of distribution.

I. BACKGROUND

A. The Parties

Delta Holdings is a Delaware insurance holding company incorporated in 1982 for the purpose of forming, acquiring, and holding

insurance and reinsurance companies. In furtherance of that purpose, Delta Holdings acquired the Elkhorn Re Insurance Company, a Kentucky property and casualty reinsurer engaged in the treaty reinsurance business, from Millennium Petrochemicals, Inc. That transaction was consummated on September 30, 1983, and was valued at $18 million. Elkhorn was subsequently renamed "Delta Re."

Before this transaction, the Objectors—Robert E. Norton, Hugh C. Brewer, III, and James D. McGurty—were employees of Millennium. All three Objectors accepted offers to work for Delta Re, beginning October 1, 1983, with Norton serving as director and President, Brewer as director and Vice President, and McGurty as Controller.[1] Less than two years following the transaction, on September 15, 1985, the Kentucky Insurance Commissioner placed Delta Re in liquidation.[2] The Kentucky Insurance Commissioner was appointed as the "Liquidator."[3]

Delta Holdings, pursuant to DGCL Section 275, was voluntarily dissolved on October 7, 1997. Following the expiration of the three-year winding-up period prescribed by Section 278 of the DGCL, this Court,

[1] Delta Holdings confirmed these appointments at a special meeting of its stockholders held on October 27, 1983. Aff. of Loren F. Selznick in Opp'n to Mot. to Distribute Assets ("Selznik Aff.") Ex. 6.
[2] Selznik Aff. Ex. 9 (the "Liquidation Order").
[3] *Id.* ¶ 4.

pursuant to DGCL Section 279, issued an Order appointing Carl R. Pingel as Receiver.

B. Overview of Reinsurance Industry

Because of the complexity of the reinsurance business, and its centrality to the current dispute, a brief introduction to the nature of the business and its terminology may be helpful. Delta Re was engaged primarily in the treaty reinsurance business. Reinsurance is "[i]nsurance of all or part of one insurer's risk by a second insurer."[4] Essentially, a primary insurer issues an insurance policy to an insured. In order to spread the risk of loss, the primary insurer then seeks what is, in all effects, insurance on the insurance policy it issued. Known as the "ceding company," the primary insurer "cedes" a portion of the original premium to the secondary insurer, or reinsurer. The reinsurer, in turn, accepts a portion of the risk of loss originally borne by the ceding insurer.

Treaty reinsurance is "[r]einsurance under a broad agreement of all risks in a given class as soon as they are insured by the direct insurer."[5] Its defining characteristic is that it paints in broad strokes, providing coverage for a *general* risk. Reinsurance companies in this business enter into "treaties," contracts where 20 or more reinsurers assume a group of risks

[4] BLACK'S LAW DICTIONARY 1290 (7th ed. 1999).
[5] *Id.* at 1291.

underwritten by a primary insurer.[6] In addition to entering into treaties, Delta Re also provided reinsurance through facultative contracts. Facultative contracts reinsure specific risks.[7]

The risks Delta Re reinsured included property and casualty risks. Although property loss by, for example, fire, is rapidly reported up the chain of insurers, casualty loss can take quite some time to be reported. Casualty insurance, generally, involves an "agreement to indemnify against any loss resulting from a broad group of causes such as legal liability, theft, accident, property damage, and workers' compensation."[8] Casualty insurance insures against third-party liability (including medical malpractice), which by its nature, involves substantial delays in discovering and reporting claims.[9] These delays can last up to fifteen or twenty years.[10]

Under generally accepted accounting principles ("GAAP"), reinsurers must establish provisions on their balance sheet for liability on claims under their insurance policies.[11] First, they must provide for "due and owing" claims—claims that a ceding company has paid to the primary insured.

