CLIENT ALERT

Supreme Court Confirms Insurers' Right to Participate in Bankruptcy Proceedings

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On June 6, 2024, the Supreme Court of the United States issued its much-anticipated decision in *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc., et al*. No. 22-1079. In a unanimous decision authored by Justice Sotomayor,[1] the Court vacated a Fourth Circuit decision and ruled in favor of Truck Insurance Exchange, confirming that an insurer with financial responsibility for a bankruptcy claim is a "party in interest" and therefore has standing to object to a Chapter 11 plan. In reaching this decision, the Supreme Court confirms the importance of allowing insurers to participate in the bankruptcy proceedings of their insureds, which will ensure that insurers will be well-positioned to object to any reorganization plans that could impair their pre-petition rights or alter the terms of the applicable insurance policies.

Background

Kaiser Gypsum Co. and Hanson Permanente Cement (together, the "Debtors") filed for Chapter 11 bankruptcy after facing thousands of asbestos-related lawsuits.[2] The Debtors submitted a proposed reorganization plan (the "Plan") which channels all asbestos-related claims to a trust created pursuant to 11 U.S.C. § 524(g). To fund the trust, the Plan transfers all of the Debtors "rights" under their insurance policies to the trust, including "all rights to coverage and insurance proceeds."[3] Truck Insurance Exchange ("Truck"), which issued these policies, would be contractually obligated by the terms of the policies to defend each covered asbestos claim and indemnify the Debtors for up to $500,000 per claim. Under the

1 Justice Alito did not take part in this decision.

2 *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc., et al.*, No. 22-1079 at 1 (June 6, 2024).

3 *Id.* at 4.

terms of the policies, the Debtors are required to cooperate with Truck to defend against these claims. However, the Plan required the Bankruptcy Court to make a finding that Debtors' conduct in the bankruptcy proceedings did not violate this duty.[4] The Plan also distinguished between insured and uninsured claims. Uninsured claims are to be submitted directly to the trust and claimants must make certain disclosures that are intended to reduce the prevalence of fraudulent claims, while insured claims are filed in the tort system and are not subject to the same disclosure requirements.[5]

Truck objected to the Plan for three reasons. First, Truck argued that the Plan was not "proposed in good faith," as required by the Bankruptcy Code, because the lack of disclosure for the insured claims reflected a collusive agreement between the Debtors and claimant representatives. Second, Truck argued that the Plan impermissibly alters Truck's pre-petition contractual rights by relieving Debtors of their obligation to cooperate and assist in the defense of these claims and barring Truck from raising this lack of cooperation as a defense in future coverage disputes. Third, Truck argued that the trust created by the Plan did not comply with various provisions of § 524(g), including the requirement to "deal equitably with claims and future demands."[6]

The Bankruptcy Code permits any "party in interest" to "raise" and "be heard on any issue" in a Chapter 11 bankruptcy.[7] When Truck raised these issues in an objection to the Plan, the District Court for the Western District of North Carolina concluded that Truck had limited standing to object and agreed with the Bankruptcy Court's recommendation to confirm the Plan without addressing Truck's objections. The District Court determined that the Plan did not increase Truck's pre-petition obligations or impair its pre-petition rights, and as a result, it was "insurance neutral" and Truck was not a "party in interest" under Section 1109(b).[8] The Fourth Circuit affirmed the District Court's decision.[9]

In October 2023, the Supreme Court granted certiorari to decide whether an insurer with financial responsibility for a bankruptcy claim is a "party in interest" under Section 1109(b) of the Bankruptcy Code.

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4 *Id.*

5 *Id.*

6 *Id.* at 5-6.

7 11 U.S.C. § 1109(b).

8 *In re Kaiser Gypsum Co.,* 2021 WL 3215102, *27 (WDNC, July 28, 2021).

9 *In re Kaiser Gypsum Co., Inc.,* 60 F.4th 73, 83 (4th Cir. Feb. 14, 2023), cert. granted sub nom. *Truck Ins. Exch. v. Kaiser Gypsum Co.*, 144 S. Ct. 325, 217 L. Ed. 2d 154 (2023).

The Supreme Court Holds that a Party with Financial Responsibility for a Claim Is a "Party In Interest" Under Section 1109(b) of the Bankruptcy Code.

