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Delaware Court Reins in Insurer's Use of "Bump-Up" Exclusions to Deny Coverage Under D&O Policies


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The so-called "bump-up" exclusion that insurers have increasingly relied on to deny coverage under director and officer (D&O) policies was recently narrowed by the Delaware Superior Court in *Harman International Industries Inc. v. Illinois National Insurance*; decided on January 3, 2025.

A company will customarily indemnify directors and officers for losses incurred in connection with actions and omissions in furtherance of such person's service to the company. The company will then typically obtain a D&O insurance policy to cover the entity and its directors and officers, including for these indemnified losses. As M&A deal litigation has accelerated in recent years, D&O insurers have increasingly pushed to include bump-up exclusions in policies and relied on these exclusions to deny coverage. Bump-up exclusions allow an insurer to reject coverage where there are allegations that the insured target company sold for a below-market price and, as a result of a judgment or settlement of such allegations, the consideration paid to the target company or its stockholders in the underlying deal is increased or "bumped up." Historically, bump-up exclusions in D&O insurance policies were used to prevent buy-side insureds from colluding with the target company and its board of directors to accept less than market value and off-load to insurance providers the risk that target company stockholders bring claims alleging insufficient consideration. In recent years, D&O insurers have drafted bump-up exclusions broadly to deny coverage for judgments and settlements that may be even indirectly related to the consideration paid in an acquisition.

Prior to the Delaware Superior Court's decision in *Harman*, courts in Delaware and other jurisdictions assessed the use of bump-up exclusions in connection with settlements of M&A related litigation, but judicial decisions generally focused on the precise use of the term "acquisition" (the operative text of bump-up exclusions in D&O policies often permit the insurer to deny coverage for losses in connection with claims that consideration paid for an "acquisition" was inadequate).

In *Towers Watson & Company v. National Union Fire Insurance Company of Pittsburgh*, the U.S. District court for the Eastern District of Virginia found that a bump-up exclusion applied to a merger of equals based on a broad reading of the terms "acquisition" and "entity" in the insurance policy. Following Towers Watson's merger with Willis Group Holdings plc, Towers Watson stockholders brought litigation alleging inadequate consideration for their shares in the merger. The stockholder suits settled, and Towers Watson's insurer refused indemnity coverage under the policy's bump-up exclusion. The Virginia Court sided with the insurer finding that the bump-up exclusion unambiguously applied to the settlements, permitting the insurer to deny coverage under the policy because: (1) the underlying stockholder actions alleged inadequate consideration; (2) Towers Watson itself was an "entity" that could be subject to an "acquisition," which, the Virginia court concluded, includes a merger; and (3) the settlements represented an effective increase in the consideration for merger.

Conversely, in *Viacom Inc. v. U.S. Specialty Insurance Company*, the Delaware Superior Court refused to apply a bump-up exclusion to an all-stock merger where

the terms “merger” and “acquisition” were separately defined in the policy. After Viacom merged into CBS Corp., Viacom stockholders asserted breach of fiduciary duty claims against Viacom’s board of directors, officers and controlling stockholders, and alleged that the stock-for-stock exchange ratio in the transaction was inadequate. The litigation ultimately settled for $122.5 million, but Viacom’s D&O insurer refused to cover this settlement arguing that the merger constituted an “acquisition” that was subject to the bump-up exclusion in Viacom’s D&O policy. Viacom argued that the bump-up exclusion did not apply to this merger because the policy separately defined “acquisitions” and “mergers,” and only the term “acquisition” was used in the bump-up provision. The Delaware Superior Court found both the insurer and Viacom’s interpretations reasonable and, consistent with Delaware precedent, held that “[i]f there is any ambiguity, it should be resolved in favor of the insured, as it is incumbent on the drafter of the insurance agreement to be unequivocally clear in carving out exclusions to coverage.”

As it did in *Viacom*, the Delaware Superior Court sided again with the insured company in *Harman* and ordered the insurer to provide coverage under the D&O policy. However, this time the Court focused more on the underlying claims made and basis for the settlement. Stockholders of Harman International Industries, Inc. brought a class action suit under Sections 14(a) and 20 of the Securities Exchange Act of 1934, alleging that the proxy statement filed in connection with the sale of Harman to Samsung Electronics Co. in 2017 was false and misleading, and caused the aggrieved stockholders not to exercise appraisal rights. More specifically, the stockholders claimed Harman negligently disseminated a misleading proxy statement that “induced [stockholders] to vote their shares and accept inadequate consideration” and “deprived [stockholders of their] right to a fully informed shareholder vote . . . and the full and fair value for [their] shares.” The plaintiffs sought compensatory and/or rescissory damages against Harman and other parties. When Harman first approached its D&O insurer, the insurer acknowledged that the action was a securities claim covered by the policy. However, while the case was continuing, Harman’s insurer sent a second letter stating that it would deny coverage for any judgment or settlement of the stockholder class action based on the bump-up exclusion in Harman’s D&O policy.

The stockholder case later settled “to avoid costly litigation” and Harman denied any wrongdoing. Consistent with its second communication, Harman’s insurer refused coverage arguing that the settlement of the class action effectively “bumped up” the sale price of the underlying transaction.

Relying on *Viacom* and other previous decisions, the insurer argued the transaction was an “acquisition” and that the settlement resulted in increased consideration paid. Although the Court agreed that the transaction was an “acquisition” and thus the bump-up provision applied to litigation settlements related to Samsung’s acquisition of Harman, the class action did not seek “to remedy inadequate deal price” and therefore a settlement of such class action would not effectively increase consideration.

The Delaware Superior Court stated that:

“For the Bump-Up to exclude any settlement or portion thereof: (1) the settlement must be related to an underlying acquisition; (2) inadequate deal price must be a viable remedy that was sought for at least one claim in the [underlying a]ction; and (3) the settlement, or a portion of the settlement, must represent an effective increase in consideration.”

Finding only one of the three prongs met (that the transaction was an “acquisition”), the Court sided with Harman. The Court noted that increasing deal consideration is not a remedy available to plaintiffs alleging violations of the federal securities laws’ proxy statement rules. A “bare request of relief for inadequate price isn’t enough; the court in the underlying action must also be authorized to remedy the inadequate deal price under the claims raised.” Further, the settlement did not itself represent an effective increase in the consideration for the transaction and the parties acknowledged that the settlement “was based solely on the conclusion that further conduct of the Litigation would be protracted and expensive.” Satisfied with this rationale, the Court found that “[a]voiding the

cost of further litigation is a valid reason to settle and the Court has no reason to believe this reasoning was pretextual." Although the plaintiff stockholders did not present any evidence of true value or an adequate sales price, the Court estimated, based on the complaint, that a potential appraisal calculation could net over $279 million in damages for the class and held that the $28 million settlement price more closely resembled the legal fees saved.

These decisions in *Harman* and *Viacom* exhibit Delaware's bent toward insureds and permitting insurers to use bump-up exclusions only in limited circumstances. Although the Court in *Harman* gave deference to the reasons stated by Harman in the stipulation of settlement and litigation documents (to which the insurer was not a party), the opinion notes that it did so because the Court did not believe the reasons stated in such documents were pretextual. There is no guarantee that Delaware courts will give similar weight to settlement documents in future litigation. Going forward, D&O insurers and insured companies alike should carefully draft and negotiate bump-up exclusions in their D&O policies to eliminate ambiguity.