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Connecting the Dots: Insurance Coverage for Corporate Successors

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Due to the nature of long-tail claims such as environmental or toxic tort actions, companies are frequently sued for bodily injury and property damage that their corporate predecessors caused many years ago. Consequently, successor corporations often request defense and indemnification from the insurers that issued policies to the predecessor corporations that are alleged to have caused the damage. In order to analyze whether an alleged successor is entitled to coverage under a predecessor's policies, the predecessor's insurer and the successor's insurer must engage in a complicated analysis that involves concepts of corporate law, insurance law, and the law governing the alleged successor's potential liability. Just as a child must "connect the dots" in a coloring book to form a coherent picture, a predecessor's insurer must "connect the dots" between the putative successor's corporate history, the conduct for which it has been sued, and the language in the predecessor's policies.

Notwithstanding the fact that the issue of coverage for corporate successors arises frequently, relatively little case law exists on the subject in the United States. California has the most developed body of case law pertaining to coverage for corporate successors under their predecessors' policies. However, appellate courts in other prominent jurisdictions such as New York, Illinois, and Texas have not spoken on many of the core issues pertaining to coverage for corporate successors. Those decisions that do exist are often difficult to understand, and in some instances reflect an inaccurate statement of U.S. law.

In the limited amount of cases that do exist, insurers often argue that the successor corporation is not entitled to coverage under the predecessor's policies, either because the asset of the predecessor's insurance coverage was not transferred to the successor, or

because the predecessor's policies include non-assignment provisions that state that the policyholder may not assign the policy without the consent of the insurer. The success of the arguments will depend on a variety of factors, including the nature of the corporate transactions between the predecessor and the successor, the claim for which coverage is sought, and the jurisdiction whose laws will govern the interpretation of the predecessor's policies. In this paper, we discuss each of these points and provide insights as to how insurers should approach "connecting the dots" to determine coverage for corporate successors.

I. DID THE RIGHT TO COVERAGE TRANSFER FROM THE PREDECESSOR TO THE SUCCESSOR?

When an alleged successor seeks coverage under a predecessor's policies, the predecessor's insurer must first determine whether the alleged successor is, in fact, a successor. In other words, the insurer must analyze the corporate history of the alleged successor to ensure that the alleged successor has a corporate relationship with the predecessor. The insurer must review any and all corporate transactional documents between the alleged successor, the predecessor, and any intermediary companies, to confirm that a connection exists between the alleged successor and the predecessor. Clearly, if the alleged successor is not actually related in any way to the predecessor, the alleged successor is a stranger to the policies issued to the policyholder and has no rights thereunder.

Once the predecessor's insurer has determined that the alleged successor is, in fact, a corporate successor, the insurer must determine whether the rights under the predecessor's policies transferred from the predecessor to the successor. A successor

may acquire the rights under a predecessor's policies either by operation of law or by contract, depending on the nature of the corporate transactions at issue.

A. Did the Successor Company Form Via a Statutory Merger?

Each state in the United States has a statute governing mergers of corporations. When two corporations join pursuant to a statutory merger, the assets and liabilities of the predecessor corporations transfer to the merged corporation by operation of law, including the rights to coverage under an insurance policy, which is considered to be a corporate asset. Therefore, because all of the predecessors' assets are transferred to the successor by operation of law under a statutory merger, coverage under the predecessors' policies is likewise transferred to the successor entity by operation of law.[1] Thus, if Company A and Company B combine via a statutory merger to form Company C, and Company C is sued for Company A's liability, Company C is entitled to seek coverage under policies issued to Company A.

B. Does Coverage for the Successor Arise by Operation of Law Based on the Successor's Liability?

When the successor corporation is not created through a statutory merger, but rather acquires the predecessor's assets through an asset purchase agreement, different considerations apply. *Northern Ins. Co. of N.Y. v. Allied Mutual Ins.*,[2] a case decided by the Ninth Circuit Court of Appeals, is the seminal case that discusses coverage for successor entities that were not formed by statutory mergers.

