U.S. Supreme Court: Debtors' Insurance Company Has Standing to Be Heard in Chapter 11 Proceeding

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Authors:

Mark A. Platt

J. Kendrick Wells IV

The U.S. Supreme Court held last week in *Truck Insurance Exchange v. Kaiser Gypsum Co.* that an insurance company with financial responsibility for bankruptcy claims is a "party in interest" with the right to object to a Chapter 11 reorganization plan.

Section 1109(b) of the Bankruptcy Code provides:

> A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.[1]

In a unanimous opinion (8-0, with Justice Alito not participating), the Supreme Court rejected the "insurance neutrality" approach that the courts below—and several other federal courts—applied in determining whether an insurance company has the right to be heard under § 1109(b). Under the insurance neutrality test, an insurance company would have the right to object to a reorganization plan only if the proposed plan would increase the insurer's prepetition obligations or impair the insurer's prepetition rights under the insurance contracts. Because that determination requires a court to examine the substance of the proposed plan and evaluate how the plan would or would not affect the insurer's rights and obligations, the Supreme Court dismissed the insurance neutrality analysis as inadequate for purposes of evaluating the threshold issue of whether the insurer is a party in interest.

The decision clarifies an important procedural issue, and it also acknowledges the potential for Chapter 11 proceedings to impact the interests of the debtor's liability insurers.

Background

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Sister companies Kaiser Gypsum Company and Hanson Permanente Cement (the "Debtors") used to manufacture products which contained asbestos. Tens of thousands of personal injury asbestos lawsuits were filed against the Debtors. Truck Insurance Exchange ("Truck") was the Debtors' primary insurer from 1965 through 1983. The insurance policies require Truck to defend the Debtors against asbestos lawsuits and to indemnify the Debtors for up to $500,000 per claim (subject to a $5,000 per claim deductible), without a maximum aggregate limit. The policies also require the Debtors to assist and cooperate with Truck in defending the claims.

Despite the insurance, the Debtors faced significant exposure for uninsured claims that fell outside of the available insurance, including claims for punitive damages and unknown future asbestos claims. The Debtors filed for Chapter 11 bankruptcy protection in 2016.

The Debtors proposed a reorganization plan (the "Plan") that would create a § 524(g) Trust to assume the Debtors' asbestos personal-injury liabilities, and an injunction to protect the Debtors from future asbestos claims.[2] Under the Plan, "insured" asbestos claims would be filed in the court system as tort lawsuits, and Truck would be required to defend those lawsuits and pay up to $500,000 per claim, with the Trust paying the $5,000 per claim deductible. However, uninsured claims would be submitted directly to the Trust, and those claimants would be required to identify all other claims related to their asbestos injury and to authorize the Trust to obtain the claimants' submissions, if any, to other asbestos trusts. Significantly, particularly from Truck's perspective, these procedures to protect against duplicative and fraudulent claims would not apply to insured claims.

The Debtors sought confirmation of the Plan and also requested a judicial determination that the Debtors' conduct in negotiating and drafting the Plan did not violate the Debtors' assistance-and-cooperation obligations under the Truck policies. Truck—the only party opposing the Plan—raised three main objections: (1) The Plan was not proposed in good faith (as required under § 1129(a)(3))

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because it reflected a collusive agreement between the Debtors and the claimant representatives to perpetuate fraudulently inflated tort claims in the court system; (2) the Plan would improperly alter Truck's rights under the insurance policies by (a) relieving the Debtors of their assistance-and-cooperation duties and implied duties of good faith and fair dealing and by (b) preventing Truck from raising the Debtors' bankruptcy conduct as a coverage defense; and (3) the proposed Trust did not comply with several § 524(g) requirements.

The Bankruptcy Court, District Court and Fourth Circuit Reject Insurer Standing

Following the bankruptcy court's recommendation on September 28, 2020, the district court[3] held on July 28, 2021 that Truck lacked standing to object to the Plan.[4] The court reasoned that Truck could only object to the Plan insofar as the Plan is not "insurance neutral," and in that limited context Truck could assert that the Debtors violated the assistance-and-cooperation provisions of the insurance policies. However, the court concluded that the Plan *is* insurance neutral because the Plan "neither increases Truck's obligations nor impairs its prepetition contractual rights" under the policies. Despite holding that Truck did not have standing to object to the Plan, the district court briefly addressed and dismissed Truck's specific objections.

On February 14, 2023, the Fourth Circuit Court of Appeals affirmed the district court's holding that Truck was not a party in interest under § 1109(b).[5] The Fourth Circuit noted that while a debtor's insurer could potentially qualify as a party in interest, the issue turns on whether the reorganization plan is insurance neutral. The appeals court agreed that the Plan at issue was insurance neutral, and that the Debtors did not violate the assistance-and-cooperation provisions in the policies by supporting a reorganization plan that lacked Truck's desired fraud-prevention measures for insured claims.

