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Enforceability of Non-Assignment Clauses in Asset Purchase Deals

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When clients are contemplating an asset purchase deal, the availability of insurance to cover the risk of claims against the business that is being acquired often presents a significant issue. New policies can be purchased, but the new policies may exclude claims arising out of operations that occurred prior to the sale. In many cases, the most appealing option is to transfer the rights under existing insurance policies to the purchaser as part of the asset sale. Whether those rights can be transferred without the consent of the insurer depends upon the language of the policy and applicable law regarding the assignment of rights to insurance.[1]

Most liability insurance policies contain a standard non-assignment or no-transfer clause which provides that the policy cannot be assigned "without the express prior written consent of the [Insurance] Company." The main purpose of the clause is to protect the insurer from a material increase in risk resulting from an ownership change. Courts differ, however, as to how this clause is enforced. The majority of jurisdictions draw a distinction between assignment of an insurance claim for an existing loss and the assignment of the insured's rights under the policy with regard to future losses.

Under the majority rule, the no-transfer clause prevents an insured from assigning the right to make claims for future losses without the consent of the insurer, but an insured can assign the rights to a claim for insurance coverage with regard to an existing loss, even in the face of a no-transfer clause and even without the insurance company's consent. In contrast, recent cases in California and Indiana have further developed a minority rule which prohibits the insured from assigning a claim for existing loss in the face of a no-transfer clause unless the loss is identifiable with precision and has already been the subject of a claim.

New York courts continue to follow the majority rule, refusing to enforce a no-transfer clause to prevent assignment of claims for a pre-transfer loss. However, in New York, a separate line of cases has limited the right to assign insurance claims for business interruption losses by treating such claims as claims for post-transfer loss.

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New York and Majority Rule

In *Globecon Group v. Hartford Fire Ins.*, the U.S. Court of Appeals for the Second Circuit discussed the rationale supporting the majority rule that a no-transfer clause does not prevent assignment of the right to recover insurance for a loss that occurred prior to the transfer.[2] The court explained that, once the loss has occurred, the policyholder is actually transferring a cause of action to recover under the policy rather than transferring all of the rights under the policy.[3]

In *Viking Pump v. Century Indemnity*, the Court of Chancery of Delaware shed additional light on the reason why a non-assignment clause does not act "as a barrier to the transfer of 'post-loss claims.'"[4] The court explained that, "although insurers have a legitimate interest in protecting themselves against additional liabilities the insurer did not contract to cover, once the insured-against loss has occurred, there is no issue of an insurer having to insure against an additional risk."[5] At that point, the only remaining question is whether the insurer will pay the insured or the insured's assignee.

New York courts view the assignment of an accrued insurance claim the same way the courts view the assignment of a chose in action. Consequently, New York and the majority of other jurisdictions hold that a no-transfer clause cannot prevent assignment of the right to recover insurance for claims arising out of events that occurred prior to the transfer.[6]

Business Interruption Loss

Although New York courts do follow the majority rule, several local courts have narrowed the circumstances in which a right to insurance may be assigned in the context of a claim for business interruption loss. These courts in essence treat the new owner's business loss as a post-transfer loss, even where the events that gave rise to the loss occurred prior to the transfer, because the change in ownership is viewed as altering the risk associated with a business interruption claim. Thus, the courts have determined that a no-transfer clause prevents assignment of these claims.

In *Holt v. Fidelity Phoenix Fire Ins. of New York*,[7] a case decided back in 1948, a fire caused the temporary closure of a movie theater. The owner made a claim for property damage caused by the fire, and the insurance company paid the claim. No claim for lost profits was made because the theater was operating at a loss prior to the fire. Shortly after the fire, the owner completed the sale of the theater to plaintiff J. Steven Holt. Following the sale, which purported to include a transfer of the theater's rights to insurance under the policy, plaintiff Holt made a claim for lost profits due to the fire and temporary closure of the theater.

