Jim's Perspective…

D&O Insurance Coverage Issue

When companies, publicly traded in the stock market, are acquired by another public company, the shareholders of the target company (i.e., the company that was bought or acquired) file suit to challenge the deal about 80% of the time.[1] The allegation by the shareholders is that the board has violated its fiduciary duty by selling the company for too low a price.

In 2013, Onyx Pharmaceuticals was acquired by Amgen for $10.4 billion. The Onyx shareholders sued the Onyx officers and directors for breaching their fiduciary duties of loyalty, good faith, and full disclosure related to the sale of Onyx to Amgen. They alleged it was a flawed sales process in which, instead of maximizing the sale price, the directors and officers of Onyx treated Amgen preferentially while suppressing other potential buyers.

Onyx believed its D&O insurance would cover all costs associated with this securities class action lawsuit, including the $30 million paid to settle the class action claim. However, D&O insurance policies usually include what is referred to as a "bump-up exclusion." This exclusion is usually found in a D&O policy's definition of "loss." A common version of the exclusion states:

> In the event of a claim alleging that the price or consideration paid for the acquisition or completion of the acquisition of all or substantially all of the ownership interest or assets in 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 is effectively increased.

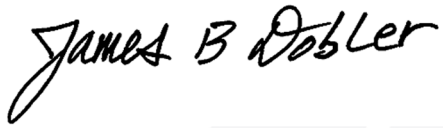
The purpose of this exclusion is that insurance carriers do not want to fund the purchase price of a publicly traded company. However, this exclusion has not always resulted in no coverage in this type of litigation. In one case, the court found that the exclusion did not apply to the acquired company's officers and directors because the action against this company is not about an increase in the price of consideration *paid,* because the target company *paid* nothing, only the acquiring company paid something. If this exclusion becomes an issue with a client, it is very important to check the case law regarding this exclusion because the courts have applied many different interpretations to this exclusion.

The bump-up exclusion has taken on added significance in recent years because of a new method of acquiring publicly traded companies. There has been a large increase in Special Purpose Acquisition Companies (SPACs). A SPAC is a form of blank check company, or shell company, that is formed by a sponsor or directors with venture capital or similar skills. The SPAC raises capital through an initial public offering, but the company has no operations or business. It's sole purpose is to acquire another publicly traded company. The SPAC is set up to operate for only a few years. Once it targets a company to buy, the shareholders of the SPAC can either agree with the intended purchase, or they can redeem their shares in the SPAC and leave the

[1]CORNERSTONE RESEARCH, Economic and Financial Consulting and Expert Testimony, September 17, 2019.

operation. 248 SPACs were listed in the stock exchange in 2020. SPACs are also a very useful way to acquire a publicly traded company because the acquisition by the SPAC can be completed much quicker than it can if done by one stock company purchasing another regularly traded stock business. All of this is also leading to a hardening of the D&O market.

Having worked at a mutual insurance company, all of this mergers and acquisitions activity is hard for me to comprehend. However, I do have a sense that there is a significant risk exposure that exists when a stock company is acquired by another company, especially a SPAC. D&O coverage related to this risk exposure should always be carefully reviewed with the board of directors and officers.



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