Threshold Test Rejected: "Insurance Neutrality"

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The "insurance neutrality" test employed by the Fourth Circuit Court of Appeals and the district court in *Kaiser Gypsum* has been applied in several other federal jurisdictions, including by the Third and Ninth Circuits.[6] However, the Supreme Court firmly rejected this approach, stating that the insurance neutrality doctrine "is conceptually wrong and makes little practical sense."

The Supreme Court observed that historically, "Congress has consistently acted to promote greater participation in reorganization proceedings[,]" and the 1978 enactment of § 1109(b) "continued the expansion of participatory rights in reorganization proceedings." The Supreme Court reasoned that the insurance neutrality doctrine is conceptually flawed because it "conflates the merits of an objection with the threshold party in interest inquiry." It reiterated: "The § 1109(b) inquiry asks whether the reorganization proceedings might affect a prospective party, not how a particular reorganization plan actually affects that party." Therefore:

> Whether and how the particular proposed Plan here affects Truck's prepetition and postpetition obligations and exposure is not the question. The fact that Truck's financial exposure may be directly and adversely affected by a plan is sufficient to give Truck (and other insurers with financial responsibility for bankruptcy claims) a right to voice its objections in reorganization proceedings.

From a practical perspective, the Supreme Court noted that the insurance neutrality doctrine "is too limited in scope" because it "zooms in on the insurer's prepetition obligations and policy rights"—but "ignores all the other ways in which bankruptcy proceedings and reorganization plans can alter and impose obligations on insurers." In this case, "[t]hey transformed the Debtors' asbestos liabilities into bankruptcy claims that Truck will now have to indemnify through the Trust without the protections of disclosure requirements in place for uninsured claims filed directly with the Trust."

Notably, in an earlier section of the opinion, the Supreme Court expounded on the "myriad ways" in which reorganization proceedings can affect an insurer's interests:

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A reorganization plan can impair an insurer's contractual right to control settlement or defend claims. A plan can abrogate an insurer's right to contribution from other insurance carriers. Or, as alleged here, a plan may be collusive, in violation of the debtor's duty to cooperate and assist and impair the insurer's financial interests by inviting fraudulent claims. The list goes on.

The Supreme Court specifically quoted the following example from an amicus brief: "For example, a plan that purports to maintain an insurer's coverage defenses could nonetheless allow claims at amounts far above their actual value and out of line with the claimants' injuries or the payment of claims for which little to no proof of injury is required[.]" In other words, boilerplate reorganization plan language purporting to preserve the insurer's rights (often expressly called, as in this case, "insurance neutrality" provisions) do not automatically shield a plan from scrutiny concerning its practical effects on the insurer.

What Happens Next?

The Supreme Court reversed the judgment and remanded the case for further proceedings consistent with the opinion. As the opinion specifically noted, "§ 1109(b) provides parties in interest only an opportunity to be heard—not a vote or a veto in the proceedings." After providing Truck the opportunity to "be heard," the lower courts may still deny Truck's objections and confirm the Plan. That seems to be a likely result given that the district court went beyond the standing issue in its original decision and found against Truck on the merits of its objections. However, the district court might be persuaded to take a fresh look at the issue of anti-fraud protections for insured claims in light of some of the Supreme Court's commentary.

For other pending and future Chapter 11 proceedings, the Supreme Court's decision clarifies that an insurer with a financial interest in the proceeding is entitled to appear and be heard on any issue—without first establishing that a proposed reorganization plan will affect the insurer's rights or obligations in a specific way. While

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this merely grants insurers a seat at the table, it is preferable to being excluded from the room altogether.

Key Takeaways

- The "insurance neutrality" doctrine is no longer the law of the land. As a result, an insurer with financial responsibility for a Chapter 11 debtor's liabilities will likely be granted section 1109(b) standing.
- In analyzing the practical effects of § 524(g) trusts, the Supreme Court appeared to recognize the profound financial impact these trusts can have on insurers; asbestos manufacturer debtors and other stakeholders thus are more likely to consider the interests of those insurers in future asbestos-related bankruptcy cases.

For more information, contact the authors or any attorney with Frost Brown Todd's Bankruptcy and Restructuring or Product, Tort and Insurance Litigation practices.

Mikey Sanders contributed to this article while working as a summer associate at Frost Brown Todd.

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[1] 11 U.S.C. § 1109(b).

[2] Section 524(g) specifically authorizes an anti-suit injunction to be implemented in connection with a trust that (among other requirements) "is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products[.]" 11 U.S.C. § 524(g)(2)(B)(i)(I).

[3] Section 524(g) plans require district court approval. 11 U.S.C. § 524(g)(3).

[4] *In re Kaiser Gypsum Co.*, No. 16-31602, 2021 WL 3215102 (W.D.N.C. July 28, 2021).

[5] *In re Kaiser Gypsum Co.*, 60 F.4th 73 (4th Cir. 2023).

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[6] *See, e.g., In re Global Indus. Tech., Inc.*, 645 F.3d 201 (3d Cir. 2011), *cert. denied sub nom. Global Indus. Tech., Inc. v. Hartford Accident & Indem. Co.*, 565 U.S. 1014 (2011); *In re Thorpe Insulation Co.*, 677 F.3d 869 (9th Cir. 2012).

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