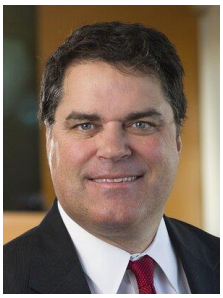
High Court Should Maintain Insurer Neutrality In Bankruptcy

By **Jeffrey Prol, Brent Weisenberg and Amanda Cipriano** (March 19, 2024)



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A recent Expert Analysis article penned by Frank Perch, "High Court Should Endorse Insurer Standing In Bankruptcy," advocates for the U.S. Supreme Court, in Truck Insurance Exchange v. Kaiser Gypsum Company Inc., to adopt a broad view of insurer standing in mass tort bankruptcy cases "to eliminate spurious roadblocks to resolving insurer objections on their merits."[1]

The article's conclusion is based on two fallacies that underpin insurers' efforts to be heard on every issue in bankruptcy cases and not just on issues that affect their pecuniary interests:

1. The goal of every mass tort bankruptcy is to achieve a global resolution of claims; and

2. The bankruptcy process "ultimately realigns the interests of the debtor with those of the claimants in obtaining the plan's approval ... and may leave little incentive to weed out invalid, fraudulent or inflated claims."

First, the goal of a mass tort bankruptcy case is not necessarily "global peace." Indeed, achieving that goal was not intended by the drafters of the U.S. Bankruptcy Code as shown by its legislative history.

Rather, the Bankruptcy Code was drafted to facilitate the consensual resolution of disputes between a debtor and its creditors so that a plan of reorganization may be confirmed. Insurers are not creditors.

And so, while achieving consensus among a debtor faced with mass tort claims, its insurers and creditors may be an eloquent solution to thorny problems, it is not, by definition, a goal of Chapter 11.

Indeed, insurers' contracts often ride through bankruptcy, meaning their contractual obligations remain after the debtor's bankruptcy is concluded and thus are not necessarily fully and finally resolved in the bankruptcy case.

Second, the article argues that the bankruptcy process leaves little incentive for the debtor and claimants to weed out invalid, fraudulent or inflated claims. And so, the insurers must be granted standing to defend against these claims.

The idea that mass tort cases are rife with fraudulent or inflated claims is a refrain often repeated by insurance carriers. Notwithstanding the fact that there is no evidence of nefarious claims, almost every bankruptcy plan of reorganization contains anti-fraud measures designed to root out unsupported claims.

Indeed, the bankruptcy system itself requires that proofs of claim be filed under penalty of perjury.

The irony of the article's assertions is evidenced by the fact that insurers try to use a bankruptcy to tamp down the value of, or avoid liability for, valid claims asserted against

their insured.

To prevent insurers from doing so, while making clear that the insurers' state law and contractual rights are preserved, a debtor and its creditors often promulgate an insurance-neutral plan of reorganization that passes insurance coverage through the bankruptcy unaltered, except as modified by the bankruptcy itself.

While insurers have standing to be heard on insurance neutrality, they have no right to be heard on issues that have no impact on their rights.

In Chapter 11 cases filed to resolve mass torts for which insurance companies may have liability, courts across the country have used one or more of the three distinct standing doctrines — statutory standing, constitutional standing and prudential standing — to determine whether the debtor's insurers should be permitted to intervene in plan confirmation proceedings.

In making this decision, courts generally ask a simple question: Will confirmation of the debtor's plan impair the insurers' rights?

If the answer is no, the plan is found to be insurance neutral, and therefore the insurers are found not to have standing to oppose the plan. If the answer is yes, the insurers are found to have standing to object to any plan provisions that may impair their rights — but not the rights of others.

The above establishes that every time an objection to insurer standing is raised, insurers are allowed to articulate how their rights are affected. Thus, contrary to the article's assertions, debtors, committees and creditors are not attempting to use "the insurance neutrality doctrine to prevent insurers from even arguing that their interests were affected."

