November 2012

Supreme Court of Kentucky Finds Anti-Assignment Clause Unenforceable

The Supreme Court of Kentucky held that an anti-assignment provision in a builder's risk insurance policy is not enforceable where the claimed loss occurs before the assignment. *See Wehr Constructors, Inc. v. Assurance Company of America*, No 2012-SC-221-CL, 2012 WL 5285774 (Ky. Oct. 25, 2012). The ruling follows the rule in the majority of United States jurisdictions and is consistent with the underwriting and expectations of insureds purchasing such policies.

Background

Murray Calloway County Hospital Corp. contracted with Wehr Constructors Inc. for construction work at the hospital. After Wehr's work was completed, a portion of the property suffered damage. A contract dispute arose between the Hospital and Wehr, which was settled. As part of the settlement, the Hospital assigned to Wehr the Hospital's rights against Assurance Company of America arising out of a builder's risk insurance policy covering the property damage. The Hospital made this assignment *after* the damage had occurred. Wehr, as the Hospital's assignee, then sued Assurance, seeking to recover payment under the policy.

Assurance moved for judgment on the pleadings, invoking the anti-assignment provision of the policy. It argued that, because it had not consented to the assignment, the assignment was unenforceable. Wehr countered that because the loss for which the Hospital sought coverage occurred before the assignment, and because the basis for Assurance's potential liability was fixed, the Hospital's right to the proceeds under the policy was freely assignable and, accordingly, the assignment did not require Assurance's consent. Wehr also argued that the anti-assignment clause was against public policy and therefore unenforceable.

The Decision of the Kentucky Supreme Court

The court considered the majority rule, which holds that a non-assignment clause in an insurance policy is not enforceable for assignments made *after* the occurrence. Under this rule, an anti-assignment clause is unenforceable once an insured occurrence takes place, because at that point the insured has a right of recovery, under the policy, that constitutes a chose in action and a form of personal property. Enforcing an anti-assignment provision would be a restraint upon the alienation of this property right and therefore violate public policy.

Under the majority view, the "purpose of an anti-assignment clause is to protect the insurer from unforeseen exposure and increased liability that may ensue if the policy was assigned to an entity that the insurer would prefer not to insure; or, would have insured only at a higher premium." However, "after an insured loss that gives rise to the insurer's liability, the insurer's risk cannot be increased by a change in the identity of the party to whom the payment is to be made." Therefore, under the majority rule, once a loss occurs and the insurer's liability becomes fixed, the insured may assign its rights under the policy regardless of an anti-assignment clause.

The court held that public policy interests are "best served" by the majority rule, finding that Assurance's anti-assignment provision was fundamentally in opposition to Kentucky's long-standing rule against

restricting a party's ability to transfer a chose in action. The court also noted that the majority rule advances the important public policy of encouraging settlements by facilitating settlement agreements.

The court acknowledged that, in Kentucky, unambiguous language in a contract will be enforced. But it found that even if the Hospital's policy unambiguously barred it from assigning its rights under the policy to Wehr without Assurance's consent, the provisions should not be enforced because of public policy considerations. The court also recognized the "low esteem for the minority rule," which does not permit assignments absent consent, and observed that "the only cases Assurance cites . . . applying the rule are cases applying Texas law."

In a concurring opinion, Judge Noble concurred with the public policy rationale and added that the issue could have been resolved as a pure legal question, as the anti-assignment clause did not make clear whether it should be applied before or after an occurrence, thereby creating an ambiguity that should be interpreted against the insurer.

Implications

In refusing to enforce an anti-assignment provision, Kentucky joins the majority of U.S. jurisdictions that prohibit insurers from requiring policyholders to obtain consent before assigning insurance claims for losses that have already occurred. *Wehr* reinforces that the majority rule better serves the public interest and recognizes the notion that insurers should not be allowed to control an insured's legal rights in a claim or the ability to transfer those rights. Indeed, it is difficult to see how the insurer's risks are changed if an assignment occurs after the loss, and the majority rule therefore appears consistent not only with insureds' expectation but with insurers' underwriting as well.

Despite this opinion, insurers will likely continue invoking anti-assignment clauses, notwithstanding the weight of authority against their enforcement. Policyholders should therefore be prepared to argue forcefully against any attempt by insurers to rely on anti-assignment provisions with respect to pre-assignment losses.

Contacts

Walter J. Andrews
wandrews@hunton.com

Lon A. Berk
lberk@hunton.com

Lawrence J. Bracken II
lbracken@hunton.com

John C. Eichman
jeichman@hunton.com

Robert J. Morrow
rmorrow@hunton.com

Curtis D. Porterfield
cporterfield@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Michael S. Levine
mlevine@hunton.com

Sergio F. Oehninger
soehninger@hunton.com

William T. Um
wum@hunton.com