Managing the Risk and Insurance Implications of Corporate Transactions

Almost every week, at least one merger, acquisition, or other transaction is among the top stories reported by leading business and financial media. While the dollar figures and personalities involved in these deals often garner attention, insurance is rarely mentioned. However, in the event that prior claims materialize after the closing, the form of the transaction — asset sale, stock purchase, or merger — can have a significant impact on insurance recovery under a predecessor's general liability (GL) policies. It is important that companies involved in M&A transactions understand the implications of a transaction's structure on their insurance programs.

TYPES OF TRANSACTIONS

M&A transactions can take many possible forms, each with unique implications on insurance and liability issues.

Stock purchase: In a stock transaction, all of the acquired company's assets and liabilities follow that acquired entity. Thus, unless varied by the purchase agreement, the liabilities (whether actual or contingent) of the acquired firm are "acquired" along with the stock. This could include product liability for goods sold or manufactured pre-closing, employment liability arising out of long-forgotten asbestos exposure, or even pollution claims from chemical spills that took place decades ago. The target company's insurance policies, whether in force or historical, also follow along with the stock.

Asset purchase: In an asset transaction, the parties identity those assets and liabilities (if any) of the target which are the subject of the transaction. In so doing, the buyer may generally avoid inheriting the liabilities of the seller. (There are exceptions to this general rule, particularly where substantially all of sellers' assets are purchased.) To the extent the buyer assumes specific liabilities, it does so pursuant to contract and not by operation of law.

Correspondingly, in an asset transaction, the target's assets, including its insurance policies, must be specifically enumerated in the purchase contract in order to be included in the transaction. It is important to consider whether a target's historical policies can and should be included among the acquired assets — an aspect of a transaction that is often overlooked by both buyers and sellers.

Merger: Whether the surviving entity continues under the name of either predecessor or takes a new one, a merger is the literal joining of two businesses into one legal entity. The assets and liabilities of both companies are now housed under a single legal entity. As such, all liabilities, including long-tail exposures of both parties, become the responsibility of the surviving entity by operation of law.

RISK MANAGER'S ISSUE

In any form of acquisition, risk managers — and their companies' legal advisors — must address this key question: If a successor company assumes the liability of a target, does the insurance coverage procured by the predecessor follow the liability, allowing the acquirer to recover?

ANTI-ASSIGNMENT POLICY PROVISIONS

GL policies frequently contain anti-assignment or change of control provisions. These provisions state that an insurer's consent must be obtained before the policy can be assigned to a new legal entity (in the case of an asset deal) or that the policy terminates in the event of a change of control (in the case of stock deal or a merger).

Anti-assignment provisions typically read as follows:

- "Assignment of interest under this policy shall not bind [the insurer] until its consent is endorsed hereon."
- Your rights and duties under this policy may not be transferred without our prior written consent."

The following is an example of the standard language included in change in control provisions:

If during the Policy Period:

1. *the first Named Insured designated in Item 1. of the Declarations consolidates with or merges into, or sells all or substantially all of its assets to any person or entity; or*
2. *any person or entity acquires an amount of the outstanding ownership interests representing more than 50% of the voting or designation power for the election of directors of the first Named Insured designated in Item 1. of the Declarations, or acquires the voting or designation rights of such an amount of ownership interests;*

this policy will continue in full force and effect as to Bodily Injury and Property Damage that occur prior to the effective date of such transaction and Personal Injury and Advertising Injury caused by an Occurrence that takes place prior to the effective date of such transaction.

Coverage will be afforded by this policy for Bodily Injury or Property Damage that occurs on or after the effective date of such transaction and Personal Injury and Advertising Injury caused by an Occurrence that takes place on or after the effective date of such transaction if the Named Insured notifies us of the transaction no later than ninety (90) days after the effective date of the transaction.

If the Named Insured fails to notify us within ninety (90) days of the effective date of such transaction coverage afforded by this policy will cease on the ninetieth (90th) day after the effective date of such transaction at 12:01 am standard time of the address of the Named Insured shown in Item 1. of the Declarations or the end of the Policy Period, whichever is earlier.

The provisions of paragraph E. shall only apply to transactions with third parties not under control or ownership of the Named Insured on the inception date of this policy.

Anti-assignment and change of control provisions are designed by insurers to confine the risk transfer to that of the original insured. Courts will generally recognize and enforce these boilerplate provisions as a legitimate way for insurers to protect themselves from accepting more risk than they bargained for. However, in the case of a loss that occurs prior to the attempted assignment, some (but not all) courts will recognize an exception based on the fact that once a loss has occurred the assignment does not increase the risk to the insurer.

PRODUCT LINE SUCCESSION RULE

While the general rule is that a seller's liability does not attach to the assets sold in an asset transaction, courts have found exceptions under certain circumstances, particularly when the buyer has purchased all or substantially all assets of the seller. Some courts will apply a 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 — even if the purchase agreement specifically states that the purchaser is not assuming these liabilities. As a result, in such situations purchasers have contended that the insurance coverage transferred by operation of law, essentially arguing that coverage should follow the involuntary transfer of the liability.

TRANSACTION BEST PRACTICES

When managing the insurance and liability issues involved in a transaction, there are a number of considerations companies should bear in mind.

1. Insurance coverage should be considered during due diligence, as an issue pre-closing, and then addressed as appropriate in the purchase and sale agreement.
2. Should current and historical policies be acquired?
3. Policies must be reviewed for anti-assignment or similar change in control provisions. If required, consent of the insurer must be obtained prior to the closing of a transaction.

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