The Supreme Court unanimously held that an insurer with financial responsibility for a bankruptcy claim is a "party in interest" under 11 U.S.C. § 1109(b) and therefore must have "a voice" in bankruptcy proceedings that permits it to object to a Chapter 11 plan.

In analyzing this question, the Court first observed that the non-exclusive list of parties that have standing under Section 1109(b) all have one thing in common: they have a financial interest in the estate's assets or they represent parties that do.[10] The Court also noted the historical context and purpose of Section 1109(b), which reflects Congress' intent to "promote greater participation in reorganization proceedings."[11] Applying these principles, the Court concluded that insurers, such as Truck, with financial responsibility for bankruptcy claims are "parties in interest."[12] The Court noted the "myriad ways" that bankruptcy proceedings can affect an insurer's interest, including by abrogating their rights, violating the debtor's duties under the policies, or impairing their financial interests by inviting fraudulent claims.[13] As to this Plan in particular, the Court noted that Truck will have to pay the vast majority of the Debtors' liability for the claims and will have to "stand alone" in carrying that financial burden.[14]

The Supreme Court also addressed the Government's position that Truck was a "party in interest" because it is a party to a contract with the debtor (here, an insurance policy) that is to be transferred or otherwise affected by the bankruptcy proceedings.[15] The Court found that this framing was "another side of the same coin," and that being a party to executory contracts would give an insurer an interest in the proceedings and here, makes Truck financially responsible for bankruptcy claims. Thus, the Court concluded, "whether Truck's direct interest is framed as its executory contracts or instead its obligations resulting from those contracts, it cashes out in the same way."[16] The Court then quoted favorably a Third Circuit case that is critical to protecting insurers' rights in bankruptcy proceedings, *Global Industrial Technologies*, stating 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."[17]

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[10] *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc., et al.* No. 22-1079 at 7-8.

[11] *Id.* at 9.

[12] *Id.* at 11.

[13] *Id.*

[14] *Id.* at 11-12.

[15] *Id.* at 12.

[16] *Id.*

[17] *Id.* at 12 (quoting *In re Global Indus. Technologies, Inc.*, 645 F. 3d 201, 204 (3d Cir. 2011)).

The Supreme Court Clarifies Applicability of the "Insurance Neutrality" Doctrine.

In reaching this decision, the Supreme Court addressed the "insurance neutrality" doctrine that was applied by the District Court and Fourth Circuit. Here, both lower courts found that the Plan was "insurance neutral" and as a result, Truck was not party in interest.[18]

The Supreme Court found that conceptually, the insurance neutrality doctrine "conflates the merits of an objection with the threshold party in interest inquiry."[19] The Court clarified that these are two separate and distinct questions and here, the Court was not asked to address the validity of Truck's objections, but only whether Truck had standing to be heard on its objections. The Court also found the insurance neutrality doctrine to be "too limited in its scope" in that it "zooms in on the insurer's prepetition obligations and policy rights" and "wrongly ignores all the other ways in which bankruptcy proceedings and reorganization plans can alter and impose obligations on insurers."[20]

Not only does the Court's decision confirm insurers' standing to participate in bankruptcy proceedings, but it also provides a helpful list of the "myriad ways" that plans can affect insurers' interests. For example, the Court noted that a plan can impair an insurer's contractual right to control settlement or defend claims, can abrogate an insurer's right to contribution from other carriers, or be collusive in violation of the insured's duty to cooperate and assist.[21] Importantly, the Court acknowledged that when, as in this case, plans eliminate the insured's liability and allows for claimant's recovery, the insurer may be "the only entity with an incentive to identify problems with the Plan" and that "participation in the bankruptcy by insurers—who will ultimately be asked to foot the bill for most or all of those claims—[is] critical."[22]

The case has been remanded for further proceedings consistent with the Supreme Court's opinion.

Conclusion

The Supreme Court's decision in *Truck* strongly supports insurer participation, and fair treatment, in bankruptcy proceedings commenced by their insureds. Although the Supreme Court was not asked to address the merits of the insurer's objections to the bankruptcy plan, the Court acknowledged all of the ways in which plans could potentially impair insurers' contractual rights and affect their financial interests. This is a first step and important victory for insurers that have increasingly had to bear the costs of mass tort claims against their insureds through bankruptcy proceedings that seek to abrogate their contractual rights.

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[18] *Id.* at 13.

[19] *Id.* at 13.

[20] *Id.* at 13.

[21] *Id.* at 11.

[22] *Id.* at 13.

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