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PERSPECTIVE

California falls in line on coverage for successors

By Kirk A. Pasich

In 1939, the 8th U.S. Circuit Court of Appeals issued its landmark decision in *Ocean Accident & Guarantee Corp. v. Southwestern Bell Telephone Co.*, 100 F.2d 441, *cert. denied,* 306 U.S. 658. In *Ocean Accident*, Kansas City Telephone (KCT) sold all of its assets and business to Southwestern Bell. The Jan. 22, 1927, bill of sale conveyed to Southwestern KCT's "property, rights and assets of whatsoever nature and description, real, personal or mixed, corporeal or incorporeal, legal or equitable, in possession or in expectancy, now owned by KCT, whether in this conveyance specifically named or not."

After the transfer, three KCT employees sued Southwestern for injuries they sustained before Jan. 22, 1927. The insurer refused to defend Southwestern, contending that its policy prohibited assignment without its consent. The 8th Circuit held that Southwestern was entitled to recover from the insurer the amounts incurred in defending and settling the lawsuits. It distinguished the assignment of the policy itself from the assignment of rights already accrued under the policy.

The court held that under Missouri law, the "loss" was the sustaining of injuries by the claimants, which occurred prior to the assignment. In refusing to apply the "no assignment" clause to assignments after a loss, the court reasoned: "Where the policy prohibits an assignment ... an assignment after a loss has transpired [does not] invalidate it. In such case the insurer becomes absolutely a debtor to the assured for the amount of the actual loss, to the extent of the sum insured, and it may be transferred or assigned like any other debt. After a loss the [identity of the insured] no longer becomes material, and even though the policy prohibits such an assignment ... such prohibition is void, as the insurer cannot restrict the assignment of a debt."

Most courts nationally have followed *Ocean Accident* in holding that an assignment of rights under an insurance policy is effective without the insurer's consent when the loss took place before the assignment, even if not discovered until after the assignment. See, e.g., *No. Ins. Co. v. Allied Mut. Ins. Co.*, 955 F.2d 1353, 1358 (9th Cir.), *cert. denied,* 505 U.S. 1221 (1992) ("We agree with the Ocean Accident court that the rationale for honoring 'no assignment' clauses vanishes when liability arises from pre-sale activity.").

However, in 2003, the California Supreme Court issued its decision in *Henkel Corp. v. Hartford Accident & Indemnity Co.*, 29 Cal. 4th 934 (2003). *Henkel* surprised many because the court departed from the majority view. The court addressed a common clause stating, "Assignment of interest under this policy shall not bind the [Insurer] until its consent is endorsed hereon." It held that under the clause, an insurer could refuse to honor an insured's assignment of the right to seek coverage under the policy for losses that had incurred before the assignment.

Now, the state high court has overturned *Henkel*, bringing California in line with most of the rest of the country. In *Fluor Corp. v. Superior Court*, 2015 DJDAR 9597 (Aug. 20, 2015), the court concluded that an Insurance Code section mandated a different result. It emphasized that Insurance Code Section 520 — a statute tracing back to 1872 — "was not cited to [it] or considered in *Henkel*."

Section 520 states: "An 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 insurer argued that Section 520 applied only to first-party property insurance, rather than to liability insurance. The court concluded that Section 520 was a "General Rule" that covered "all classes of insurance." The court focused on the phrase "after a loss has happened" in Section 520. It held that the phrase "is ambiguous when viewed in the context of liability policies."

The court then engaged in an extensive review of the legislative history of Section 520. The court also extensively discussed case law from around the country, focusing on *Ocean Accident*. It noted that *Ocean Accident* "was quickly recognized as a leading case" whose "national influence" was confirmed by subsequent discussions and citation in secondary authorities.

It noted that "parties to transactions, and litigants generally *assumed* that legal propriety of assigning to a successor, in connection with a transfer of assets and liabilities, the right to invoke insurance coverage for losses that had previously occurred, even if those losses were not determined with precision or indeed known, let alone reduced to judgment." It commented that "the pervasiveness of this practice appears attributable to the widespread acceptance of and deference to *Ocean Accident.*" The court emphasized that, "more recent experience reveals that *Ocean Accident*'s influence has continued and indeed grown."

The court then discussed one of California seminal insurance cases — *Montrose Chemical Corp. v. Admiral Insurance Co.*, 10 Cal. 4th 645 (1995). In *Montrose*, the court held that when successive insurance policies have been purchased, "bodily injury and property damage that is continuing or progressively deteriorating throughout more than one policy period is potentially covered by all policies in effect during those periods."

In *Fluor*, the court noted *Montrose* "repeatedly employed and equated the term 'loss,' not with a judgment or settlement for a sum of money ... , but as synonymous with occurrence of bodily injury and property damage." The court noted that its interpretation of "loss" in *Montrose* "was consistent with insurance industry publications in the mid-1960s authorized by officials with the National Bureau of Casualty Underwriters — the insurer entity that drafted the standardized CGL language employed in third-party liability policies — reflecting industry understanding that the term 'loss' is essentially synonymous with personal injury or property damage." The court also recognized the value and appropriateness of considering such industry drafting materials and commentary in understanding and interpreting insurance policy language.

The court next discussed the "no assignment" clause itself. It pointed out that the rationale for such a clause "is to protect an insurer from bearing a risk or burden relating to a loss that is greater than what it agreed to undertake when issuing the policy. The court turned to the realities of the world: "But the 'postloss exception' to the general rule restricting assignability recognized in many cases ... and codified in section 520, 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."

The court resoundingly rejected arguments advanced by insurers that the "no assignment" clause immunizes them from liability when an insured engages in a transaction involving a transfer of rights under a policy for a pre-transfer loss that had not yet resulted in an adverse judgment against the insured. The court stated: "We conclude that the statutory phrase does not contemplate that there need have been a money judgment or approved settlement before such a claim concerning that loss may be assigned without the insurer's consent. Only this interpretation of the statute's language barring veto of assignment by an insurer honors the clear intent demonstrated by the history of section 520 to avoid any 'unjust' or 'grossly oppressive' enforcement of a consent-to-assignment clause."

The court recognized that by adopting this interpretation of Section 520, it was protecting "the ability of an insured, in the course of transferring assets and liabilities to another business entity in connection with a corporate sale or reorganization, to assign rights to claim defense and indemnification coverage provided by prior and existing insurance policies concerning the business's previous conduct."

By so holding, the court not only rendered a decision that reflects the custom and practice in commercial transactions, but also one that affects the evaluation of assets and liabilities in mergers and acquisitions. The court's ruling enables parties who engage in transactions involving potential liabilities to evaluate the possibility that coverage provided by previously purchased insurance policies may extend to those liabilities, after acquisition. The value of such recognition may vary from fairly nominal amounts to, in the case of long-term liabilities, tens, if not hundreds, of millions of dollars. It is a value now confirmed by *Fluor*.

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