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The Forgotten Calif. Statute That Overrules Henkel


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Law360, New York (August 22, 2011) -- The California Supreme Court's decision in *Henkel Corp. v. Hartford Accident & Indemnity Co.*, 29 Cal. 4th 934 (2003), was a major moment in the ongoing saga of the enforceability of "anti-assignment" clauses in liability insurance policies. Henkel's pro-insurer result — invalidating unconsented-to assignments of insurance rights granted prior to the time the coverage claim is "reduced to a sum of money" owed under the policy — surprised litigators and deal lawyers alike, and drew national attention.

Henkel remains the poster child for the pro-insurer position. A few courts in other states have followed its lead; most have rejected it. Meanwhile, California policyholders have spent considerable energy trying to find ways around it (for example, by establishing that another state's law governs their policies), or repair the havoc it has wrought, while insurers have regularly refused to recognize assignments of coverage for long-tail liabilities.

Remarkably, through it all, the courts, the insurers and the policyholders have overlooked the California law that actually governs the assignment issue. California Insurance Code Section 520 — enacted in 1872, but cited only a single time by any court in the intervening 140 years — provides the controlling rule of decision in anti-assignment cases. And that rule is contrary to the one announced in *Henkel*.

The Anti-Assignment Clause Under *Henkel*

The pattern is familiar. Seller decides to sell off its XYZ division. Buyer agrees to purchase the XYZ assets and assume the XYZ liabilities. The assets are recited to include rights to coverage for pre-closing "occurrences" under Seller's historical insurance policies, which insured the XYZ business for decades. The liabilities include long-tail asbestos, environmental or product liabilities that trigger those policies.

But when the claims come in post-closing, the insurers invoke the ubiquitous anti-assignment clause: "Assignment of interest under this policy shall not bind the Company until its consent is endorsed hereon."

Because the insurers were not asked for, or did not give, their consent to the assignment of rights, they deny coverage.

Henkel allowed them to do so. The Supreme Court acknowledged the universally accepted principle that anti-assignment clauses become unenforceable at some point. But in California, the court held, that point comes only when the policyholder's claim against the insurer has been "reduced to a sum of money due or to become due under the policy," which the court equated with a "chose in action."

That moment will typically arrive only when the policyholder is ultimately held liable to a third party, or the insurer breaches the policy. Thus, under *Henkel*, assignments made at any earlier time are ineffective — even if, in the court's words, "the event giving rise to liability [i.e., the "occurrence"] has occurred." Buyers of businesses who thought they had purchased the seller's insurance for long-tail liabilities found that the cupboard was bare.

Justice Carlos Moreno filed a lone dissent in *Henkel*, arguing that under the common law of contract and relevant public policy, "after a loss," policy benefits can be assigned without insurer consent. And the relevant "loss," in Justice Moreno's view, was not the payment by the policyholder to a third-party claimant, or the insurer's breach of the policy.

Rather, it was the happening of the "occurrence" constituting the bodily injury or property damage that triggers coverage: "[T]he date of the injury ... is when the loss occurs. ... So long as the injury-causing event has occurred during the policy period, coverage is triggered, and a loss has occurred."

The right to proceed against the insurer, in Justice Moreno's view, becomes vested at the time of "loss" — the "occurrence" — and should thereafter be freely assignable. (That was also the view of Justice Walter Croskey, the renowned writer on insurance who had authored the Court of Appeal decision that the Supreme Court reversed.) The six other justices were, however, unpersuaded.

But Wait a Minute: Insurance Code Section 520

Justice Moreno's conclusion was sounder than even he apparently realized. For as *Henkel* worked its way through the courts — and for more than a century before that — there sat Insurance Code Section 520: "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."

As is readily apparent, Section 520 is thus a virtual paraphrase of Justice Moreno's conclusion in dissent that "After a loss, the policy benefits can be assigned without insurer consent, the no-assignment clause notwithstanding."

Remarkably, among the three California courts, the several insurers, the parties, and the multiple Supreme Court amici curiae involved in the *Henkel* litigation, not a single one appears to have cited, considered or even been aware of Section 520. Surely a party who believed that the statute supported its reading of the anti-assignment clause would have rushed to call it to the courts' attention. And a lawyer who concluded the contrary would nonetheless have been bound by the duty of candor to do likewise. Thus, it seems, Section 520 was simply missed.

