

# BETTER LATE THAN NEVER: THE CALIFORNIA SUPREME COURT REVERSES ITSELF, HOLDING THAT CORPORATE POLICYHOLDERS MAY ASSIGN INSURANCE RIGHTS WITHOUT INSURER CONSENT

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## Insurance Coverage Alert

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## INTRODUCTION

Asset purchase and sale transactions are a preferred structure for many corporate deals. For a variety of reasons, it may be prudent for businesses or product lines to be transferred through these transactions, and an asset purchase and sale may also be a useful vehicle for internal restructuring. But these deals are not without risks. After a transaction, some purchasers may find themselves deemed to be a "successor" to the liabilities of the seller or otherwise responsible for the liabilities arising out of the seller's historical operations. These "successors" facing liability for historical operations of a deemed "predecessor" may look to the historical insurance assets of the "predecessor" to defend and indemnify against those liabilities. That is especially true when the "successor" has inherited long-tail liabilities, such as asbestos personal injury claims, that may trigger historical policies issued to the predecessor.

Twelve years ago, in *Henkel Corp. v. Hartford Accident & Indemnity Co.*,<sup>[1]</sup> the California Supreme Court—in a ruling at odds with the majority of other jurisdictions to consider the matter—concluded that a transfer of corporate assets and liabilities from one company to another violated the consent-to-assignment clauses found in many general liability policies, even if the transfer took place *after* the coverage-triggering event.<sup>[2]</sup> This created an obvious problem: companies found liable for claims arising out of a predecessor's historical operations might face the prospect of defending and resolving those claims without assistance from any insurer.

In *Fluor Corp. v. Superior Court*,<sup>[3]</sup> the California Supreme Court reversed its decision in *Henkel*, effectively realigning historical liabilities and insurance assets transferred to a successor corporation as part of a sale of assets.

## A REVIEW OF THE *HENKEL* DECISION

*Henkel* arose out of a series of complicated transactions, including the contractual separation of two product lines of what was then a wholly-owned subsidiary of Union Carbide Corporation. In 1977, Union Carbide acquired Amchem Products, Inc., which manufactured and sold agricultural and metallic chemicals.<sup>[4]</sup> After the acquisition, Amchem Products, Inc., a Pennsylvania corporation ("Amchem No. 1"), created a new Delaware corporation of

the same name ("Amchem No. 2"). Amchem No. 1 then transferred "all of its rights, title and interest . . . in and to its domestic assets utilized in its metalworking business" to Amchem No. 2.<sup>[5]</sup> The board of Amchem No. 2 unanimously accepted Amchem No. 1's transfer of "assets, liabilities and goodwill utilized in its metalworking chemical activities."<sup>[6]</sup> Henkel Corporation ultimately became the successor to Amchem No. 2 by its 1980 acquisition of all of Amchem No. 2's stock and the subsequent merger of the two entities.<sup>[7]</sup>

Claims arising out of the historical operations of Amchem Products, Inc. were asserted against Henkel in a suit brought by current and former Lockheed employees. The Lockheed plaintiffs alleged injuries arising out of exposure to metallic chemicals between 1959 and 1976. Henkel ultimately settled with the Lockheed plaintiffs for \$7.65 million and sued the insurers for declaratory relief.<sup>[8]</sup>

The California Supreme Court was asked to decide, among other things, whether the rights under the historical Amchem liability insurance policies followed the liabilities so that Henkel could benefit from its predecessor's coverage. After concluding that Amchem No. 2 (and ultimately Henkel) assumed by contract the historical liabilities at issue in the Lockheed plaintiffs' suit,<sup>[9]</sup> the court ruled that Henkel's rights, as successor to Amchem No. 2, to any benefits under the insurance policies "depend on the terms of the 1979 contract by which Amchem No. 2 acquired the assets of Amchem No. 1."<sup>[10]</sup> Ignoring the broad asset transfer language set forth in the board resolutions that formed the basis of the contract between Amchem No. 1 and Amchem No. 2, the court concluded that any contractual assignment "would be invalid because it lacked the insurer's consent."<sup>[11]</sup> The court held that a policy provision purporting to prohibit "assignment of interest" under the policy "without the insurer's consent endorsed on the policy" was effective to preclude the assignment.<sup>[12]</sup>

