Alert

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COZEN O'CONNOR

Delaware Supreme Court Rejects Fundamentally Identical Relatedness Standard

On March 16, 2022, in a unanimous decision the Delaware Supreme Court affirmed a Superior Court ruling that a securities class action and a later-filed opt out action were related claims, and thus the subsequent action was excluded from coverage under later-issued policies. *First Solar, Inc. v. Natl. Union Fire Ins. Co.*, C.A. No. 217, 2021 (Del. Mar. 16, 2022). In doing so, the Delaware Supreme Court rejected the "fundamentally identical" relatedness standard applied by the lower court and applied the relatedness standard defined by the plain meaning of the policies.

Discussion

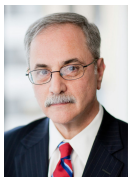
The insured, First Solar, manufactured solar panels and sold photovoltaic power plants. In March of 2012, First Solar was sued in a securities class action alleging that the company violated federal securities laws by making false or misleading public disclosures (the *Smilovits* action). Among other things, the *Smilovits* plaintiffs alleged that from April 30, 2008, to February 28, 2012, First Solar misrepresented that it "had a winning formula for reducing manufacturing costs so rapidly and dramatically as to make solar power competitive with fossil fuels," concealed and misrepresented certain manufacturing and design defects, and artificially inflated its stock price. First Solar's insurer provided a defense for the *Smilovits* action under a 201l-2012 claims made D&O policy.

On June 23, 2015, while the *Smilovits* action was pending, certain First Solar stockholders who opted out of the *Smilovits* action filed a second securities class action, referred to as the *Maverick* action. The *Maverick* action alleged violations of the same federal securities laws as the *Smilovits* action, as well as violations of Arizona statutes and claims for fraud and negligent misrepresentation. Among other things, the *Maverick* plaintiffs alleged that from May 2011 to December 2011, First Solar "misrepresented how close it was to achieving grid parity — 'the point at which solar electricity became cost competitive with conventional methods of producing electricity without government subsides,'" concealed certain defects in its panels and manufacturing process, falsely represented that it was on track to meet its financial targets, and artificially inflated its stock price.

When the *Maverick* action was filed in 2015, First Solar had a $20 million D&O insurance program for the 2014-2015 policy period. The '14-'15 policies provided, in relevant part, that "[a]ny Related Claim that is subsequently made against an Insured and that is reported to the Insurer shall be deemed to have been first made at the time that such previously reported Claim was first made. … Claims actually first made or deemed first made prior to the inception date of this policy … are not covered under this policy." The '14-'15 policies defined a related claim as "a claim alleging, arising out of, based upon or attributable to any facts or Wrongful Acts that are the same as or related to those that were … alleged in a Claim made against an Insured."

First Solar originally obtained defense coverage for the *Maverick* action under its '11-'12 polices. First Solar, however, exhausted its '11-'12 policies in connection with defense and settlement of the *Smilovits* action, which settled in January 2020 for $350 million. First Solar then settled the *Maverick* action for $19 million, and sought coverage from its '14-'15 insurers for that amount. The '14-'15 insurers denied coverage, and First Solar filed suit.

The Superior Court held that the *Smilovits* and *Maverick* actions were related claims (and thus barred under the '14-'15 policies), but did so by applying the "fundamentally identical" standard. In connection with that standard, the court noted that a complaint is "related to" or "arises out of" a previous complaint if the claims are "fundamentally identical," which requires that the actions involve the "same subject" and "common facts, circumstances, transactions, events, and



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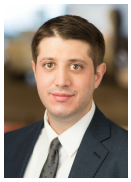

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decisions." Among other aspects, the Superior Court found that the lawsuits stemmed from the same original suit, were against identical defendants, overlapped in time, and contained allegations of the same securities law violations, and relied on the same specific disclosures. While there were some differences, including the theory of damages claimed by the *Maverick* plaintiffs, the court held that the differences did not outweigh the similarities. Accordingly, the *Maverick* action was fundamentally identical to the *Smilovits* action, and was excluded as a related claim under the '14-'15 policies.

The Delaware Supreme Court affirmed the Superior's Court's holding, but rejected the application of the "fundamentally identical" relatedness standard. The court instead held that the relatedness standard provided in the policy language controlled, and under that language as well, the lawsuits were related claims.

As to the proper relatedness standard, the Delaware Supreme Court agreed with the insurers that the Superior Court's use of the "fundamentally identical" standard disregards the plain language of the policies and was an error. The Supreme Court traced the error to "a misunderstanding" of Superior Court precedent in connection with relatedness language. Additionally, the court held that "[w]hether a claim relates back to an earlier claim is decided by the language of the policy, not a generic 'fundamentally identical' standard."

Thus, the proper relatedness standard was the one provided for in the '14-'15 policies. The question then was whether the *Maverick* action raises claims that "aris[e] out of, [are] based upon or attributable to any facts or Wrongful Acts that are the same as or related to" the *Smilovits* action. The court found that this standard was met as both actions were based on the same alleged misconduct — First Solar's misrepresentations about the cost-per-watt of its solar power. The court supported its conclusion further by a side-by-side comparison of the allegations in the two complaints. Accordingly, there was no coverage for the *Maverick* action under the '14-'15 policies.

In its appellate filings, First Solar cited several purported differences in support of its claim that the *Smilovits* action and the *Maverick* action were distinct, including that the actions sought different types of damages. The Delaware Supreme Court disagreed and found that the differences were not meaningful to the relatedness inquiry because "absolute identity is not required." The court highlighted that both actions alleged violations of the same federal securities laws in connection with First Solar's misrepresentations about the cost of solar power as part of a fraudulent scheme to increase stock prices. Finally, the court cited to prior statements made by First Solar when it was seeking to transfer both the *Smilovits* action and the *Maverick* action to the same judge. In that context, First Solar itself noted that the "substantial overlap in legal and factual issues and the substantial overlap in parties weigh in favor of" transferring both actions to the same court.

Analysis

The Delaware Supreme Court's holding in *First Solar* should be the death knell of the "fundamentally identical" standard under Delaware law. Additionally, the holding provides support for the primacy of policy language in general in connection with the interpretation of insurance policies. The foundation of the court's holding was that the scope of coverage is prescribed by the language of the policy. As also noted by the court, absent any ambiguity, the plain, ordinary meaning of the policy controls.

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