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Preserving insurance assets in M&A deals: South Carolina high court validates post-loss assignment of rights under insurance policies

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Following a record year of dealmaking in 2021, M&A[1] in the first quarter of 2022 remained strong, despite inflation, ongoing regulatory scrutiny, and rising interest rates and stock market volatility. The parties to those deals are likely well aware of the tight D&O insurance market when trying to secure adequate coverage for both legacy and going-forward liabilities.

PCS is one of many rulings that highlight the importance of properly navigating through the policy requirements before there is a loss or claim.

In addition to immediate D&O needs, companies and their directors and officers should carefully consider whether potential targets possess fulsome insurance to respond to any long-tail exposures and whether the interests to recover under those historical insurance policies are preserved.

A recent decision[2] from the South Carolina Supreme Court addressing the validity of so-called "post-loss assignments" highlights a powerful tool to protect against those exposures, even following mergers, acquisitions, and transactions long after the policies were issued. The case is *PCS Nitrogen v. Continental Casualty*, No. 28093 (S.C. Apr. 13, 2022).

As explained below, this decision is one of many rulings that highlight the importance of properly navigating through the policy requirements before there is a loss or claim and illustrate the importance of how the law of different states can vary on these key considerations.

Anti-assignment and no-action provisions

Most liability insurance policies contain "consent-to-assignment" or "anti-assignment" provisions, which prohibit assignment of interests under the policy without the insurer's consent.

Anti-assignment provisions work in tandem with "no action" provisions that prevent the policyholder from pursuing a claim against the insurer without first fully complying with the policy conditions, including the prohibition against assignments without consent.

Lack of consent may violate the anti-assignment provision and, in turn, could support an insurer defense barring any subsequent action by the new party-in-interest to recover, which was the issue before the court in *PCS*.

Background

Columbia Nitrogen Corporation began operating a fertilizer manufacturing site in Charleston, South Carolina in 1966. From 1966 to 1985, CNC purchased liability insurance policies, which had both anti-assignment and no-action provisions.

CNC ceased all production at the Charleston site in 1972 and ultimately sold assets to a new entity, which also assumed liabilities related to the old fertilizer production business. That 1986 deal transferred — without the insurers' consent — all of the legacy company's rights under the expired liability policies spanning 1966 to 1985.

The court in PCS joined the majority of states, like California, New Jersey, and Florida, recognizing the validity of post-loss assignments.

A 2005 suit argued that the new owner of the Charleston site, PCS, was liable under CERCLA for environmental remediation. PCS disputed whether it had assumed liabilities for the 1986 transaction but ultimately was held liable under CERCLA.

Decision

PCS sought a declaration that the CNC insurers were obligated to provide coverage for PCS's defense costs and environmental liabilities in connection with the CERCLA litigation. The insurers rejected the claim on the grounds that they had not provided consent to the assignment of rights under the policies in the 1986 deal. PCS argued that consent was not required because the assignment occurred after the loss.

The lower court granted summary judgment to the insurers, finding that a loss does not take place until the insurer's obligation to pay is fixed by a judgment and that PCS's pre-loss assignment without consent was unenforceable.

The South Carolina Supreme Court agreed with PCS and overturned the ruling in favor of the insurers. Recognizing that South Carolina follows the majority rule that a consent-to-assignment provision does not bar assignments made after a loss, the court looked at when the loss occurred.

Like the enforceability of post-loss assignments, the successful transfer of interests under insurance policies in a particular transaction can turn on applicable state law.

The court rejected the insurers' position that no loss could occur until a judgment or settlement was entered and agreed with PCS that "loss" is synonymous with the "occurrence."

Any loss related to the discharge of contaminants at the Charleston site would have occurred before CNC executed the assignment in 1986.

Therefore, the court held: "An insured's claim to coverage does not have to be reduced to a sum due or to become due under the policy for the claim to be assignable without insurer consent. After an occurrence, the insured possesses a contingent right to coverage, and it is a right that may be assigned without insurer consent."

