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Fifth Circuit Enforces General Liability Policy's Non-Assignment Clause under Texas Law, Leaving Successor Corporation Without Coverage for Pre-Asset Transfer Losses

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The U.S. Court of Appeals for the Fifth Circuit confirmed in *Keller Foundations, Inc. v. Wausau Underwriters Insurance Co.*, 2010 WL 4673026 (5th Cir. Nov. 19, 2010) (only Westlaw citation currently available) that, under Texas law, insurance policy non-assignment clauses are enforceable, thus negating transfers of insurance rights as a "chose in action" or under a product line successor liability theory. The court also determined, as a matter of first impression, that a transfer of insurance rights by operation of law would likely be rejected under Texas law. This decision underscores the importance of expressly addressing insurance rights, as well as choice of law, in all corporate transaction documents. Recognizing these issues will help both the predecessor and successor better prepare in the event of future losses or future lawsuits relating to pre-transaction losses.

Background

Keller Foundations involved an appeal by Wausau of a judgment requiring Wausau to defend and indemnify Keller Foundations, Inc., and Suncoast Post-Tension, L.P. (together, "the Keller Companies") under a commercial general liability policy issued to Travis International, Inc., from whom the Keller Companies acquired certain assets. The corporate transaction and the insurance policy at issue were described by the court as follows. Keller Suncoast, L.P. ("New Suncoast"), a Keller Foundations company, had purchased certain assets and assumed certain liabilities from Suncoast Post-Tension, Inc. ("Old Suncoast"), a Travis International, Inc., subsidiary. Although the purchase agreement transferred all assets and some liabilities of Old Suncoast to New Suncoast, it excepted from transfer certain excluded assets, including all insurance policies issued to Old Suncoast. Old Suncoast had been insured under a Wausau general liability policy that included a non-assignment clause, which stated: "Your rights and duties under this policy may not be transferred without our written consent except in the case of death of an individual named insured." Old Suncoast did not request that Wausau transfer coverage to New Suncoast. After the sale, several lawsuits were filed relating to work performed by Old Suncoast prior to the asset purchase and during the Wausau policy period. The Keller Companies assumed the defense of those claims, pursuant to its assumption of liabilities in the asset purchase agreement, and sought coverage from Wausau. Wausau denied coverage and the Keller Companies sued, seeking both defense and indemnity.

Keller Foundations, at *1. The U.S. District Court for the Western District of Texas found for the Keller Companies, holding that Wausau's insurance was transferred to the Keller Companies either as a chose in action or by operation of law. *Keller Foundations*, at *2. Wausau appealed.

The Appeal

The issue before the Fifth Circuit was whether pre-transfer losses were covered under the Wausau policy despite the policy's non-assignment clause. *Keller Foundations*, at *2-3. The Fifth Circuit noted that a majority of courts have found that non-assignment clauses do not apply to losses that precede a transfer of assets. The court further noted that Texas courts have consistently diverged from the majority rule, finding non-assignment clauses enforceable even in the case of post-loss assignments. *Id.* at *2-3, *citing Texas Farmers Ins. Co. v. Gerdes*, 880 S.W.2d 215, 219 (Tex. App. 1994); *Texas Pacific Indem. Co. v. Atlantic Richfield Co.*, 846 S.W.2d 580, 583 (Tex. App. 1993); *Conoco, Inc. v. Republic Ins. Co.*, 819 F.2d 120, 124 (5th Cir. 1987). The court also rejected the argument that insurance can be transferred as a "chose in action," stating that, to circumvent the non-assignment clause by labeling the transfer of insurance rights as the transfer of insurance "proceeds" is specious. Id. at *3, *citing Conoco*, 819 F.2d at 124.

The Fifth Circuit also addressed whether the insurance rights could be transferred by operation of law, an issue of first impression for Texas courts. *Keller Foundations*, at *4. The Keller Companies argued that Texas courts would follow *Northern Insurance Co. of New York v. Allied Mutual Insurance Co.*, 955 F.2d 1353, 1358 (9th Cir. 1992), in which the Ninth Circuit held, under California law, that insurance coverage for pre-acquisition losses is transferred by operation of law when the liabilities in question were transferred by operation of law, notwithstanding a non-assignment clause in the insurance policy. The court in *Northern Insurance* reasoned that the purpose of non-assignment clauses is to avoid drastic alteration to the insurer's exposure, but that such a concern is eliminated where liability arises from presale activities. *Keller Foundations* at *4, *citing Northern Ins.*, 955 F.2d at 1358. The Fifth Circuit noted that other courts, including some California courts, have rejected the *Northern Insurance* rule and found that Texas courts would likewise reject it, especially where liabilities are assumed through an asset purchase agreement, not by operation of law, and where that agreement specifically excludes transfer of the relevant insurance policy. *Keller Foundations*, at *4-5. Accordingly, the Fifth Circuit reversed and granted summary judgment in favor of Wausau. *Keller Foundations*, at *6.

Implications

Keller Foundations illustrates the importance of considering predecessor coverage and choice of law issues when structuring corporate transactions and asset transfers. The decision likewise illustrates the potentially significant value that a predecessor company's insurance policies might add to any corporate transaction or asset transfer. In most cases, however, whether coverage is available will depend on both a fact-intensive and jurisdiction-specific inquiry, thus underscoring the significance of the language used in the transaction documents and any insurance contracts, as well as the applicable jurisdictional law.