

"Bump Up" Exclusion Bars Coverage for Claims Against Insured Company, But Not Against Directors & Officers

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The United States Court of Appeals for the First Circuit, applying Massachusetts law, has held that the plain language of an "inadequate consideration" or "bump up" exclusion bars coverage for that portion of a settlement payment made to settle claims against the company, but not to any amounts that may have been paid to indemnify directors and officers. *Genzyme Corp. v. Fed. Ins. Co.*, 2010 WL 3991739 (1st Cir. Oct. 13, 2010). The court also reversed the district court's holding that coverage was precluded for the settlement as uninsurable loss on the basis of Massachusetts public policy.

The underlying claim arose out of the insured's proposal to consolidate three "tracking stocks," each of which was a class of shares that tracked the performance of a different division of the company, into a single class of shares. Holders of the class of shares that tracked the insured's Biosurgery Division sued the company, alleging that the exchange ratio pursuant to which their shares would be exchanged for general shares of the company did not reflect the fair market value of the Biosurgery Division. Specifically, they alleged that the insured had conspired to depress the value of the Biosurgery Division's tracking stock in order to minimize the number of general shares that the insured would have to issue to repurchase all outstanding Biosurgery Division tracking shares. The insured eventually settled the claims of its former Biosurgery Division shareholders with a one-time payment of \$64 million, for which it sought coverage from its insurers.

The directors and officers (D&O) liability policy at issue contained an "inadequate consideration" or "bump up" exclusion, which excluded coverage for "that part of Loss . . . which is based upon, arising from, or in consequence of the actual or proposed payment by any Insured Organization of allegedly inadequate or excessive consideration in connection with its purchase of securities issued by [the company]." This exclusion applied to losses under an insuring clause that covered claims against the company, but not to losses under another insuring clause that applied to sums paid by the company as indemnification to its directors and officers. The primary insurer denied coverage on the grounds that the settlement represented an amount that the company had improperly withheld from the underlying claimants in the first place and, therefore, was not a "Loss" as defined in the policy and uninsurable as a matter of public policy. The insurer also denied coverage because the settlement fell within the "bump up" exclusion. In ensuing coverage litigation, the district court held that the policy did not provide coverage both because the settlement amount constituted

uninsurable loss and because the "bump up" exclusion applied.

The First Circuit first began by holding that the settlement was not uninsurable as a matter of public policy under Massachusetts law. The court opined that, based on its reading of Massachusetts case law and relevant statutory law, Massachusetts law has only recognized one public policy reason for finding a claim to be uninsurable, namely that a party may not insure itself against legal liability for deliberate bodily injury or intentional criminal wrongdoing. In the absence of any precedents from state courts or legislation, the court declined to find the settlement in this case uninsurable as a matter of public policy.

Turning to the "bump up" exclusion, the court held that the settlement fit squarely within the plain language of the exclusion. The court rejected the insured's argument that the share exchange was not a "purchase," holding that it fit the dictionary definition of a "purchase" and noting that the insured's own articles used the verb "pay" to describe the transaction. The court also pointed to the insured's own concession in prior briefing that share exchanges "in which corporations cancel one series or class [of] shares and replace those shares with newly-issued shares are not uncommonly referred to in layman's terms as 'buy backs' or 'repurchases.'" The court further held that, because the "bump-up" exclusion applied to loss "arising from . . . the actual *or proposed* payment . . . of allegedly inadequate . . . consideration," it was broad enough to include a subclass of underlying claimants who had sold their shares in the market after the share exchange was announced but before it actually took place.

Finally, the court found that the plain language of the policy restricted the application of the "bump up" exclusion to claims made against the insured entity but that it did not apply to amounts paid by the company as indemnification for claims against its directors and officers. Accordingly, the court ordered that the case be remanded to determine what portion of the settlement, if any, was paid to indemnify directors and officers named in the underlying litigation.