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In Landmark Reversal, California Supreme Court Holds That Insurance Assignments Are Allowed Without Insurer Consent

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Insurance

In *Fluor Corp. v. Superior Court*, No. S205889 (Cal. Aug. 20, 2015), the California Supreme Court overruled its own 12-year-old decision in *Henkel Corp. v. Hartford Accident & Indemnity Co.*, 29 Cal. 4th 934 (2003), and returned California law to the mainstream by once more allowing policyholders to assign rights to insurance coverage without obtaining insurance company consent. This is good news for corporate policyholders because it removes a significant and widely criticized legal impediment to mergers and acquisitions that implicate business operations and potential liability exposures in California. The decision may also signal a positive shift in thinking about insurance law by one of the country's most influential courts.

Background and *Henkel*

Henkel involved a common transaction in which a company transfers assets to another entity along with rights to insurance coverage for the accompanying liabilities. The assignment of insurance policy rights is a key part of many asset transfer deals: the acquiring company may be unwilling to take on new liabilities unless it inherits the predecessor's insurance rights too.

To the surprise of many, and bucking a decades-long national trend as well as earlier California law, the California Supreme Court in *Henkel* ruled that these routine transfers violated the "consent to assignment" provisions found in many insurance policies. These provisions say that the policyholder cannot transfer its coverage rights to another entity without the insurance company's prior consent. Such provisions are said to protect the insurance company from having to cover new entities that may have different risk profiles than it originally underwrote. But American common law has long recognized that the rationale for enforcing anti-assignment clauses is no longer relevant once a covered loss has occurred. The insurer's coverage duties are fixed at that point, and what is being assigned then is not the policy as such but merely the contractual right to be indemnified for a particular liability the insurer is already obligated to cover -- a contractual right that should be assignable like any other.

The *Henkel* court, however, held that such an assignment was not valid without the insurer's consent, at least not until the loss had been liquidated (through a judgment for example). This ruling represented a major barrier to asset transfer deals, which often require insurance rights to be transferred in order to protect the successor from future claims that might arise out of past business operations, like asbestos or environmental lawsuits. Insurance companies have little or no incentive to agree to these assignments after they have collected their premiums, and before *Henkel* many corporate insureds did not bother to ask for insurer consent because the law seemed clear that they did not need to. *Henkel* threw a wrench into the works by creating an unexpected legal impediment to asset transfers involving operations in California, and it cast into doubt an important aspect of many corporate transactions that had already been consummated.

Fluor's **Triumph of Common Sense**

Nearly a decade later, the Court granted review in *Fluor* to consider the effect of Cal. Ins. Code § 520, a statute that had not been mentioned during the briefing in *Henkel*. It provides that "[a]n agreement not to transfer the claim of the insured against the insurer after a loss has happened, is void if made before the loss." On its face, this statute says that insurance policy anti-assignment provisions are unenforceable if the assignment occurs after the covered loss occurs, and therefore directly contradicts the California Supreme Court's ruling in *Henkel*. The trial court in *Fluor* however concluded that it did not have the authority to second-guess *Henkel*, and the Court of Appeal concluded that § 520 did not require a different result anyway, reasoning that § 520 was first enacted in 1872 -- before liability insurance existed -- and so could not have been meant to apply to third-party (as opposed to first-party) insurance claims like the asbestos injury claims at issue in *Fluor*.

The Supreme Court reversed, and in doing so repudiated its own previous ruling in *Henkel*. In a unanimous opinion by Chief Justice Cantil-Sakauye, it exhaustively detailed the initial enactment of § 520, as well as subsequent reenactments and amendments, demonstrating that third-party liability insurance was well-known to the Legislature when § 520 was amended and reenacted in 1935 and 1947, and must therefore have been intended to apply to assignments of not only first-party property insurance policy rights, but rights under third-party liability insurance policies too.

As to the critical question of what the Legislature meant by the phrase "after a loss has happened," the Court acknowledged the phrase standing alone was ambiguous. To determine its meaning, the Court surveyed the consent-to-assignment law in effect at the time of the statute's initial and subsequent enactments, which was near-universal in holding that the relevant "loss" occurred at the time of the covered injury and not when the policyholder was later adjudged to be liable.

The Court concluded by adopting that the majority rule that insurance policy anti-assignment clauses are not enforceable if the assignment is made after the covered property damage or bodily injury has occurred. It recognized moreover that this majority is "a venerable rule that arose from experience in the world of commerce" and "has been acknowledged as contributing to the efficiency of business by minimizing transaction costs and facilitating economic activity and wealth enhancement" by allowing the marketplace freely to allocate assets to their most profitable uses. The Court rejected an appeal to *stare decisis*, noting that "'probably the strongest reason' for not following a prior decision [is] that it overlooked an existing statute."

Analysis

For policyholders, Fluor is unquestionably welcome news. Also welcome is the Supreme Court's approach, which treated the issue of contractual assignments with historical depth and contextual breadth. The Court also took the opportunity to reaffirm several of its other landmark rulings, including that a "continuous trigger" applies to long-tail injury claims and that policyholders can "stack" or add together the limits of successive years of insurance policies to pay for a multi-year loss. Finally, the court's acknowledgement of the economic benefits and burdens of its decisions on the assignment issue may harken a return to a more robust interpretative practice, in which the reasonable expectations of policyholders may be afforded a prominent place in the Court's insurance coverage jurisprudence (for example, perhaps it presages the end of California's insistence that an environmental administrative enforcement action is not sufficiently like a "suit" to trigger standard general liability coverage).

It is also worth asking what role § 520 actually played in the Court's analysis. The Court frankly acknowledged that the statute was ambiguous, and could be reasonably interpreted as supporting the position of either party. To determine the statute's meaning the Court relied on case law before and after the statute's enactment, as well as learned commentary and insurance industry drafting history information, much of which was available when it decided *Henkel* in 2003. That it engaged in such a searching inquiry suggests that the Court (the membership of which has almost completely changed in the intervening years) may simply have seen that its original reasoning had unintentionally rewarded insurers for what it described as their "unfair or oppressive conduct" in "precluding assignment of an insured's right to invoke coverage under a policy attributable to past time periods for which the insured had paid premiums."

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