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Returning to the **Majority Rule:** Liability Insurance **Rights** Can **Follow** the **Liability**

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Corporate deal lawyers had for many decades designed corporate acquisitions and divestitures on the long-held foundation that historical rights to insurance proceeds were freely assignable, and that the rights to the proceeds of liability insurance could freely follow the liabilities. The design of those deals was called into question in 2003 in *Henkel Corp. v. Hartford Accident & Indemnity Co.*, 29 Cal. 4th 934 (Cal. 2003), which severely impeded companies involved in such transactions by enforcing consent-to-assign clauses even though policy periods had expired and the right to insurance already had accrued. In 2015, California reversed course and restored the ability of corporations to freely assign the rights available under insurance policies after a loss. *Fluor Corp. v. Superior Court*, 61 Cal. 4th 1175 (Cal. 2015).

Mitigation of Risk and Transfer of Insurance Rights in a Corporate Restructuring. The reversal to return to the majority rule in California will have a pro-business impact, given the current pace of mergers and acquisitions. Such activity, essential to the efficient functioning of a modern economy, depends on the ability to assign insurance assets, or the ability to assign the inchoate "chose in action" (the as-yet undeveloped

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potential claim) under a liability insurance policy.

An assignment of insurance rights may be particularly vital with respect to liability policies that provide coverage for long-tail claims—typically referred to as "occurrence-based" policies. While "claims-made" policies generally are triggered only when an "occurrence" and reporting of the occurrence take place during the policy period, occurrence-based policies provide coverage for an occurrence that happens during a given policy period regardless of when it is reported.

Occurrence-based liability insurance policies never expire, and thus provide lasting protection. In insurance-speak, this protection is referred to as protection against incurred but not yet reported (IBNR) losses. Occurrence-based policies enable an entity to purchase liability insurance protection at the time it engages in a potentially loss-causing operation and be assured that, as long as the amount of insurance purchased is adequate, the entity will have protection against future claims relating to that activity, no matter when those claims are raised.

These occurrence-based policies have helped facilitate the creative restructuring and the mergers and acquisitions of the past few decades. A company contemplating an asset or stock purchase of another company may be less concerned about an acquisition target's ancient IBNR liabilities if the prospective acquisition has maintained a robust program of bought-and-paid-for occurrence-based liability policies covering potential historic risk.

An acquiring company could acquire rights under occurrence-based liability policies in different ways. First, it could expressly indicate in the asset purchase agreement that it was acquiring all of the to-be-acquired company's insurance policies. Second, many courts over many decades (and even centuries) have held that the insurance policies covering IBNR losses and owned by the to-be-acquired company pass to the acquiring company "by operation of law." Under this doctrine, even when there is no explicit agreement that the insurance policies transferred to the acquiring company or the new resulting entity, courts deem the insurance policies transferred by operation of law in one of two ways. Either the policies transfer through the product-line rule of successor liability or under the theory of corporate succession.

Under some formulations of the product-line rule, a purchaser of substantially all assets of a company assumes, with some limitations, the obligation for product liability claims arising from the selling company's presale activities. Courts have held that liability insurance passes to the purchaser along with the potential liability. Under the theory of corporate succession, the purchasing company assumes the burdens and becomes invested with the rights of the predecessor company. Courts have held that one of these "rights" includes the right to the predecessor company's liability insurance.

'Henkel' Diverged from the Majority Rule Allowing Assignment of Insurance. While courts in various states around the country have differed in the applicable theory justifying insurance policy assignment, in the majority of states the end result was clear: Occurrence-based insurance policies passed to the acquiring company and provided coverage for IBNR claims. This principle represented the majority rule without much controversy until one decision took the opposite view. In *Henkel*, the California Supreme Court held that insurance companies that issued occurrence-based policies could refuse to honor a policyholder's assignment of these policies for which the policyholder already had paid premiums if the policies in question contained clauses purportedly requiring the insurance companies' consent to assign the policies—clauses that had been interpreted to apply to pre-loss assignments in order to prevent a drastic change in the risk insured.

In 1980, Henkel acquired a metallic chemical product line of Amchem Products (Amchem) and assumed all related liabilities. In 1989, former employees filed suit against Henkel, alleging injuries arising from exposure to metallic chemicals during the period between 1959 and 1976. Henkel tendered suit to the insurance companies that insured Amchem between 1959 and 1976, but they refused coverage.

In denying coverage, the insurance companies argued that each of the policies in question contained a clause providing that there could be no "[a]ssignment of interest under this policy" without the insurance company's consent endorsed on the policy. 29 Cal. 4th at 943. Henkel countered by first arguing that it acquired the benefits of the insurance policies by operation of law along with Amchem's liabilities. The court rejected this argument, finding instead that Henkel had acquired Amchem's liabilities by contract, not by operation of law. Id. at 944.

Second, Henkel argued that an insurance company's consent to assign is not required under an occurrence-based liability policy once the event giving rise to liability already has occurred. Henkel reasoned that courts consistently had allowed an assignment of money due in spite of anti-assignment clauses stating the contrary. The court rejected this argument as well, finding that the claims brought by plaintiffs in the underlying personal injury suit "had not been reduced to a sum of money due or to become due under the policy." Id. at 944.

