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Calif. Policy Transfer Ruling Ends Insurer 'Windfall'

By **Jeff Sistrunk**

Law360, Los Angeles (August 20, 2015, 10:26 PM ET) -- The California Supreme Court's Thursday ruling allowing companies to freely assign insurance rights to successors after a loss has occurred overturned a decision that policyholder attorneys claim created a windfall for insurers and brought the state in line with the majority of other jurisdictions that have considered the issue.

In a unanimous opinion, the California high court reversed its landmark 2003 decision in Henkel Corp. v. Hartford on the grounds that the earlier ruling conflicts with Section 520 of the state's insurance code, which permits a company to assign its rights under insurance policies to successors without an insurer's consent once a loss has already happened. The court sided with Fluor Corp. in its dispute with Hartford Accident & Indemnity Co. over coverage for legacy asbestos liabilities.

Policyholder lawyers say the decision negates unfair benefits that insurance companies reaped from Henkel, which insurers wielded in order to enforce their policies' anti-assignment clauses.

"Essentially, the original Henkel decision created a windfall for the insurance industry and allowed them to escape payment of claims they knew for decades they were on the hook for," Covington & Burling LLP partner Rene Siemens said.

Fluor used a complex restructuring transaction in 2000 to split its business between two independent companies — a new Fluor company dedicated to engineering, procurement, construction and project management services and another company called Massey Energy Co. that would handle coal mining and energy operations.

Hartford, which provided 11 liability policies to the original Fluor, has defended asbestos lawsuits against the company since 1985. But the carrier refused to extend coverage to the later version of Fluor, arguing its consent-to-assignment provisions had been violated.

Fluor contended before the trial court that Henkel should be disregarded because the California Supreme Court hadn't weighed Section 520 in that decision. The lower court judge was unmoved, however, saying he didn't "have the luxury" of considering or applying the statute because Henkel definitively addressed the enforcement of anti-assignment clauses.

A state appellate court affirmed the trial court's decision in August 2012, emphasizing that the statute was obscure and had only been cited once in a 130-year period. In its opinion, the appeals court also found that Section 520 had no effect on Fluor's case because liability insurance didn't exist when the statute’s

predecessor was enacted in 1872.

After conducting a lengthy analysis of Section 520's legislative history, the development of liability insurance in California and relevant case law, the state high court concluded Thursday that the statute applies to third-party liability policies.

Section 520's rule that anti-assignment clauses can't be used to bar the transfer of insurance rights after a loss has already occurred is "consistent with the overwhelming majority of cases decided before and since Henkel," the court found.

"The principle reflected in those cases — precluding an insurer, after a loss has occurred, from refusing to honor an insured's assignment of the right to invoke policy coverage for such a loss — has been described as a venerable one, borne of experience and practice, facilitating the productive transformation of corporate entities, and thereby fostering economic activity," Chief Justice Tani Cantil-Sakauye said in the opinion.

The decision brings California into line with a majority of jurisdictions by allowing the assignment of insurance policies after a loss has happened regardless of the policies' anti-assignment provisions, attorneys say.

"Fluor really sets things right," Reed Smith LLP partner Traci Rea said. "Henkel was decided without the benefit of Section 520, and allowed insurance carriers to escape what they had agreed to cover based on the fortuity of the corporate transaction. This ruling puts California back in line with the majority of courts and preserves what the insurance was purchased for."

Nossaman LLP partner Joan Cotkin said the rationale behind Section 520's rule voiding anti-assignment clauses after a loss has occurred "makes perfect sense."

"The insurance company accepted a risk of loss and sold the policy to Company A," Cotkin said. "If Company A engages in activity causing injury or damage to others, then sells its business or is merged into another company and assigns the coverage, the injury-causing event has already occurred, so it's not a burden on the insurance company. The insurer got exactly what it bargained for. Section 520 prevents what would otherwise be a free pass for insurers, which is completely unfair."

According to attorneys, the decision recognizes economic realities and lifts a barrier to companies' ability to transfer insurance rights in connection with mergers and other transactions.

"A crucial element in the ability of companies to allocate resources efficiently is the ability to transfer rights to insurance coverage along with liabilities as a part of mergers, asset purchases and sales," Siemens said.

The ruling should ease the challenges that companies experience when pursuing corporate transactions, attorneys say.

"In a jurisdiction that strictly enforces these 'consent' provisions, an additional wrinkle is added to the due diligence process with respect to addressing consent questions and resulting complications," said Linda Kornfeld, a Kasowitz Benson Torres & Friedman LLP partner. "Insurance considerations continue to be an important part of the process during corporate transactions, but the court's ruling today will at least reduce some of the complications during a California transaction that arise from the 'consent' conundrum."

The Henkel decision made California an unfavorable jurisdiction for policyholders to file coverage litigation involving the transfer of insurance policies to successor corporations. With the reversal of Henkel, that is no longer the case, attorneys say.

"From a practitioner's standpoint, when Henkel came out, choice of law became a big consideration in deciding where to file and how to file in cases involving successor liability issues," Hunton & Williams LLP policyholder counsel William Um said. "At least for policyholder counsel, that's something you had to be cognizant of because if the case was filed in California, Henkel was a potential barrier to coverage."

In view of the California high court's ruling, every policyholder "that has seen Henkel thrown up as a barrier to coverage should revisit those claims and reassess whether they should be pursuing coverage or pushing back, assuming such claims are not time-barred or otherwise can no longer be pursued," Um added.

With Henkel being reversed, insurers may have to change their underwriting practices to some extent "to account for the fact that they may be on the hook for defending two companies rather than one at some point in time," according to Larry Golub, a Hinshaw & Culbertson LLP partner.

However, because cases in other jurisdictions already follow the rule set forth in the California Supreme Court's decision, some insurers may have previously taken such steps, he said.

"As earthshaking as this decision seems because the Supreme Court is reversing itself after just 11 years, the ruling's impact may be minimal because this is already the law in other jurisdictions," Golub said.

The case is Fluor Corp. v. the Superior Court of Orange County, case number S205889, in the Supreme Court of California.

--Editing by Jeremy Barker and Christine Chun.

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