Insurance considerations in M&A deals

The court in *PCS* joined the majority of states, like California,[3] New Jersey,[4] and Florida,[5] recognizing the validity of post-loss assignments and is an example of just one of many different coverage issues that can arise out of M&A transactions. Here are four such issues to consider in structuring potential deals:

1. Evaluate assignments of insurance interests against policy language and governing law

Starting first with post-loss assignments, policyholders should not assume that such assignments are valid without considering the policy language, facts, and applicable law at issue. Governing state law is especially important because, even though the majority of states acknowledge post-loss assignments, it is not a uniform rule.

The court in *PCS*, for instance, identified several outlier decisions from Hawaii, Oregon, and Indiana that either took a narrower view of when "loss" occurs or held that no assignments, even those made after a loss, are valid without insurer consent.

2. Consider how deal structure may impact insurance

In many deals, a surviving or acquiring entity does not assume all liabilities of the company it is acquiring. Limitations on transfer of liabilities or assets to a surviving company may impact that entity's ability to access legacy insurance policies or to trigger coverage for claims arising from pre-transaction wrongful acts.

Like the enforceability of post-loss assignments, the successful transfer of interests under insurance policies in a particular transaction can turn on applicable state law.

For example, state merger statutes may govern whether merging or consolidating company's rights and liabilities — including interests under insurance policies — automatically vest with the surviving company. Considering how insurance rights may be extinguished or preserved is another factor to consider when structuring a deal.

3. Identify and preserve insurance records to facilitate future recoveries

Adequate insurance due diligence is of paramount importance to maximize coverage for successor liability exposure, especially for environmental and similar long-tail liabilities like those at issue in *PCS*. Dozens of primary and excess or umbrella liability policies may be implicated in any given claim, so identifying and preserving records of all policies can help facilitate an efficient and effective response should a claim arise.

4. M&A insurance considerations are not limited to occurrence-based liability policies

Coverage disputes involving post-loss assignments, like those in *PCS*, focus on historical losses, policy periods, and transactions under commercial general liability policies dating back years or even decades earlier. However, as alluded to above, M&A transactions also raise numerous forward-looking insurance considerations under other types of policies.

Insurance policies, like deal documents, are individualized and often subject to negotiation that leads to significant departure from "standard" or "market" terms.

One key example is placement of "runoff" or "tail" D&O coverage to protect the legacy company and its directors and officers against post-transaction claims alleging pre-transaction wrongful acts. The runoff terms depend on both the language of the seller's D&O policy, which may provide for automatic conversion to runoff upon a change in control, and effective date of the deal.

In addition to common runoff questions related to length of the reporting period or payment of additional premium, the transition to runoff poses a host of issues, starting with how and when a particular deal may trigger the D&O policy's change-in-control provision.

Policyholders should not assume that all runoff terms are the same — endorsements may reduce available limits, modify or narrow the scope of coverage, or leave gaps for "straddle" claims involving wrongful acts spanning both sides of the transaction or for post-transaction conduct by individuals tasked with winding down legacy operations.

Careful review of all pertinent policy language and coordination between the pre- and post-transaction policies between the buyers, sellers, and other stakeholders who may have purchased relevant coverage (or may want to access the company's runoff coverage) will ensure there are no surprises should a claim arise.

Conclusion

The issues above are just some of the more common insurance coverage disputes that can arise following M&A deals. Insurance policies, like deal documents, are individualized and often subject to negotiation that leads to significant departure from "standard" or "market" terms.

As a result, each insurance claim, including those arising from the 1980's deal in *PCS*, will turn on the specific policy language and deal terms at issue. For that reason, integrating experienced risk professionals — like brokers and outside coverage counsel — throughout each stage of the deal process will help resolve likely insurance-related issues and maximize recoveries for future claims.

Notes

[1] https://bit.ly/3LNBgH5

[2] https://bit.ly/38NW2Yq

[3] https://bit.ly/3MSFflC

[4] https://bit.ly/38QUYTs

[5] https://bit.ly/3MSnH9q

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