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MAKING INSURANCE PART OF THE DEAL

Businesses buying assets from other firms seek policy rights as well

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Businesses commonly purchase assets and liabilities from other businesses. It is important for any prospective buyer to know, with respect to the liabilities it intends to assume, whether it will also assume the rights to any applicable insurance coverage through policies maintained by the seller.

Businesses generally acquire the assets of other businesses in one of three ways: stock purchases, statutory mergers, and asset purchases. Businesses acquire the liabilities of other businesses in two ways: by contract or by operation of law.

In a stock purchase situation, while ownership of the purchased company changes, the company remains intact. The purchased company retains its liabilities, and its insurance stays with it under its new ownership.

In the case of a statutory merger, the target company is essentially absorbed by the acquiring company. The acquiring company takes all the assets of the target, and, by operation of law, all of its liabilities. Courts have consistently held that where liabilities pass to a new company as a matter of law, any correspond-



ing insurance coverage rights pass to the new company as well. Thus, insurance transfer issues rarely arise in the context of mergers or stock purchases.

Retaining Identity

Limited asset/liability purchases present the most difficult insurance transferability issues. An asset purchase situation is different primarily because both companies retain their identity after the sale, and only some of the seller's assets and liabilities pass to the buyer. The majority of state and federal courts that have examined this issue have held that the buyer acquires whatever rights to insurance proceeds the seller would have had absent the purchase for any liability arising from pre-purchase occurrences or incidents.

Insurers generally resist this concept. Among other things, they are concerned that the risk management profile of an acquiring company may be different, and they do not want to be faced with a situation where they must defend and potentially indemnify two entities instead of one. (Very often both the seller and buyer companies are sued over pre-sale liabilities.)

As a result, many policies contain language purporting to restrict or prohibit transfer of policy rights. Although many states refuse to enforce these restrictions, the courts of at least one influential state, California, have recently expanded the applicability of restrictive policy language in the asset purchase setting. (See *Henkel Corp. v. Hartford Accident & Indemnity Co.*, 29 Cal. 4th 934 (2003).) Many

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states, including Connecticut, have little or no precedent concerning the transferability of insurance in limited asset sales. This has created a climate where insurers are more willing to contest coverage following an asset sale.

Managing The Risk

As a buyer in a prospective asset and liability purchase agreement, there are a number of steps that can be taken to manage the risk associated with the liabilities.

First, all potentially applicable insurance policies should be obtained from the seller and examined carefully for any policy language that places a restriction on transfer. Next, an analysis should be done about which state's law is likely to apply to the issue of insurance transferability and how that law will affect the

outcome. Will insurance transferability be governed by law which enforces restrictive clauses? Does the governing state have no law on the issue? If there is a concern that restrictive policy language might be enforced, are there steps that can be taken to render the restrictive language inapplicable? For example, if a policy states that the insurer must consent to any transfer, does it make sense to ask the insurer for consent?

One potential way around restrictive policy language may be to ask the insurer to name the buyer as an additional insured on the policy. Before doing so, though, care must be taken to insure that additional insured status does not provide narrower coverage than that granted to the "first named insured." (For example, some policies do not cover additional

insured's insured contracts.)

If the insurer will not agree to the transfer of policy rights, or the policy contains other potentially enforceable restrictive language, it may be possible to add consideration in the asset purchase agreement to compensate for the risk of uncovered liabilities, or it may also be possible to modify the scope of the seller's indemnification obligation to obtain coverage under the prior policies. Another option may be for the buyer to purchase insurance specifically written to cover the acquired pre-sale liabilities.

A careful analysis of the insurance implications of any proposed asset/liability purchase is always a good idea and can help prevent what looks like a good deal from later turning into a very bad deal. ■