In *Northern Insurance*, a case purporting to interpret California and Washington law, the underlying plaintiffs sued the makers of California Cooler, an alcoholic beverage, after their child was born suffering from fetal alcohol syndrome.[3] Brown-

Forman Corporation had purchased California Cooler through an asset purchase agreement two years after the birth of the child and two years prior to the filing of the underlying suit.[4] The asset purchase agreement specified that California Cooler would indemnify Brown-Forman for any product liability claims arising from California Cooler's pre-sale activities.[5] The agreement also excluded from the sale the assignment of any contract that required consent to assign.[6]

Brown-Forman tendered its defense to Northern Insurance, the company that had insured California Cooler during the last 12 days of the pregnancy, and to Allied Mutual, the company that had insured California Cooler prior to Northern Insurance.[7] The court noted that because the asset purchase agreement excluded the transfer of any contract that required consent to assign, and the Allied Mutual policy included a provision prohibiting assignment without the consent of Allied Mutual, the asset purchase agreement did not transfer the asset of the Allied Mutual policy to Brown-Forman.[8] However, the court reasoned that pursuant to the product-line liability theory espoused in *Ray v. Alad Corp.*,[9] where the California Supreme Court held that the purchaser of substantially all assets of a company assumes, with some limitations, the obligation for product liability claims arising from the selling company's presale activities, Brown-Forman was subject to liability by operation of law for harm caused by California Cooler's products.[10] With little analysis, the *Northern Insurance* court then held that because liability was transferred to Brown-Forman by operation of law, the benefits of the Allied Mutual policy were transferred by operation of law as well.[11] *Northern Insurance* has been interpreted to stand for the proposition that when the successor is liable for the predecessor's tort by operation of law, the successor is entitled to the predecessor's

coverage by operation of law. This view has been adopted by a minority of courts.[12]

The majority of courts have criticized the *Northern Insurance* rationale. These courts hold that coverage does not transfer to a successor by operation of law solely where the successor's liability arises by operation of law. For example, in *General Accident Insurance Co. v. Superior Court*,[13] another case decided under California law, a successor corporation was liable by operation of law for injuries due to its predecessor's sale of asbestos.[14] The successor sought coverage under the predecessor's insurance policies. The successor urged the court to adopt the reasoning of *Northern Insurance*, and argued that because liability for its predecessor's actions arose by operation of law, it was likewise entitled to coverage under the predecessor's policies by operation of law.[15] The California Court of Appeals disagreed and declined to follow *Northern Insurance*.[16] The court stated:

> An insured-insurer relationship is a matter of contract. Successor liability is a matter of tort duty and liability. It is one thing to deem the successor corporation liable for the predecessor's torts; it is quite another to deem the successor corporation a party to insurance contracts it never signed, and for which it never paid a premium, and to deem the insurer to be in a contractual relationship with a stranger.[17]

Several courts have agreed with the analysis in *General Accident* and have refused to follow *Northern Insurance* even though the successor's liability in those cases arose by operation of law.[18] Like *General Accident*, these courts emphasize that insurance coverage is a matter of contract law, and therefore the nature of the successor's liability should not have any bearing on the successor's ability to seek coverage under the predecessor's policies.

C. Did the Successor Acquire the Rights to the Predecessors' Policies Via Contract?

When a successor's liability for its predecessor's conduct does not arise by operation of law, or when the successor's liability arises by operation of law but the governing law of the jurisdiction does not deem the rights to insurance to transfer as a matter of law, the question becomes whether the successor acquired the asset of the predecessor's insurance policies via contract.

A leading case discussing this issue is *Henkel Corp. v. Hartford Accident & Indemnity Co.*,[19] a case decided by the California Supreme Court. There, through a series of agreements, Henkel Corporation acquired the metallic chemical product line of Amchem Products.[20] Henkel was sued by workers who alleged injuries due to exposure to metallic chemicals. Henkel, in turn, sought coverage from the insurers of Amchem.[21] Henkel argued that in accordance with *Northern Insurance*, it should be entitled to the benefits of Amchem's policies by operation of law.[22] The court reasoned that *Northern Insurance* did not apply because Henkel was not liable for the torts of Amchem by operation of law.[23] Instead, the court concluded that Henkel voluntarily assumed liability for Amchem's products in the asset purchase agreement between Henkel and Amchem.[24] The court therefore held that in order for Henkel to claim under Amchem's policies, Henkel needed to demonstrate that Amchem had transferred the rights under its policies to Henkel through contract.[25]

The majority of courts agree with *Henkel* that the *Northern Insurance* rationale is inapplicable when the successor's liability did not arise by operation of law. These courts have concluded that when the successor contractually assumes the predecessor's

liability, the successor is entitled to seek coverage under the predecessor's policies only if the rights to coverage were transferred contractually from the predecessor to the successor.[26] Similarly, in states where courts have rejected reliance on *Northern Insurance* even when the successor's liability arose by operation of law, courts also look to whether the rights to coverage under the policy were transferred by contract to the successor.[27] To determine whether coverage was transferred via contract, an insurer must analyze the documents that purport to transfer the assets and/or liabilities between the predecessor and the successor.

