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The D&O Diary

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Exclusion Bars Coverage for Insured Company's Acquisition Underpayment

By Kevin LaCroix on January 17, 2023

The so-called "Bump-Up" Exclusion found in many D&O insurance policies typically excludes coverage for claims alleging that the insured company, *as the acquiror*, underpaid or sought to underpay for the acquisition of a target company. However, in a recent decision following a bench trial, in which the court interpreted an unusually worded exclusion that arguably applied to preclude coverage whether or not the insured company was the acquiror *or the acquisition target*, the court held that the exclusion unambiguously precluded coverage for the settlement of a claim that the directors of Onyx Pharmaceuticals, the insured company, had breached their duties by accepting an inadequate amount for the sale of their company. The judge's opinion is a cautionary tale for anyone involved in the placement of D&O insurance and also has important implications about the wording of the bump-up exclusion. A copy of the court's December 30, 2022, post-trial Final Statement of Decision can be found **here**.

Background

Onyx Pharmaceuticals develops and markets cancer drugs. In August 2013, Onyx received an unsolicited tender offer from Amgen for Amgen to purchase Onyx for $125 per share. Amgen subsequently acquired Onyx at the tender offer price. Shareholders of Onyx sued the company and its directors and officers alleging that the directors failed in their duty "to seek the highest price for Onyx shareholders in its sales process." The underlying shareholder claim ultimately settled for $30 million.

At the relevant time, Onyx maintained a program of D&O Insurance that consisted of a $10 million primary layer and three excess layers totaling an additional $25 million. The primary policy contained a so-called bump-up exclusion, although the exclusion in the primary policy was unusual in that, unlike the standard bump-up exclusion which precludes coverage for loss arising from claims that the insured company has underpaid for an acquisition, the exclusion in Onyx primary policy arguably applied whether the insured was the acquirer or was being acquired. The exclusion provided that:

> 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 of 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.

The trial record in the coverage litigation showed that in an earlier policy year (that is, a year prior to the policy year in which the shareholder litigation took place), Onyx's insurance broker had sought to have the wording of the bump-up exclusion changed so that the exclusion only applied when the allegation was that the insured as the acquirer underpaid for an acquisition. The primary insurer declined to make this change, and the bump-up exclusion as set out above remained in the primary policy through the subsequent policy renewal transactions. The trial record also showed that the policyholder was not told of the existence of this wording in the bump-up exclusion.

The primary insurer funded the defense of the shareholder claim, and the remainder of its $10 million layer funded a portion of the settlement. The excess carriers refused to pay any portion of settlement in reliance on the bump-up exclusion, leaving Onyx to pay the remaining $26 million settlement amount. Onyx sued the excess insurers in California state court seeking a judicial declaration that the excess insurers' policies covered the $26 million portion of the settlement.

The insurance dispute went to a bench trial before California (San Mateo County) Superior Court Judge **Marie S. Weiner**. As reflected in an earlier post (**here**), in October 2020, Judge Weiner released a "tentative decision" in the parties' dispute. The parties filed objections to her tentative ruling, and on December 30, 2022, Judge Weiner filed her "Final Statement of Decision."

The December 30, 2022, Final Statement of Decision

In her detailed post-trial Final Statement of Decision, Judge Weiner held that "the Loss Exclusion unambiguously excludes coverage here, whether the insured company is the acquiror or the acquiree." She added that "it is reasonable that the insurance carriers did not want to have the insurance proceeds be a means of funding the purchase of assets by a corporation – which, as a pragmatic matter, would be the result if the insurance funds were paid to Onyx, which is now a wholly-owned by its acquirer Amgen."

Judge Weiner went on to say that her conclusion was "bolstered by the drafting history of the Loss Exclusion," and is supported by the evidence that there were one or more alternative D&O insurance policies available in the marketplace that contained different Loss Exclusions that were more narrow and would have provided M&A Coverage if Onyx itself was the acquisition target, but would exclude coverage if Onyx was the acquirer." The record, Judge Weiner said, showed that Onyx's insurance advisors were aware of the concerns with the language and had sought to have the language changed in an earlier policy year, so the Exclusion was "not a provision slipped into a policy unexpectedly, but rather the Loss Exclusion was a part of the primary D&O policy for several years prior to the subject Claim."

Discussion

As noted at the outset, the bump-up exclusion is typically worded so as to preclude coverage for loss arising from a claim that the insured company paid inadequate consideration for the acquisition of a company. Thus, the record in this case showed that Onyx's insurance advisors, in an earlier policy year, had sought to have the bump up exclusion in Onyx's primary D&O policy revised to match the wording available in another policy available in the marketplace; the alternative wording precluded coverage for "any amounts that represent, or are substantially equivalent to an increase in the price of consideration paid, or proposed to be paid, *by the Company*" in connection an acquisition securities or assets. The basic idea of this exclusionary wording is that the insurer should not have to help fund the insured's underpriced attempt to acquire another company.