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[6] Mem. of Law in Opp'n to Mot. to Distribute Assets 3.
[7] *Id.*
[8] BLACK'S LAW DICTIONARY 803 (7th ed. 1999).
[9] *Delta Holdings, Inc. v. Nat'l Distillers & Chem. Corp.*, 945 F.2d 1226, 1229 (2d. Cir. 1991).
[10] *Id.*
[11] Information on forms of reinsurance claims and reserves is taken from the United States Court of Appeals for the Second Circuit's discussion in *Delta Holdings. Id.*

While due and owing claims are the only claims for which a reinsurer is currently liable to a ceding company, reinsurers must also make provisions in their financial statements for liabilities on future unpaid claims. There are two forms of future unpaid claims. Known claims are claims that have been made, but for which the definitive loss amount is not currently known. Funds set aside to provide for estimated losses arising out of known claims are called "case reserves." Incurred-but-not-reported ("IBNR") claims are claims which have not been reported, but which must be estimated so that the company can pay future claims. Funds set aside to provide for IBNR claims are, predictably, called "IBNR reserves." Case reserves and IBNR reserves, together, are labeled "loss reserves." Due to the long reporting delays involved in casualty insurance, IBNR reserves for companies engaged in reinsuring that form of risk are generally much larger than case reserves.

C. Delta Re Liquidation

As will be discussed in more detail below, any claim under Delta Holdings' indemnification provision that the Objectors have will vest if they are made party to a proceeding by reason of the fact that they were directors and officers of Delta Re. As such, a discussion of potential liabilities and their relationship to Delta Re's liquidation is necessary.

1. Liabilities Going Into Liquidation

The liquidation of Delta Re has spanned almost twenty years and is expected to conclude in late 2004.[12] During the liquidation, the Liquidator retained the actuarial firm of Tillinghast, Towers Perrin ("Tillinghast") to determine the liabilities of Delta Re. The last Tillinghast report for the 1984 underwriting year,[13] prepared as of December 31, 1998 (the "Tillinghast Report"), showed $127.874 million in due and owing claims, $17.372 million in reported but unpaid claims, and $59.248 million in IBNR claims.[14] The IBNR numbers are based on four categories of losses: nontoxic; asbestos; breast implants; and pollution.

2. The Liquidation Order and Creditors Dividend Payment Plan

The Liquidation Order required "formal notice of the making and entry of th[e] Order" to be given to all policyholders, creditors, and "all other persons . . . having any unsatisfied claim or demand of any character against Delta Re."[15] It provided that "all outstanding policy and other insurance obligations of Delta Re terminate and all liability thereunder cease

[12] Selznick Aff. ¶ 32.
[13] The Objectors state that "Delta Holdings is only required to indemnify" them "for claims relating to the 1984 underwriting year." Mem. Of Law in Opp'n to Mot. to Distribute Assets 8 n.22.
[14] Selznick Aff. Ex. 13, at Ex.1, Sheet 1.
[15] Liquidation Order ¶ 5.

and be fixed as of 12:01 a.m. . . . on October 1, 1985."[16] The Order also permanently enjoined:

> [t]he officers, directors, trustees, policyholders, agents and employees of Delta Re and all other persons, including but not limited to claimants, plaintiffs and petitioners who have claims against Delta Re . . . from bringing or further prosecuting any action at law, suit in equity, special or other proceeding against [Delta Re] . . . , or the Commissioner and his successors in office, as Liquidator thereof, or from making or executing any levy upon the property or estate of [Delta Re], or from in any way interfering with the Commissioner, or any successor in office, in his possession, or in the discharge of his duties as Liquidator thereof, or in the liquidation of the business of [Delta Re].[17]

The Creditors Dividend Payment Plan (the "Plan"), approved by the Kentucky Liquidation Court, recounted that the Fixing of Rights Date—"the date that all of Delta's reinsurance contracts in force were terminated and the rights of creditors were fixed"—was October 1, 1985.[18] The Claims Bar Date—the date for ceding companies and other creditors to update their existing proof of claims—was set for December 2, 1996.

The Plan defined three forms of claims. "Absolute Claims" include due and owing claims, and known claims.[19] "Liquidated Claims" include due and owing claims and known claims multiplied by a present value

[16] *Id.* ¶ 11.
[17] *Id.* ¶ 17.
[18] Selznick Aff. Ex. 32 ("Creditors Dividend Payment Plan") at § III(A)(1).
[19] *Id.* § III(A)(4).

discount factor.[20] "Contingent Claims" include claims "for which liability has not become absolute and liquidated" as of the Claims Record Date—essentially, IBNR claims.[21] The Plan allowed Liquidated Claims, but disallowed IBNR claims.[22]

To the extent a claimant failed to timely file a claim, the Plan deemed it "to have waived any claim against Delta [Re] notwithstanding any previously filed proof of claim."[23] Finally, the Plan states,

