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District Court Rejects "Bump-Up" Exclusion in Favor of Policyholder-Friendly Interpretive Principles

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Practical Policyholder Advice

A recent policyholder favorable ruling from the Eastern District of Virginia adopted a narrow, strict construction of a "bump-up" exclusion in a directors' and officers' liability policy. Following a "reverse triangular merger," the policyholder faced multiple shareholder lawsuits, which eventually settled for $90 million. The insurers refused to pay, invoking what is referred to as a "bump-up" exclusion of the effective increase in price or consideration paid or proposed to be paid for "the acquisition of all or substantially all the ownership interest in or assets of an entity." The court held the exclusion ambiguous and disposed of the insurers' multiple arguments related to the meaning of the exclusion's terms pursuant to dictionary definitions and Delaware corporate law; the fact that the merger transaction included a brief step in which one entity temporarily became a subsidiary of the other before the completion of the merger; and the tax and accounting treatment of the temporary "parent" entity as the "acquiring company" of the other. The court's definitive rejection of these and other arguments not only provides crucial interpretive guidance for this type of exclusion but also demonstrates the robust application of interpretive principles useful to policyholders in a broader array of coverage disputes.

The United States District Court for the Eastern District of Virginia recently granted partial summary judgment in favor of a policyholder under a directors' and officers' (D&O) management liability insurance policy, holding that settlements of underlying securities litigation were not unambiguously excluded by a "bump-up" exclusion. Following a proposed or completed acquisition of a public company, the target company's shareholders frequently bring legal challenges regarding the amount of consideration paid or proposed to be paid supporting the acquisition. Bump-up exclusions, sometimes referred to as "inadequate consideration" exclusions, are a common fixture in D&O liability insurance policies. Although they are typically located within the policy definition of "Loss" rather than as standalone exclusions, courts (including the court in this case) have recognized that they operate as an exclusion and have treated them as such. Insurers write this type of exclusion into policies to discourage acquiring an entity at a discount and then relying on the insurer to pick up the difference. Given the prevalence of these exclusions, *Towers Watson & Co. n/k/a WTW Delaware Holdings LLC v. National Union Fire Insurance Co. of Pittsburgh, P.A.*, No. 1:20-cv-810 (AJT/JFA), 2021 WL 4555188 (E.D. Va. Oct. 5, 2021), is of interest to any policyholders, particularly those involved with a merger or acquisition.

Towers Watson & Co. n/k/a WTW Delaware Holdings LLC (Towers Watson) executed a "reverse triangular merger" with Willis Group Holdings plc (Willis), of Willis Tower (formerly known as the Sears Tower in Chicago) fame. One stage of the multi-phase merger involved a qualified stock purchase by which, in exchange for 100% of the outstanding shares of Towers Watson's common stock, Willis temporarily became the "parent" of Towers Watson and Towers Watson became a wholly-owned subsidiary of Willis. Willis only arguably held the outstanding shares of Towers Watson's common stock when Towers Watson issued new shares, never held by any of its shareholders, before being merged

into a Willis subsidiary. Ultimately, pursuant to the merger, both Towers Watson and Willis cancelled and delisted all of their outstanding publicly traded shares and Towers Watson shareholders received certificates entitling them to newly-issued Willis shares. Willis never acquired any of those formerly-owned Towers Watson shares. By the end of the transaction, Towers Watson shareholders owned 49.9% of the newly constituted Willis, and Towers Watson no longer existed. Further, Towers Watson shareholders controlled half of the board seats and the former CEO of Towers Watson became the new CEO of the merged company.

Towers Watson, its post-merger CEO, Willis, and certain related entities and former directors and officers subsequently faced a putative class action proxy solicitation lawsuit and consolidated shareholders' derivative lawsuits related to the merger. Towers Watson looked to its $80 million tower of D&O liability insurance procured from National Union Fire Insurance Company of Pittsburgh, Pa. (AIG) and six excess insurers.

The insurers agreed that the claims alleged in the underlying actions constituted "Claims" for "Wrongful Acts," and any "Loss" arising out of the "Wrongful Acts" was therefore potentially within the scope of coverage of the AIG policy, to which the excess policies followed form. AIG accepted defense of the underlying actions. However, the insurers prospectively refused to indemnify Towers Watson for any settlements or judgments in the underlying actions, invoking the AIG policy's bump-up exclusion:

> 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.

Towers Watson sued its insurers and filed a motion for partial summary judgment, seeking a declaration that the bump-up exclusion would not operate to exclude any settlement or judgment from coverage. Before the court ruled on the motion, the underlying actions settled for a combined total of $90 million. The settlements were approved and the underlying actions dismissed.

Applying Virginia law, the court recited standard presumptions and principles of insurance law: deference to the language in the policy, respect for the ordinary and customary meaning of words, consideration of the policy as a whole to shed light on specific terms or provisions. The court also stated it would apply the rule of *contra proferentem* in the event of an ambiguity, favoring interpretations that expand rather than narrow coverage. Against that backdrop, the court framed the issue as whether the bump-up exclusion unambiguously excluded the settlements in the underlying actions from the definition of a covered "Loss," or whether a reasonable construction made the bump-up exclusion inapplicable to the settlements.