Third, Henkel argued that the court should permit assignment of the policies for the IBNR claims of the former employees because the assignment would not place additional risk on the insurance company beyond that for which it already had bargained. Henkel explained that there would be no additional risk to the insurance company because the IBNR loss already had occurred before the assignment, and the assignment did not affect either liability or policy limits. Id. at 945. The court rejected this argument as well, noting "the ubiquitous potential for disputes over the existence and scope of the assignment." The court feared that an insurance company would be dragged into a finger-pointing battle where two or more companies would blame the other for a given IBNR loss and expect coverage for that loss under the same insurance policy. The court stated that this scenario thus subjected the insurance company to "increased burdens" if not increased risk. Id.

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In the years following *Henkel*, commentators, insurance experts, and other courts virtually uniformly criticized the California Supreme Court's departure from the majority rule regarding assignment of insurance rights. See, e.g., 1 Stempel on Insurance Contracts, §3.15D, pp. 3-118.1 through 3-127 (extensively critiquing *Henkel* in six respects and concluding that the case "may become an outlier decision apart from the mainstream"). Indeed, the California Supreme Court later acknowledged in *Fluor* that *Henkel* "has not been well received." Since *Henkel* was decided in 2003, only one other state court has followed its reasoning, and that decision has not been followed by any other jurisdiction. See *Travelers Cas. & Sur. Co. v. United States Filter*, 895 N.E.2d 1172 (Ind. 2008) (declining to enforce a post-loss assignment of rights to invoke coverage under third-party liability coverage concerning "occurred but not yet reported losses" and rejecting the majority rule allowing post-loss assignment, finding instead that in order to qualify for assignment, "the loss must be identifiable with some precision" and "must be fixed, not speculative").

The Recent Decision in 'Fluor' Reversed 'Henkel'. In *Fluor*, the California Supreme Court reversed *Henkel*, finding that policyholders freely could assign their liability insurance policies for IBNR losses under California law without regard to consent-to-assign clauses contained in their policies. Fluor had performed engineering, procurement, and construction (EPC) operations since 1971 for various corporate entities at sites where asbestos allegedly was used. The company had purchased occurrence-based liability policies from 1971-1986 from Hartford Accident & Indemnity Company (Hartford). Since the mid-1980s, Fluor has been named as a defendant in numerous lawsuits alleging liability caused by exposure to asbestos, and Hartford defended and indemnified Fluor in connection with these actions.

In 2000, Fluor undertook a corporate restructuring and tax-free stock distribution known as a "reverse spinoff." As part of this restructuring, Fluor transferred its EPC operations, assets and liabilities to a new company (also called Fluor). Even after Fluor notified

Hartford of this restructuring, Hartford continued to defend and indemnify "new Fluor" for approximately seven years in connection with the asbestos suits. In 2008, however, Hartford sought a declaration that it had no duties under the policies to defend or indemnify new Fluor for the asbestos suits because the policies had consent-to-assign clauses and Hartford never consented to the assignment of the policies to new Fluor, a factual situation similar to *Henkel*.

Fluor argued that even if its case were factually indistinguishable from *Henkel*, the court in *Henkel* had failed to consider Insurance Code §520, a provision that was first enacted in 1872. Section 520 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 … ." The court began its analysis by focusing on whether the phrase "after a loss has happened" referred to the bodily injury suffered by a third party or after the policyholder incurred a direct loss by virtue of entry of judgment, or the finalization of a settlement, fixing a sum of money due on the claim. Interestingly, the court entertained almost the exact same arguments it had rejected in *Henkel*, but in *Fluor* it found that the legislature had accepted those arguments in codifying §520 as part of California's insurance law. The court therefore overruled *Henkel* to the extent it was inconsistent with §520.

While *Fluor* grounded its opinion on the *legislature's* intent, it expressly endorsed the public policies behind the legislature's decision. Specifically, *Fluor* stated:

> The "postloss exception" to the general rule restricting assignability … is itself a venerable rule that arose from experience in the world of commerce. The rule has been acknowledged as contributing to the efficiency of business by minimizing transaction costs and facilitating economic activity and wealth enhancement. A major rationale for commercial insurance is to facilitate economic activity and growth by providing risk management protection for economic actors … . In the modern American economy, mergers, acquisitions, and sales are part of corporate life … . To the extent that insurance protection (for past but possibly unknown losses) may be more freely assigned as part of corporate recombinations, this lowers transaction costs and facilitates economic activity and wealth enhancement.

61 Cal. 4th 1175, 1218-19. Accordingly, while some might interpret *Fluor* as a limited holding interpreting a previously forgotten law, the reasoning and force of *Fluor* appears designed to convince other courts to turn the majority pro-assignment rule into the only assignment rule.

Important Considerations for Insurance Rights and Policy Review. Although *Fluor* re-established the majority rule regarding assignment of policies in California, note that other states, such as Indiana, Hawaii, Oregon, Texas, and Louisiana, do not clearly follow the majority pro-policyholder rule on assignment.

Corporate Counsel and Risk Managers should consider *Fluor* and similar cases, not only because they impact planning for any type of corporate restructuring, but also because they impact whether companies should buy occurrence-based or claims-made policies. Under *Fluor*, occurrence-based policies potentially could be assigned and applied to IBNR claims, and companies should keep this risk-management tool in mind.

As has happened in other areas of insurance recovery, the now reversed rule in *Henkel* was the product of insurance industry overreach, putting their short-term financial interest before the obvious intent of their insurance policies or the good of their policyholders. *Fluor* is a welcome return to a pro-business rule in this area, and one that will enhance the ability to conduct useful corporate transactions.

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