If the contracts do not indicate that the predecessor's rights under its insurance policies were transferred to the successor, then the successor is not entitled to coverage under the predecessor's policies. For example, in *Red Arrow Products Co. v. Employers Insurance of Wausau*, the asset purchase agreement at issue stated that only rights under insurance policies listed on a particular exhibit appended to the agreement would be transferred to the successor, and the insurance policies under which the successor sought coverage were not listed on the exhibit.[28] The *Red Arrow Products* court held that because the predecessor's insurance policies were never assigned to the successor, the successor could not recover under the policies.[29]

In contrast, if the corporate transactional contracts state that the assets were transferred from the predecessor to the successor, the successor may assert rights under the predecessor's policies. To illustrate, in *Viking Pump, Inc. v. Century Indemnity Co.*,[30] the asset purchase agreement at issue stated that the predecessor was transferring to the successor "all of the properties and assets . . . (whether tangible or intangible, real or personal) required for the conduct of the business of the [predecessor]."[31] The court held

that such language was sufficient to evidence an intention to transfer the rights under the predecessor's insurance policies to the successor.[32]

II. DOES AN ANTI-ASSIGNMENT CLAUSE IN THE PREDECESSOR'S POLICIES BAR COVERAGE FOR THE SUCCESSOR?

Once it has been determined that the rights under the predecessor's policies transferred to the successor, the insurer must then engage in an analysis of the insurance contract itself. Many insurance policies include provisions that prohibit the policyholder from assigning rights under the policy without obtaining the consent of the insurer. Because a predecessor rarely, if ever, seeks consent from its insurers before engaging in corporate transactions that result in the transfer of rights under the predecessor's policies, these provisions essentially operate as anti-assignment clauses. U.S. courts have taken different approaches when analyzing whether these anti-assignment clauses preclude coverage for successors under their predecessors' policies.

A. The Majority Rule

On this issue, the majority of U.S. courts follow the reasoning of the Ninth Circuit Court of Appeals in *Northern Insurance*. The *Northern Insurance* court reasoned that the rationale for honoring "no assignment" clauses in insurance policies vanishes when liability arises from pre-sale activities.[33] According to the court, the purpose of "no assignment" clauses is to protect an insurer against an increase in risk that could develop if the policy is assigned to a new insured.[34] However, when the loss occurs prior to the assignment, "the characteristics of the successor are of little importance: regardless of any transfer the insurer still covers only the risk it evaluated when it wrote the policy."[35] Under that reasoning, the *Northern Insurance* court held that the right to defense and

indemnification transferred to the successor for all "presale occurrences."[36] Most courts follow this analysis and have held that an anti-assignment clause does not bar coverage for occurrences that took place prior to the transfer of policy rights.[37]

Notwithstanding the above, among those jurisdictions following the majority rule, there is some disagreement as to exactly when a "loss" occurs. In *Henkel*, *supra*, the California Supreme Court recognized that coverage could transfer from Amchem to Henkel, despite the existence of an anti-assignment provision in the Amchem policies, if the loss existed as a "chose in action" prior to the assignment. A "chose in action" is defined as a "proprietary right in personam, such as a debt owed by another person, a share in a joint-stock company, or a claim for damages in tort."[38] The term can also be defined as "[t]he right to bring an action to recover a debt, money, or thing."[39] The *Henkel* court concluded that when the assets of Amchem were transferred to Henkel, the claims of the underlying plaintiffs had not become an assignable chose in action because the claims had not been reduced to a sum of money due, or to become due, under the policy, and Amchem's insurers had not breached any duty to defend or indemnify Amchem at that time.[40] Thus, because the assignment preceded the "loss," the *Henkel* court held that the insurers had no obligation to cover Henkel.

