QUARTERLY UPDATE

Q3 2023

IMA EXECUTIVE RISK SOLUTIONS

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Cases of Interest

Ambiguity in 'Bump-Up' Exclusion Results in Coverage for Merger Objection Claim

Whether insurance coverage will be available under a D&O policy for claims arising in the context of a merger or acquisition is something a lot of ink has been spilled over. Coverage litigation regarding the applicability of a "bump-up" exclusion can drag on for years, long after the completion of a transaction. Meaning, the policy wording negotiated prior to consummation of such a transaction is of utmost importance. In this case, a D&O policy's bump-up exclusion language determined whether a $122.5 million settlement was covered or not.

Under the primary policy at issue, and specifically the bump-up exclusion contained therein, coverage did not extend to "any amount representing the amount by which the price of or consideration paid or proposed to be paid for the acquisition or completion of the acquisition of all or substantially all of the ownership interest in, or assets of, an entity, including a Company, was inadequate or effectively increased." The court characterized the question as being whether the merger constituted such a transaction. The transaction was the 2019 merger of Viacom, Inc. (n/k/a Paramount Global) and CBS Corporation. Shareholders brought suit and the case eventually settled for $122.5 million. Viacom sought coverage under its D&O insurance tower; however, the insurers sought to deny coverage on various grounds and this case ensued.

The insurers took the position that the bump-up exclusion applied and the transaction fit within the language of the exclusion. The court disagreed, finding the exclusion to be ambiguous. "The Merger may be 'an acquisition of all or substantially all of the ownership interest in, or assets of, an entity' because all assets of Viacom vested in CBS. On the other hand, the Merger Objection Claim and Material Changes in Condition Provision suggest that 'an acquisition of all or substantially all of the ownership interests in, or assets of, an entity' exclude merger transactions, such as the Merger. Because the Bump-Up Provision is subject to two, contrary reasonable interpretations, ambiguity should be resolved in favor of Plaintiffs."

As noted above, the precise wording used means all the difference, and here the insureds were fortunate that ambiguity was deemed to exist. The best approach for insureds engaged in M&A activity is to have deal counsel and their insurance broker work together to do their utmost to ensure the transaction will not be subject to a bump-up exclusion, or better yet ensure that such an exclusion either does not exist in an insured's D&O program or has been significantly narrowed. *Viacom Inc. n/k/a Paramount Global v. U.S. Specialty Insurance Company*, 2023 WL 5224690 (Del. Sup. August 10, 2023).

Cases of Interest

Umbrella Policy Potentially Available Even if Exclusions Bar E&O Coverage

This case is included as an example that even if a particular exclusion precludes coverage under one insurance program, having an experienced broker with an in-house claims advocacy team on your side can make all the difference. Here, the insureds were sued by a patient who alleged sexual harassment by a therapist employed by the insureds. The lawsuit was tendered under the errors and omissions ("E&O") program in place; however, coverage was disclaimed. The insured then brought suit against its insurers seeking a declaration of coverage.

The court entered summary judgment for the E&O insurers, finding material misrepresentations in the application filled out by the insured during the renewal process. While the court agreed with the insured that it was not obligated to disclose a prior criminal conviction by the therapist since she was no longer an employee, the court held the insured was definitely aware of the criminal case and conviction. As a result, the insured was obligated to disclose it was aware of facts that could give rise to a malpractice claim. Because this knowledge ran afoul of the "prior knowledge" exclusion, coverage was precluded under the E&O policy.

The court rejected the remainder of the insured's arguments seeking, at the very least, a defense by the insurers, even if indemnity coverage was barred. However, in reviewing the possibility of coverage under the insured's general liability policies, it noted a difference between the primary and umbrella policies. The definition of "bodily injury" in the two policies was different, with the umbrella policy using a much broader definition. As such, the court found the potential for coverage under the umbrella policy.

By ensuring this claim was tendered under all potentially available insurance, coverage remained available under the umbrella policies even after the insurer's disclaimers were upheld under the E&O and CGL policies. *Evanston Insurance Company v. Footprints Behavioral Interventions, Inc.*, 2023 WL 4317198 (C.D. Cal. May 24, 2023).

Cases of Interest

Failure to Adequately Investigate Facts in Support of Coverage Renders Insurer Liable

The U.S. District Court for the Southern District of California recently issued a scathing opinion against a professional liability insurer over its claims handling practices. The background of the claim that gave rise to the coverage dispute revolved around defective seeds sold by the insured to customers. As a part of its regular business practices, the insured procured professional liability E&O insurance to defend and indemnify it against claims arising from professional services as a seedsman. In June of 2018, the insured began to receive complaints from farmers, and after gathering written claims, formal notice of a claim was submitted under the insured's E&O policy.