> The failure of a claimant to avail itself of the procedures set forth in this Plan with respect to its claim shall be deemed an acceptance of and waiver of any objection or challenge to the Liquidator's determination of liability, and a full and complete release and discharge of Delta [Re], the past, present, and future Liquidator, his staff, and all attorneys, accountants and consultants employed by any of them, of any and all claims of any kind or description whatsoever, whether in law or equity, known or unknown, arising out of or relating to the subject claim, these proceedings and this Plan.[24]

Although the Liquidation Order terminates all insurance obligations and liabilities of Delta Re, the Plan does not authorize or provide for payments for IBNR liabilities. It is this gap that troubles the Objectors. The Plan addresses this lack of provision:

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[20] *Id.* § III(A)(5). Liquidated Claims thus overlap with Absolute Claims.
[21] *Id.* § III(A)(6).
[22] *Id.* § III(B)(2).
[23] *Id.* § IV(A)(6).
[24] *Id.* § IV(D)(3).

> Claims against Delta [Re] include significant contingent claims under reinsurance contracts which, if permitted to develop in the ordinary course, could take many years to mature. As a result, without this Plan the liquidation of Delta [Re] could continue well into the next century. The Liquidator believes the interests of Delta [Re's] creditors and the orderly administration of the estate are best served by a plan that does not await the eventual maturation of all of the claims against the estate.[25]

Although addressing its reasoning for not making provision for the IBNR claims, the Plan has the unfortunate characteristic of not explicitly stating what appears implicitly obvious: Although the Plan does not provide for IBNR claims, those claims, pursuant to the Liquidation order, are terminated.

3. Litigation Arising From the Liquidation

The insolvency of Delta Re led to a plethora of lawsuits. The first of such suits was a 1985 suit filed by Delta Holdings, bringing claims of breach of contract and common law fraud and alleging that Elkhorn was insolvent at the time of the sale due to a deficiency in loss reserves and that Norton was aware of the deficiency but concealed it from Delta Holdings prior to the sale. Following a trial court's decision in favor of Delta Holdings, the

[25] *Id.* § I.

Second Circuit found that Norton acted in good faith and exercised reasonable care in connection with the sale.[26] In addition to this suit, the Liquidator brought suits in Kentucky and New York, charging that various parties, including Norton and Brewer, mismanaged Elkhorn (and subsequently) Delta Re. All such actions were settled by 2001.[27] The cost of defending the former directors and officers in those suits exceeded $30 million. In addition, the Liquidator sued certain stockholders of Delta Holdings who became reinsurers of Delta Re[28] for reinsurance recoverables. All such suits were settled by 2003.[29]

In 1990, a group of ceding companies commenced a direct action against Norton and Millennium based on the fraud finding of the District Court in the *Delta Holdings* case (the "1990 Suit"). The Liquidator moved the Kentucky Liquidation Court to enjoin that action due to the Liquidator's exclusive right to bring such actions. The action was held in abeyance and later voluntarily dismissed.[30]

[26] *Delta Holdings, Inc.*, 945 F.2d 1226.
[27] Selznick Aff. ¶ 21.
[28] Reinsurers of Reinsurers are known as "Retrocessionaires."
[29] Selznick Aff. ¶ 22.
[30] *Id.* ¶ 23.

The cost for defending the former directors and officers in all suits was approximately $32,074,734.[31] An initial suit for indemnity under Delta Holdings' indemnity provisions was settled on October 2, 2003.[32]

D. Delta Holdings' Indemnification Provision

Delta Holdings' indemnification provision is found in its certificate of incorporation. It provides, "[t]he corporation shall, to the full extent permitted by Section 145 of the Delaware General Corporation Law, as amended, from time to time, indemnify all persons whom it may indemnify pursuant thereto."[33] This mandatory provision is extremely broad. Section 145 of the DGCL, if invoked to its fullest in a mandatory contract provision, requires a corporation to indemnify any person who "is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative . . . by reason of the fact that the person is or was . . . serving at the request of the corporation as a director, [or] officer . . . of another corporation."[34] This indemnity, in such a provision, must extend to "expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with

[31] *Id.* ¶ 25.
[32] *Id.* ¶ 31.
[33] *Id.* Ex. 1, at DH-05709.
[34] 8 *Del. C.* § 145(a)

such action, suit or proceeding."[35] The only express limitation in such a provision is that the indemnified party must have "act[ed] in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the corporation."[36]

Moreover, subsection (e) of Section 145 of the DGCL provides for the advancement of expenses incurred in such proceedings. The only express limitation on advancement in the broad form of provision contained in Delta Holdings' certificate of incorporation is that the advanced funds must be paid back if the party receiving advancement "is not entitled to be indemnified by the corporation,"[37] as provided in subsection (a). In certain circumstances, an unsecured undertaking must be provided before funds are required to be advanced.

