CARLTON FIELDS

Wisconsin Federal Court Finds That "Inadequate Consideration" Carve-Out Bars Coverage for Securities Fraud Settlement

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In *Joy Global Inc. v. Columbia Casualty Co.*, Judge Lynn Adelman of the Eastern District of Wisconsin addressed whether certain shareholder claims fell under a carve-out of coverage for "inadequate consideration claims."

Many D&O policies contain similar carve-outs or exclusions — commonly referred to as "inadequate consideration" or "bump-up" provisions — which generally bar coverage of claims brought by shareholders alleging that they received inadequate consideration for their shares in the context of the acquisition of all or substantially all of a company's shares. Significantly, however, there is very little case law addressing such policy language.

In *Onyx Pharmaceuticals Inc. v. Old Republic Insurance Co.*, a California trial court found that coverage of a shareholder suit was barred by a bump-up provision. In *Northrop Grumman Innovation Systems Inc. v. Zurich American Insurance Co.*, a Delaware trial court construed an analogous bump-up provision more narrowly in favor of coverage. The Wisconsin federal court's August 18 decision in *Joy Global* helps to solidify this decisional landscape by applying a bump-up provision based on its "clear and unambiguous" terms while finding the *Northrop* decision to be "unpersuasive" in the process.

In 2016, the insured, Joy Global, was acquired by a multinational corporation, Komatsu America Corp. In response to the acquisition, Joy Global's shareholders filed eight lawsuits against the company, each of which eventually settled. The suits alleged that Joy Global had issued a false or misleading proxy report that induced the plaintiff shareholders to vote in support of a merger agreement, which in turn secured inadequate consideration for the plaintiffs' shares. Joy Global's insurers denied

coverage for the resulting settlements, asserting the actions fell under a policy carve-out of coverage for "inadequate consideration claims."

In its decision in the ensuing declaratory judgment action, the court first considered the applicable policy language. The court quoted the policy's definition of loss as follows:

> Loss (other than Defense Costs) shall not include: . . . any amount of any judgment or settlement of any Inadequate Consideration Claim other than Defense Costs and other than [loss incurred by directors and officers that is not indemnified by Joy Global] . . .

The court further noted that "inadequate consideration claims" are defined in the policy as:

> [T]hat part of any Claim alleging that the price 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 is inadequate.

The court found that this language "is clear and unambiguous, and its effect is not uncertain." The court explained:

> Because the language is unambiguous, a reasonable insured in the position of Joy Global would understand the language of the provision to exclude coverage for any amount of any settlement if: (1) the part of the Claim which was settled (2) alleges that the price or consideration paid or proposed to be paid for an acquisition transaction was inadequate, and (3) the proposed or completed transaction involved the acquisition of all or substantially all of the ownership interest in or assets of an entity.

Turning to the facts of the underlying shareholder claims, the court noted that each such claim alleged that Joy Global issued a false or misleading proxy report that was either intended to induce, or did in fact induce, the plaintiff shareholders to vote in support of a merger that secured inadequate consideration for their shares. Thus, according to the court, "each complaint alleged that the price proposed to be paid for an acquisition transaction was inadequate." In concluding that the coverage for the settlements was barred by the policy's "inadequate consideration claims" provision, the court found that "[e]ach settlement resolved the entire suit or suits at issue and each cause of action within the suits relied on the allegations of inadequate consideration, so in each case the part of the Claim which was settled alleged inadequate consideration."

The court further rejected the policyholder's reliance on *Northrop*, finding that it "is not binding and its reasoning is unpersuasive for two reasons." First, the court noted that the *Northrop* court "read

the relevant exclusion as limited to a claim alleging 'only' that inadequate consideration was paid for an acquisition, despite the word 'only' not appearing in the provision." And second, the court found the language of the "inadequate consideration" provision at issue in *Northrop* to be distinguishable, as that provision "applied only to that part of a settlement of an Inadequate Consideration Claim 'representing the amount by which such price is effectively increased.'" After rejecting the insured's other arguments in favor of coverage, the court granted summary judgment for the insurer.

The *Joy Global* decision appears to be the first federal court decision on the issue. It has been designated for publication in West's print reporter. We will watch closely to see if this line of reasoning in this published federal decision becomes the prevailing view on this issue.

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