Alert

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COZEN O'CONNOR

Seventh Circuit Affirms Insurers' Application of Bump Up Provision to Exclude Coverage

On January 23, 2023, the U.S. Court of Appeals for the Seventh Circuit, in *Komatsu Mining Corp. v. Columbia Casualty Company et al.*,[1] (applying Wisconsin law), affirmed a district court's holding that a settlement in connection with various shareholder lawsuits met the definition of an inadequate consideration claim in a public company directors & officers (D&O) policy and did not constitute a covered loss.

Discussion

In 2016, a merger occurred in which the insured, Joy Global, was acquired by another company, Komatsu. In response to the acquisition announcement, shareholders of the insured filed multiple lawsuits against the insured and its D&Os, alleging that they had issued false or misleading proxy reports to induce them to vote their shares for inadequate consideration. These eight lawsuits were eventually settled for $21 million. The insured tendered the lawsuits to its D&O insurers and sought indemnification for the settlement payment.

The insurers denied coverage for the settlement concluding that the actions constituted inadequate consideration claims, which were defined as "that part of any claim alleging the price or consideration paid or proposed to be paid for the acquisition of all or substantially all of the ownership interest in or assets of an entity is inadequate." The definition of loss in the policies provided that it "shall not include any judgment or settlement of any Inadequate Consideration Claim…" and therefore the settlement constituted an exception to a covered loss.

The insured argued that the shareholder actions were covered because they alleged liability on the basis of misrepresentation in proxy statements, not on the basis of inadequate consideration. The district court rejected that argument and granted summary judgment in favor of the insurers. The court found that all the actions alleged that the insured's shareholders received inadequate consideration in the transaction and that the policy unambiguously excludes the entire settlement where a part of a claim alleged inadequate consideration. *Joy Glob. Inc. v. Columbia Cas. Co.*[2]

The Seventh Circuit affirmed. Rejecting the insured's arguments on appeal, the Court held that the complaint alleged that the insured failed to reveal that the share price was too low and by concealing that information, the proxy statements induced shareholders to vote in favor of a merger. The Court found that these allegations met the definition of an inadequate consideration claim. The Seventh Circuit reviewed all the complaints and found the only objection to the merger was that the insured could have, and should have, held out for more money and that the claims related to the false or deficient disclosures did not depend on anything other than the share price.

The Seventh Circuit also reasoned that insurers use clauses about inadequate consideration to protect themselves from the moral hazard of incentivizing a buyer to underpay in an acquisition with the rest of the true value coming from insurance after the shareholders file suit.

Like the district court, the Seventh Circuit rejected the holding of a recent Delaware superior court case relied on by the insured, *Northrop Grumman Innovation Systems, Inc. v. Zurich American Insurance Co.*,[3] which held that inadequate consideration exclusions only apply when inadequate price is the sole allegation in the underlying complaint. In rejecting that decision, the Seventh Circuit reasoned that not only were the laws of Delaware and Wisconsin different, but also the language of the provision in the policies differed. The Seventh Circuit concluded that because not all D&O policies contain the same language, courts should not proceed as if they do.

Conclusion

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Komatsu is one of the first appellate decisions on the application of inadequate consideration or bump up provisions in D&O policies. The decision demonstrates the importance of the particular language of the policy provision, which can lead to different results in similar cases, as is evident from the *Komatsu* and *Northrop* decisions. As the Seventh Circuit noted, not all provisions are the same, and courts should not proceed as if they are. *Komatsu* also demonstrates the Seventh Circuit's willingness to review the underlying claim closely and not merely rely on the characterizations argued by the parties when evaluating coverage.

While the insured here argued the provision should not apply when the policyholder is the seller in a corporate transaction and does not offer to pay anything, the Seventh Circuit did not address that argument. The Seventh Circuit was also not faced with an argument about whether the structure of the business combination meets the undefined term merger or acquisition, an issue in *Northrop*, and another bump up case pending before the United States Court of Appeals for the Fourth Circuit on appeal from a decision in favor of the insured, *Towers Watson & Co. v. National Union Fire Insurance Co*.[4] With *Komatsu* and *Towers Watson* in the near future, insureds and insurers are beginning to obtain some appellate guidance on this important issue in D&O insurance.

[1] *Komatsu Mining Corp. v. Columbia Casualty Company et al.*, No. 21-2695, 2023 WL 354732 (7th Cir. Jan. 24, 2023)

[2] *Joy Glob. Inc. v. Columbia Cas. Co.*, 555 F. Supp. 3d 589 (E.D. Wis. 2021)

[3] *Northrop Grumman Innovation Systems, Inc. v. Zurich American Insurance Co.,* 2021 Del. Super. LEXIS 92 (Feb. 2, 2021)

[4] *Towers Watson & Co. v. National Union Fire Insurance Co.*, 20-cv-810, 2021 WL 4555188 (E.D. Va. Oct. 5, 2021)