The Objectors, who served as directors and officers of Delta Re at the request of Delta Holdings, are covered under Delta Holdings' indemnification provision. Should they be made party to a proceeding by reason of their status as former directors and officers of Delta Re, Delta Holdings would be required to advance legal fees and, under proper

[35] *Id.*
[36] *Id.*
[37] 8 *Del. C.* § 145(e).

circumstances, fully indemnify them. The Objectors, then, take the form of corporate creditors.[38]

E. Receiver's Motion For Approval of Distribution and Objectors' Objections

On January 16, 2004, the Receiver moved for Court approval of the distribution of Delta Holdings' assets to stockholders, the purchase of the D&O Policy, the payment of certain professional expenses, and the discharge of the Receiver. According to the Receiver's motion, Delta Holdings has $10,599,615 million in gross assets, and approximately $9.57 million in net liquid assets.[39] Of the net liquid assets, the Receiver proposes to reserve $205,000. Of this amount, $124,000 would be used to pay additional expenses or liabilities incurred by or billed to Delta Holdings after the distribution would be made, and approximately $81,000 would be used to purchase the D&O Policy.[40] The remaining $9.365 million would then be distributed to the Delta Holdings stockholders within 20 days of court approval.[41]

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[38] *See In re RegO Co.*, 623 A.2d 92, 105 (Del. Ch. 1992) (describing future claimants as corporate claimants, and giving the two sets of claimants equal priority in determining reasonableness of a pre-distribution provision).

[39] Receiver's Mot. for Approval of Distribution of Assets, Purchase of Insurance, Payment of Expenses and Discharge of Receiver ("Receiver's Mot.") ¶¶ 1, 5 & Ex. D.

[40] *Id.* ¶ 6.

[41] *Id.* ¶ 7. The Receiver also requests approval to pay $83,302.47 in professional fees for the year ending June 30, 2003. Although the Court Order establishing receivership only allowed the incurrence of up to $75,000 in expenses a year, the Receiver states he needed

The D&O Policy is sought so as to provide for indemnity claims of the Objectors. The policy procured by the $81,000 premium provides $1 million in coverage for a period of six years after distribution of assets to the stockholders.

The Objectors argue that the proposed D&O Policy does not reasonably provide for the amounts that they may be entitled to under Delta Holdings' indemnification provision. They ask the Court to require an updated actuarial estimate of the IBNR claims and to require the Receiver to procure an insurance policy with enough coverage to protect against that estimate. They further ask that the stockholders be required to post a bond or irrevocable letter of credit in the amount of their distributions to pay for additional coverage if needed.[42]

II. ISSUES PRESENTED

The Objectors' briefs present two key questions. First, the Court must determine whether the indemnity claim of the Objectors is a present, contingent contractual claim or whether it is not a present claim, but one that may arise in the future. If the former, Delta Holdings must make reasonable provision for it regardless of how likely the claim is to vest. If the latter,

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to incur such fees to pursue settlement agreements in proceedings lodged against Delta Holdings.

[42] Mem. Of Law in Opp'n to Mot. to Distribute Assets 15.

Delta Holdings only must make reasonable provision for it if it is "likely" to arise.[43]

Since the Court finds that the Objectors' claim is a present, contingent contractual claim, it moves to the second key issue: the reasonableness of the provision that Delta Holdings has made for that claim—the D&O Policy. In assessing the reasonableness of the D&O Policy, the Court evaluates the probability of such a claim vesting. Specifically, the Court looks at whether the liquidation of Delta Re eliminated the threat of suit by ceding companies with unpaid IBNR claims and whether future claims against the Objectors would be barred by the statute of limitations.