## BACKGROUND FACTS IN *FLUOR*

The original Fluor Corporation ("Fluor") performed engineering, procurement, and construction operations for decades, and it commonly operated at sites where asbestos allegedly was used.<sup>[13]</sup> Since the mid-1980s, various Fluor entities have been named as defendants in numerous asbestos personal injury lawsuits, and a number of those actions are still pending in California and elsewhere.<sup>[14]</sup>

Between 1971 and 1986, Hartford issued 11 commercial general liability policies to Fluor, which covered, among other things, "personal injury liability."<sup>[15]</sup> Fluor tendered its early asbestos lawsuits to Hartford, and Hartford led the defense and settlement of these actions for more than 25 years.<sup>[16]</sup>

In 2000, Fluor undertook a corporate restructuring known as a "reverse spinoff." Fluor incorporated a newly formed subsidiary with no prior corporate existence—referred to as "Fluor-2" by the California Supreme Court—which retained the "Fluor Corporation" name to acknowledge continuation of the company's longstanding engineering, procurement, and construction business.<sup>[17]</sup> The original Fluor Corporation changed its name to "Massey Energy Company" and, at the same time, transferred all the assets and liabilities related to its engineering, procurement, and construction business to Fluor-2.<sup>[18]</sup> The new Massey Energy Company retained A.T. Massey's coal mining business (a mining business Fluor Corporation acquired in the 1980s).<sup>[19]</sup>

After the reverse spinoff, Fluor-2 operated as the continuation of the original Fluor Corporation's engineering, procurement, and construction business. Fluor-2 claimed that it was vested with all the assets (including insurance policies) and obligations (including liability relating to the asbestos suits) arising from that business.<sup>[20]</sup> In May 2001, Fluor-2 notified Hartford of the reverse spinoff. With no objections based on the reverse spinoff,

Hartford continued to defend Fluor-2 for about seven years under the original Fluor's long-expired general liability policies.<sup>[21]</sup>

Some questions (unrelated to the reverse spinoff) later arose concerning the scope of Hartford's coverage obligations under the liability policies and, as a result, Fluor-2 sued Hartford in 2006 seeking declaratory relief.<sup>[22]</sup> Hartford filed a cross-complaint in mid-2009, alleging, for the first time, that the original Fluor Corporation failed to comply with consent-to-assignment clauses contained in each Hartford policy, which state: "Assignment of interest under this policy shall not bind the Company until its consent is endorsed hereon."<sup>[23]</sup> Hartford alleged that the reverse spinoff reflected a purported assignment of insurance rights to Fluor-2, and because this was done without Hartford's consent, the assignment was invalid. Based on this, Hartford sought a declaration that it had no obligation to defend or indemnify Fluor-2; Hartford also asserted unjust enrichment, seeking reimbursement of the payments it had already made on behalf of Fluor-2.<sup>[24]</sup> The trial court agreed with Hartford, and Fluor-2 then sought review by the court of appeal.

## THE COURT OF APPEAL'S DECISION

When the original Fluor transferred its assets and liabilities to Fluor-2, there was no fixed sum of money due or to become due. The court of appeal relied on *Henkel* and held that the consent-to-assignment clauses in Hartford's policies, which were identical to those in *Henkel*, barred coverage.<sup>[25]</sup>

Fluor-2 had argued that the court of appeal should not follow *Henkel* because, in *Henkel*, the California Supreme Court had not considered the effect of Insurance Code Section 520, which provides: "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. . . ." <sup>[26]</sup> Fluor-2 argued that when an assignment of insurance rights takes place *after* a third party's exposure to asbestos resulting in personal injury for which the insured may be liable, "a loss has happened" within the meaning of section 520 and an insurer cannot rely on a consent-to-assignment clause in a liability policy to void the assignment.<sup>[27]</sup>

The court of appeal rejected Fluor-2's argument, holding: (1) that section 520 applies only in the context of first-party insurance policies and not third-party liability policies, and (2) even if section 520 were applicable to liability insurance, the court would construe a loss as happening only on a finding of liability or imposition of a judgment, not on a finding that a third party had been exposed to asbestos that later resulted in personal injury.<sup>[28]</sup> Fluor-2 then sought review by the California Supreme Court.

