M&A Rulings Provide Guidance On 'Bump-Up' Claim Coverage

By **Robin Cohen and Orrie Levy** (November 18, 2021)

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M&A activity has surged in 2021, totaling an unprecedented $4.3 trillion in activity in the first nine months of the year.[1] Some estimates suggest that total M&A activity could hit a record $6 trillion by the end of this year.[2]

This uptick in M&A activity is likely to be followed by an increase in litigation, such as shareholder derivative lawsuits, appraisal actions, class actions and lawsuits asserting violations of securities laws.

It is therefore critical that companies assess whether their insurance programs are structured to appropriately cover losses arising from M&A transactions. Specifically, many insurance policies include a so-called bump-up exclusion, which insurers have cited as a basis to deny coverage for claims in the M&A space.

Although the language of bump-up exclusions varies from policy to policy, one such illustrative exclusion reads as follows:

> In the event of a Claim alleging that the price or consideration paid or proposed to be paid for the acquisition or completion of the acquisition of all or substantially all the ownership interest in or assets of an entity is inadequate, Loss with respect to such Claim shall not include any amount of any judgment or settlement representing the amount by which such price or consideration is effectively increased; provided, however, that this paragraph shall not apply to Defense Costs or to any Non-Indemnifiable Loss in connection therewith.

Insurers have recently argued that this exclusion generally bars coverage whenever a policyholder pays a settlement or judgment that amounts to an increase in consideration to the shareholders of a company following an M&A transaction.

Insurers have argued that this exclusion bars coverage irrespective of whether: the underlying transaction is a merger or an acquisition, the policyholder is an acquiring entity or the entity being acquired, or the shareholder's theory of damages actually sought an increase in consideration for its shares.

Therefore, as interpreted by numerous insurers, this exclusion would bar coverage for losses arising from a wide swath of M&A transactions. This would likely come as a surprise to many companies, who reasonably believe that their insurance programs cover losses arising from M&A-related litigation. This also creates uncertainty in connection with a company's risk assessment of a particular M&A transaction.

Recent cases have helped inform the scope of this exclusion and offer guidance as to certain themes and considerations that make the exclusion more or less likely to apply. Companies should carefully consider their particular policy language and the nature of the M&A transactions they are engaged in or are contemplating in the context of these themes.

The Bump-Up Cases

In four recent cases, judges from Virginia, California, Delaware and Wisconsin have grappled with the scope and applicability of bump-up exclusions in a range of transactions. These cases offer critical insight to companies assessing the likelihood of coverage in the event that a contemplated M&A transaction results in litigation. In the first two, the courts found that a bump-up exclusion did not bar coverage. In the latter two, the courts found that a bump-up exclusion did bar coverage.

Towers Watson

The case of Towers Watson & Co. v. National Union Fire Insurance Co. of Pittsburgh PA[3] decided on Oct. 5 by the U.S. District Court for the Eastern District of Virginia was a coverage dispute regarding a policyholder's settlement of two underlying litigations — an action alleging violations of proxy solicitation rules under Sections 14(a) and 20(a) of the Securities Exchange Act, and a consolidated shareholders' derivative action alleging breaches of fiduciary duty.

These actions arose from a 2015 merger between Towers Watson and Willis and alleged omissions in the proxy materials relating to that merger. The insurers denied coverage based on a bump-up exclusion. The court found that the exclusion did not bar coverage for the settlement, in part, on the ground that the exclusion only applies to traditional takeovers, rather than mergers.

Northrop Grumman

In the case of Northrop Grumman Innovation Systems Inc. v. Zurich America Insurance Co., decided on Feb. 2, the Chancery Court of Delaware considered whether a bump-up exclusion barred coverage for the settlement of a class action alleging violations of Section 14(a) of the Securities Exchange Act following a reverse triangular merger between Alliant Techsystems Inc. and Orbital Sciences Corp., resulting in the creation of a new entity.[4]

In finding that the exclusion did not bar coverage, the court held that the exclusion only applied to a particular type of transaction — "an acquisition of all or substantially all of an entity's assets or ownership" and that "an 'acquisition' in the corporate transactions context means a 'takeover of one corporation by another if both parties retain their legal existence after the transaction.'"[5]

The transaction in the Northrop action, however, was a reverse triangular merger, which the court held was distinct from an acquisition or takeover under Delaware law. The court further found that the settlement did not reflect an increase in consideration because the shareholders sought compensatory damages for allegedly overvalued stock "extracted through falsified proxy forms to effectively decrease what they 'paid.'"[6]

Onyx Pharmaceuticals

The case of Onyx Pharmaceuticals Inc. v. Old Republic Insurance Co., decided by the California Superior Court on Oct. 1, 2020, involved coverage for a settlement of a class action brought against Onyx and certain members of its board of directors by shareholders of Onyx.[7]

These shareholders alleged that they received inadequate consideration for their shares when Onyx was acquired by Amgen Inc. Onyx's insurers denied coverage, asserting that a bump-up exclusion barred coverage.

