Supreme Court considers standing of insurers in Chapter 11

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It is not common for the United States Supreme Court to wade into the area of insurance contracts or the rights of insurers in mass tort cases. Nevertheless, an important bankruptcy case is now before the nation's highest court and requires the Court to do just that.

On Tuesday, March 19, the Supreme Court heard oral argument in *Truck Insurance Exchange v. Kaiser Gypsum Company, Inc.*, a case that will influence claims and policyholders' liabilities for which insurers may be called upon to defend or provide indemnification. The issue to be decided is whether an insurer with financial responsibility for a bankruptcy claim is a "party in interest" that may object to a Chapter 11 plan of reorganization.

The outcome of the Court's ruling in Truck Insurance Exchange *will have major implications for the resolution of mass tort claims in Chapter 11.*

A central point in the appeal is whether the bankruptcy doctrine of "insurance neutrality" may be applied to exclude an insurance company from raising objections to a plan of reorganization when the plan ostensibly does not increase the insurer's liability exposure above pre-bankruptcy levels.

The outcome of the Court's ruling in *Truck Insurance Exchange* will have major implications for the resolution of mass tort claims in Chapter 11. The decision will impact insurance providers as well as companies seeking to rid themselves of mass tort liabilities in Chapter 11 bankruptcy cases.

Legal framework

Chapter 11 of the Bankruptcy Code is a collective proceeding that permits a debtor to achieve a comprehensive resolution of all its liabilities, including mass tort claims. Congress created a structure that encourages participation by those whose rights may be affected. The applicable statutes are clear and broad in scope: Any "party in interest" is empowered to "raise" and "appear and be heard on any issue" in a Chapter 11 reorganization case.

Insurers often play an important, albeit indirect, role in defending tort cases on behalf of their insureds. In fact, insurers are at the center of mass tort bankruptcies. Bankruptcy reorganizations that involve companies facing mass tort liabilities often result in the establishment of a trust to resolve and pay claims against a debtor. That trust is funded, at least in part, with insurance proceeds. The trust is generally responsible for administering a court-approved (and streamlined) procedure for resolving tort claims and making distributions.

Unlike the tort system, the trust process established under a Chapter 11 plan can alter the dynamics that normally exist between an insurer and its policyholder. The previous alignment of interests changes due to the bankrupt's desire to rid itself of liability and limit its participation in the claims resolution process. Indeed, debtors often have little or no incentive to fight mass tort claims in bankruptcy cases because plans, which discharge the debtor of liability, assume that payment to tort creditors will come from the insurance company.

The goal of debtors is in fact to maximize the insurance proceeds available to pay claims and to minimize an insurer's ability to dispute coverage or challenge claim valuations. The concern of insurers involved in mass tort bankruptcies is that a flood of meritless or inflated tort claims will be allowed without scrutiny and the economic obligor — the insurance company funding the trust — will be left without meaningful recourse.

Factual background

Kaiser Gypsum Company, Inc. and Hanson Permanente used to sell products containing asbestos. Facing over 38,000 asbestos-related lawsuits, the companies sought refuge in Chapter 11. The debtors proposed a reorganization plan to halt all litigation, channel tort claims to a trust and move liability away from the debtors.

The viability of the Chapter 11 plan was dependent on general insurance liability policies issued by the insurer to defend the claims. The insurer was the only objector to the plan.

The insurance carrier opposed the plan due to perceived failures to include provisions that would mitigate potential fraudulent claims (for example, claims that may have received partial payment from an alternate source or were otherwise inflated). The insurer contended the plan's impact increases the insurer's economic exposure.

The bankruptcy court confirmed the Chapter 11 plan, finding it to be "insurance neutral" and therefore not impacting the rights or obligations of the insurance provider under existing policies. The bankruptcy court refused to allow the insurer to participate in the bankruptcy at all. The court declined to consider the merits of the insurer's objections centering on the concerns that the plan contained insufficient protections against fraudulent and excess payments.

