Recent Developments in Corporate Successor Rights to Coverage under Predecessor Insurance Policies

By Marianne E. Brown

As mergers, sales of assets, and the creation of subsidiaries constantly reconstitute the structure of America's businesses, corporations may seem to have more lives than a cat. When a latent claim, like a toxic tort case dating to exposure decades previous, or an environmental cleanup claim for waste dumped long ago, hits such a company, the company may assert a claim for insurance coverage under Comprehensive General Liability (CGL) policies held by predecessor corporations that date back to the time of exposure or contamination. Over the past decade, case law has developed around the question: Where those policies were held in the name of the predecessor company, when will the carrier have a duty to defend or indemnify the named defendant?

Until recently, the answer was fairly simple: Where the corporate transfer documents, statute, or common law provided that all assets were transferred pursuant to the merger or acquisition, the transferor's rights under existing policies transferred by operation of law.[1] Other courts phrased it this way: that the coverage is a chose in action that passes to the successor along with all other assets.[2] These doctrines clearly favored successor rights. The courts justified this ruling by observing that the risk was already fixed for the insurers, because in these latent manifestation cases, the contamination or exposure occurred prior to the corporate transaction.

In recent years, there has been a growing trend toward validating and upholding the terms of the insurance contract. If the contract provides that the carrier must consent to the assignment of the policy, and if the consent is not given, then the coverage rights do not transfer.

The first leading case to adopt this view came from the Supreme Court of California in *Henkel Corp. v. Hartford Accident & Indemnity Co.*[3] In that case, the court strictly upheld the anti-assignment provisions in the insurance contract and rejected the view that all policy rights passed by operation of law. *Henkel* was followed by the Supreme Court of Hawaii ruling in *Del Monte Fresh Produce v. Fireman's Fund Ins. Co.*[4] That case concerned an Environmental Protection Agency action under the Comprehensive Environmental Response, Compensation, and Liability Act addressing hundreds of gallons of fumigant allegedly released into the soil of a pineapple plantation in Hawaii by the predecessors to the Del Monte Corporation. Del Monte tendered its defense to all liability insurers of the land since the 1940s. The lower court had adopted the earlier view that even in the presence of an anti-assignment clause, "where a successor corporation seeks coverage and that coverage really does not increase the risk to the carrier, then by operation of law, coverage should be extended to the plaintiff."[5] The Supreme Court of Hawaii reversed, holding that rules of insurance contract interpretation favored the validity of the anti-assignment clause, and that the lower court's conclusion was "[not] consistent with Hawaii's rules governing construction of insurance policies."[6] There, the Hawaii Code specifically provided that an insurance "policy may be assignable or not assignable, as provided by its terms."[7]

Recently, the Supreme Court of Indiana offered its own thorough analysis of these questions. *Travelers Casualty and Surety Company v. U.S. Filter Corp.,*[8] concerned companies with an ownership history of stock assignments, mergers, subsidiaries, and asset sales that spanned a hundred years. Over 80 policies of insurance were involved. The underlying claims asserted injuries allegedly caused by exposure to silica from work performed near a blast machine. The supreme court reversed the appellate court ruling that the right to coverage for the claim under predecessor policies was a chose in action that transferred independently from the policies themselves.

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The court first took up the question of whether the subject policies had been assigned in the two key corporate transactions at issue. Regarding the first transaction, a spinoff occurring in 1986, the corporate transfer documents indicated that the parties did not expressly attempt to transfer the relevant insurance policies in the assignment of corporate assets. The second key transaction was in 1996. At that time, the predecessor corporation, Wheelabrator Technologies Inc. (WTI), and U.S. Filter entered into an insurance agreement as part of the asset sale. That agreement provided that WTI would convey to U.S. Filter "the relevant insurance policies[,] any claim, chose in action, or other right WTI . . . may have to insurance coverage under past and present insurance policies insuring WIT . . . and/or any of [its] predecessors. . . ."[9]

By its terms, the transaction appeared to attempt to transfer all prior policies and, at a minimum, all policies since the 1986 transaction.