The defendant insurance company denied the claim on the grounds that the claim could not be assigned due to the no-transfer clause. The Appellate Division, Third Department, affirmed the ruling of the trial court in favor of the insurer. In so doing, the court pointed out that the theater owner could have assigned its claim for property damage or lost profits to Holt, but held that Holt could not maintain a claim for its own lost profits for the period after the purchase, because Holt's

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lost profit claim did not accrue until after the sale of the theater.

More recently, the Southern District followed the reasoning of *Holt* in *Bronx Entertainment v. St. Paul's Mercury Insurance*,[8] rejecting the business loss claim asserted by the purchaser of a golf center. In *Bronx Entertainment*, the owner of a golf center suffered damages when the driving range netting was torn by severe weather. The owner sought coverage for the cost of repairing and replacing the netting and damages for lost revenue during the period when the driving range was shut down.

A few weeks later, the golf center was sold to plaintiff Bronx Entertainment and the sale purported to include an assignment of the rights under the golf center's insurance policy. Following the reasoning in *Holt*, the Southern District permitted Bronx Entertainment to maintain a claim for the loss incurred by the original owner, because that loss accrued prior to the asset sale and transfer of insurance rights. However, the court refused to allow a claim by Bronx Entertainment for loss incurred after the sale, on the grounds that the claim was barred by the non-assignment clause.

These two cases were discussed in detail by Judge Michael B. Mukasey, then sitting in the Southern District, in *SR International Business Insurance v. World Trade Center Properties*,[9] a discussion later cited with approval by the Second Circuit in *Globecon Group*.[10] Mukasey explained that to determine whether a post-loss assignment of an insurance claim is permissible in the face of a no-transfer clause, courts review "(i) the characteristics of the assignee (i.e., who the policy is transferred to, as well as their conduct) and (ii) the nature of the claim (i.e., whether it is fixed and measurable, as opposed to speculative and contingent)."[11] Both factors relate to whether the risk imposed on the insurer is "meaningfully different" than the risk borne by the insurer before the assignment.[12]

Mukasey further explained that, in *Holt* and *Bronx Entertainment*, the new owners were prohibited from asserting their own business loss claim because assignment of the right to assert such a claim "would unduly increase the risk borne by an insurer by allowing a new owner operating a new business nevertheless to seek coverage for its own lost profits as if it initially had been covered by the original insurance policy."[13] In contrast, in *Globecon*, the dispute at issue concerned an insurance claim for lost rents, the amount of which was fixed and ascertainable prior to any assignment.

Minority Rule Cases

While New York courts have distinguished cases involving business interruption loss incurred by the transferee by treating such claims as claims for post-transfer loss, courts in a minority of jurisdictions have narrowed the circumstances in which the assignment of an insurance claim for pre-transfer loss will be permitted without insurer consent. These courts have held that only claims where the existing loss can be identified with precision may be assigned in the face of a no-transfer clause.

For example, in *Henkel Corporation v. Hartford Accident and Indemnity*,[14] the Supreme Court of California denied the plaintiff successor the right to its predecessor's insurance, due to the absence of insurer consent, even though the loss occurred prior to the assignment and during the period that the insurance policies were in effect. The loss at issue concerned injuries alleged to have occurred due to exposure to metallic chemicals manufactured by the plaintiff's predecessor between 1959 and 1976.

After the claimants filed suit against the plaintiff successor entity, plaintiff tendered defense of the claim under the terms of occurrence policies issued by the defendant insurers. The insurers denied the claim and refused to contribute to the plaintiff's settlement of the case. The court upheld the insurers' position, enforcing the anti-assignment clause even though the loss had occurred prior to the transfer. The court explained, over criticism from the dissent, that the plaintiff could not overcome the no-transfer clause because the underlying claims had not been "reduced to a sum of money due or to become due under the policy."[15]

In 2009, the Supreme Court of Indiana adopted the *Henkel* rationale in *Travelers Casualty & Surety v. United States Filter*.[16] In *United States Filter*, the court was faced with an insurance dispute concerning underlying claims for injury allegedly caused by the claimants' exposure to silica while working at the plant of an entity whose assets were later sold to United States Filter.

