INSURANCE COVERAGE ISSUES IN MERGERS AND ACQUISITIONS FOR INTELLECTUAL PROPERTY / ANTITRUST EXPOSURES

David A. Gauntlett
GAUNTLETT & ASSOCIATES
18400 Von Karman, Suite 300
Irvine, CA 92612
949-553-1010
949-553-2050
www.gauntlettlaw.com

00001-003-9/28/2008-141271.2

I. INTRODUCTION

Companies that acquire, or through merger obtain legal rights to, all of the assets of another company are in a position to benefit from insurance available to the other entity. Indeed, many large companies with significant self-insured retention may obtain first dollar coverage for claims pursued jointly against the larger entity that also involved the conduct of the smaller company. Care needs to be taken that, upon acquisition or merger, the new entity obtain the same rights that were available to the acquired company through its policies of insurance.

Commercial General Liability Policies often contain a provision prohibiting assignment without the insurer's written consent. These clauses are typically enforced by courts on the grounds that an assignment of an insurance policy which changes the risk upon which the insurer based its premium should not be permitted. It will be a rare factual scenario that causes a change in the risk under an insurance policy issued to an acquiring company where an acquiring company seeks to access the benefits thereunder. This follows because intellectual property torts are continuing in nature and the risk of liability would be the same under the acquiring company's policies as under the acquired company's policies. Since there is no change in risk, the insurer should not be able to prevent an assignment even in light of this restrictive policy provision.

Nevertheless, case law addressing the ability of companies to assign their insurance policies to another company is not uniform throughout the United States. In *Henkel Corp. v. Hartford Accident & Indemnity Co.*, 29 Cal. 4th 934 (Cal. 2003), the California Supreme Court held that where claims had not become an assignable chose in action or reduced to a sum of money due or to become due under the policy, the purchaser of the company's assets had no right to policy benefits of an acquired company

whose conduct subjected it to liability. The solution is an assignment, which cannot be withheld absent proof by the insurer of a change in its risk of loss. (*Henkel*, 29 Cal. 4th at 944, "(*see Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal. 4th 645, 689 [42 Cal. Rptr. 2d 324, 913 P.2d 878]), policy benefits can be assigned without consent once the event giving rise to liability has occurred.").

II. ACQUIRING COMPANY

A. Rights to Policy Proceeds under an Acquired Company's Policies

Although the court decided this case on other grounds, applying Texas law, the facts which the court implicitly accepted are illustrated by the underlying facts of *Doskocil Inc. v. Fireman's Fund Ins. Co.*, 41 Fed. Appx. 75, 2002 U.S. App. LEXIS 13610 (9th Cir. (Cal.) July 3, 2002). Doskocil Manufacturing Co., Inc. ("Doskocil") was a named insured under a CGL policy issued by Travelers Insurance Co. ("Travelers"). On September 19, 1997, Doskocil merged with another manufacturer of pet products named Dogloo, Inc. ("Dogloo"). The surviving corporation was Doskocil. Dogloo ceased to exist. By endorsement issued through Doskocil's broker of record, AON, which was Traveler's appointed agent, Dogloo was referenced as an additional insured on Doskocil's policy.

Dogloo was sued in an action brought by Michael E. Finnegan, USDC Arizona Case No. 971920 (EHC) (the "Finnegan Action") for continuing tortious conduct. Because the complaint was filed and served just days before the merger between Dogloo and Doskocil, the great majority, if not all of the alleged continuing tortious activity which Mr. Finnegan sought to enjoin, was post-merger activity by Doskocil. The claims in the Finnegan Action were for continuing torts. The Finnegan Action is based upon claims that the LeBistro® line of product advertised and sold by Dogloo and then by

Doskocil through Doskocil's advertising of its Dogloo product line had the same look as another competing product, the Pet Well®, advertised and sold by the plaintiff Finnegan through the company "Finnegan."

Travelers denied coverage for the claims asserted against Dogloo since Dogloo was not the insured under its policy, but was the acquired entity which ceased to exist following the merger.

Travelers' policy provides coverage for the post merger activities whether they are attributed to Doskocil or Dogloo. This followed because Dogloo was made an additional named insured under Travelers' policy effective as of September 19, 1997, the date of the merger. This reflected a clear intent by Travelers to provide coverage for all post-merger activities which, prior to merger, were performed by Dogloo. Doskocil also agreed to pay additional premiums for the risks arising out of Dogloo's former operations. The endorsement adding Dogloo further references that the policy premium would be adjusted pursuant to the post-policy period audit to pay any additional premium owing.

All post-merger activities were Doskocil's and covered by Travelers' policy irrespective of whether Dogloo was named as an additional insurer. Travelers' policy applied to all post-merger activities of Doskocil, whether considered to rise from Dogloo or from Doskocil itself, at issue in the Finnegan Action. Travelers' duty to defend the Finnegan Action for its post-merger activities was therefor triggered. The bulk of damages would be attributable in this fact scenario moreover to the conduct of Doskocil rather than Dogloo. While there was a separate section of Travelers' policy, Section

Two, under which Dogloo may not qualify as an "additional insurer," that is irrelevant to the coverage provided elsewhere.

B. Impact of the "Loss in Progress" Rule on Recovery of Pre-Acquisition Company Policy Proceeds

One caveat, where a suit was filed against the acquiring company prior to the date of the merger, the policy "acquisition" facilitated by the merger may lead a court to erroneously assert an argument that the lawsuit referenced a loss in progression as of the date of the merger. Thus, in *Doskocil, Inc.*, the court, applying Texas law, stated:

> Even assuming Dogloo was automatically added to Doskocil's policy on the date of the merger, Doskocil may not insure against the loss because the loss had already begun and was known to have begun by September 19, 1997, the date of the merger. *See Two Pesos, Inc. v. Gulf Ins. Co.*, 901 S.W.2d 495, 501 (Tex. Ct. App. 1995). Thus, on the merits, we affirm. *Id*. at *2.