## FLUOR'S REVERSAL OF HENKEL AND ADOPTION OF THE MAJORITY RULE LIMITING THE ENFORCEMENT OF ANTI-ASSIGNMENT CLAUSES

There was no real dispute that, under *Henkel*, the original Fluor's purported transfer of its rights to insurance coverage to Fluor-2 was ineffective. But in *Fluor*, the California Supreme Court held that section 520—which was not considered in *Henkel*—changes the result.

As an initial matter, the Supreme Court disagreed with the court of appeal and found that section 520's legislative history demonstrates that the statute does indeed apply to third-party liability policies.<sup>[29]</sup> While the Supreme Court recognized that the Legislature did not likely contemplate liability insurance in 1872 when it first enacted the

statute that has now become section 520, the court noted that in 1935, when the Legislature created the Insurance Code, it did not just *adopt* all former laws relating to insurance—"it actually *revised* the law relating to insurance."<sup>[30]</sup> By 1935, third-party liability insurance was common. Indeed, the Legislature recodified what had been Civil Code former section 2533 (listing the five "most usual kinds of insurance") as Insurance Code section 100 and, in doing so, the Legislature amended the statute to list 20 classes of insurance, including liability insurance. Furthermore, the wording of what became section 520 was slightly changed, showing that specific attention was paid to that particular provision.<sup>[31]</sup> And most importantly, the court found that the 1947 amendment of section 520 showed that the statute applied to third-party liability insurance. That year, the Legislature amended section 520 to exclude two specific types of insurance policies—life and disability—yet did not exclude liability insurance. This showed, the court found, that the Legislature viewed section 520 as a "general rule" covering all classes of insurance, even those not specifically identified by the 1872 Legislature.<sup>[32]</sup> It also showed that only certain, specified types of insurance were excluded from this general rule, and those do not include liability insurance.<sup>[33]</sup>

After determining that section 520 applies in the third-party liability insurance context, the court then discussed *how* the statute applies.<sup>[34]</sup> The controversy centered around the meaning of the phrase "after a loss has happened." The court held that this phrase was ambiguous. On one hand, it could refer to the time period after the injury or "loss" to a third party has happened—i.e., when an "occurrence" takes place under the policy for which the insured may be liable. On the other hand, it could refer to a much later point in time—the period after the insured has incurred a direct loss by virtue of the entry of a judgment or finalization of a settlement, fixing a sum of money due on a claim. The court found that either interpretation would be reasonable.<sup>[35]</sup>

Ultimately, the court agreed with Fluor-2 and concluded that the phrase "after a loss has happened" in section 520 should be interpreted to refer to "a loss sustained by a third party that is covered by the insured's policy, and for which the insured may be liable."<sup>[36]</sup> The court found that only this interpretation honors the clear intent demonstrated by the history of section 520 to avoid any "unjust" or "grossly oppressive" enforcement of consent-to-assignment clauses. Furthermore, the court concluded that only this interpretation would protect the ability of an insured, in the course of transferring its assets and liabilities to another company, to assign rights to insurance coverage provided by prior policies concerning the insured's previous operations or conduct. The court was guided by the fact that this "postloss exception" to the general rule restricting assignability—which is supported by the many cases the court discussed and the history of section 520—is a good rule that contributes to the "efficiency of business by minimizing transaction costs and facilitating economic activity and wealth enhancement."<sup>[37]</sup>

## CONCLUSION

*Fluor* is welcome news for policyholders and brings California law in line with the majority of states that have looked at this issue.<sup>[39]</sup> Thus, *Henkel* remains a cautionary tale that should remain top of mind when insurance rights are analyzed as part of a corporate transaction.<sup>[40]</sup> Purchasers of a business, even where stock is being acquired, should perform careful due diligence regarding prior internal transactions to determine whether an acquiree had earlier assumed liabilities for which historical insurance assets may not be available. Corporations should also consider carefully the insurance implications of internal restructurings that could result in the

assumption of liabilities but not the transfer of insurance rights. That is especially true for corporations that face toxic tort or environmental liabilities that arise out of historical operations.