However, the policies at issue all contained the boilerplate clauses requiring insurer consent to assignment. The claimants admitted that such consent had neither been sought nor obtained. On this basis, the court ruled—in spite of the clear intent of the parties and language of the transfer documents—that none of the insurance policies at issue had been transferred in the transactions. In enforcing the anti-assignment clause, the court recognized the insurer's "legitimate business interest in restraining assignment" as protection from a material increase in risk because of the nature of the insured.[10]

Next, the court turned to the successors' argument, successful before the lower court, that even if the policies themselves had not transferred as part of the corporate transactions, the claim was a chose in action that transferred, notwithstanding the absence of the insurers' consent. The successors attempted thus to apply the widely held "exception to the enforcement of consent-to-assignment clauses for assignments made after a loss has occurred."[11] As Williston & Lord observe, "[O]nce a loss occurs . . . [it] is now a vested claim against the insurer and can be freely assigned or sold like any other chose in action or piece of property."[12]

The key question is when the loss occurred, and whether it had truly occurred before the corporate succession. The rub here comes from the nature of the injury triggering coverage. The claims were made under these occurrence-based policies for injuries that apparently occurred years before the transaction, but were not yet manifest and thus not yet reported. Do such "occurred but not yet reported losses" form the basis of a chose in action that would have transferred through succession?[13]

In answering these questions, the Indiana supreme court followed the California supreme court's seminal *Henkel* decision, where it ruled in a similar context that the claim would only rise to a chose-in-action status if it had been asserted prior to the transfer. As the Indiana court explained, "At a minimum, for an insured loss to generate an assignable coverage benefit, the loss must be identifiable with some precision. It must be fixed, not speculative."[14] The California supreme court had held similarly in *Henkel* that a claim is not an assignable chose in action until it is "reduced to a sum of money due or to become due under the policy."[15] Here, the Indiana supreme court added:

> A right not currently held is not a chose in action assignable at law. It follows that a chose in action only transfers in these circumstances if it is assigned at the moment when the policyholder could have brought its own action against the insurer for coverage. Under the liability policies implicated here, that moment does not arrive until a claim is made against the insured. Put another way, at a minimum the losses must have been reported to give rise to a chose in action.[16]

Thus, because the blast machine injuries at issue had not yet been reported at the time of the transactions, they did not constitute an assignable chose in action, and the claimants were held to have no right to coverage under their predecessors' insurance policies.

The Indiana supreme court justified this result with the argument that to hold otherwise would unfairly increase the risk to the carrier, given the change in the nature of the insured that may occur through succession. Thus, the court rejected the rationale, set forth by the Ninth Circuit in *Northern Insurance Co. v. Allied Mutual Insurance Co.*,[17] that there would seem to be little increased risk to the carrier associated with the assignment of a policy, years after any damage could have been done. The *Northern Insurance* court observed that either an injury will manifest itself or not; that is, the current state of the holder of the policy could not possibly affect the nature of the indemnity risk.[18] Notwithstanding this apparent reality as to indemnification, however, the Indiana supreme court observed that about the duty to defend, "the risk of being called to court to defend more than just the underlying claims seems substantial, as this dispute soundly demonstrates."[19] Indeed.

The Indiana court reached this ruling with the acknowledgment that, as the amici curiae had pointed out, "The free flow of capital and assets between business entities is important for the vitality of national and international markets."[20] The court noted that the parties to transfer of assets or merger can address "occurred-but-not-yet-reported" losses in other ways. For example, "the asset purchaser could negotiate for indemnification of losses that have occurred up to the moment of exchange."[21] Under those circumstances, the predecessor corporation, while indemnifying its successor, could itself assert a direct claim for coverage under its own old policy. Unfortunately, that avenue had not been negotiated for the coverage claimants in the *Travelers v. U.S. Filter* case. ♻

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Endnotes

1. *See, e.g.*, Northern Ins. Co. v. Allied Mut. Ins. Co., 955 F.2d 1353 (9th Cir. 1992).
2. *See* Conrad Bros. v. John Deere Ins. Co., 640 N.W.2d 231 (Iowa 2001).
3. 62 P.3d 69 (Cal. 2003).
4. 183 P.3d 734 (Haw. 2007).
5. *Id.* at 743.
6. *Id.* at 745 (footnote omitted).
7. *Id.* at 747.
8. 895 N.E.2d 1172 (Ind. 2008).
9. *Id.* at 1178.
10. *Id.*
11. *Id.* at 1178–79, *citing Conrad Bros. v. John Deere Ins. Co*., *supra* note 2.
12. Williston & Lord, A Treatise on the Law of Contracts § 49:126 (4th ed. 2000).
13. *Travelers v. U.S. Filter*, 895 N.E.2d at 1179.
14. *Id.* at 1180 (citation omitted).
15. 62 P.3d at 75.
16. 895 N.E.2d. at 1180.
17. 955 F.2d 1353 (9th Cir. 1992).
18. *Id.* at 1358.
19. 895 N.E.2d. at 1180.
20. *Id.* at 1177.
21. *Id.* at 1180.