Insurance Coverage
The Insurance Coverage Risks Involved in Corporate Asset Transfers, Reprised – A Review of the Glidden Decision.\(^1\)

Business executives confronting legacy asbestos, environmental, silica, chemical exposure and other long-tail liabilities arising out of past asset acquisitions quite rightly are looking for clear answers to what appear to be simple questions: Are we covered? And under what policies?

Similarly, executives for buyers and sellers of corporate assets understandably want clarity and predictability on the allocation of both pre-acquisition liabilities and pre-acquisition insurance coverage: Who is responsible for future claims? And who has access to historical insurance coverage? Millions of dollars, and perhaps even company survival, may turn on the answers to these questions.

Unfortunately, clarity and predictability have fallen prey to conflicting court decisions, decisions based on competing notions of equity and fairness on one hand, and strict construction of contractual language on the other. As demonstrated by a review of the most recent of those rulings, The Glidden Company v. Lumbermens Mutual Casualty Co.\(^2\), the legal conflicts are likely to continue into the future. There are, however, strategies that businesses may employ to increase clarity and predictability with respect to historical insurance coverage in the context of asset deals. After a brief review of the Glidden ruling, we outline those strategies below.

THE GLIDDEN RULING
Overview
In a divided ruling, an Ohio Court of Appeals recently held in Glidden that a corporate asset purchaser has rights to liability insurance coverage that originally was issued to the predecessor corporation, rejecting the contrary ruling reached by the California Supreme Court in Henkel Corporation v. Lloyd’s of London.\(^3\) According to the Ohio court, an acquiring corporation may be entitled to insurance coverage even if specific contractual provisions failed to transfer insurance rights because, by operation of law, insurance coverage follows transferred liabilities.

In Glidden, the present-day Glidden Company (called “Glidden III” by the court) had been held liable for claims arising from the production and sale of lead-based paints, paints to which the underlying claimants had been exposed prior to Glidden III’s acquisition of the Glidden paints business.\(^4\) Glidden III filed suit against five insurance companies, seeking a declaratory judgment that they were required to defend and indemnify it with respect to the underlying lead-based paint claims. The Ohio Court of Appeals in Glidden found that, by operation of law, the insurance benefits (including the right to indemnification and the right to defense) follow the liability for losses arising from pre-acquisition activities, even when an

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\(^4\) Glidden, 2004 WL 2931019 at *1.
attempted transfer of insurance rights by contract failed when executed by the incorrect party (i.e., the parent of the insured). In so ruling, Glidden rejected the oft-discussed Henkel decision, prompted a dissent and illustrated the conflicting decisions dealing with insurance rights arising out of asset deals.

The Transactional Background
Glidden involved a particularly complicated corporate history, as outlined at pages 2-4 of the ruling. That complexity notwithstanding, two salient points emerge from the opinion: 1) Glidden III was a corporate entity distinct from the original policyholders that had succeeded to the certain historical assets and liabilities of the Glidden paint business and 2) a letter agreement purporting to transfer certain insurance rights was ineffective because the transferor did not possess the insurance rights it sought to transfer. These factors eventually led to the court’s operation of law ruling. To place the opinion in context, however, a brief review of the corporate history is in order.

The Pre-Deal History
Glidden involved a series of mergers and acquisitions. The chain of corporate transactions began with the original SCM, which existed from 1924 to 1986, and the original Glidden I, which existed from 1917 to 1967 and manufactured and sold lead-based paints and pigments that were used in paints. In 1967, Glidden I merged into SCM and thereafter was known as SCM’s Glidden-Durkee Division. The policies at issue in the Glidden case named both Glidden I and SCM as insureds and were in effect from 1959 to 1987.

The Formation of Glidden III
Following Glidden I’s merger with SCM, the company participated in a series of significant mergers and acquisitions, which culminated in the formation of Glidden III. In 1986, HSCM Industries, Inc. (HSCM-1, Inc.), an indirect subsidiary of Hanson Trust Plc. (“Hanson”), acquired control of SCM by a stock tender. Thereafter, HSCM-1, Inc. liquidated SCM by transferring stock ownership of SCM to certain indirect subsidiaries of Hanson. Pursuant to this liquidation, the coatings and resins division of SCM was transferred to another subsidiary of Hanson called HSCM-6, Inc. Hanson agreed to sell HSCM-6, Inc. to ICI American Holdings, Inc. (“ICI”). One week later HSCM-6, Inc.’s name was changed to The Glidden Company (“Glidden II”).

Prior to the October 31, 1986 closing, ICI assigned its rights under the Purchase and Sale Agreement to two of its wholly-owned subsidiaries, Atkemix Seven, Inc. and Atkemix Eight, Inc. On December 30, 1986, Glidden II was liquidated and its assets were distributed to Atkemix Seven, Inc. and Atkemix Eight, Inc., after which Atkemix Eight, Inc. was renamed ‘The Glidden Company’ ("Glidden II"). In 1987, Glidden III acquired Atkemix Seven, Inc. (then known as the Macco Company).

