2016 CLM Annual Conference
April 6-8, 2016
Orlando, FL

"Your Mergers and Acquisitions Have Consequences"

I. Introduction

A. Framing the issues – typical scenarios

There are three well recognized situations in which a buyer of corporate assets may be liable for the torts of its predecessor, notwithstanding the purchaser's failure to assume liability by contract.

First, the buyer of corporate assets may be liable as a corporate successor if the transaction amounts to a consolidation or merger of the two corporations, the purchasing corporation is a mere continuation of the seller, or the transfer of assets to the purchaser is for the fraudulent purpose of escaping liability for the seller's debts.

Second, a company that acquires another company's product line may be liable for injuries caused by its predecessor's defective products, if certain conditions are met. One condition is the virtual destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business.

Third, some statutes, notably the Comprehensive Environmental Response, Compensation, and Liability Act (42 U.S.C. § 9601 et seq.), impose liability upon successor corporations without regard to contract. See, e.g., Henkel Corp. v. Hartford Accident & Indemnity Co., 29 Cal. 4th 934, 62 P.3d 69, 129 Cal. Rptr. 2d 828 (Cal. 2003)

B. Examples of Liabilities arising from discontinued operations and entities

Types of liabilities commonly arising from mergers and acquisitions that require a response by insurers are long tail issues

leading to bodily injury claims such as exposure to toxic substances by workers, their families, and others such as tenants (lead, silica, asbestos, and uranium come immediately to mind), and damage to property and resources such as water supplies arising from the operation of auto repair facilities, former armed forces installations, aircraft manufacturing plants, mining operations, battery manufacturing plants, smelting operations, as well as waste disposal and landfill operations and construction defects.

Finally, bodily injury claims can arise from defective products manufactured by companies which have ceased business altogether, whose assets have been purchased by a successor, or whose operations essentially continue, albeit under a different name and ownership. See, e.g., Ray v. Alad Corp., 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (Cal. 1977)

II. How does liability insurance survive a merger

When companies are acquired with ongoing operations, including owned or leased property and facilities, tail liabilities can be either known, in the sense an ongoing and existing claim that is being responded to, studied, mitigated or litigated at present, or unknown and unexpected, i.e., an injury that has not yet occurred, or in the case of environmental claims, latent, undiscovered pollution which has not yet led to a suit or remediation demand, but which will become an issue at some future point in time after the merger or acquisition has been finalized and the sale closed.

Typical policy forms generally have a more or less standardized condition that states, in effect, that an insurance contract may not be assigned or transferred without the underwriters' express consent. The reasons for this are obvious, carriers need to understand the risks they assume, to determine whether they want to accept the business in the first place, and then appropriately price it when accepted. A merger, acquisition, and change in participants may markedly change the nature of the enterprise, the management, and the scope of the business, for better or for worse.

Courts wrestling with the concept of whether insurance survives a merger have traditionally adopted two distinct approaches. The first is rather simplistic, being that the anti-assignment clause means what it says, and once the entity issued the policy ceases to exist, so does

the insurance coverage for its operations. See, e.g., Henkel Corp., supra.

A more sophisticated analysis delves into the legal concept of a chose of action, and when liability becomes fixed. An example of this line of reasoning can be found in Pilkington N. Am., Inc. v. Travelers Cas. & Sur. Co., 112 Ohio St. 3d 482, 2006-Ohio-6551, 861 N.E.2d 121 (Ohio 2006). Pilkington arose out of pollution claims against the former Libbey Owens Ford, whose glass operations had been acquired by a British firm. Libbey's insurers contended that the purchaser, Pilkington could not reap the benefit of policies issued its predecessor in interest. Pilkington contended that it was entitled to the protection afforded by the Libbey policies. The Court agreed with Pilkington, and disagreed with the Henkel line of reasoning.

The Pilkington court analyzed the issue beginning with the concept of a chose in action, basically the right to make a claim. The Pilkington court reasoned that if a chose in action existed because a claim had already arisen, the ability to transfer the chose in action would trump the anti-assignment clause of a policy in that the duty of the insurer had been fixed by the happening of the occurrence.

A dozen years later, the California Supreme Court revisited and disapproved much of the Henkel decision in Fluor Corp. v. Superior Court, 61 Cal. 4th 1175 (2015). In an about-face and with the apparent gift of hindsight, the Court held that California Insurance Code section 520 "An agreement not to transfer the claim of the insured against the insurer after a loss has happened, is void if made before the loss except as otherwise provided"), which it had not considered in Henkel, barred a carrier from refuse to recognize a "post loss" assignment.

Fluor court concluded:

a) Section 520 applies to third-party insurance
b) Section 520 makes assignable insurance for a loss sustained by a third party that is covered by the insured's policy, and for which the insured may be liable;
c) the statute does not contemplate that there needs to be a money judgment or approved settlement before such a claim concerning that loss may be assigned without the insurer's consent.