Towers Watson argued that the transaction was a "merger of equals" and therefore not an "acquisition" as referenced in the exclusion. The AIG policy did not define the term acquisition, and the insurers proffered dictionary definitions as support for application to the merger. However, the dictionary definitions did not shed light on the exclusion's specification of an "acquisition…of all or substantially all the ownership interest in or assets of an entity." Under Delaware corporate law,[1] that type of acquisition traditionally referred to the takeover of one company by another rather than the joining of two companies into a single entity. Further, the policy contained a definition of "Transaction" that explicitly included mergers and additional types of transactions other than the "acquisition…of all or substantially all the ownership interest in or assets of an entity." Because the exclusion did not include all of the transaction types included within the definition of "Transaction," under the principle of *expression unius est exclusion alterius*, the other transaction types—including a merger—should not be read into the exclusion. Although the court recognized reasonable arguments for interpreting the term "acquisition" in the exclusion as including the reverse triangular merger at issue here, the insurers

could only prevail if that was the *only* reasonable reading of the term. Because a reasonable, narrow reading existed, the court held the merger was not unambiguously an "acquisition" as that term was used in the exclusion.

Having rejected the application of the exclusion, the court did not decide other issues raised by Towers Watson, including whether: (i) the underlying actions were "Claim[s] alleging that the price or consideration paid for [the] acquisition…is inadequate;" (ii) the term "entity," which was also not defined in the policy, included Towers Watson; and (iii) the settlements were an "amount…representing the amount by which such price or consideration is effectively increased."

Towers Watson is a welcome addition because it provides support to policyholders faced with a coverage denial based on a bump-up exclusion. Policyholders should carefully consider the following arguments advanced by the insurers and the reasons the court rejected each of them, as these arguments are likely to arise again in future litigation:

- The dictionary definitions and corresponding argument that the plain meaning of the term "acquisition" is "the act of acquiring something" and "acquire," in turn, is "to come in possession and control, often by unspecified means." The insurers argued this applied to the brief point of time in which Willis acquired the outstanding shares of Towers Watson stock that had never been owned by any Towers Watson shareholder. The court rejected this argument because it viewed the merger according to its overall scheme and final result, rather than focusing on a mere snapshot in time during the multi-phase transaction. Similarly, the court also rejected the insurers' argument that definitions found elsewhere in the policy (namely, the term "Transaction") did not foreclose the bump-up exclusion from applying to an acquisition structured as a merger. The court stated, "the issue is not whether, in some sense, a merger can be structured and viewed as a type of acquisition, but whether 'the acquisition' specifically described in the bump-up exclusion necessarily references the Merger." Policyholders facing similar claims would do well to advocate for a practical approach to complicated, multi-phase transactions, and to search for language elsewhere in both the provision and the rest of the policy that support a favorable construction. In addition, policyholders may consider the argument that in order for an insurer to prevail, it must establish that its interpretation of a policy provision, particularly an exclusion, is the *only* reasonable interpretation.

- The merger included at one point in time a step wherein Willis became the parent company of Towers Watson and Willis received all of the outstanding shares of Towers Watson's outstanding stock. Again, the court took a practical view of the overall scheme and final result of the merger. This further underscores the wisdom in future policyholder litigants carefully considering how they frame a complicated, multi-step corporate transaction to maximize benefits under the relevant policies.

- Delaware corporate law treatises describe "triangular mergers" as an acquisition technique and the description of a "merger of equals" has no legal significance. The court deferred to the expertise of the Delaware Superior Court in *Northrop Grumman Innovation Systems, Inc. v. Zurich American Insurance Co*., No. CV N18C-09-210, 2021 WL 347015 (Del. Super. Ct. Feb. 2, 2021), which held the identical bump-up exclusion inapplicable to similar underlying securities litigation arising from a reverse triangular merger.[2] *Northrop Grumman* is another useful opinion for policyholders facing bump-up exclusions, and the *Towers Watson* court's endorsement of the Delaware Superior Court opinion may give it additional weight as persuasive authority throughout the country.

- Willis had been designated the "acquiring company" and the merger was characterized as a "qualified stock purchase" for accounting and tax purposes. Here, the court pointed to the specific type of "acquisition" created by the bump-up exclusion's language and found that the tax and accounting treatment did not resolve the ambiguities in the language. This also ties into the utility

of the argument that an insurer can only prevail where it establishes its interpretation of a policy provision is the *only* reasonable one.

More generally, the *Towers Watson* court appropriately and decisively applied the broad interpretive principles helpful to policyholders engaged in coverage litigation on a number of issues, not just bump-up exclusions. The case should be considered "required reading" for companies seeking D&O insurance coverage for claims stemming from mergers or acquisitions, but many of the takeaways listed above have broader application beyond the realm of bump-up exclusions.

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[1] As noted by the court, the merger became effective upon the filing of the Certificate of Merger with a Delaware state agency.

[2] The *Northrop Grumman* analysis was rejected by the United States District Court for the Eastern District of Wisconsin in another recent bump-up exclusion case, *Joy Global Inc. v. Columbia Casualty Co*., No. 2:18-CV-02034, 2021 WL 3667077 (E.D. Wis. Aug. 18, 2021) (applying Wisconsin law). *Joy Global* contained different bump-up exclusion language, specifying that "Loss" did not include "any amount of any judgment or settlement of any Inadequate Consideration Claim other than Defense Costs and other than [loss incurred by directors and officers that is not indemnified by Joy Global]" and defining "Inadequate Consideration Claim" 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." Also, the court described the transaction at issue as an "acquisition of all the ownership interest of an entity." *Joy Global* is on appeal to the United States Court of Appeals for the Seventh Circuit.

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