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California Court Broadens a D&O Policy's Bump-Up Exclusion to Bump Out Coverage

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Recently, a California state court expanded a "bump up" exclusion in excess D&O policies to bar coverage for a settlement of a shareholder class action lawsuit against Onyx and its directors and officers. The shareholders alleged that the directors and officers failed to maximize a buyer's offer to purchase Onyx's shares. By upholding the denial of coverage for the $30 million settlement, the court broadened the bump-up exclusion far beyond its traditional limited and intended application to claims that an **acquirer** paid too little for a target. *Onyx Pharm., Inc. v. Old Republic Ins. Co.*, Case No. CIV 538248, slip op. at 2 (Cal. Super. Ct., Oct. 1, 2020).

This decision serves as a cautionary tale to corporate policyholders, particularly as it applies to coverage for M&A-related litigation. Indeed, the court acknowledged Onyx's "surprise" and "outrage[]" when the excess insurers denied coverage because Onyx "thought this was a 'securities case' under the Securities Claim coverage; and they thought that M&A was covered." However, the court found that Onyx was not adequately informed of "the distinctions between policy language and policy coverage available in the D&O liability insurance market – and of their options in that regard."

Thus, when it comes to D&O coverage, the devil is in the details of the policy language. Despite the limited intended reach of the bump-up exclusion, Onyx's policy did not have the narrowest language that is available in the D&O marketplace, which cost it substantially in the end. This decision reinforces the importance of policyholders working with coverage counsel to understand the "fine print" of policies and to secure language that clearly fulfills the parties' intent.

Background

The shareholder class action against Onyx's directors and officers arose out of an offer by Amgen to purchase Onyx, the named insured, for $125 per share. Onyx's directors and officers accepted that offer. Consequently, the shareholders alleged that the directors and officers breached their fiduciary duties by failing to secure an increased share purchase price because Onyx's market price was higher than Amgen's offer and another potential buyer had offered to pay more. Onyx ultimately settled the shareholder lawsuit for $30 million with a contribution from its primary insurer, National Union, which had acknowledged its coverage obligation and **did not** invoke the bump-up exclusion. Even so, three excess D&O insurers, whose policies followed form to the National Union policy and incorporated the same bump-up exclusion, denied coverage for the remaining settlement amount based on the exclusion.

The Intent of the Bump-Up Exclusion

The bump-up exclusion in the National Union and excess policies stated that "[i]n the event of a Claim alleging that the price or consideration paid … for the acquisition … of all or substantially all of the ownership interest in … an entity is inadequate, Loss … shall not include any amount … by which such price or consideration is effectively increased."

Onyx argued that the plain meaning of the exclusion is that the policy does not cover Onyx's increased consideration when **it** acquires "'an entity' [which] does not refer to Onyx itself." The excess insurers rebutted that "an entity" should include Onyx.

The purpose of bump-up exclusions is to exclude insured **acquirers** from intentionally

agreeing to pay too low of a price for a target and then, once becoming defendants in shareholder litigations, looking to their insurers to pay the court-ordered bump-up in consideration or the negotiated settlement amount. *See generally Gardner Denver, Inc. v. Arch Ins. Co*., 2016 WL 7324646, at *3-4 (E.D. Pa. 2016).

In fact, the National Union underwriter who drafted the bump-up exclusion at issue "testified that the [exclusion] was created back in the 1990's, and was designed to exclude **acquirer** bump-ups in the acquisition price, if **the insured** is the acquirer." The underwriter also confirmed that the term "entity" was intended "to exclude claims **by acquirers**," though he testified he "could have done a better job drafting this, in hindsight." As a result of the historical purpose of bump-up exclusions generally, and the intention behind National Union's exclusion specifically, the underwriter also testified that "an insured could reasonably expect **coverage for claims** against an acquired/sold/target company and its officers and directors for breach of fiduciary duty in the M&A context."

The Court Broadens the Bump-Up Exclusion Beyond Its Intent

Even though National Union, which drafted the bump-up exclusion, provided coverage, the court affirmed the excess insurers' denial of coverage for the class action settlement. The court held that this specialized and technical M&A exclusion must be given its "common usage meaning," and when that is done, it bars coverage even for claims against the insured that is being acquired.

In doing so, the court disregarded well-established rules of policy interpretation and the clear and contrary evidence presented at trial. For instance, the court acknowledged it should consider "drafting history in the interpretation of disputed policy language," but the court effectively ignored that intent, i.e., the bump-up exclusion only applied to an insured-acquirer, when the court applied the exclusion to Onyx, the acquiree. Likewise, the intent and the historic purpose of the bump-up exclusion also gives policyholders a reasonable expectation of coverage for shareholder claims against the acquired entity, but the court refused to fulfill the policyholder's expectations despite recognizing that the "goal is to give effect to the reasonable expectations of both the insured and insurer."

Finally, the court gave short shrift to well-established principles of insurance interpretation that require (i) exclusions to be narrowly construed—in this case to only apply to insured-acquirers; and (ii) any ambiguity to be construed in favor of coverage, especially where, as here, the drafter of the policy language in dispute conceded it was unclear.

This ruling should confirm to corporate policyholders—particularly those actively engaged in M&A activity—that the **best** practice of having clear and well-drafted policy language must be their **standard** practice as well.

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