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Commentary

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Last week, the California Supreme Court issued its long-awaited decision in *Fluor Corp. v. Superior Court,*[1] overruling its own 12-year-old decision in *Henkel Corp. v. Hartford Accident & Indemnity Co.*[2] The landmark ruling returned California law to the mainstream by once more allowing policyholders to assign rights to insurance coverage without obtaining prior insurance company consent. The change is welcome news for corporate policyholders because it eliminates a significant and widely criticized legal impediment to mergers and acquisitions that implicate business operations and liability exposures in California. The decision may also signal a heightened recognition by one of the country's most influential courts of the real-world impact of its insurance coverage jurisprudence.

I. Background

Henkel involved a common kind of corporate transaction in which a company transfers assets to another entity along with insurance coverage rights for the corresponding liabilities. The assignment of coverage rights is often a key component of such deals. The acquiring company may be unwilling to take on new liabilities unless it knows it can avail itself of the predecessor's rights to insurance coverage for them.

In *Henkel*, the California Supreme Court held, contrary to decades of case law in California and around the country, that these routine transfers violated the "anti-assignment" provisions found in many insurance policies, which purport to prohibit policyholders from transferring their insurance coverage rights to another entity without the insurer's prior consent. Such "consent to assignment" clauses are said to offer insurance companies protection against having to cover new entities that may have different risk profiles than the original policyholder. But, as the court acknowledged in *Fluor*, almost all American courts before and after *Henkel* recognized that the rationale for enforcing anti-assignment clauses is no longer relevant once a covered loss has occurred. At that point, the insurer's coverage duties have ripened; what is being assigned is not the insurance coverage itself but merely the contractual right to be paid for a particular liability that the insurer is already obligated to cover.

Departing from settled case law, the *Henkel* court held that such an assignment was invalid without prior consent of the insurance company (unless the loss had been liquidated by a judgment or settlement for example).[3] This ruling erected a major barrier to asset transfer deals involving California markets or business operations by casting a long shadow over the ability of companies freely to transfer their liabilities and assets, including insurance coverage. It also threw into doubt decades of corporate transactions premised on the assumption that insurance coverage for long-tail claims, like environmental and asbestos suits, could be transferred along with the liability for them. Before *Henkel*, many corporate insureds had not bothered to ask for insurer consent to these assignments because it seemed clear that they did not need to, and because insurance companies usually had no incentive to agree to them anyway.

II. Common Sense Triumphs in *Fluor*

Nearly a decade later, the Court granted review in *Fluor* to consider the effect of California Insurance Code § 520 on the assignability of insurance rights. Inexplicably, that statute had not been mentioned in the briefing of *Henkel*, even though 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."[4] On its face, this statute says that insurance policy anti-assignment provisions are not enforceable to prevent assignments made after the covered loss occurs. It therefore directly contradicts the California Supreme Court's ruling in *Henkel*.

The trial court in *Fluor* concluded that it did not have the authority to second-guess the high court, and the Court of Appeal concluded that § 520 did not require a different result anyway.[5] In its view, that provision was first enacted in 1872 — before liability insurance even existed — and so could not have been intended to cover third-party (as opposed to first-party) insurance claims like the asbestos injury claims at issue in *Fluor*.[6]

The Supreme Court reversed, and in doing so overturned its own prior ruling in *Henkel*.[7] In a unanimous opinion skillfully drafted by the Chief Justice, it exhaustively detailed the initial enactment of § 520, as well as subsequent reenactments and amendments of the statute, in order to determine its legislative intent. The Court concluded that because third-party liability insurance was well-known to the Legislature when § 520 was amended and reenacted in 1935 and 1947, and because the Legislature did not modify the provision to exempt third-party liability insurance as part of those reenactments, it must have intended the statute to apply to assignments of not only first-party property insurance policy rights, but also rights under third-party liability insurance policies.[8]

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.[9] The Court acknowledged that it could have resolved that ambiguity in a manner consistent with its holding in *Henkel* by concluding a "loss" occurs not at the moment of the covered injury, but only later, when liability is established and a fixed sum of money becomes due. Instead, to ascertain the phrase's intended 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.[10]

The Court concluded by adopting 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.[11] It recognized, moreover, that this was "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.[12] Finally, 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"[13] — which, as was now clear, was the case in *Henkel*.

III. Analysis

The holding in *Fluor* is unquestionably good news for policyholders. The Supreme Court's approach and detailed analysis — its examination of the issue of contractual assignments against its historical backdrop and in terms of its practical consequences — was also welcome for insurance coverage practitioners and corporate policyholders. The Court's recognition that its decisions on the assignment issue impact real-world business transactions and decision-making 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, one cannot help wondering whether the move 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.)

Importantly, in the course of analyzing the assignment issue, 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.[14]

On closer inspection of the opinion in *Fluor*, one might question the real importance of § 520 — the statute that forced the Court to reconsider the assignment issue in the first place — for the Court's analysis. The Court frankly acknowledged that the statute was ambiguous, and could reasonably be interpreted as supporting the position of either party. To clarity this ambiguity, the Court turned to the case law before and after the statute's enactment, learned commentary, and insurance industry drafting history, 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 *Fluor* as an opening to repudiate its *Henkel* ruling without upsetting established principles of stare decisis. Indeed, in the twelve years since *Henkel*, it appears the Court has, to the relief of policyholders, realized 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."[15]

Endnotes

1. No. S205889, 2015 WL 4938295 (Cal. Aug. 20, 2015).
2. 29 Cal. 4th 934 (2003).
3. *Henkel*, 29 Cal. 4th at 944-46.
4. Cal. Ins. Code § 520.
5. *Fluor Corp. v. Superior Court*, 146 Cal. Rptr. 3d 527, 530, 533-37, *review granted and opinion superseded sub nom. Fluor Corp. v. S.C.*, 288 P.3d 1287 (Cal. 2012) and *rev'd*, No. S205889, 2015 WL 4938295 (Cal. Aug. 20, 2015).
6. *Fluor*, 146 Cal. Rptr. 3d at 533-37.
7. *Fluor*, 2015 WL 4938295, at *2, 29.
8. *Id.* at *10-12.
9. *Id.* at *12-13.
10. *Id.* at *13-26.
11. *Id.* at *29.
12. *Id.* at *25.
13. *Id.* at *28 (internal citations omitted).
14. *Id.* at *25 & n.48.
15. *Id.* at *25. ■

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