AKO FINANCIAL SERVICES ALERT

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# Do Not Be Misled By Insurance Company Arguments Regarding The "No Assignment" Clause In Your Liability Insurance Policy

By John Gasior[1]

Mergers, acquisitions, spin-offs, consolidations — the organization and reorganization of companies is today a matter of frequent routine. Today's division is tomorrow's independent corporation and vice versa. In all the shuffling, it can be easy to lose track of insurance coverage that remains available over many years, regardless of various corporate structural changes that take place.

Take the following hypothetical situation. Beau Instrument Company, after 20 years of independent corporate existence, is acquired in 1965 by MegCorp, a large holding company. MegCorp folds Beau Instrument into its corporate structure and renames it the Beau Instrument Division of MegCorp. For 20 years the Beau Instrument division is covered by general liability insurance policies sold to MegCorp by INSURA insurance company. In 1985, MegCorp decides to spin-off the Beau Instrument division and Beau Instrument becomes a separate corporation, Beau Instrument, Inc.

Two years after the spin-off, the EPA informs Beau Instrument that it has been named a potentially responsible party for environmental contamination at several sites where, over the past 40 years, Beau Instrument has had manufacturing operations. Beau Instrument immediately notifies not only its present insurance company of the EPA action, it also notifies INSURA. Beau Instrument's risk manager reasons that the "assets" or rights transferred to Beau Instrument, Inc. at the time of the spin-off must include insurance policies purchased to cover liabilities arising from operations of the Beau Instrument Division of MegCorp from 1965 to 1985.

INSURA almost immediately denies coverage based upon a "no assignment" clause in the insurance policies sold to MegCorp. The clause, typical of those found in many insurance policies, states:

> Assignment of interest under this policy shall not bind INSURA until its consent is endorsed hereon.

INSURA informs Beau Instrument that INSURA was never informed of the Beau Instrument spin-off and certainly never consented to any assignment of MegCorp's interest under the policy to Beau Instrument, Inc.

Is Beau Instrument entitled to insurance coverage for the EPA action under the INSURA insurance policy sold to MegCorp despite of the "no assignment" clause? The answer is yes. This result is based upon the principle that insurance coverage follows liability, not the policy of insurance. One court, explaining this result in the context of a corporate spin-

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off, explained that, if the law holds the successor liable for its predecessor's tortious acts – no matter the nature of those acts – then the law likewise transfers the insurance benefits covering liability for those acts to the successor corporation.

This result does not work any injustice to an insurance company. Courts which have refused to adopt the insurance industry's interpretation of the "no assignment" clause frequently distinguish between liability arising from pre-spin-off events and post-spin-off events. For example, while Beau Instrument was a division of MegCorp, INSURA was fully able to evaluate the risks it agreed to insure and could price its premium accordingly. When a company like Beau Instrument is spun-off, the risk contemplated by INSURA is not substantially altered with regard to the pre-spin-off activities of the new corporation. This result is consistent with the operation of "occurrence" based insurance policies which provide coverage for damages which take place during the policy period, in contrast, for example, to "claims made" insurance policies. INSURA should not be permitted to prevail in its argument that EPA liability imposed upon Beau Instrument, Inc., which originated in acts performed by Beau Instrument while it was a division of MegCorp, are not covered by the occurrence based INSURA insurance policy.

Companies contemplating a merger or spin-off also should make it a practice to consider preparation of an "insurance separation agreement" which clarifies the rights of recovery under relevant insurance policies between all the parties. This can help to avoid competing claims for coverage in the event of a loss.

Thus, companies which have evolved out of another corporate entity should recognize that one of the most valuable assets they may acquire at the inception of their corporate existence is insurance coverage for existing losses or claims — insurance company arguments regarding the "no assignment" provision of an occurrence-based insurance policy notwithstanding. ■

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