Alert

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COZEN O'CONNOR

Supreme Court Orders Stand Down on Insurance Neutrality Test for Standing

On June 6, 2024, the United States Supreme Court issued its long-awaited ruling in *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc., et al.,*[1] nullifying the insurance neutrality test for insurer standing in bankruptcy proceedings and holding that insurance companies that may face liability for bankruptcy claims filed against a debtor are parties in interest under section 1109(b) of the Bankruptcy Code that are entitled to "be heard on any issue" in such debtor's bankruptcy case.

Kaiser Gypsum Co., Inc. (Kaiser Gypsum) and an affiliate debtor filed Chapter 11 bankruptcy cases in 2016, seeking to address environmental and asbestos-related tort liabilities. Truck Insurance Exchange (Truck) was the primary insurer for the Debtors. In the Debtors' bankruptcy cases, Truck filed an objection to the Debtors' Chapter 11 plan of reorganization (the Plan), which established a trust under section 524(g) of the Bankruptcy Code for current and future asbestos personal injury liabilities.

One hundred percent of the asbestos personal injury claimants who cast ballots regarding confirmation of the Debtors' Plan had approved the proposed Plan, as had all other parties involved in the bankruptcy cases—aside from Truck.[2] Chief among its objections to the proposed Plan, Truck argued that the Plan could not be confirmed because it was not proposed in good faith (as required under section 1129(a)(3) of the Bankruptcy Code), as it was the product of a collusive agreement between the Debtors and claimant representatives."[3]

Under the proposed Plan, the Debtors' rights under their insurance policies would be transferred to the trust, and Truck, as the primary insurer, would be obligated to defend and indemnify each covered asbestos personal injury claim in the tort system.[4] Uninsured claims would be submitted directly to the trust.[5] The Debtors fashioned specific disclosure requirements that were intended to reduce fraudulent and duplicative claims, but only uninsured claims submitted directly to the trust would be subject to such anti-fraud provisions under the terms of the Plan.[6] Truck argued that the Debtor breached its duty to cooperate under the insurance contract by providing anti-fraud protections for claimants with uninsured claims but providing for no such anti-fraud protections in connection with insured claims.[7] Truck also argued that the Debtor was contractually obligated to cooperate and assist Truck in reaching effective settlements under the terms of the insurance contract and—in the Chapter 11 bankruptcy context—this meant, in relevant part, establishing such anti-fraud protections under the Plan for covered claims to protect Truck from fraudulent or duplicative claims.[8]

The bankruptcy court, the district court, and the Fourth Circuit Court of Appeals held that Truck was not a party in interest under section 1109(b) of the Bankruptcy Code and, therefore, lacked standing to object to the Plan.[9] The ruling that Truck was not a party in interest was premised on an insurance neutrality doctrine applied in some jurisdictions, most notably the Fourth and Seventh Circuits, pursuant to which courts determined the standing of insurers to oppose a proposed Chapter 11 plan based on whether the plan altered the insurer's contract rights or its quantum of liability. In other words, such courts considered whether the plan increased the insurer's prepetition obligations or impaired its prepetition rights under the applicable insurance contract. The lower courts found that the proposed Plan of Kaiser Gypsum did not alter Truck's contract rights or its quantum of liability thereunder and, therefore, held that Truck was not a party in interest entitled to object to the Plan.

Truck filed a petition for certiorari, and on June 6, 2024, the Supreme Court unanimously ruled that an insurer with financial responsibility for bankruptcy claims is a party in interest under §1109(b) of

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the Bankruptcy Code that "may raise and may appear and be heard on any issue" in a Chapter 11 bankruptcy case because the insurer may be directly and adversely affected by the reorganization plan.

The Supreme Court held that the insurance neutrality doctrine is "conceptually wrong and makes little practical sense" because it "conflates the merits of an objection with the threshold party in interest inquiry." [10] The initial party in interest inquiry "asks whether the reorganization proceeding might affect a prospective party, not how a particular reorganization plan actually affects that party."[11] The Court concluded that "[t]he 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."[12]

The Court emphasized that Truck would be required to pay the vast majority of the post-confirmation trust's liability for personal injury claims ("up to $500,000 per claim for thousands of covered asbestos-injury claims"), and because of the channeling injunction in place that would stay any action against the Debtors, Truck would carry the financial burden of such claims alone.[13] 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.'"[14]

Moreover, in this case, neither the Debtors nor the claimants "ha[d] an incentive to limit the postconfirmation cost of defending or paying claims."[15] The Court observed that because the Plan eliminated all of the Debtors' ongoing liability and the claimants had no reason to propose any provisions that could deny or reduce compensation on their claims, Truck could be the only entity with any incentive to identify problems with the Plan. Quoting an amicus brief submitted by the Complex Insurance Claims Litigation Association and American Property Casualty Insurance Association,[16] the Court observed that the "realignment of the insured's economic incentives . . . makes participation in the bankruptcy by insurers—who will ultimately be asked to foot the bill for most or all of those claims—critical."[17]

The Supreme Court's ruling in *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc., et al.*, significantly benefits insurance companies that are necessarily implicated in Chapter 11 cases—particularly mass tort bankruptcy cases—by relieving the insurance companies from needing to litigate the issue of standing to be heard on issues before the court. Additionally, it is significant that the Supreme Court embraced and agreed with the insurance trade associations' argument that once the Chapter 11 debtors' liability was eliminated via the plan, the debtor insureds no longer had any incentive to screen and defend against any of the covered claims asserted, and the "realignment of the insured's economic incentives" rendered the participation of the insurers critical. This language has the potential to influence future Chapter 11 proceedings by obligating Chapter 11 debtors to consult insurers during the plan drafting process and to incorporate requested protective provisions into any draft plan. Due to the need to now include additional parties in interest in plan negotiations, the plan confirmation process is likely to become slower and more cumbersome, resulting in greater administrative costs being incurred by the Chapter 11 estates. Furthermore, the Supreme Court's acknowledgment that Chapter 11 debtors might not be incentivized to propose protective measures in their plans in accordance with their contractual obligations as insureds lays the groundwork for potential defenses that could be raised by insurers in post-confirmation coverage litigation.

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[1] *Truck Ins. Exch. v. Kaiser Gypsum Co.*, No. 22-1079, __ U.S. __, 144 S. Ct. 1414 (2024).

[2] *Truck Ins. Exch. v. Kaiser Gypsum Co. (In re Kaiser Gypsum Co.)*, 60 F.4th 73, 80 (4th Cir. 2023).

[3] 144 S.Ct, at 1423.

[4] *Id.* at 1422.

[5] *Id.*

[6] *Id.* at 1422-23 & 1427.

[7] *Id.* at 1423.

[8] *Id.*

[9] Section 1109(b) of the Bankruptcy Code states that "[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."

[10] 144 S.Ct, at 1427.

[11] *Id.*

[12] *Id.*

[13] *Id.* at 1426.

[14] *Id.* (citing *In re Global Indus. Technologies, Inc.*, 645 F. 3d 201, 204 (3rd Cir. 2011)).

[15] *Id. at 1426*

[16] Both amici organizations are trade associations of property and casualty insurance companies.

[17] *Id.* at 1426-27.