III. ANALYSIS

A. The Potential Claims for Indemnification Are Present, Contingent Contractual Claims

Although the DGCL provides alternative schemes for dissolution, "Section 281(b) is a default provision that governs every corporation in dissolution that does not elect to pursue the elective procedure set forth in Sections 280 and 281(a)."[44] Delta Holdings did not elect to pursue the elective procedure. Thus, Section 281(b) governs. That section provides:

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[43] Of course, even if a present, contingent claim, likelihood of the claim vesting, as will be explained in further detail below, is to be taken into consideration in determining "reasonableness" of Delta Holdings' provision.

[44] *In re RegO Co.*, 623 A.2d at 97.

> (b) A dissolved corporation or successor entity which has not followed the procedures described in § 280 of this title shall, prior to the expiration of the period described in § 278 of this title, adopt a plan of distribution pursuant to which the dissolved corporation or successor entity (i) shall pay or make reasonable provision to pay all claims and obligations, including all contingent, conditional or unmatured contractual claims known to the corporation or such successor entity, (ii) shall make such provision as will be reasonably likely to be sufficient to provide compensation for any claim against the corporation which is the subject of a pending action, suit or proceeding to which the corporation is a party and (iii) shall make such provision as will be reasonably likely to be sufficient to provide compensation for claims that have not been made known to the corporation or that have not arisen but that, based on facts known to the corporation or successor entity, are likely to arise or to become known to the corporation or successor entity within 10 years after the date of dissolution.[45]

After making such provision (as required by the statute), the remaining assets are to be "distributed to the stockholders of the dissolved corporation."[46]

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[45] 8 *Del. C.* § 281(b).

[46] *Id.* As former-Chancellor Allen noted, directors of a dissolved corporation, which has not complied with this Section by not making reasonable provisions, may be personally liable to corporate creditors. *In re RegO Co.*, 623 A.2d at 97. Thus, the statutory scheme allows for the alternative dissolution procedure, set out in 8 *Del. C.* §§ 281(a) and 280. The alternative procedure allows for *ex ante* judicial determination as to whether the reasonableness standard is met.

Because Delta Holdings did not elect the alternate procedure set out in Sections 281(a) and 280, the statute itself does not provide for *ex ante* Court approval. However, the Court Order appointing the Receiver, except in limited circumstances, limited the Receiver from making distributions of Delta Holdings' assets without Court permission. *See* Order Appointing Receiver ¶ I (submitted as Exhibit A to Receiver's Mot.). The Court will not grant such distributions unless Delta Holdings is in compliance with the

Section 281(b), then, requires reasonable provision be made for three types of claims before assets may be distributed to stockholders. The first form of claim is a present claim, *including* contingent contractual claims. The second is for claims against the corporation that are the subject of pending proceedings. Finally, the corporation must make reasonable provision for claims that have not arisen, but "*are likely to arise* . . . within 10 years after the date of dissolution."[47]

The first and third forms of claims present an interesting comparison: present but contingent claims, and claims not present, but likely to arise. All present claims, regardless of whether they are contingent, must be reasonably provided for, but only those nonpresent claims that are *likely* to arise must be reasonably provided for.

In the context of this case, the Receiver argues that even if the Objectors' indemnification rights may be triggered based on IBNR claims, such a scenario is *unlikely*. Thus, he argues, because the indemnification rights are not present *and* not likely to arise, no provision must be made for them, and the D&O Policy was procured not out of legal duty, but out of an overabundance of caution. In contrast, the Objectors argue that their

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DGCL. Thus, the Court's *ex ante* review of the reasonableness of Delta Holdings' provisions is premised not on the DGCL itself, but on the Court Order.

[47] 8 *Del. C.* § 281(b)(iii) (emphasis added).

indemnification rights are present and contingent only on an underlying proceeding triggering those rights; and, therefore, consideration of the likelihood of an underlying proceeding is only appropriate in determining the reasonableness of the provision.

Indemnification rights (including the right to advancement) that are contained in a mandatory, expansive indemnification provision, are present contractual rights, contingent only on meeting the requirements of Section 145.[48] Claims arising under the express terms of a certificate of incorporation are contract-based claims.[49] Here, the certificate of incorporation contained an indemnification provision. The indemnification provision, in a nutshell, says that if certain events occur, the corporation *shall* provide funds to those covered under the provision. This is the very

[48] For general indemnification, these requirements include: (1) a threatened, pending or completed action, suit or proceeding; (2) to which the party seeking indemnification is a party by reason of the fact of, in this case, his position as a former director or officer of Delta Re; and that (3) the party seeking indemnity acted "in good faith and in a manner which [he] reasonably believed to be in or not opposed to the best interests of the corporation." 8 *Del. C.* § 145(a). For advancement of funds, a determination as to the third requirement is made in an *ex post* indemnification proceeding. Parties seeking advancement, however, may be required to provide an unsecured undertaking. *See* 8 *Del. C.* § 145(e).

