ALERT

Supreme Court Finds Insurer Has Standing Despite "Insurance Neutrality"

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SCHULTE ROTH + ZABEL

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Introduction

On June 6, 2024, the Supreme Court – in a unanimous decision delivered by Justice Sotomayor – addressed the issue of whether an insurer holding financial responsibility for a bankruptcy claim qualifies as a party in interest under Bankruptcy Code § 1109(b). Reversing the Fourth Circuit decision below, the Court concluded that insurer Truck Insurance Exchange is sufficiently concerned with the proceedings so as to qualify as a party in interest because § 1109(b) is "capacious" and "asks whether the reorganization proceedings *might* directly affect a prospective party, not how a particular reorganization plan *actually* affects that party." *Truck Ins. Exch. V. Kaiser Gypsum Co., Inc.*, No. 22-1079, 2024 WL 2853106 (U.S. June 6, 2024) (emphasis added).

Background

Debtors Kaiser Gypsum Company, Inc. and its parent company, Hanson Permanente Cement, Inc., produced and sold products containing asbestos, and consequently faced tens of thousands of asbestos-related lawsuits. To resolve these liabilities, Debtors filed for Chapter 11 bankruptcy and, under the proposed reorganization plan, created a § 524(g) Asbestos Personal Injury Trust. Section 524(g) "allows a Chapter 11 debtor with substantial asbestos-related liability to establish and fund a trust that assumes the debtor's liability for 'damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products.'" Here, the trust contains all present and future claims related to liability springing from asbestos use. In addition to the § 524(g) trust, the Plan also set out to transfer all of Debtors' rights under their insurance contracts to the trust.

Truck Insurance served as Debtors' primary insurer. Under the terms of Truck Insurance's contract, transferred under the Plan, Truck Insurance is obligated to indemnify Debtors up to $500,000 per claim while Debtors must pay a $5,000 deductible per claim and assist in defending against the claims. At issue was the Plan's provision treating insured and uninsured claims differently. While insured claims are to be filed in the tort system for the benefit of insurance coverage, uninsured claims are to be submitted directly to the trust for resolution. Most importantly, insured claims, unlike uninsured claims, lack disclosure requirements necessitating claimants to identify any related claims in order to reduce fraudulent and duplicative claims.

With the above discrepancy in mind, Truck Insurance filed an objection to the otherwise consensual Plan. Truck Insurance objected, asserting that the trust does not comply with § 524(g) and "the Plan would provide 'anti-fraud' protections to the trust in resolving uninsured claims but not to Truck Insurance in resolving insured claims," subjecting Truck Insurance to potentially millions of dollars in fraudulent tort claims. *In re Kaiser Gypsum Company, Inc.*, 60 F.4th 73, 80 (4th Cir. 2023). Truck Insurance had previously insisted to Debtors that the anti-fraud measures be applied to insured claims but Debtors declined, leading to Truck Insurance's other contention that the Plan "appear[ed] to be collusive and in violation of [the Debtors'] duty to cooperate and assist," and in breach of the implied covenant of good faith and fair dealing. *Id.*

In September 2020, the Bankruptcy Court for the Western District of North Carolina ruled against Truck Insurance and recommended that the District Court for the Western District of North Carolina confirm the Plan. In its recommendation, the Bankruptcy Court adopted Debtors' Proposed Findings of Fact and Conclusions of Law and set out that Truck Insurance was not a party in interest and lacked standing to object to the Plan. More specifically, the Bankruptcy Court concluded that Truck Insurance could not object because the Plan is "insurance neutral" and returns Truck Insurance to the tort system exactly as it was prepetition. The Bankruptcy Court also stated that Truck Insurance lacked standing despite being a creditor in the case. Later in July 2021, the District Court adopted the Proposed Findings of Fact and Conclusions of Law and confirmed the Plan. Truck Insurance subsequently appealed to the Fourth Circuit.