The Letter Agreement
Significantly, the Purchase and Sale Agreement between Hanson and ICI called for a sharing of the pre-closing liabilities of the paint business, with Hanson retaining ownership of all insurance policies. In addition to the Purchase and Sale Agreement, the parties executed a side letter agreement of the same date providing that Hanson would give ICI and its subsidiaries the benefit of those policies to the extent that they provided coverage for pre-acquisition liability.

The Ohio Appellate Court Ruling
The trial court ruled that, because of ICI’s 1986 acquisition of Glidden, Glidden III was not entitled to claim rights under insurance policies that were issued to SCM (or any division thereof) or to The Glidden Company (as the corporation existed prior to its 1967 merger with SCM). In finding that Glidden III was not insured under any of the policies at issue, the trial court followed the line of reasoning adopted by the California Supreme Court in Henkel, noting that the policy language restricts the insurer’s obligations to
the insured, and does not necessarily follow the insured’s liabilities. This approach adopts a strict contractual interpretation approach and does not authorize insurance rights to transfer by operation of law. Furthermore, the trial court held that the parties failed to effectuate the assignment of claims in the letter agreement because said claims had not been reduced to a sum of money due or become due under the policy.

The appellate court reversed, holding that Glidden III was entitled to defense and indemnity costs under those policies that were issued before its acquisition of the paints business because the insurance benefits follow the liability for losses arising from pre-acquisition activities by operation of law. In so holding, the appellate court noted the split in authority on the issue and rejected the line of reasoning adopted by the trial court as derived from the holding in Henkel.

Significantly, the record reflected Hanson and ICI’s attempt to transfer historical insurance rights for pre-acquisition liabilities through the side letter agreement they executed. Nevertheless, employing an analysis somewhat reminiscent of the strict construction approach found in decisions such as Henkel, the appellate court found that the side letter agreement did not serve to transfer insurance rights because Hanson was a parent company and “an insurance policy issued to a subsidiary does not automatically cover the parent.” Therefore, because Hansen was not a party to the original insurance contracts, it could not transfer any rights and duties under those policies to ICI.

From that point, however, the Ohio Court of Appeals moved beyond the strict construction approach. Rather than simply conclude that Glidden III did not have insurance rights because the Letter Agreement failed to transfer them, the court ruled that Glidden III was, in fact, entitled to coverage under the historical policies by ruling that the historical insurance coverage follows the historical liabilities by operation of law.

In adopting the operation of law approach, the appellate court noted that a variety of situations require insurance coverage to transfer as a matter of law, and did not treat any of them as requiring a particularly different result. Specifically, the court explained that coverage of a predecessor corporation transferring to a surviving corporation after a merger does not result in increased risk to an insurer. The court also explained that insurance coverage (including rights to indemnity and defense) usually transfers by operation of law to a successor corporation in product-line successor cases for pre-sale occurrences. The court extended this ruling to also apply to contractual assumption of liability, such as took place with respect to Glidden III and its predecessors.

In reaching this ruling, the appellate court discussed and rejected the Henkel line of reasoning that the defendant insurance companies had urged. In Henkel, the Henkel Corporation had acquired a product line of another company and assumed all related liabilities. The California Supreme Court held that coverage follows liability only in those specific instances when liability was imposed as a

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9 Id. at *8 (noting that the insurance companies urged the appellate court to reject the operation of law theory); citing Henkel 129 Cal. Rptr. 2d at 835-38.
11 Id.
12 Id. at *6.
13 Although the court found that the insurers’ anti-assignment clause arguments were moot because the insurance transferred by operation of law, the court did observe that “a majority of courts refuse to enforce anti-assignment provisions against claims for pre-assignment losses.” Id. at *7, n. 8, citing Northern Ins. Co. of N.Y. v. Allied Mutual Ins. Co., 955 F.2d 1353, 1357-58 (9th Cir. 1992), cert. denied, 505 U.S. 1221; B.S.B. Diversified Co. v. American Hardware Mutual Ins. Co., 947 F. Supp. 1476 (W.D. Wash. 1996); Total Waste Management Co. v. Commercial Union Ins. Co., 857 F. Supp. 140, 148 (D.N.H. 1994).
16 Id. at *8, n.10.
17 For a more detailed discussion of the Henkel case and its impact on the transfer of insurance benefits, see the K&LNG Update referenced in note 1 above.
matter of law. The court noted that liability was not being imposed upon the Henkel Corporation by law, but rather by its contractual assumption of liability. Therefore, the court limited the Henkel Corporation’s rights as a successor to those that were defined and limited by the contract. The contract did not specify that the insurance coverage transferred along with the liability; therefore, the court held that it could not transfer coverage, meaning that the Henkel Corporation had acquired the seller’s liability without acquiring the corresponding insurance coverage. The court in Henkel also held that, because the policy benefits were assigned without the insurer’s consent, the assignment violated the anti-assignment clause of the contract.

