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Will A Bump-Up Exclusion Bar Coverage of an M&A Settlement? It Depends.

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Public company insurance policyholders beware: In recent years, insurance carriers have increasingly invoked the "bump-up" exclusion, which is a carve out provision typically found in directors and officers (D&O) insurance policies. In many public company M&A deals, the shareholders of the target or acquired company will file a lawsuit challenging the deal, generally alleging that the board violated its fiduciary duties or the law by selling the company for a below-market price. Enter the bump-up exclusion, which bars coverage for settlements (or judgments) in M&A litigation that, in effect, bump up the consideration paid to the shareholders of the target company in the underlying deal. In other words, if settlement of the M&A claim would result in the acquired company's shareholders receiving more value for the sale of the company, then the settlement will not be covered by the D&O policy.

Industry observers have noted that, as public company M&A deal litigation has accelerated, D&O insurers are relying on the bump-up exclusion more frequently and applying it more broadly to exclude coverage. Historically, insurers used the bump-up exclusion to prevent buy-side insureds from colluding with a target company's board to acquire the company for less than market value, then turning to their insurers to fill the gap after the target company shareholders inevitably sue for the shortfall. Now, insurers are drafting and enforcing bump-up exclusions to bar coverage even when it is the sell-side insured or acquisition target who is seeking coverage.

Whether a bump-up exclusion in a D&O insurance policy applies to a particular settlement depends on the wording of the exclusion, the structure of the underlying deal, and the law of the jurisdiction applicable to the insurance contract. Four recent cases illustrate this variability – and underscore the importance of public companies reviewing their D&O policies to ensure sufficient coverage in the event of post-close merger litigation.

Recent cases examining bump-up exclusions

Towers Watson

In March 2024, in ***Towers Watson & Company v. National Union Fire Insurance Company of Pittsburgh***, the US District Court for the Eastern District of Virginia (on **remand from the US Court of Appeals for the Fourth Circuit**) applied Virginia law and determined that the bump-up exclusion **did apply** to the settlement of a post-close lawsuit. The bump-up exclusion at issue stated:

> In the event of a Claim alleging that the price or consideration paid for the acquisition or completion of the acquisition of all or substantially all the ownership interest or assets in 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 is effectively increased.

Previously, the district court had ruled that the language of the bump-up exclusion was ambiguous and did not bar coverage because the underlying deal involved a merger of equals – i.e., it was not an "acquisition" as that term is understood under Delaware law. The Fourth Circuit reversed and remanded the case back to the district court for further proceedings, emphasizing the need to focus on the "plain meaning" of the exclusion and noting that it would not apply only when its plain meaning lent itself to an "equally possible" interpretation precluding the exclusion's applicability. The Fourth Circuit noted that the term "acquisition" was not defined in the policy and nothing in the exclusion hinted that "acquisition" was intended to refer only to a takeover acquisition under Delaware law.

On remand, the district court addressed three questions concerning the applicability of the bump-up exclusion:

1. Whether the underlying actions alleged inadequate consideration.

2. Whether Towers Watson is “an entity” under the policy whose acquisition is covered by the exclusion.
3. Whether the settlements represent an effective increase in consideration for the merger.

The district court concluded that the answer to the first question was yes, given that allegations of inadequate consideration were the basis for the harm alleged in the applicable complaints. The district next concluded that that Towers Watson is “an entity” for purposes of the exclusion’s applicability, based on the “ordinary and customary meaning” of the term and because elsewhere in the policy, where Towers Watson was meant to be excluded from the term “entity,” the policy so specified. Finally, the district court also answered the third question in the affirmative, concluding that “after giving all the words in the Exclusion their reasonable and ordinary meaning,” “the Settlements ‘represent’ amounts that ‘effectively increased’ the consideration for the merger, such that the Exclusion unambiguously applies to the Settlement.”

Northrop Grumman

In ***Northrop Grumman Innovation Systems, Inc. v. Zurich American Insurance Company***, a 2021 case before the Delaware Superior Court, the court determined that the bump-up exclusion did not apply to the settlement of a post-close lawsuit because, under Delaware contract law, the underlying transaction did not qualify as an “acquisition” that would be excluded from coverage pursuant to the terms of the carveout. In *Northrop Grumman*, the bump-exclusion provided:

> In the event of a Claim alleging that the price or consideration paid for the acquisition or completion of the acquisition of all or substantially all the ownership interest or assets in 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 is effectively increased.

