Lowenstein Sandler's In the Know Series
Video 26 – Understanding the Bump-Up Exclusion in D&O Insurance

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Eric Jesse: Hi, I'm Eric Jesse, partner in Lowenstein Sandler's Insurance Recovery Group. Welcome to "In the Know."

A hot button issue in the directors and officers insurance world, or D&O insurance, is what's commonly called the "bump-up" or inadequate consideration exclusion, and we are seeing more and more insurers adding this exclusion to D&O policies.

And when a claim comes, insurers invoke this exclusion to try to bar coverage for shareholder lawsuits alleging that the board of directors failed to secure adequate sale proceeds for their shareholders when the company is part of a merger or acquisition. But insurers are often painting with a broad brush when they invoke this exclusion.

As we say here on "In the Know," the words matter, and insurers often go beyond the policy language when applying this exclusion. Courts have held that the bump-up exclusion prevents acquirers in a transaction from paying too little for a target. And then, once the acquirer is a defendant in the shareholder litigation, the acquirer cannot look to insurers to pay the difference between the price paid and the price that should have been paid.

What this means is that the exclusion does not apply when the defendant is from the sell side, such as the target's board of directors. Also, insurers more and more are trying to use the exclusion as a silver bullet to completely avoid coverage for the entire shareholder lawsuit. Insurers ignore that there is a host of other categories of damages or loss that may be claimed by shareholders that have nothing to do with inadequate consideration and therefore cannot fall within the exclusion.

For example, by its own terms, the inadequate consideration exclusion does not apply to plaintiffs' attorneys' fees awards, or damages associated with a tainted sale process or inadequate disclosures by the target, which is separate and apart from a fair price.

Therefore, coverage should remain for these loss categories. D&O insurance policies will often expressly cover settlements and parties settle for a host of reasons that have nothing to do with alleged inadequate consideration, yet insurers still try to avoid coverage under those

circumstances anyway. And when shareholders bring a lawsuit, they may have various theories of liability.

One theory can be a price reversion theory. In this situation, shareholders allege that the target should not have been sold and they should still have their stock. Therefore, no consideration at all should have been paid, and the damages are the harm to the stock value that they should still have. And so, when an insurer denies coverage, as they like to do, and invokes the bump-up exclusion to do so, companies and directors and officers should not take no for an answer, because the insurer just may be overreaching.

Thank you for joining us on “**In the Know**."