The court acknowledged that the majority of other courts "recognize an exception to the enforcement of consent-to-assignment clauses for assignments made after a loss has occurred."[17] However, the court determined that the exception did not apply because the underlying claims involved "occurred but not yet reported losses," which were not reported for years after United States Filter's acquisition of the assets of the insured entity.[18] Instead, the court adopted the rationale of *Henkel*, finding that the rights to the insurance can only transfer, in the absence of insurer consent, where the underlying claim has already been made against the insured, at a point in time where the insured could have brought a claim for insurance coverage against the insurer.[19]

More recently, the Court of Appeals of Indiana decided C*ontinental Insurance v. Wheelabrator Technologies*, explaining that it was constrained to follow the Supreme Court of Indiana's ruling in *United States Filter.*[20] According to the court, under *United States Filter*, the rights to insurance can only be transferred in violation of a no-transfer clause where the loss at issue is "identifiable with some precision" and is "fixed, not speculative."[21]

The court refused to allow the successor entity rights to the insurance of its predecessor because, even though the loss had occurred prior to the transaction that transferred the policy rights, the underlying claims were not known or identifiable prior to that transaction. Therefore, the court held that there was no assignable post-loss chose of action.[22] The Supreme Court of Indiana may soon have another opportunity to address this issue, as a motion to transfer this case to that court is currently pending.

Looking Forward

New York courts have shown no sign of moving away from the majority rule, except in cases involving insurance for business interruption loss. However, given the emergence of the minority view in certain other jurisdictions, where a transaction may not be governed by New York law, it is prudent to seek insurer consent prior to the assignment of policy rights. Further, in the absence of a recently published New York case on this subject, even in transactions governed by New York law, it may be worthwhile to seek insurer consent to avoid uncertainty with regard to insurance rights for loss that has occurred but has not yet become a known claim.

1. This column only addresses the right to transfer insurance rights in the context of an asset purchase deal. It does not address insurance rights related to other transactions like stock purchase agreements or mergers.
2. *Globecon Group v. Hartford Fire Ins.*, 434 F.3d 165 (2d Cir. 2006).
3. Id.
4. *Viking Pump v. Century Indemnity*, No. 1465-VCS, 2009 WL 3297559 (Del. Ch. Oct. 14, 2009).
5. Id. at *18.
6. See *Egger v. Gulf Insurance*, 588 Pa. 287 (Pa. 2006); *R.I. Vallee v. American International Specialty Lines Ins.*, 431 F.Supp.2d 428 (D. Ver. 2006); *Pilkington North America v. Travelers Casualty & Surety*, 112 Ohio St.3d 482 (Ohio 2006).
7. *Holt v. Fidelity Phoenix Fire Ins. of New York*, 273 A.D. 166, 76 N.Y.S.2d 398 (3d Dept. 1948).
8. *Bronx Entertainment v. St. Paul's Mercury Insurance*, 265 F.Supp.2d 359 (S.D.N.Y. 2003).
9. *SR International Business Insurance v. World Trade Center Properties*, 375 F.Supp.2d 238 (S.D.N.Y. 2005).
10. 434 F.3d 165, 172-174.
11. 375 F.Supp.2d at 248.
12. Id.
13. 375 F.Supp.2d at 249.
14. *Henkel Corporation v. Hartford Accident and Indemnity*, 29 Cal.4th 934, 62 P.3d 69 (2003).
15. Id. at 944.
16. *Travelers Casualty and Surety v. United States Filter*, 895 N.E.2d 1172 (Ind. 2009).
17. Id. at 1178-79.
18. Id. at 1179.
19. Id. at 1180.
20. *Continental Insurance v. Wheelabrator Technologies*, No. 49A02-1010-PL-1110 (Indiana Ct. App. Dec. 6, 2011).
21. Id.
22. Id.

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