[49] *See In re Aquila, Inc. S'holders Litig.*, 805 A.2d 184, 192 (Del. Ch. 2002) (describing a plaintiff's certificate-of-incorporation-based claim as a contract-based claim); *see also Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 559 (Del. 2002) ("[I]ndemnification is a right conferred by contract, under statutory auspice . . . .").

definition of a contingent claim, which is "[a] claim that has not yet accrued and is dependent on some future event that may never happen."[50]

On the contrary, claims that are not present but may arise go beyond contractual claims. These include tort claims based on injuries by "defective products or by undiscoverable and actionable environmental injury."[51] Admittedly, these are the very claims that underlie the need for INBR loss reserves. But the claims underlying the need for INBR loss reserves are not those that, at this initial Section 281(b) claim-defining stage, concern the Court. Rather, it is the nature of the former directors' and officers' indemnification claims that are initially at issue before the Court and the Court concludes that these claims were present (albeit contingent) from the time the Objectors took their positions at Delta Re.

Having made this determination, I now turn to whether Delta Holdings has met the requirements of 8 *Del. C.* § 281(b)(i).

B. Reasonableness of Delta Holdings' Proposed D&O Policy

Holding that indemnification rights of former officers and directors fall within subparagraph (i), as opposed to subparagraph (iii) of Section 281(b), however, does not mean that the corporation should not take into account the likelihood of a triggering event in determining what is a

[50] BLACK'S LAW DICTIONARY 241 (7th ed. 1999).
[51] *In re RegO Co.*, 623 A.2d at 96.

reasonable provision. Indeed, one could foresee many cases where the likelihood of a triggering event at the time of distribution approaches zero, leading to the logical conclusion that *no* provision for future indemnification claims is reasonable.[52]

In determining the reasonableness of the Receiver's proposed D&O Policy, the Court follows the teachings of *Boesky v. CX Partners, L.P.*:[53]

> [A] liquidating trustee's judgment as to what constitutes adequate security, even when made in good faith and advisedly, is not entitled to the powerful effects of the business judgment rule; . . . in such a setting, it is inescapably the function of the court that supervises the liquidation to make an independent judgment of the adequacy of such security when it is challenged.[54]

The Court, in reviewing the proposed D&O Policy, will take into account the likelihood of the contractual indemnification claim vesting, the likely value of that claim, and the financial condition of the distributing company.[55] The likelihood of the indemnification claim vesting rests

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[52] Thus, the Receiver's reasoning that because claims under indemnification provisions fall under Section 281(b)(i), as opposed to 281(b)(iii), "no Delaware corporation could be liquidated because of its present and former directors and officers' 'indemnification rights,'" is incorrect.

[53] 1988 WL 42250 (Del. Ch. Apr. 28, 1988).

[54] *Id.* at *16. Although *Boesky* involved a proposed partial liquidating distribution of a limited partnership, former-Chancellor Allen discussed this standard in light of the 1987 amendments to the DGCL, which began crafting the dissolution provisions as they exist today. The same considerations guiding the Court in that decision—the protection of creditors in the end-game of an entity's existence—guide the Court here. Moreover, the *Boesky* statement comports with the form of review former-Chancellor Allen performed in *In re RegO*.

[55] The Court also notes the following passage from *Boesky*:

(assuming the other requirements of the Section 145 are met) entirely on the likelihood of a triggering event—the commencement of a proceeding against one of the Objectors by reason of the fact of their position at Delta Re.[56]

The Objectors seem to take the position that they would somehow be personally liable for the obligations of Delta Re under its insurance policies under a common law indemnification theory. I cannot see how this would be possible.[57] As directors and officers of a reinsurer, it is unlikely they would be personally liable for the obligations of that reinsurer based on

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> When claims are contingent, such a judgment will inevitably present a task that requires much thought. Obviously, the most conservative technique in that regard would be to set aside the full amount of the claim, at least assuming that it appears to be a litigable claim. To discount the claim by a probability of its success and to reserve only the discounted value might work in the rare instance in which there were a sufficiently large number of similar claims so that statistical techniques might apply. Where, however, there are few claims or each is quite different, such a technique obviously raises a danger to those who ultimately do prove a contested claim.