What transpired following the submission of the claim is the nightmare every purchaser of liability insurance fears. The insurance company initially sought to restrict coverage under a sub-limit that would have decreased the available limits from $2 million, to $100,000. Next, the insurer engaged coverage counsel, who advised coverage could be denied entirely. After the insured was forced to engage coverage counsel of its own, the carrier offered to pay half the policy limit, or $1 million. When the insured refused the offer, the insurer paid the full $2 million policy limit but immediately sued the insured to recoup everything.

In a detailed opinion laying out exactly how the insurer breached its obligations to the policyholder, the court upheld coverage for the underlying claim and additionally awarded the insured approximately $1.1 million in legal fees incurred in the coverage litigation, finding that the fees were incurred to obtain policy benefits to which the insured was entitled. The court found the insurer put its interests above those of the insured by intentionally construing coverage clauses narrowly and exclusions broadly, thereby doing exactly the opposite of what is legally required of insurers. It chose to only review information that supported denying coverage, unreasonably chose to file the coverage suit without gathering evidence that would support coverage and failed to consider new evidence or reevaluate its positions.

What the insured endured throughout this claim and coverage litigation is deeply troubling. Working with an insurance broker that tracks this sort of litigation and can speak to insurer behavior should be a key element of every policy placement and is something we cannot stress enough. *Houston Casualty Company v. Cibus US LLC*, 2023 WL 5432510 (S.D. Cal. August 23, 2023).

Cases of Interest

Individuals on Both Sides of Transaction Liable for Aiding and Abetting Breach of Fiduciary Duty

In mid-2016, TC Energy Corporation completed its acquisition of Columbia Pipeline Group, Inc., paying $25.50 per share, with the full purchase price amounting to approximately $13 billion including the assumption of $2.8 billion in debt. Shareholders commenced litigation, arguing the price paid to be unfair. Certain shareholders pursued an appraisal action, which went to trial in October of 2018. The court's decision therein reaffirmed the $25.50/share price as being fair value; however, it found the Proxy statement filed in advance of the shareholder vote contained material misstatements and omissions. The CEO and CFO of Columbia Pipeline eventually agreed to settle the matter for $79 million. The case then proceeded against TC Energy, wherein claimants sought to hold it liable for aiding and abetting breaches of fiduciary duty by Columbia's CEO and CFO.

To hold the acquiror liable for aiding and abetting breaches of fiduciary duty, a claimant must show: (1) the existence of a fiduciary relationship giving rise to a duty to the plaintiff; (2) a breach of that duty by the fiduciary; (3) knowing participation in the breach by the defendant, and; (4) damages proximately caused by the breach. In his opinion finding for claimants, Vice Chancellor Laster went into excruciating detail on the actions by Columbia's CEO and CFO as well as that of TC's principal negotiator. At 192 pages, this opinion spares no expense in laying out the factual record of what occurred and when. It details specifically how TC Energy exploited the knowledge that Columbia's CEO and CFO were motivated to sell and use their proceeds to retire. Throughout the sales process, standstill agreements were routinely violated and backchannel communications between the parties occurred that were in violation of the duty of loyalty by Columbia's CEO and CFO.

Here, the court utilized the "enhanced scrutiny" standard of review. It requires a showing by fiduciaries that they acted for a proper purpose and used appropriate means to effectuate the result. It also allows the court to evaluate the entire sales process as a whole in its review. While finding the CEO and CFO wanted to do the right thing and get the best price possible, they also wanted to trigger their change-in-control benefits and ride off into the sunset. The court found they behaved in ways that undercut Columbia's negotiating leverage which led to lower offers. "It was their conflicted behavior that gave [TC Energy] the confidence to offer $24 per share in the first place, and later to renege on the $26 deal." In the end, the court came to the conclusion that the CEO and CFO acted in bad faith and TC Energy knowingly exploited it to their benefit. The court isn't shy about its feelings on how in-house and external counsel handled the negotiations either. In spite of both supposedly being a check on the conduct of the negotiators, they were ineffectual.

Cases of Interest

Individuals on Both Sides of Transaction Liable for Aiding and Abetting Breach of Fiduciary Duty (cont'd)

Given the size of the transaction, the potential damages involved are astronomical. The court struggled with the appropriate remedy, especially given that aiding and abetting liability against a purchaser is incredibly rare. After a review of other cases that were deemed similar, the court landed on an award of $0.50 per share for the disclosure claim and $1 per share for the sales process claim. However, they were deemed not to be cumulative, with claimants only entitled to an additional $1 per share. A final order specifying the exact amount in damages awarded to plaintiffs has not yet been issued. *In re Columbia Pipeline Group Merger Litigation*, 299 A.3d 393 (Del. Ch. June 30, 2023).