Glidden reasoned that the contract-based approach which the court in Henkel adopted is contrary to well-settled law and is contrary to the general rule that after a loss has occurred, policy benefits can be assigned without insurers’ consent and without regard to an anti-assignment clause. The court in Glidden agreed with the dissent in Henkel, by refusing “to enforce anti-assignment provisions against claims that arise from pre-assignment occurrences.” The court in Glidden explained that, if it were to hold that the defendant insurance companies were not obligated to provide coverage to Glidden III, the agreed premium would result in an unfair windfall to those insurers, which would owe no coverage on a risk which they had promised to insure against and for which they were paid a premium.

Again citing the reasoning of the dissent in Henkel, Glidden pointed out the disproportionate exposure that a successor company would face after assuming the risk of liability for the torts of a predecessor without also receiving the benefits of the predecessor’s insurance coverage for presale occurrences. The court reasoned that it would be nearly impossible for such a company to obtain insurance coverage for injuries that have already occurred before the successor’s acquisition of the business. The court noted the chilling effect that such a scenario would likely have, as it would undoubtedly restrict corporate restructuring, mergers, and sales.

The defendant insurance companies contended that coverage should not transfer by operation of law because such a transfer would burden them with increased risks that they did not agree to. The court also rejected this argument, noting that several courts have recognized that no such increased risk exists when the duty to indemnify and defend relates to events that occurred prior to transfer because “when the activities giving rise to the damage or loss occur during the term of the policy and prior to any transfer of assets, the risk is no greater than when the policy was written.” In sum, the court held that, when the coverage passes by operation of law, the insurer faces no more risk than that to which it initially agreed.

A single judge dissented from the Glidden ruling, declining to join the majority’s conclusion that insurance rights transfer to a successor corporation by operation of law. The dissenting judge adopted the rationale behind the Henkel case, contending that “the contractual nature of insurance policies” should control the issue.

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18 Henkel, 129 Cal. Rptr. 2d at 833 (noting that an asset purchaser may be subjected to liability under three broad criteria that focus upon the transaction itself: (1) when the transaction amounts to a consolidation or merger of the two corporations; (2) when the purchasing corporation is a mere continuation of the seller; or (3) when the transfer of assets is for the fraudulent purpose of escaping liability. The court reviewed these three situations and concluded that none of them applied to Henkel).

19 Id. at 833.

20 Id. at 834.

21 Id.

22 The Glidden Co., 2004 WL 2931019 at *9, citing Henkel, 129 Cal. Rptr. 2d at 837 (Moreno, J., dissenting).


24 Id. at *10, quoting Henkel, 129 Cal Rptr. 2d at 841 (Moreno, J., dissenting).


26 Id.

27 Id. at *9.

28 Id. at *9, citing Northern Insurance Co., 955 F.2d at 1358.

CONCLUSION

While *Glidden* will be welcomed by many policyholders, it also serves to illustrate the sharp divisions that exist in the case law on the treatment of historical insurance coverage in asset transactions. Strategies that businesses may take in response to this uncertain legal environment include the following:

- **Survey the Legal Landscape** – As demonstrated above, questions of insurance policy interpretation and the effects of corporate successorship rulings are governed by state law, which can vary substantially. Consequently, in assessing past exposures and in preparing for future transactions, businesses should undertake a careful review of the likely governing law that may apply to questions of insurance coverage rights. Because of the varied rulings under different state law, understanding the state law or laws that may apply to past and future transactions is crucial.

- **Expect Conflicting Law When Drafting** – In many cases, efforts to assess the legal landscape will prove inconclusive. Thus, asset transactions should be documented, to the extent possible, to be responsive to conflicting rules of law. Depending upon the parties’ objectives (e.g., to transfer insurance rights, or to preserve rights), the parties to a transaction might explore covenants that preserve their intent and allocate risks and benefits, regardless of what a future court may do in an action against insurers.

- **Consider Remedial Measures** – In many cases, the insurance rights for legacy liabilities will be determined by historical contractual provisions. If circumstances permit, amendments to historical transaction documents – particularly internal restructuring done for tax and other reasons – may be in order.

- **Consider Approaches to Insurers** – Insurance policies, while governed by special rules and performing important public policy functions, are creatures of contract. As such, corporate policyholders faced with questions regarding rights under historical insurance policies and future policies for current transactions may wish to consider an approach to their insurers for consent to insurance rights transfers, whether past or prospective. While such inquiries may not be practical options and are likely to be met with resistance or ignored, simply making the request may assist in a future litigation.

*Glidden*, and the decisions that preceded it, teach that clarity and predictability on the questions of the insurance rights arising out of asset deals will remain elusive. Careful businesses would be wise to analyze their particular circumstances closely, therefore, with reference to the considerations set forth above.

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30 In some cases, policyholders may have expressly contracted against a transfer of insurance benefits for a number of reasons. These could include, for example, a desire to preserve insurance limits for the transferor corporation or a desire to avoid the potential imposition of obligations under retrospective premium agreements and other self-insurance features. Because the *Glidden* decision did not expressly address such a situation, it is unclear what, if any, impact the decision may have on such transactions. In such cases, however, the parties may be well-served to craft contractual provisions that provide for implementing the parties’ intentions, regardless of what a future court may rule.

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