

Fool Me Twice: Ongoing Failures To Transfer Rights To Insurance Coverage

After the debacles of asbestos, silica, other toxic tort and environmental litigation over long past activities, it is hard to imagine that significant asset purchases continue to be accomplished with little regard to historic insurance coverage. Recent court decisions have only added to the risk and uncertainty associated with asset purchase agree-

PATRICK J. LAMB
JOSEPH P. NOONAN III

ments. The lessons of these cases and other experiences form the basis for some simple rules to follow, particularly when your company is the buyer.

The scenario generally is a typical one. One company has decided to sell a division or other operating entity, and your company has decided to buy. As everyone knows, pure asset acquisitions are uncommon. The norm is that the buyer acquires assets, frequently a product line including the equipment to manufacture the product, and liabilities associated with the assets, that is, liabilities associated with the product line. Frequently the definition of what is acquired is broad enough to include environmental liabilities from the production of the product as well as liabilities for injuries caused by the product.

This typical scenario is frequently complicated by the seller's retention of other divisions or subsidiaries, all of which have been named on the seller's insurance policies along with the division or entity being sold. In such circumstances, the seller is not highly motivated to part with an asset as valuable as insurance. Many buyers assume that the rights to insurance are an asset included with all the other assets they are buying. Several courts have concluded that this assumption is misplaced.

A case of great importance in this area is *Henkel Corporation v. Hartford Accident and Indemnity Company*, 29 Cal. 4th 934, 129 Cal. Repr.2d 828 (2003). In *Henkel*, the plaintiff had acquired the metallic chemical product line of Amchem Products, Inc. As part of this transaction,

Henkel agreed to assume Amchem's liabilities associated with this product line. Henkel later faced lawsuits based on injuries sustained prior to its purchase, but during the period of policies issued to Amchem, and sought coverage under the policies issued to Amchem. The California Supreme Court determined that, because Henkel was liable for the pre-purchase injuries only because it had assumed those liabilities by contract, the insurers had not consented to an assignment of the policies to Henkel and consequently Henkel was not entitled to coverage. The court focused primarily on the language of the insurance contract, noting that each of the policies contained anti-assignment provisions. Because Henkel had assumed the liability at issue by contract and not by operation of law, the court concluded, the anti-assignment language must be honored. Henkel argued that the assignment did not increase the insurer's risk and the insurance should therefore follow the risk, but the court disagreed, finding that some risk existed because the predecessor company survived and there was "ubiquitous potential for disputes over the existence and scope of the assignment." In the court's view, the risk of two companies claiming the right to defense and indemnity was reason to uphold the insurer's right to assignment.

There are, to be sure, cases that have gone the other way. For example, in *Glidden Company v. Lumberman's Mutual Casualty Co.*, No. 81782, 2004 WL 2931019 (Ohio Ct. App. Dec. 17, 2004), the Ohio Court of Appeals found that insurance benefits follow a covered liability as a matter of law. The *Glidden* court "agree[d] with the *Henkel* dissent and cases which refuse to enforce anti-assignment provisions against claims that arise from pre-assignment occurrences." The court concluded that "[w]e find that a corporation which succeeds to the liability for pre-acquisition operations of another entity acquires rights of coverage by operation of law. This theory applies even where the acquisition was a purchase of

assets or only part of a predecessor corporation.” The court rejected the *Henkel* argument that the insurer’s risks increase because of the acquisition, saying that “when the activities giving rise to the damage or loss occur during the term of the policy and prior to any transfer of assets, the risk is no greater than when the policy was written.”

The *Glidden* decision quite reasonably focuses on the windfall to the insurers that follows the application of the *Henkel* court’s reasoning. But because California insurance coverage decisions have historically been of considerable influence nationally, asset purchasers which have assumed that coverage was an acquired asset should doubt the validity of that assumption. Certainly until more courts have spoken on this issue, it will be impossible to predict with any comfort what will happen in any given transaction. It is essential, therefore, for transactions to be documented to accomplish the transfer of coverage rights if the parties intend to do so as part of the transaction.

Given this uncertainty, what should be done in asset purchase transactions?

First, the buyer should insist that the seller seek its insurers’ consent for the assignment of policy rights to the buyer. This is relatively easy to do for recent policies, but much more difficult with respect to historic policies that typically are not immediately available. It would be worth engaging insurance archeologists to uncover historic policies as part of the acquisition process. Even if all policies can be found, however, there is no assurance that the insurers will give their consent. So while consent should be sought, seeking consent should not be the only approach to the problem.

The next protection the buyer should seek is to assume liabilities “net of insurance.” In essence, the obligation to pay to seek insurance and to maximize the value of the insurance asset is shifted to the buyer, the liability technically stays with the seller, at least until the possibility of insurance coverage is exhausted. This approach appears to avoid most of the problems identified in *Henkel*.

The third option is to assign insurance rights specifically, including rights to causes of action and policy proceeds. Coupled with an obligation on the part of the seller to cooperate in securing insurance, this affords some protection not otherwise provided by the simple assumption that insurance will follow the risk. This

approach is problematic for a number of reasons discussed above, however.

The moral of the story is this: in every asset acquisition, the buyer can never know the detailed history of every product ever sold, of every act or failure to act that can potentially create liability for the buyer. It is predictable that injured parties will look to the buyer for relief, whether instead of or in addition to the seller, even if doing so is technically improper. It is foreseeable, if not likely, that some courts will afford injured parties a measure of protection by allowing them to proceed against asset buyers, leaving the buyer and seller to “sort it out.” As a result of these predictable eventualities, it is incumbent on every buyer’s counsel to make the transfer of insurance assets or rights a focal point of the transaction.

Notwithstanding the risks asset buyers confront, a number of major American law firms have failed to provide their clients with adequate protection in transaction documents. At this point in time, there simply is no excuse for using boilerplate language from prior deals or relegating this issue to young associates for handling. Likewise, General Counsel and other senior corporate counsel must demand that this issue receive the attention required and not simply assume that things will sort themselves out at a later date. If the best lawsuit is the one avoided, perhaps the time has come for an extensive dialogue among transactional lawyers and litigators on this topic.

Patrick J. Lamb is a partner and Joseph P. Noonan III an associate with Butler Rubin Saltarelli & Boyd LLP, a Chicago litigation firm. The view expressed are personal to the authors. Comments can be directed to Patrick Lamb at plamb@butlerrubin.com.



BUTLER RUBIN
excellence in litigationsm