

## Yes, We Are Contemplating An Exit *Always Be Forthright on Insurance Applications*

10.11.2019

### Overview

Start-ups are always looking for an exit. Achieving that exit, closing on a sale of the company, should be cause for celebration. But one company recently got burned post-closing for not disclosing to its insurance company that a potential acquisition had been on the horizon.

In November 2013, Computer Sciences Corporation ("CSC") acquired ServiceMesh, Inc. ("SMI"), a California-based tech start-up, for over \$260 million. CSC acquired SMI pursuant to an agreement that included an earnout provision, meaning that \$98 million of the purchase price would only be payable to the selling stockholders if SMI met certain revenue targets in the next year. The targets were achieved and the earnout was paid.

Then Eric Pulier, the founder and former CEO of SMI, found himself in difficulty. Pulier was the subject of both U.S. and Australian criminal investigations, alleging that he had bribed two executives of the Commonwealth Bank of Australia to entice the bank to enter into contracts with SMI to artificially inflate earnings, triggering the earnout.

The successor to SMI, CSC Agility Platform, Inc. ("CSCAPI"), paid in excess of \$18 million in advances to Pulier for fees and expenses defending these claims. Pulier was entitled to the advance under the company's bylaws and the company's agreement to indemnify him from claims arising from his position as an officer of SMI.

SMI filed a claim for reimbursement from Scottsdale Insurance Company ("SIC"), under its Business and Management Indemnity Insurance policy. SMI had applied to renew the policy in June 2013. The renewal policy was issued on August 24, 2013. In completing the renewal application, SMI's representative answered "No" to Question 8: "Does the Company contemplate transacting any mergers or acquisitions in the next 12 months where such merger or acquisition would involve more than 50% of the total assets of the company?"

At the time, SMI and CSC were engaged in discussions about a potential strategic partnership. They had exchanged information and were exploring entering into a business relationship. An acquisition was one possible form the relationship could take. During meetings and exchanges, both parties expressed a desire that the discussions would lead to CSC offering to acquire SMI.

CSC delivered a term sheet to acquire SMI on September 9, 2013, more than two months after SMI submitted its renewal application. SMI signed the term sheet two days later and the acquisition closed on November 15, 2013.

### CAPABILITIES

Corporate and Business Law

Emerging Companies

Mergers and Acquisitions

SIC rejected SCSAPI's claim under the insurance policy. SIC argued that SMI's "No" answer to Question 8 constituted a material misrepresentation, nullifying the policy. SMI's representative testified that she had not misrepresented the facts. When completing the renewal application she understood Question 8 to be asking whether SMI's Board of Directors was considering an acquisition offer, which it was not at the time.

The United States District Court for the Central District of California agreed with SIC. In its decision in [Scottsdale Ins. Co. v. CSC Agility Platform, Inc. et al.](#), 2019 U.S. Dist. LEXIS 62985, the court ruled that as a matter of law, the word "contemplated" as used in Question 8 "can encompass consideration of a mere *possibility* of future action." The court rejected SMI's reading of Question 8 as too narrow and not consistent with the ordinary meaning of the word "contemplate." It declared the policy void *ab initio*. CSCAPI had no claim against the insurance company for reimbursement of costs and fees advanced to its former CEO.

#### Key Takeaway

Always be forthright when completing applications for insurance. If you have questions, ask your broker. Even if discussions are still preliminary, if the application asks whether an exit is contemplated, answer "Yes".