1988 WL 42250, at *16. The Court in *Boesky*, however, was not considering contingent Section 145-based indemnification claims. Such indemnification claims are unique in that while present and contingent, events triggering them often are of the form of claims limited by the "likely to arise" standard of future, yet unknown tort claims. To address this apparent incongruity, the Court must discount the amount required to reasonably provide for contingent indemnification claims by the likelihood of such underlying claims arising.

[56] For advancement claims, this statement holds stronger because funds are advanced *subject* to a later determination of ultimate entitlement to indemnification.

[57] Although, for purposes of determining "reasonable provision," I must make judgments as to the probability of success of potential triggering proceedings, I do so without the benefit of full briefing as to those proceedings from any potential interested parties to potential proceedings. Thus, discussion of the likelihood of success of these proceedings should not be taken to have any weight in potential subsequent proceedings.

treaties to which they are nonsignatories.[58] Moreover, although the Creditors Dividend Plan did not explicitly state that any IBNR claims would formally terminate, the Liquidation Order stated, "all outstanding policy and other insurance obligations of Delta Re terminate and all liability thereunder [will] cease."[59] It is difficult to view the Plan, simply by not making payments for the IBNR claims, to somehow change what seems obvious under the Liquidation Order: that no liability under Delta Re's insurance contracts survived liquidation.

The Objectors next contend that to the extent IBNR claimants find no relief under contract law, they are apt to commence proceedings against the Objectors based on tort theory (*e.g.*, fraud in the inducement; negligent misrepresentation). The Objectors present several facts in support of this notion. First, they cite the Tillinghast Report to show that as of December 31, 1998, there were approximately $59 million in IBNR claims for the 1984 underwriting year, which, according to the Report, will gradually mature into due and owing claims through at least 2021.[60] In addition, they argue that the concentrated nature of the IBNR claims, in the hands of only a few

[58] "This Court has recognized the '*general principle of contract law* that only a party to a contract may be sued for breach of that contract.'" *Izquierdo v. Sills*, C.A. No. 15505, Slip. Op. at 16 (Del. Ch. June 29, 2004) (quoting *Wallace v. Wood*, 752 A.2d 1175, 1180 (Del. Ch. 1999)) (emphasis added).
[59] Liquidation Order ¶ 11.
[60] Selznick Aff. ¶ 17. According to a deposition of the actuary who prepared the Report, the last such payment would occur in 2049. *Id.* Ex. 12.

number of firms, would eliminate economic constraints to litigation. The Objectors note that twenty ceding companies account for approximately 70% of the IBNR claims and that ten firms account for over 50% of those claims.[61] Finally, the Objectors point to the 1990 Suit discussed above as an illustration of the potential form of lawsuit against them.

The Receiver argues, however, that the Liquidation Order gave the Liquidator exclusive standing to bring suit against the Objectors. It points to language from *Corcoran v. Hall*,[62] a New York case,[63] which provides, "[p]ublic policy and judicial economy are considerations which also impel the conclusion that the [Liquidator] have such exclusive standing to assert claims on behalf of not only [the liquidating insurer], but also its policyholders and creditors."[64] That court went on to say, however, that any tort claims that at the time of liquidation would interfere with the liquidator's duties would only be stayed pending the end of the liquidator's work.[65] It appears then, that the independent claims of creditors against the Objectors in their individual capacity would survive the Liquidation.

The Receiver next argues that any such tort claim would be barred by other states' relevant statutes of limitations. He argues that such a claim

[61] *Id.* ¶ 15 & Ex. 14.
[62] 545 N.Y.S.2d 278 (N.Y. App. Div. 1989).
[63] New York liquidation statutes are similar to those of Kentucky.
[64] *Corcoran*, 545 N.Y.S.2d at 282.
[65] *Id.* at 285.

would accrue at the time of the wrongful act—for tort purposes, 1984—and that the Liquidation Order would not have tolled any statute of limitations. The Objectors assert that such a claim *would be tolled* by the Liquidation Orders permanently enjoining suits by creditors that would interfere with the conduct of litigation.[66]

As former-Chancellor Allen held in *RegO*,

> Where as here the corporation has reason to know that claims will arise but cannot know the jurisdictions in which such claims may arise and thus cannot know what statute of limitations will apply to the claims or when, under applicable law that statute may be tolled, the limitation provision of Section 280(c), in effect, provides no limitation for planning . . . purposes.[67]

Although discussing statutes of limitations in the context of claims "reasonably likely to arise," the reasoning in *RegO* applies with equal effect here. The triggering events that would cause the Objectors' contingent claim to vest—and that are the object of the Court's current scrutiny—are the types of claims contemplated by the statement above.

