

Settlement of Claim Alleging Inadequate Consideration for Tracking Stock Does Not Give Rise to a "Loss"

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The United States District Court for the District of Massachusetts has dismissed a policyholder suit alleging that its directors & officers (D&O) insurer was obligated to fund a settlement of a claim alleging that the exchange ratio for the conversion of tracking stock shares was inadequate. The court found that the settlement did not give rise to a "Loss" and that a bump-up exclusion in the policy would bar coverage in any event. *Genzyme Corp. v. Fed. Ins. Co.*, No. 08-cv-10988-NG (D. Mass. Sept. 28, 2009). Wiley Rein LLP represented the insurer in the case.

From 1994 to 2003, Genzyme Corporation's capital structure included a series of "tracking stock" intended to track the performance of a particular division of Genzyme. In 2003, Genzyme determined to eliminate the tracking stock structure. It offered to exchange tracking stock shares for a specified ratio of Genzyme "general" division shares. After the transaction closed, tracking stock shareholders sued and alleged that the exchange ratio was inadequate. Genzyme ultimately settled the case for \$64 million and then asked its D&O insurer to fund the settlement. The insurer declined on the grounds that the payment did not give rise to a covered "Loss" and that the policy's bump-up exclusion would preclude coverage in any event.

Genzyme brought suit against the insurer, which moved to dismiss. The court sided with the insurer. First, it found, the settlement did not give rise to a covered "Loss." According to the court, the original exchange of tracking stock shares for general division shares at an inadequate price benefited general division shareholders at the expense of tracking stock shareholders. The settlement simply recalibrated among groups of shareholders the relative benefits of the exchange. Distinguishing "no loss" cases involving the payment of allegedly inadequate consideration, the court opined that Genzyme was "less a Butch Cassidy than a Robin Hood." While the exchange did not harm or help the corporation, the court noted that shareholders would care a great deal about the ratio the corporation applied. The settlement remedied the imbalance by shifting assets to pay the former tracking stock shareholders. According to the court, asking the insurer to fund a settlement to remedy the imbalance created by the original transaction would produce an "absurd" result.

The court also found that the policy's "bump-up" exclusion would bar coverage. It precluded coverage under

the insuring clause applicable to the company for claims based upon or arising out of the payment of actual or alleged payment of inadequate consideration in connection with the purchase of shares of the insured organization. Genzyme argued that the share exchange was not a "purchase" of securities. The court squarely rejected that argument and held that, while rules of construction "stack the deck" against the insurer, the share exchange was a "purchase" under the commonly understood meaning of the term. The court also dismissed the argument that the presence of directors and officers as defendants in the underlying case would implicate the insuring clauses in the policy applicable to claims against insured persons, to which the bump up exclusion did not apply. According to the court, "it would make little sense to allow a corporation to sidestep coverage limitations in its insurance policy through the simple expedient of claiming that a settlement payment was made to indemnify its directors and officers." The court refused to endorse a reading of the policy that would "encourage such chicanery."