Because the provision was an exclusion in an insurance contract, Delaware law required the court to interpret the provision “narrowly and strictly.” Using this lens, the court granted the insured’s motion for summary judgment, concluding that the language of the bump-up exclusion limited it to transactions that that can “only” be called “acquisitions,” which “in the corporate transactions context” means “a takeover of one corporation by another if both parties retain their legal existence after the transaction.” Accordingly, the bump-up exclusion did not apply to the settlement of the post-close lawsuit because the underlying transaction was a merger of equals, as opposed to one company acquiring the other, and once the transaction closed, the separate legal existence of the two companies ceased.

Joy Global

In ***Joy Global Inc. v. Columbia Casualty Company***, another case from 2021, the US District Court for the Eastern District of Wisconsin determined that the bump-up exclusion **did apply** to a settlement because:

1. The central claim in the underlying litigation was that Joy Global’s shareholders received inadequate consideration for the sale of the company.
2. The language of the exclusion was “unambiguous” and applied to the settlement of any claim alleging that the consideration paid for the acquisition of Joy Global was inadequate.

Specifically, the bump-up exclusion carved out from the definition of covered “Loss . . . any amount of any judgment or settlement of any Inadequate Consideration Claim,” which in turn was defined as “that part of any 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 of the ownership interest in or assets of an entity is inadequate.”

Applying Wisconsin law, the district court granted the insurance carrier’s motion for summary judgment. The district court noted that the complaint before it alleged that Joy Global issued a false or misleading proxy report for the purpose of inducing shareholders to vote in support of a merger agreement which secured inadequate consideration for Joy Global’s shares. Accordingly, under the clear and unambiguous terms of the bump-up exclusion, the settlement was excluded from coverage.

On appeal, **the US Court of Appeals for the Seventh Circuit affirmed**. In an opinion written by Judge Frank Easterbrook, the court declined to follow *Northrop Grumman*, which it distinguished, pointing out differences in the policy language:

> What's more, the language of the exclusion in *Northrop Grumman* differs from the definition of "inadequate consideration claim" in Joy Global's policies. Komatsu Mining wants us to proceed as if all D&O policies contain the same language, but they don't, so we shouldn't.

Viacom

In 2023, in ***Viacom Inc. v. U.S. Specialty Insurance Company***, the Delaware Superior Court again applied Delaware law and held that the bump-up exclusion **did not apply** to the settlement of a post-close lawsuit because the underlying deal did not qualify as an "acquisition" under the terms of the exclusion. The bump-up exclusion at issue stated that covered "Loss" did not include:

> any amount representing the amount by which the price of or consideration paid or proposed to be paid for the acquisition or completion of the acquisition of all or substantially all of the ownership interest in, or assets of, an entity, including , was inadequate or effectively increased.

The court noted that the underlying transaction was an all-stock merger between Viacom and CBS, at the close of which CBS owned all of Viacom's assets, and Viacom shares were automatically converted into CBS common stock, with former Viacom shareholders owning approximately 39% of CBS outstanding common stock. After examining the bump-up exclusion, the court determined that it was ambiguous. While the merger qualified as an acquisition of Viacom by CBS under the ordinary dictionary definition of "acquisition," other provisions in the D&O policy distinguished between a "merger" and an "acquisition" and treated them as distinct types of transactions. Because the exclusion was ambiguous – and Delaware law required ambiguity to be resolved in favor of the insured – the court held that the bump-up provision did not apply to the settlement of the post-close litigation commenced by former Viacom shareholders.

Significance

Given the variability of these recent decisions, insurance counsel should carefully review D&O policies as they come up for renewal to ensure that clients will have sufficient coverage in the event of any post-close merger litigation. Going forward, and in light of this developing case law, we expect insurance carriers will include broad and effective bump-up exclusion provisions that will limit coverage of breach of fiduciary duty claims arising out of an M&A transaction. M&A practitioners also should carefully review their clients' D&O policies to appropriately counsel their clients on the likelihood that an M&A-related claim will not be covered.

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