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Justices' Standing Ruling May Embolden Carriers In Ch. 11

By Ganesh Setty

Law360 (June 6, 2024, 8:45 PM EDT) -- The U.S. Supreme Court said Thursday that an insurer with a responsibility for its policyholder's Chapter 11 bankruptcy claims can intervene in those bankruptcy proceedings, potentially giving insurers greater leverage in reorganization negotiations and likely causing an influx of insurer objections in bankruptcy court, experts tell Law360.

The U.S. Supreme Court unanimously ruled that Truck Insurance Exchange, as a "party in interest," may challenge its two insureds' reorganization plan. (iStock)

The high court **unanimously ruled** that Truck Insurance Exchange qualified as a "party in interest" under Section 1109(b) of the Bankruptcy Code to challenge the proposed reorganization plan of its two insureds, Kaiser Gypsum Co. Inc. and parent company Hanson Permanente Cement Inc., which face numerous asbestos injury claims.

"An insurer with financial responsibility for a bankruptcy claim is sufficiently concerned with, or affected by, the proceedings to be a 'party in interest' that can raise objections to a reorganization plan," Justice Sonia Sotomayor

wrote for the court. "Section 1109(b) grants insurers neither a vote nor a veto; it simply provides them a voice in the proceedings."

Justice Samuel Alito did not participate in the case.

"This decision confirms that insurance companies who will be paying out claims against the debtor under a plan have the ability to object and have their day in court," Matthew M. Madden, deputy chair of Kramer Levin Naftalis & Frankel LLP's Supreme Court and appellate litigation practice, told Law360. "That does give them some leverage in plan negotiations and other proceedings to shape the provisions that matter to them."

But Daniel J. Healy, a partner at Brown Rudnick LLP who specializes in insurance recovery, noted that "insurance companies are not bashful in these bankruptcy proceedings," as they file objections already.

"I think we're going to see just as much objection activity, perhaps more, but the courts are going to have to wrestle with how to deal with those," he told Law360. "Insurers can be expected to argue that based on this decision, they have more power and more standing to shape the plans."

"That is most likely what they are going to argue, and I think we can expect more litigation and aggressive arguments from insurance companies in that regard," Healy said.

Truck specifically sought to challenge the proposed reorganization plan's implementation of certain anti-fraud provisions for uninsured asbestos injury claims but not for insured ones.

The at-issue policies, which ran from the 1960s to the early 1980s, were already found to provide coverage for the debtors' asbestos liabilities arising from that period and contained per-occurrence limits of $500,000. Crucially, though, the policies contained no aggregate coverage limit. Without the inclusion of the anti-fraud provisions for insured asbestos claims, Truck's "liability remains inflated," the insurer argued.

Section 1109(b) of the Bankruptcy Code generally allows a "party in interest," such as a creditor, to appear and "be heard on any issue" in a Chapter 11 bankruptcy proceeding. Once permitted, a party in interest is also allowed to propose modifications to a reorganization plan or object to its confirmation.

But in February 2023, a Fourth Circuit three-judge panel **unanimously held** that Truck could not object to the proposed reorganization plan of the two debtor manufacturers under the so-called insurance neutrality doctrine. The proposed plan, which received unanimous support by all other parties except Truck, didn't alter Truck's prebankruptcy coverage obligations or prebankruptcy rights under the at-issue policies, the panel found.

The Supreme Court rejected that rationale Thursday to assess standing. It said the insurance neutrality doctrine "is conceptually wrong and makes little practical sense," and that the "plain meaning" of party in interest "refers to entities that are potentially concerned with or affected by a proceeding."

The doctrine specifically "conflates the merits of an objection with the threshold party in interest inquiry," Justice Sotomayor wrote, saying the doctrine "wrongly ignores all the other ways in which bankruptcy proceedings and reorganization plans can alter and impose obligations on insurers."

Laura A. Foggan, a Crowell & Moring LLP partner who wrote a brief for the American Property Casualty Insurance Association supporting Truck's case, told Law360 that the high court did not totally do away with the insurance neutrality doctrine, but instead ruled that the doctrine alone cannot determine party in interest standing.