This approach is contrary to the law applied in a majority of jurisdictions that properly characterize a lawsuit as a "claim" other than a "loss" in progress.

As the Fourth Circuit, applying South Carolina law, recently found in accord with the majority rule knowledge of a claim, or lawsuit pending, was insufficient to contribute a "known loss" without proof that the insured had pre-policy inception "actual knowledge" of a loss or was "substantially certain" that a loss would occur. *Stonehenge Engineering Corp. v. Employers Ins. of Wausau*, 201 F.3d 296, 301-302 (4th Cir. (S.C.) 2001) ("[T]he burden of proving [this affirmative defense's] applicability rests with [Wausau].").

III. TARGET COMPANY

Counsel involved in corporate acquisitions and mergers must be sensitive to preserving insurance coverage benefits that may protect intellectual property assets. They have the same obligations as risk managers to help their organization protect its

intellectual property as carefully as they do its tangible assets in connection with merger activities.

Unlike Directors and Officers policies, which are subject to rigorous underwriting requirements and limited to "claims made" coverage, "advertising injury" is typically sold on an "occurrence" basis and is often not underwritten with a view to minimizing the insurer's responsibility for intellectual property/business tort claims. Beginning in 1976, Insurance Services Office began marketing "advertising injury" offense coverage as part of "the broadest package of products available to the average insured." "Advertising injury" coverage remains one of the most valuable components of standard form Commercial General Liability Policies. Since 1986, broad-based offense coverage for "advertising injury/personal injury" offenses has been part of standard form Commercial General Liability policies. As such, it will respond to claims that may have arisen many years ago but have only recently been asserted. Therefore, earlier policy forms possessed by the acquired company may come in to play in response to litigation which pre-dates the acquisition or merger.

Indeed, there is a significant opportunity for companies to revisit denials of potential coverage since, so long as notice has been provided to an insurer, the statute of limitations applicable to coverage claims may be large enough to revisit denials of coverage over a decade ago. Thus, Indiana has a 20-year statute of limitations, Illinois and Iowa have a ten-year statute, Connecticut, Massachusetts, Michigan, Minnesota, New Jersey and New York have six-year statutes. Moreover, most states toll the statute while the underlying action is pending through appeal until its final resolution.

Recoverable sums may include reasonable attorneys' fees expended in settlements or judgments paid and, critically, prejudgment interest from date of invoice. These rates are 12% in Massachusetts and Nebraska, 10% in Arizona, California, Connecticut and Ohio, and 9% in New York.

IV. SECURING A RIGHT TO HAVE AN INSURER FUND DUTIES TO INDEMNIFY A THIRD PARTY

A. The Indemnification Problem

A policyholder may obtain a right to pursue coverage for entities for whom the policyholder assumes an indemnity obligation. A policyholder may become exposed to this risk as a consequence of contractual agreements, including licensing arrangements as well as by operation of law. The Uniform Commercial Code holds vendors responsible for securing the intellectual property rights necessary to sell their products.

B. Policy Exclusions Which Bar Indemnification Absent Special Endorsements

Procuring an insurer-funded defense for a party to a contract may require modifications to standard form CGL policy provisions. A typical exclusion, such as exclusion 3(b) to a 1986 ISO policy form, excludes coverage for "'advertising injury' arising out of: (1) breach of contract, other than misappropriation of advertising ideas under an implied contract." That exclusion may be removed by endorsement at the time that an insurance policy is purchased. Critically, exclusion 3(b) does not limit coverage for claims which potentially fall within "personal injury" coverage.

Intellectual property lawsuits may generate claims that fall within "personal injury," as well as coverage for the offenses of "malicious prosecution" or "libel" or "slander" or "invasion of a person's right to privacy" or "disparagement of an organization's goods, products or services." Moreover, claims that are not based upon a

breach of contract (i.e., tort) will trigger coverage even when the applicable exclusion would otherwise apply. The more limited exclusion 3.(2) for "assumed liability under a contract" only precludes coverage for damage or injury that occurs prior to the effective date of an indemnity agreement.

C. Obtaining Favorable Indemnification Policy Provisions

Zurich American Standard Umbrella Policy Form No. U-EU-100-BCW/12/93 provides:

> **Coverage Part B-1 Special Liability Occurrence**
>
> **E. Insured Contract**
>
> Any written or oral agreement entered into by the **insured** in the usual course of the **insured's** business operations, in which the **insured** assumes tort liability of another to pay damages because of **bodily injury, personal injury, property damage** or **advertising injury** to a third person or organization, where the contract or agreement is made prior to the injury.

This policy provision could also be added via endorsement to a policy form that has no language addressing indemnification obligations.

> **Additional Definitions**
>
> **Insuring Agreements**
>
> A. We will pay, on behalf of the **insured**, those sums the **insured** becomes legally obligated to pay or assumes under an **insured contract**, which are in excess of the Retained Limit specified in the Declarations of our policy or any valid and collectible **other insurance**.

Under this provision, defense fees incurred and settlements, and judgment entered against a party who the insured must indemnify, is its or its insurer's obligation.

V. CONCLUSION

To preserve an insurance asset at the time of a merger or acquisition, the insurer should be notified of the transaction and asked to confirm that the transaction will not impact the acquiring company's right to rely upon the insurance that will flow with the risks which create rights of a defense and indemnity under "occurrence" based coverage. If no such assurances can be negotiated, a suit should be pursued in the forum whose choice of law rules will support legal findings that permit access to the acquired company's policy proceeds.