Insurers may argue that because third-party liability insurance was unknown in the United States when Section 520 was first enacted as part of the original Civil Code in 1872, the statute should simply not apply to third-party liability policies. They may also contend that because "loss" in 1872 generally referred to first-party "loss" under fire insurance policies, "loss" today should be read narrowly in line with the *Henkel* majority's "chose in action" view.

However, the placement of Section 520 in the Code division containing the "General Rules Governing Insurance" confirms its applicability to "occurrence"-based policies. And by the time Section 520 was reenacted as part of the 1935 Insurance Code, third-party liability insurance was well established. The statute provides the governing rule of decision.

Section 520 Overrules *Henkel*

Although insurers will surely argue otherwise, the omission of Section 520 from the *Henkel* court's analysis was not a harmless error. Section 520 requires the opposite result. "Loss" as used in Section 520 is properly understood to refer to the "occurrence" under general liability policies, not to the *Henkel* majority's "chose in action."

The words of the statute are few and plain: Anti-assignment provisions are "void" if they restrict the policyholder's right to assign "after a loss has happened." Although Justice Moreno's analysis of the anti-assignment issue was based upon the common law, his understanding of "loss" is also clearly the correct gloss on the statute.

"Loss," after all, is understood by insurers themselves to refer to the coverage-triggering "occurrence": "[T]hird party CGL policies ... provide coverage for injuries and damage caused by an "occurrence," and typically define "occurrence" as an accident (or sometimes a "loss") ... that results in bodily injury or property damage during the policy period." *Montrose Chem. Corp. v. Admiral Ins. Co.*, 10 Cal. 4th 645, 664 (1995).

The Secretary of the National Bureau of Casualty Underwriters explained the industry's original adoption of the "occurrence" form in the mid-1960s thus: "[T]he definition of occurrence serves to identify the time of loss for the purpose of applying coverage." Richard H. Elliott, The New Comprehensive General Liability Policy.

Unsurprisingly, California courts understand "loss" the same way. Montrose, for example, held: "[T]he loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer entered into the contract of insurance ... that the insured had a legal obligation to pay damages to a third party in connection with a loss."

If "loss" referred to a "sum of money due under the policy," rather than to the coverage-triggering "occurrence," such statements would make no sense.

Reading "loss" to refer to "occurrence" is also consistent with the majority American rule, from which *Henkel* departs. For example: "[A] "loss" is "the occurrence of the event, which creates the liability of the insurer. ... The event that occasioned the liability of Gulf, was the "Occurrence" to which the policy applied; i.e., the bodily injury." *Egger v. Gulf Ins. Co.*, 588 Pa. 287, 299-300 (2006).

Similarly, in *Pilkington N. Am. Inc. v. Travelers Cas. & Sur. Co.*, 112 Ohio St. 3d 482 (2006), the Ohio Supreme Court held that "[t]he distinction created in *Henkel* does not align with the obligations recognized in Ohio that the insured's right to recover arises automatically at the time of loss." Because "[t]he losses are fixed at the time of the occurrence," the court concluded, assignments following the "occurrence" are not barred by the anti-assignment clause.

In sum, *Henkel* missed the governing statute, and so missed the issue. Section 520 makes "loss" the test for assignability, and vindicates Justice Moreno's common-law analysis: Under Section 520, anti-assignment clauses are ineffective once the "occurrence" happens.

Once More Into the Breach

The damage done in the eight years *Henkel* has held sway — to would-be sellers of businesses who cannot transfer their liabilities, to buyers deprived of insurance they expected would cover liabilities they assumed, and to claimants whose recoveries are delayed or denied by a lack of insurance proceeds — may never be tallied. In all events, *Henkel* must be written off the books.

Fortunately, although the Supreme Court is the only court that can actually overrule *Henkel*, the case is not binding precedent. Cases are not authority for propositions they do not consider, are not precedent when decided in ignorance of controlling statutes, and are without effect if they contradict the written law. The rule of stare decisis neither requires nor permits courts to ignore their duty to defer to the expressed legislative will when it is contrary to precedent. Litigation under Section 520 is already under way to confirm that proposition.

Henkel represents a rare breakdown of the adversary system. The California courts should embrace the opportunity to revisit and repair a broken rule of decision, and others should question its persuasive force.

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