The court agreed, finding that the acquisition at issue — which involved the acquisition of 100% of the ownership interest in Onyx by Amgen — fell into the terms of the exclusion.

Joy Global

The case of Joy Global Inc. v. Columbia Casualty Co., decided by the U.S. District Court for the Eastern District of Wisconsin on Aug. 18, involved coverage for the settlement of lawsuits brought by shareholders of Joy Global against Joy Global and its directors and officers.[8]

Those lawsuits asserted false or misleading statements in proxy materials in a transaction whereby Joy Global was acquired by Komatsu. Joy Global's insurers denied coverage based on a bump-up exclusion.

In finding that the exclusion applied the court noted, among other things, that unlike the policyholder in Northrop, Joy Global was acquired by — not merged into — Komatsu America Corp.

The court further found that the policy language at issue was distinguishable from that in the Northrop action in that the exclusion in the Northrop action "applied only to that part of a settlement of an Inadequate Consideration Claim 'representing the amount by which such price is effectively increased.'"[9] That limiting language did not appear in the Joy Global policy.

Themes and Considerations

These cases, taken together, reflect several critical themes and considerations for companies assessing the availability of insurance coverage for claims involving M&A transactions.

First, the particular language of a bump-up exclusion in an insurance policy is critical.

For example, the exclusion in the Northrop action only applied to a claim representing an increase in consideration, whereas the exclusion in the Joy Global action did not have this limitation. This distinction was one reason why these cases reached different results as to coverage.

Similarly, the court in the Onyx action described different variations of bump-up exclusions available in the insurance marketplace, noting that certain of these exclusions are broader than others. Thus, these cases reinforce that companies considering M&A transactions should pay close attention to the precise language of any bump-up exclusion in their insurance program and confirm that the scope of the exclusion aligns with the company's potential risks, the nature of the transactions it is contemplating, and the likely form of any litigation challenging any such transaction.

Second, these cases reflect that, as a general proposition, a claim arising from a transaction structured as a traditional takeover or asset-acquisition is more likely to implicate a bump-up exclusion.

This is evidenced by the Onyx action and the Joy Global action, both of which found that coverage was barred by a bump-up exclusion in the context of an acquisition by one company of another.

In contrast, a claim arising from a transaction structured as a merger is less likely to be barred by a bump-up exclusion. This is reflected in the Northrop action and Towers Watson action, both of which found that a bump-up exclusion did not apply, in part, because the transaction at issue was a merger, rather than a traditional acquisition or takeover.

Third, these cases reflect that the nature of damages sought in a litigation arising from an M&A transaction can affect the applicability of the exclusion.

For example, in the Northrop action, the exclusion only applied to losses representing an effective increase in consideration. The theory of damages asserted in that case, however, was akin to bump-down damages.

A shareholder's theory of damages, of course, is related to the nature of the underlying transaction. Therefore, the more likely a transaction is to yield a claim by a shareholder that it is entitled to an increase in consideration for its shares as the basis for its damages claim, the more likely it is that a bump-up exclusion may apply.

Conclusion

Both M&A transactions and bump-up exclusions come in many forms. Further, bump-up exclusions often include numerous elements, all of which must be satisfied for the exclusion to apply. Therefore, whether a claim involving a particular M&A transaction will be covered requires a careful assessment of, among other things, the exclusionary language at issue, the particular type of transaction at issue, and the nature of the claim against the policyholder.

The above cases provide helpful insights into these variables and the availability of coverage for particular types of M&A transactions. These cases should therefore guide companies both in terms of structuring their insurance programs and in assessing the risk of whether a claim arising from a particular type of transaction may be covered by insurance.

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Disclosure: The authors represent the plaintiff in Towers Watson & Co. v. National Union Fire Insurance Co.

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[1] https://www.reuters.com/business/finance/pandemic-recovery-fuels-deal-craze-third-quarter-ma-breaks-all-records-2021-09-30/.

[2] https://www.cnbc.com/2021/10/12/kpmg-on-global-ma-market-hitting-record-6-trillion-in-2021.html.

[3] Towers Watson & Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA , No. 120CV810AJTJFA, 2021 WL 4555188 (E.D. Va. Oct. 5, 2021).

[4] Northrop Grumman Innovation Sys. v. Zurich Am. Ins. Co. , No. N18C-09-210, 2021 Del. Super. LEXIS 92 (Super. Ct. Feb. 2, 2021).

[5] Id.

[6] Id.

[7] Onyx Pharmaceuticals Inc. v. Old Republic Insurance Co., No. CIV 538248, 2020 WL 9889619, at *1 (Cal.Super. Oct. 01, 2020).

[8] Joy Global Inc. v. Columbia Casualty Co. , No. 2:18-CV-02034, 2021 WL 3667077, at *1 (E.D. Wis. Aug. 18, 2021).

[9] Id.