There was extensive testimony at trial from a variety of D&O insurance experts about the origins, meaning, purpose, and wording of the Bump-Up exclusion in this policy. (For those of us who have

been around a while, the roster of experts who testified at trial contains a number of familiar names.) Judge Weiner's opinion sets out at some length the various experts' testimony; readers can decide for themselves how helpful the various experts' testimony proved to be in the end. However, the one thing that does come through is that, in its origins, the point of the bump-up exclusion was to preclude coverage when the insured company allegedly was underpaying or attempting to underpay for an acquisition, not when there was underpayment for the acquisition of the insured company.

A significant part of Judge Weiner's final decision consists of a recitation of the trial testimony concerning Onyx's insurance advisors' earlier attempt to change the language of the Onyx primary policy's bump up exclusion, in order to revise the policy to reflect the more conventional wording. For me, the significance of the testimony about the attempts to negotiate a wording change is that the insurance advisors did in fact identify the potential problem with the wording, but that the primary insurer refused to budge.

Judge Weiner pretty heavily implies that, given that there were alternatives available in the marketplace with the more favorable bump-up wording, then coverage should have been placed with a carrier willing to offer the more favorable wording. This aspect of Judge Weiner's decision strikes me as 20-20 hindsight. The reality is that the wording of the bump-up exclusion was only one of a myriad of issues relevant in connection with Onyx's insurance placement, and insurance is placed with one carrier rather than another for a host of reasons, of which the wording of the bump-up exclusion was at the time of the placement only one, relatively small part.

One particularly troublesome aspect of Judge Weiner's decision, and an aspect to which she returns over and over again in her opinion, is the question of what Onyx was told about the bump-up exclusion. I find this aspect of Judge Weiner's opinion inexplicable, especially since it is clear from that what the insured knew about the exclusion was irrelevant to the ultimate outcome of the coverage issue.

There are, however, some important lessons from Judge Weiner's review of what Onyx was told about the exclusionary wording. At a minimum, Judge Weiner's opinion does underscore the importance for practitioners of being able to show what was done in the course of policy negotiation and why, as well as what was communicated to the insured about the specific policy language and the scope of coverage resulting from the negotiation. I strongly suspect that upon reading Judge Weiner's opinion, many practitioners will conclude that they should review how they communicate with their client about how coverage was negotiated and what coverage was put in place.

There are other lessons from Judge Weiner's opinion, as well. Among other things, if it was not clear before, it is unmistakably clear now, the bump up exclusion wording that was on the Onyx policy is fundamentally defective, in that it can produce a result that no one ever intended. Well-advised practitioners will not accept this policy language on their clients' policies, and, in light of Judge Weiner's decision, they will refuse to place coverage with insurers who insist on the bump up exclusion wording that was at issue in this case unless no commercially practicable alternatives are available. Of course, as I noted above, the way the insurance is placed in any particular situation is going to be the reflection of a host of competing issues, and it may sometimes be the case that other factors may have to determine the ultimate placement.

One other aspect of this situation that observers will want to note is that in the end the primary insurer, the one that refused to modify the bump-up exclusion wording on Onyx's policy, paid what appears to be as much as $4 million of the settlement of the underlying claim, notwithstanding the exclusionary wording. It was the *excess insurers* on Onyx's program that contested coverage in reliance on the bump up exclusion, not the primary insurer. In a noteworthy aspect of Judge Weiner's decision, she determined that the excess insurers, each of which had its own separate insurance contract with Onyx, were not bound by the primary insurer's interpretation of its policy – even though the excess insurers sought to deny coverage in reliance on specific exclusionary wording in the primary policy.

One final note about where Judge Weiner's decision leaves this case. She style her decision as the "Final Statement of Decision After Phase One." Phase One, according to the Final Statement, was intended to adjudicate the claims for declaratory relief. The other issues at issue between the parties, including Onyx's breach of contract and bad faith claims, were bifurcated prior to the Phase One bench trial. In her Final Statement, Judge Weiner directs the parties to meet and confer "regarding the procedural path for adjudication of all remaining causes of action," which will be followed by a case management conference before the court. I note these procedural issues in order to point out that the case is not yet ripe for appeal. That said, I would be very surprised if Onyx does not appeal when the case does reach that point.

Special thanks to a loyal reader for providing me with a copy of Judge Weiner's Final Statement of Decision.