The matter involved multiple appeals, including a ruling last year by the 4th U.S. Circuit Court of Appeals affirming the finding that the insurer lacked standing to challenge the plan and was not a "party in interest."

The 3rd U.S. Circuit Court of Appeals, in contrast, has recognized that insurers should have an opportunity to challenge such a plan since they are the ultimate payors and have cognizable injuries that afford standing.

Positions of the parties

The debtors argued before the Supreme Court that the Chapter 11 plan was "insurance neutral," a finding supported by the rulings of the lower courts that considered the issue.

The debtors contended that the insurer, which is bound under existing policies to pay on claims up to its insurance limits, is seeking to *improve* its position by mandating new protections not provided for in its policies for resolving claims. The insurer is therefore seeking to inject itself into bankruptcy proceedings when its rights are not impaired and claiming an entitlement that it does not currently have.

The insurer chided the lower courts for deciding it lacked standing to be heard based upon judge-made limitations engrafted over the express provisions of the Bankruptcy Code. The insurer argued to the Court at the beginning of oral argument that it is *the* party in interest in the bankruptcy case since it will be the one satisfying the claims against the debtor's estate: "If anyone is entitled to be heard it is the insurer who is paying all the claims."

The United States Government joined in the briefing to the Court and supported the insurer's position, contending that the contracts between the debtors and their insurers are property of the bankruptcy estate. As such, the contracts must be either rejected, assumed, or assigned in a Chapter 11 proceeding — in any case, impacting the interests of the counterparty. As the insurer is a creditor and party in interest based upon its contracts, it should be recognized as a party that has a bona fide interest in the outcome of case.

Questioning by Court and implications

In arguments on March 19, the justices appeared sympathetic to the position of the insurance company with respect to the fundamental issue before the Court: "Who can be heard?" in a Chapter 11 proceeding.

The members of the Court peppered the insurer with challenging questions about when the party-in-interest standard is to be determined, at the beginning of the bankruptcy case or at some other point in time given the fluid nature of bankruptcy. Hypotheticals were also posed to counsel about whether someone could be a party in interest if it had not reason to believe that the plan would impact it in any way.

It became clear that the Justices were not receptive to the debtors' argument that the insurer is unimpaired with interests too attenuated to be afforded standing to object to the plan. Justice Elena Kagan indicated in her remarks to debtors' counsel that "What everybody is saying to you, is 'well [the insurer does] have an interest,' not just a concern but a material interest.'" Justice Brett Kavanaugh observed that the debtors simply do not want the insurers "to be heard" at all and that it was "just common sense that an insurer ... is going to have an interest."

The issue of who can object to a plan of reorganization or otherwise participate in a Chapter 11 bankruptcy case is significant:

- The stakes in *Truck Insurance Exchange* are high for the U.S. tort system. The Supreme Court's ultimate decision will add clarity, and undoubtedly a new dynamic, to mass tort bankruptcies, as organizations such as the Boy Scouts of America, the Catholic Dioceses and Purdue Pharma developed bankruptcy plans that addressed the avalanche of tort claims each was facing — all were dependent upon funding from insurance policies.
- The ramifications of denying insurance companies that have an undeniable economic stake in the outcome of a Chapter 11 bankruptcy case the right to participate and, yes, even object, is significant in cases where mass tort claims and insurance are at issue. The questioning at oral argument by the Justices did not seem to favor a process that excludes an interested party and leaves the very insurer whose policies were central to the resolution of the case out of the claims resolution process that could increase the prospect of inflated and meritless claims.

The ultimate question in *Truck Insurance Exchange v. Kaiser Gypsum Co.* is whether insurers have a big enough stake in bankruptcy plans to have the right to challenge them (or at least be heard). The Supreme Court will examine the statutory text of the Bankruptcy Code in light of the standards required by Article III of the U.S. Constitution as well as the effects of the plan and undoubtedly clarify the "party in interest" requirement for standing — focusing on whether the insurer has an interest sufficient enough to have a voice.

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