"Insurance neutrality is important, but an insurer has a stake in more than its coverage rights and defenses. For instance, an insurer has a key stake in whether — and if so, how and how many — claims are allowed against its insured," she said.

"But, whether by the 'insurance neutrality doctrine' or not, insurance companies will still have to establish that their objections are well-founded and that proposed plans do harm their rights under the policies," Madden also noted.

"Saying that Truck gets to object doesn't mean it gets a vote or a veto," he added.

During the Chapter 11 process, any party in interest can object to a proposed reorganization plan, whether or not they are entitled to vote on confirmation of that plan, Madden explained, whereas a debtor's creditors have the right to vote on a proposed plan. Objections allow a bankruptcy court to resolve alleged issues with a plan before confirming it, he said.

Truck did alternatively argue that it was a party in interest since it is a creditor to deductible payments from Kaiser Gypsum and Hanson Permanente. The high court did not address that argument in its decision.

In its briefs, Truck said that it merely had to show it retains standing under Article III of the Constitution to establish standing under Section 1109(b). The government meanwhile, in its own amicus brief for the insurer, maintained that a counterparty to a debtor's executory contract, or a contract not yet fulfilled, should qualify as a party in interest instead.

"The decision basically says 'Truck argued this, the government argued this, but the practical effect is the same,' and then the court goes on to rule based on the practical effect," Healy said. "So it didn't really adopt either argument, which is I guess not atypical for the Supreme Court."

As for the future of the proposed reorganization plan at issue for Kaiser Gypsum and Hanson Permanente, George H. Singer, a Holland & Hart LLP partner who specializes in bankruptcy law, told Law360 the parties must now face Truck's

objection.

"The parties will need to decide whether a settlement of the objections through an amendment to the plan can be achieved or whether to litigate the objections of the insurer before the bankruptcy court," he said. It's "highly likely" the parties will reach a negotiated resolution, he added.

In all, Thursday's decision on insurer standing "does not unfairly tilt the table, but, consistent with the collective proceeding concept, lets all interested parties have a seat," Singer continued, noting that "all parties in a bankruptcy case are acting to advance or protect their own interests."

"The plan confirmation process employed by the debtor in this case deprived one of the most significant financial constituents of a voice altogether," he said.

And though it may very well be touted by the insurance industry, the decision has "some real limitations on it," Healy continued.

"This is not a revamping of either insurance coverage law or all of bankruptcy law," he said.

Truck Insurance Exchange is represented by Allyson N. Ho, Jonathan C. Bond, Michael A. Rosenthal, David W. Casazza, Addison W. Bennett, Russell H. Falconer, Elizabeth A. Kiernan, Stephen J. Hammer and Robert B. Krakow of Gibson Dunn & Crutcher LLP.

The debtor parties are represented by C. Kevin Marshall, Gregory M. Gordon, Paul M. Green, Brinton Lucas, Alexis Zhang, William J. Strench and Daniel C. Villalba of Jones Day, by Ross R. Fulton and John R. Miller Jr. of Rayburn Cooper & Durham PA and by Mark A. Nebrig of Moore & Van Allen PLLC.

The Official Committee of Asbestos Personal Injury Claimants is represented by David C. Frederick, Joshua D. Branson, Collin R. White and Jordan R.G. González of Kellogg Hansen Todd Figel & Frederick PLLC, by Kevin C. Maclay, Todd E. Phillips, James P. Wehner and Lucas H. Self of Caplin & Drysdale Chartered and by Sara W. Higgins of Higgins & Owens PLLC.

The Future Claimants' Representative is represented by Edwin J. Harron, Sharon M. Zieg, Travis G. Buchanan and Felton E. Parrish of Young Conaway Stargatt & Taylor LLP.

Robert M. Horkovich of Anderson Kill PC is special counsel to the committee and the Future Claimants' Representative.

The government is represented by Solicitor General Elizabeth B. Prelogar and by Brian M. Boynton, Curtis E. Gannon, Anthony A. Yang, Mark B. Stern and Brian J. Springer of the U.S. Department of Justice.

The case is Truck Insurance Exchange v. Kaiser Gypsum Co. Inc. et al., case number 22-1079, in the U.S. Supreme Court.

--Additional reporting by Hope Patti. Editing by Nick Petruncio.

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