The Receiver has not provided the Court with a list of jurisdictions in which such tort actions may arise, those jurisdictions' statutes of limitations, or applicable tolling principles. The Receiver cannot be said, then, to meet

[66] The Receiver argues such a claim against the Objectors would not be tolled because it would not violate an injunction preventing suits brought against Delta Re. It is unclear, however, how certain jurisdictions would view the injunction's prohibition of suits interfering with the Liquidator's work.
[67] *In re RegO Co.*, 623 A.2d at 102 n. 27.

his burden, as the party seeking to make the distribution,[68] of convincing the Court that the proposed D&O Policy is sufficient to comply with DGCL Section 281(b)(i).

That said, the Court once again returns to the "reasonableness" standard of DGCL Section 281(b)(i). The Objectors retain no contract-based liability arising from their status as former directors and officers of Delta Re that would trigger the indemnification claim. Moreover, although the Receiver has not convinced the Court of the impossibility of a successful tort-based claim, the Court nonetheless believes that the probability of such a suit surviving any jurisdiction's statute of limitations is quite low. To the extent that the Objectors would be found liable for tortious conduct, they would then have to persuade the Court that despite engaging in such tortious conduct, they were acting "in good faith and in a manner which [they] reasonably believed to be in or not opposed to the best interests of" Delta Re[69] in order to have entitlement to indemnification for such amounts (or to keep funds advanced to them). The Court, then, does not believe that setting aside enough money to cover the value of all potential IBNR claims is

[68] *Cf. Boesky*, 1988 WL 42250, at *17 ("[W]here a liquidating trustee elects to distribute assets to partners in respect of the partnership interest before either all creditors have been paid, or actually funded . . . and segregated reserves for their claims have been established, it is the burden of such liquidating agency to persuade a court that adequate security for the payment of such claims has been provided.").
[69] 8 *Del C.* § 145(a).

required to meet Section 281(b)(i)'s reasonableness standard.[70] As such, the Court also does not believe that stockholders to whom such distributions would be made need post any bond to provide for additional coverage.

The Tillinghast Report, however, *does* estimate that IBNR claims may arise many decades from now. Those claims may cause some ceding companies to attempt individual tort suits against the Objectors in the same form as the 1990 Suit and the Receiver has failed to show adequately that these suits would have no merit. The Objectors would endure *some* expense in defending these suits, even if not likely proceeding beyond the pleadings stage. Thus, some form of insurance policy must be procured. The Court, then, must evaluate the proposed D&O Policy with this prospect in mind.

The proposed D&O Policy extends $1 million in coverage for a period of 6 years. Its $81,000 premium is .76% of Delta Holdings' gross assets and .85% of its net liquid assets. An alternative policy, which would increase coverage to $5 million and extend the term to 20 years, would have cost $200,500. That is 1.9% of gross assets and 2.1% of net liquid assets. Given the availability of this alternative policy, which would satisfy the

[70] Moreover, the only claims that appear viable against the Objectors are tort-based claims. Damages that may be awarded in tort (including punitive damages) would be based on alleged misconduct of the Objectors, and not necessarily on the value associated with the contract-based IBNR claims. This cuts against the notion of tying reasonableness of provision to potential IBNR claims based on policies and/or treaties entered into by Delta Re.

Court's concerns, and the fact that such a policy would amount to a negligible percentage of the corporation's assets, and in light of evidence presented to the Court of the potential for at least defending suits in the distant future, I cannot agree that the Receiver's proposed plan complies with the provisions of DGCL Section 281(b)(i).

For the foregoing reasons, the Receiver's motion is denied. The Receiver shall procure a suitable D&O Policy, which would account for the necessity to defend against such suits for a number of years. The coverage limit of such policy need not reach the potential value of IBNR claims.

IT IS SO ORDERED.