## NOTES:

[1] *Henkel Corp. v. Hartford Accident & Indem. Co.*, 29 Cal. 4th 934 (2003).

[2] *Id.*

[3] *Fluor Corp. v. Superior Court*, No. S205889, 2015 WL 4938295 (Cal. Aug. 20, 2015).

[4] *Henkel*, 29 Cal. 4th at 938.

[5] *Id.* at 938–39.

[6] *Id.*

[7] *Id.* at 939.

[8] *Id.* at 939–40.

[9] *Id.* at 942.

[10] *Id.* at 943.

[11] *Id.*

[12] *Id.*

[13] *Fluor Corp.*, 2015 WL 4938295, at \*2.

[14] *Id.* at \*2–3.

[15] *Id.* at \*2.

[16] *Id.* at \*2–3.

[17] *Id.* at \*3.

[18] *Id.*

[19] *Id.*

[20] *Id.* at \*4.

[21] *Id.*

[22] *Id.* at \*5.

[23] *Id.*

[24] *Id.*

[25] *Id.* at \*8–9.

[26] *Id.* at \*1, 8–9.

[27] *Id.*

[28] *Id.* at \*8–9.

[29] *Id.* at \*9.

[30] *Id.* at \*10 (emphasis added).

[31] *Id.* at \*11.

[32] *Id.*

[33] *Id.*

[34] *Id.* at \*12.

[35] *Id.* at \*12–13.

[36] *Id.* at \*26.

[37] *Id.* at \*25.

[38] See, e.g., *Gopher Oil Co. v. Am. Hardware Mut. Ins. Co.*, 588 N.W.2d 756, 763–764 (Minn. Ct. App. 1999); *In re ACandS, Inc.*, 311 B.R. 36, 41 (Bankr. D. Del. 2004); *Elliott v. Liberty Mutual Ins. Co.*, 434 F. Supp. 2d 483, 491 (N.D. Ohio 2006); *Egger v. Gulf Ins. Co.*, 903 A.2d 1219, 1223, 1226–1228 (Pa. 2006); *Pilkington N. Am., Inc. v. Travelers Cas. & Sur. Co.*, 861 N.E.2d 121, 126, 129 (Ohio 2006); *In re Ambassador Ins. Co.*, 965 A.2d 486, 490–491 (Vt. 2008); *Viking Pump, Inc. v. Century Indem. Co.*, 2 A.3d 76, 107 (Del. Ch. 2009); *Illinois Tool Works v. Commerce & Indus. Ins. Co.*, 962 N.E.2d 1042, 1050, 1055 (Ill. App. Ct. 2011); *Narruhn v. Alea London, Ltd.*, 745 S.E.2d 90, 94 (S.C. 2013).

[39] See, e.g., *Travelers Cas. and Sur. Co. v. U.S. Filter Corp.*, 895 N.E.2d 1172 (Ind. 2008).

[40] The issues raised in *Flour* and *Henkel* have been addressed by other courts with mixed results. See D.F. McGonigle, "Long-Tail Successor Liability and the Right to Access a Predecessor's Insurance Coverage: Conflicting Responses from California Courts," J. of Ins. Coverage, Vol. 4, No. 4, 71, 77 (Autumn 2001). The article refers to *Gopher Oil Co. v. Amer. Hardware Mut. Ins. Co.*, 588 N.W.2d 756 (Minn. Ct. App. 1999), which holds that a successor is entitled to coverage under a predecessor's policy. However, the article also makes reference to *Red Arrow Products Co., Inc. v. Employers Ins. of Wausau*, 607 N.W.2d 294 (Wis. Ct. App. 2000) in which the court denies coverage to the successor because they were neither a party to the original insurance contract, nor an assignee of the policy. See also *B.S.B. Diversified Co., Inc. v. Am. Motorists Ins. Co.*, 947 F. Supp. 1476, 1482 (W.D. Wash. 1996) (holding that a contractual sale of assets is an effective transfer of both liabilities and insurance coverage).

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