The Fourth Circuit affirmed the District Court's judgment. In its analysis, the Fourth Circuit held: "[i]n determining whether a particular reorganization plan sufficiently affects an insurer's legal rights to render that insurer a party in interest, courts typically look to see whether the plan is 'insurance neutral.'" *In re Kaiser Gypsum Company, Inc.*, 60 F.4th at 83. Put differently, "[i]f a plan is insurance neutral, the objecting insurer ordinarily is not a party in interest under § 1109(b) and thus lacks standing to challenge the substance of the Plan." *Id.*

According to the Fourth Circuit, a plan is deemed insurance neutral "if it doesn't increase the insurer's pre-petition obligations or impair the insurer's pre-petition policy rights." *Id.* Ultimately, the Fourth Circuit held that "the Plan was insurance neutral because it expressly preserved Truck [Insurance]'s coverage defenses and the Debtors' assistance-and-cooperation obligations under the policies, thereby placing Truck [Insurance] in the same position as it was pre-bankruptcy." *Id.* at 83-84.

Truck Insurance appealed to the Supreme Court and the Court granted certiorari.

The Supreme Court Reverses the Fourth Circuit's Decision

The Court began its analysis by looking at the language, context and history of § 1109(b). This provision of the Bankruptcy Code sets out that "[a] party in interest, including the debtor, the trustee, a creditors' committee, 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."

The Court held that a common thread among the parties listed in § 1109(b)'s definition of a party in interest "is that each may be directly affected by a reorganization plan either because they have a financial interest in the estate's assets…or because they represent parties that do."

As to context and history, the Court found the following. First, Congress uses the term "'party in interest' in bankruptcy provisions when it intends the provision to apply broadly," and the "general theory behind [§ 1109(b)] is that anyone holding a direct financial stake in the outcome of the case should have an opportunity…to participate in the adjudication of any issue that may ultimately shape the disposition of his or her interest." Second, "Congress consistently has acted to promote greater participation in reorganization proceedings." Finally, drafters of the Bankruptcy Code hoped that with an expansive definition of party in interest, a broad range of individual/minority interests would be allowed to intervene in Chapter 11 cases and prevent dominant interests from controlling the restructuring process.

The Court next held that insurers with financial responsibility for bankruptcy claims are parties in interest given that reorganization proceedings can affect insurers' rights in a variety of ways. For example, "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."

In the case at hand, the Plan, lacking disclosure requirements for insured claims, risks exposing Truck Insurance to millions of dollars in fraudulent claims and thus gives Truck Insurance an interest in the bankruptcy proceedings and the proposed Plan. Additionally, since the Plan eliminates the Debtors' ongoing liability and claimants have no incentive to propose barriers to their recovery, Truck Insurance may be the only entity with the incentive to identify any issues with the Plan. Citing to *In re Global Indus. Technologies, Inc.*, 645 F.3d 201, 204 (CA3 2011), the Court held that "[w]here a proposed plan 'allows a party to put its hands into other people's pockets, the ones with the pockets are entitled to be fully heard and to have their legitimate objections addressed."

Lastly, in reversing the decision below, the Court also addressed the "insurance neutral" doctrine. According to the Court, "[t]his doctrine is conceptually wrong and makes little practical sense" because it "conflates the merits of an objection with the threshold party in interest inquiry." More simply put, § 1109(b) evaluates whether a plan might affect a party, not how a plan actually affects a party. Thus, "[w]hether and how the particular proposed Plan… affects Truck [Insurance]'s prepetition and postpetition obligations and exposure is not the question."

Analysis and Takeaways

- On the micro-level, this case broadens the ability of insurance companies to challenge proposed reorganization plans.
- More generally, by reversing the Fourth Circuit's decision and holding that Truck Insurance is a "party in interest," the Court has established that future § 1109(b) inquiries are to look not at the merits of an objection, but rather whether a prospective party may be affected by a proposed plan.
- The "insurance neutral" doctrine seemingly reached merits on the substance of a claim – before even considering the issue of standing. The Court roundly and unanimously rejected that approach.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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