The *Henkel* court's analysis of when a chose in action accrues has been heavily criticized by other courts. For instance, in *Pilkington North America, Inc. v. Travelers Casualty & Surety Co.*, the Ohio Supreme Court concluded that under Ohio law, a chose in action in the insurance context does not accrue when the claims have been reduced to a sum of money owed, but rather at the time of the occurrence.[41] Noting that case law in Ohio "consistently recognized that the insurer's coverage obligation in an occurrence

policy arises at the time of the occurrence," the court refused to follow *Henkel*.[42]

A similar result was reached in *Viking Pump, Inc. v. Century Indemnity Co.*,[43] an opinion authored by a Delaware court interpreting New York law. In *Viking Pump*, two companies, Warren Pumps LLC and Viking Pump, Inc., sought coverage under insurance policies issued to an alleged predecessor-in-interest. Relying on *Henkel*, the predecessor company's insurers argued that because the insured loss had not been reduced to a fixed amount prior to the assignment of the policy rights, the anti-assignment clauses in the policies barred coverage. The *Viking Pump* court rejected the insurers' argument and reasoned:

> [T]he distinction that the California Supreme Court drew in *Henkel* simply does not exist in New York case law. Instead, courts applying New York law have treated the "loss" as occurring when liability arose. In this way, New York law on this matter is in accord with the dissent in *Henkel*, which stressed that anti-assignment clauses should not apply in this context because "[t]he risk insured against does not increase because the insurer's duty to defend and indemnify relates to an injury or damage which was suffered by the claimant prior to the assignment of benefits to a successor corporation." The majority's conclusion in *Henkel* is also at odds with New York's public policy, because it could hamstring markets for the sale of corporate assets and lead to insufficient recoveries for tort plaintiffs in situations when insurance to cover the plaintiffs' claims was bought and paid for.[44]

Thus, when a predecessor's insurer is faced with a claim from a successor and the law governing the predecessor's policies subscribes to the majority rule, whether the anti-assignment clause precludes coverage depends upon the timing of the loss at issue and how the governing law treats the concept of a chose in action.

B. The Minority Rule

Although the majority rule is that anti-assignment provisions in occurrence

policies are unenforceable if the assignment occurred after the loss, a minority of U.S. courts strictly interpret anti-assignment provisions and hold that they bar coverage for successors even if the transfer of policy rights occurred subsequent to the loss. In *Del Monte Fresh Produce, Inc. v. Fireman's Fund Insurance Co.*,[45] the Supreme Court of Hawaii began its analysis by rejecting the operation of law theory espoused in *Northern Insurance*. The court concluded that in order for a successor to assert rights under a predecessor's insurance policy, the rights must be transferred to the successor via contract. Notwithstanding that the loss at issue took place prior to the assignment of rights under the policies to the successor, the *Del Monte* court strictly enforced the anti-assignment clause in the insurers' policies and held that the post-loss assignment was invalid.

Other courts have strictly construed anti-assignment language to bar coverage due to the strong public policy in certain jurisdictions in favor of freedom of contract. For example, in *Keller Foundations, Inc. v. Wausau Underwriters Insurance Co.*,[46] the Fifth Circuit Court of Appeals held that under Texas law, an anti-assignment clause in an insurance policy precludes coverage for a successor even if the assignment occurred after the loss. The *Keller Foundations* court emphasized that Texas courts had consistently enforced anti-assignment clauses in insurance policies and other contracts according to their plain language. In light of Texas' public policy in favor of strictly construing anti-assignment clauses, the Fifth Circuit concluded that the Texas Supreme Court would reject the majority rule and would hold that an anti-assignment provision precludes a successor from seeking coverage under a predecessor's policy, regardless of whether the loss preceded the transfer of the policy rights from the predecessor to the successor.[47]

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As evidenced by the discussion above, the law in the United States pertaining to coverage for corporate successors under their predecessors' policies is quite complicated. Therefore, whenever an insurer is asked to provide coverage to a successor under a predecessor's policy, it is helpful to break down the coverage analysis into a series of steps. The insurer first must determine whether the entity seeking coverage is, in fact, a successor of the policyholder and, if so, the insurer must then analyze whether the predecessor's rights under its policies transferred to the successor. The insurer must keep in mind that coverage may have transferred by operation of law even if the rights were not transferred in any of the contracts entered into by the predecessor and the successor. Then, if the insurer concludes that coverage did, in fact, transfer to the successor, the insurer must evaluate whether the predecessor's policies included anti-assignment provisions and, if so, whether they are potentially enforceable under applicable law. Of course, after a predecessor's insurer has conducted the difficult, multi-step analysis described above and has determined that the successor is entitled to seek coverage under the predecessor's policies, the insurer must still consider the full panoply of coverage terms, conditions, and exclusions in the policies to the extent that they preclude or limit coverage for the successor.

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[1] *See, e.g., Knoll Pharm. Co. v. Auto. Ins. Co.*, 167 F. SUPP.2D 1004, 1010-11 (N.D. Ill. 2001); *Texaco A/S v. Commercial Ins. Co.*, 1995 U.S. DIST. LEXIS 15818, *16-*18 (S.D.N.Y. 1995) (unpublished opinion),

vacated on other grounds, 160 F.3d 124 (2d Cir. 1998); *Brunswick Corp. v. St. Paul Fire & Marine Ins. Co.*, 509 F. SUPP. 750, 752-53 (E.D. Pa. 1981).