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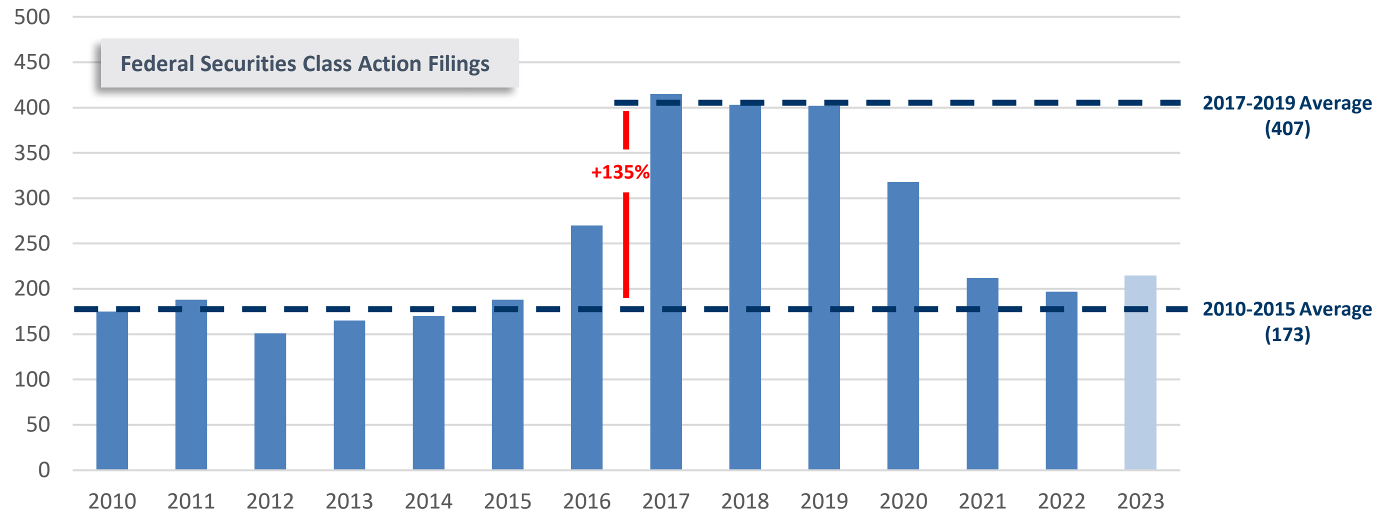
D&O Filings

- As we have previously reported, D&O Federal Securities Class Action Claims decreased noticeably over the last three years.
- In 1H 2023, filings increased compared to 2022, with 113 total Federal Securities Class Action Claims (v. 104 in 1H22).
- Filing rates through September 2023 imply an annualized number of 215 Federal Securities Class Action Claims.
  - This would represent a year-over-year *increase* of 9.1%.



**2023 full year estimate based on actual filings through September (161)*

D&O Pricing and Outlook

- With D&O litigation having declined each of the last three years, dismissal rates remaining elevated, and new capacity entering the marketplace, D&O pricing for recent renewals has in nearly all instances been more favorable than year ago levels, most noticeably for post-IPO and post de-SPAC companies.
- The current pricing environment continues to be a story of "supply and demand". New capacity has entered the market (supply) during a period where there are a significantly lower number of IPOs and de-SPAC transactions (demand). This combination of events has created more competition for "legacy" business.
- We do continue to pay close attention to recent litigation trends along with D&O carrier performance and the impact both may have on the marketplace. *Many D&O carriers have publicly stated that current rates may not be sustainable.*
- As we look forward over the remainder of 2023, we are optimistic that market conditions will remain favorable, with incremental pricing improvement and stable capital deployment.

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About IMA

IMA Financial Group is a privately held, diversified financial services firm focused on protecting client assets and creating exceptional value for our clients around the world. Our diverse team of experienced and talented professionals shares an unwavering commitment to excellence.

IMA Executive Risk Solutions is our world-class team of professionals focused on providing thoughtful advice, a unique legal perspective, a broad range of executive risk insurance solutions, and excellent service to our valued clients. Our professionals have deep experience handling complex executive risk exposures for a variety of clients – from pre-IPO start-ups to multibillion-dollar corporations.