

Corporate Successors Barred from Tapping Policies for Historic Liabilities?

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Contemplating a corporate acquisition? Assuming the predecessor corporation's latent liabilities (such as asbestos, environmental, product liability, etc.)? Counting on the predecessor's liability insurance to fund them if they arise? You might want to think again.

Until recently, it was commonly assumed that a corporate successor could tap a predecessor's historic insurance policies to fund such liabilities. These policy benefits were considered "choses in action" – property interests that are freely transferable notwithstanding boilerplate clauses in policies prohibiting assignment without the insurer's consent. The rationale for disregarding such anti-assignment clauses was (1) it promotes free trade and (2) post-loss assignments ostensibly do not increase the insurer's risk because the claim has already occurred.

In 2003, the California Supreme Court decision in *Henkel Corp. v. Hartford Accident and Indemnity Co.* dramatically curtailed the ability of corporate successors to tap into predecessors' liability policies. The *Henkel* court held that where a successor corporation contractually assumes liabilities, the corollary insurance benefits do not automatically follow.

The court also held that policy benefits were not transferable choses in action unless at the time of transfer they could be reduced to a monetary sum certain. The court reasoned that historic product or environmental liabilities may not even be known to the predecessor at that time, much less reduced to a sum certain, so coverage for them cannot be transferable choses in action.

The court also reasoned that the policy transfer may well increase an insurer's risk because the insurer might have to defend both the predecessor and the successor if both are named in an underlying lawsuit. Thus, the *Henkel* court concluded that policy assignment requires the insurer's consent.

In a disturbing trend, several state and federal courts in Hawaii, Indiana, Ohio, New York, and Michigan have followed *Henkel* or its reasoning to some extent. Colorado courts have not squarely addressed policy assignments in the context of a corporate predecessor's latent liabilities, but the weight of Colorado law currently appears to favor transferability. In other contexts, the Colorado Supreme Court has repeatedly held that liability insurance benefits – including the insurer's contingent duty to defend and indemnify – are transferable choses in action. Still, Colorado courts could well follow *Henkel* if squarely presented with the issue.

Additionally, Colorado law does not necessarily govern insurance policies issued to a Colorado predecessor corporation, and thus such policies could be subject to *Henkel* or similar cases in other states. Determining which state's law governs the interpretation of liability policies is a complicated, fact-specific process, particularly where the policies cover locations in multiple states, where the insured corporation markets or distributes products or services across state or national borders or through the Web, or where the claims or suits are brought in states other than where the insured corporation is incorporated or headquartered.

Moreover, tracing the predecessor's liabilities and insurance policies can be complex. Over time, assets and liabilities may change hands multiple times through a variety of transactions.

What is clear is that, after *Henkel*, inattention to these issues could haunt the successor corporation. Although *Henkel* arguably applies only to asset purchases, insurers could try to apply it to other types of transactions.

There are a variety of measures to minimize a corporate successor's risk of assuming uninsured latent liabilities. These include making insurance due diligence a priority, structuring the deal to maximize the

ability to tap into the predecessor's policies, and crafting backup plans if such policies become unavailable.

For litigation, the *Henkel* line of cases means the parties need to analyze possible insurance coverage in detail very early. Among other things, the litigants need to make sure they assert their claims (or counterclaims and cross-claims) against the entities with rights under the insurance policies that may cover the events causing the conditions at issue, or possibly substitute them as defendants where necessary and practicable. Discovery should focus on determining the details of the circumstances under which successor entities may assert that predecessors' insurance coverage transferred to them.

A full exploration of transactional measures and litigation considerations is beyond the scope of this alert, but if you are contemplating a corporate transaction or if you could potentially be involved in litigation where a corporate predecessor's insurance policies may be relevant, you should discuss these issues with your DGS team early on.