The Court reasoned that this interpretation protected the ability of an insured, in the course of transferring assets and liabilities to another business entity in connection with a corporate sale or reorganization, to assign rights to claim indemnification and defense coverage provided by prior and existing insurance policies concerning the business's previous conduct.

Because any such new business entity typically will assume both the assets and the liabilities of the prior business entity, the new business entity will understandably expect to obtain the rights to claim defense and indemnification coverage for such liabilities triggered during the policy period. If the insurer were able to prevent its insured from assigning rights to assert such claims unless first reduced to a money judgment or approved settlement, it would effectively exert precisely the type of unjust and oppressive pressure on the insured that the early decisions, California Code Commissioners, and Legislature sought to foreclose.

Cases from around the country though vary on the result in these scenarios. E.g., Travelers Ca. & Surety Co. v. United States Filter Corp., 895 N.E.2d 1172 (Ind. 2008) (insureds could not valid assign to successor companies – asbestos liability); Pilkington North America v. Travelers Cas. & Surety Co., 2006 Ohio 6551 (2006 Ohio) (duty to indemnify may be assigned after loss, suggesting perhaps different rule for duty to defend); Viking Pump, Inc. v. Century Indemnity Co., 2 A.3d 76 (Del. Ch. 2009) (applying New York law; allowing assignment despite anti-assignment provision; assignment is "post-loss" so long as event causing liability has occurred); Givaudan Fragrances Corp. v. Aetna Cas. & Sur. Co., 120 A.23d 959 (2015, N.J. Super. A.D.) ("the assignment of rights to the policies specified in the assigning documents could not have increased the risk to any . . . insurer because all losses occurred before the assignment"); Northern Ins. Co. of New York v. Allied Mut. Ins. Co., 955 F.2d 1353 (9th Cir. 1992) (indemnity & defense rights follow transfer of liabilities as a matter of law)

II. Unresolved issues

Different jurisdictions apply differing rules to successor liability. For example, some states apply the rule of product-line successor liability. Under this theory, "a purchaser of substantially all assets of a firm assumes, with some limitations, the obligation for product liability claims arising from the selling firm's presale activities. Liability is

transferred irrespective of any clauses to the contrary in the asset purchase agreement." The rationale for transferring insurance coverage for indemnification and defense by operation of law in such an instance is that an unwary purchaser may be liable for significant bodily injury or property damage occurring before the sale, solely as a result of the purchase. The result also serves to ensure that the injured party receives recompense.

Other jurisdictions have adopted the general rule of successor liability, which provides that the purchaser of a corporation's assets is not liable for the debts and obligations, including liability for tortious conduct, of the seller corporation.

Some states recognize exceptions to this general rule, three of which impose liability without regard to contract. A successor corporation may be held liable when:
"(1) the buyer expressly or impliedly agrees to assume such liability;
"(2) the transaction amounts to a *de facto* consolidation or merger;
"(3) the buyer corporation is merely a continuation of the seller corporation; or
"(4) the transaction is entered into fraudulently for the purpose of escaping liability."

Additionally, some statutes, including the Comprehensive Environmental Response, Compensation, and Liability Act (Section 9601 et seq., Title 42, U.S.Code) have been construed as imposing liability on successor corporations without regard to contract.

Thus, will a different result obtain when liability is imposed without regard to contract and by by operation of law?

Still other courts have expanded the doctrine to include successor-liability cases not based on the product-line theory. See, e.g., *Glidden Co. v. Lumbermens Mut. Cas. Co.*, 8th Dist. No. 81782, 2004 Ohio 6922, P 64. See, also, *B.S.B. Diversified Co., Inc. v. Am. Motorists Ins. Co.* (W.D. Wash.1996), 947 F.Supp. 1476, 1481-1482; *Total Waste Mgt. Corp. v. Commercial Union Ins. Co.* (D.N.H.1994), 857 F.Supp. 140.

There are a number of courts, that have taken a different approach, holding that the contractual obligation defines the relationship between the parties when the liability arises as a matter of contract. *Red Arrow Prods. Co., Inc. v. Employers Ins. of Wausau* (Wis.App.2000), 2000 WI App 36, 233 Wis.2d 114, 132-134, 607 N.W.2d 294; *Gen. Acc. Ins.*

Co. v. Alameda Cty. Super. Court (1997), 55 Cal.App.4th 1444, 1454-1455, 64 Cal.Rptr.2d 781; *Quemetco, Inc. v. Pacific Auto. Ins. Co.* (1994), 24 Cal.App.4th 494, 500-503, 29 Cal.Rptr.2d 627.

Finally, yet other courts reason that where the underlying liability is contractually assumed and does not arise as a matter of law do so under the simple rationale that coverage should follow liability. Some courts have criticized this line of thinking for cases in which liability is contractually assumed.

The possibilities, and variations, are endless.