Under the guise of arguing insurers' voices are silenced in plan confirmation proceedings, the article's argument would open Pandora's box by granting party-in-interest status for insurers, with rights to be heard on a range of matters that have no bearing on insurers' rights, be it the fees payable to counsel for survivors of sexual abuse, the allowance of untimely claims solely for purposes of a distribution from a debtor's estate and even who may mediate disputes solely between a debtor and the committee.

In diocesan bankruptcy cases across the country, insurers have ground the cases to a snail's pace, concocting all sorts of objections on issues that have no impact on them.

Their goal is transparent: Facing billions of dollars of exposure, they seek to delay conclusion of the cases to attempt to force debtors and creditors into unfavorable settlements.

Thus, the problem with granting insurers wide-ranging standing in bankruptcy cases is that it will encourage insurers to litigate as many issues as possible — regardless of whether their own pecuniary interests are affected — solely to achieve their ultimate goal of delay.

The doctrine of standing, as applied to insurers in bankruptcy proceedings, must therefore remain narrowly construed to avoid unnecessary delay to the reorganization efforts of debtors and creditors in these proceedings.

To allow insurers to participate in the day-to-day of a bankruptcy prior to establishing that a redressable injury exists would result in madness. This is shown by In re: C.P. Hall Co. in the U.S. Court of Appeals for the Seventh Circuit in 2014, which stated that although the insurer's "desire to butt in [to oppose a proposed settlement] is understandable," "[t]hat

way madness lies — settlements made impossible by crowds of objectors."

Indeed, to invite third parties, like insurers, to participate in all aspects of a Chapter 11 case, where their rights are neither currently affected nor implicated, would create a playground for mischief and delay. As the debtor in Kaiser Gypsum recognized in its brief filed with the Supreme Court:

> [T]he focus of Chapter 11 is aiding debtors and their creditors, not the cornucopia of characters that may fear a collateral injury from a reorganization plan. Indeed, given that Article III requires only but-for causation, the roster of possible Chapter 11 hecklers under [the insurers'] theory is virtually endless.

The doctrine of standing generally, and insurance neutrality, specifically, are designed to prohibit this sort of gamesmanship and interference.

Thus, the Supreme Court should not overturn the long line of cases holding that where a debtor's proposed plan of reorganization is insurance neutral, the insurers lack standing to object to confirmation of the plan.[2]

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[1] See In re Kaiser Gypsum Co., 60 F.4th 73 (4th Cir.), cert. granted sub nom. Truck Ins. Exch. v. Kaiser Gypsum Co., 144 S. Ct. 325 (2023).

[2] See, e.g., In re Burns & Roe Enters., No. 08-4191, 2009 U.S. Dist. LEXIS 13574, at *66–67 (D.N.J. Feb. 23, 2009) (finding insurers lacked standing under the party-in-interest test given that revesting of debtors' rights in insurance policies left insurers in same position they were in at commencement of cases); Findings of Fact, Conclusions of Law, and Order Confirming the First Amended Plan of Reorganization of Leslie Controls, Inc. Under Chapter 11 of the Bankruptcy Code, In re Leslie Controls, Inc., No. 10-12199 (CSS) (Bankr. D. Del. Jan. 18, 2011), ECF 503 ¶ 69 (finding that the plan was insurance neutral and therefore the insurers lacked standing to be heard on any issues relating to plan confirmation); In re Fed.-Mogul Glob. Inc., No. 01-10578 (JKF), 2007 WL 4180545, at *42 (Bankr. D. Del. Nov. 16, 2007) ("[B]ecause the Plan has been rendered "insurance neutral" and broadly preserves the Asbestos Insurance Companies' rights and defenses to coverage, the Plan does not affect the direct interests of the Asbestos Insurance Companies (with the exception of the assignment issue discussed [in the decision]), and hence the Asbestos Insurance Companies lack standing to contest Confirmation of the Plan.").