[2] 955 F.2D 1353 (9th Cir. 1992).

[3] *Id.* at 1355.

[4] *Id.*

[5] *Id.* at 1355-56.

[6] *Id.* at 1356.

[7] *Id.*

[8] *Id.* at 1357.

[9] 19 CAL.3D 22 (1977).

[10] *Northern Insurance*, *supra* note 2, 955 F.2D 1353 at 1357.

[11] *Id.* at 1358.

[12] *See B.S.B. Diversified Co. v. Am. Motorists Ins. Co.*, 947 F. SUPP. 1476 (W.D. Wash. 1996) (holding that in accordance with *Northern Insurance*, the successor was entitled to coverage because the successor was liable for the predecessor's contamination by operation of law and the benefits of the policies followed the successor's liability); *Total Waste Mgmt. Corp v. Commercial Union Ins. Co.*, 857 F. SUPP.2D 140 (D.N.H. 1994) (same).

[13] 55 CAL. APP.4TH 1444 (1st App. Dist. 1997).

[14] *Id.* at 1445-46.

[15] *Id.* at 1449.

[16] Although *Northern Insurance* purported to interpret California law, it was decided by a federal court sitting in diversity and therefore was not binding upon the California courts.

[17] *Id.* at 1451.

[18] *See Del Monte Fresh Produce, Inc. v. Fireman's Fund Ins. Co.*, 117 HAW. 357, 368 (2007) (holding that the predecessor's insurer had no duty to defend or indemnify the successor even though the successor was liable for the predecessor's contamination by operation of law); *Red Arrow Prods. Co. v. Employers Ins. of Wausau*, 233 WIS.2D 114 (Ct. App. 2000) (same).

[19] 29 CAL.4TH 934 (2003).

[20] *Id.* at 938.

[21] *Id.* at 939.

[22] *Id.* at 941.

[23] *Id.* at 941-42.

[24] *Id.* at 943.

[25] *Id.*

[26] *Keller Founds., Inc. v. Wausau Underwriters Ins. Co.*, 626 F.3D 871 (5th Cir. 2010) (interpreting Texas law); *Koppers Indus. v. N. River Ins. Co.*, 1996 U.S. LEXIS 22860, *17-*19 (W.D. Pa.), *aff'd*, 103 F.3D 113 (3d Cir. 1996); *Pilkington N. Am., Inc. v. Travelers Cas. & Sur. Co.*, 112 OHIO ST.3D 482, 491 (Sup. Ct. 2006).

[27] *See Del Monte*, *supra* note 18, 117 HAW. at 368; *Red Arrow Prods.*, *supra* note 18, 233 WIS.2D at 120; *General Accident*, *supra* note 19, 55 CAL. APP.4TH at 943.

[28] *Red Arrow Prods.*, *supra* note 18, 233 WIS.2D at 120.

[29] *Id.* at 134.

[30] 2 A.3D 76 (Del. Ct. Chancery 2009).

[31] *Id.* at 96.

[32] *Id.* at 97-98.

[33] *Northern Ins.*, *supra* note 2, 955 F.2D at 1358.

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *See* 3 COUCH ON INSURANCE 35.7 (3d ed. 1999); *Globecon Group, LLC v. Hartford Fire Ins. Co.*, 434 F.3D 165, 170-71 (2d Cir. 2006) (interpreting New York law); *Elat, Inc. v. Aetna Cas. & Sur. Co.*, 280 N.J. SUPER. 62, 66-68 (App. Div. 1995); *see also Keller Foundations, Inc. v. Wausau Underwriters Ins. Co.*, 626 F.3D 871, 874 n.4 (5th Cir. 2010) (collecting cases).

[38] BLACK'S LAW DICTIONARY (8th Ed. 2004) at 258.

[39] *Id.*

[40] *Henkel*, *supra* note 19, 29 CAL.4TH at 944.

[41] *Pilkington*, *supra* note 26, 112 OHIO ST.3D at 486.

[42] *Id.*

[43] 2 A.3D 76 (Del. Ct. Chancery 2009).

[44] *Id.* at 105-06 (footnotes omitted).

[45] *Supra* note 18.

[46] *Supra* note 26.

[47] *Id.* at 874-75.