Consumer & Commercial Law State Bar of Texas

Standing Room Only: US Supreme Court Ruling Clarifies Insurers' Rights in Chapter 11 Proceedings

Blog Hunton Insurance Recovery Blog

Hunton Andrews Kurth LLP

USA | June 18 2024

Because insurance law is a creature of state law, it is rare for the United States Supreme Court to wade into insurance matters. But as our colleagues explained last fall, the Supreme Court agreed to do just that when it granted certiorari in *Truck Insurance v. Kaiser Gypsum*, a Fourth Circuit bankruptcy case. On June 6, 2024, the Supreme Court issued an opinion unanimously reversing the Fourth Circuit. In doing so, the Court held that insurers with financial responsibility for bankruptcy claims are "parties in interest" under the United States Bankruptcy Code and, therefore, may appear and be heard, including to object to Chapter 11 reorganization plans. This decision clarifies an important issue and paves the way for potentially greater participation by insurers in the Chapter 11 process.

The Lower Courts Hold That Truck Insurance Does Not Have Standing to Object

The story began when Kaiser Gypsum, a manufacturer of products containing asbestos, filed for Chapter 11 bankruptcy protections after facing a wave of asbestos-related mass tort claims. In the Chapter 11 proceedings, Kaiser Gypsum filed a proposed reorganization plan that created an asbestos personal injury trust. Under the proposed plan, all current and future asbestos-related claims were to then be channeled into the trust. Truck was Kaiser Gypsum's primary insurer. Truck opposed the reorganization plan on the grounds that, among other things, it did not include sufficient anti-fraud protections, which, according to Truck, meant that Truck could end up paying claim amounts in error.

The district court rejected Truck's objection on procedural grounds, reasoning that the plan was "insurance neutral" and that Truck, thus, did not "have standing to advance confirmation issues." The Fourth Circuit agreed, reasoning that the plan did not "impair Truck's policy rights or otherwise alter Truck's quantum of liability but simply maintains Truck in its pre-petition position with all its coverage defenses intact."

The Supreme Court granted certiorari.

The Supreme Court Unanimously Reverses, Holding That the Bankruptcy Code Provides Truck With an Opportunity to Be Heard

Justice Sonia Sotomayor delivered the opinion of a unanimous Court, which held that an insurer with financial responsibility for bankruptcy claims is a "party in interest" under section 1109(b) of the Bankruptcy Code that "may raise and may appear and be heard on any issue" in a Chapter 11 proceeding.

The Court reasoned that section 1109(b), which permits any "party in interest" to "appear and be heard on any issue" in a Chapter 11 proceeding, is "capacious" and intended to provide a voice to those with a financial stake in the outcome of a bankruptcy case. The Court rejected the narrow "insurance neutral" standard applied by the Fourth

Circuit holding that the question is not "[w]hether and how" the insurer's interests are affected. Rather, the fact that those interests "may be directly and adversely affected" is sufficient to make the insurer a party in interest under section 1109(b). According to the Court, Truck had the required financial stake in that the anti-fraud measures it sought could have impacted the amounts it had to pay.

The Court also focused on the economic incentives noting that the Debtors and the asbestos claimants (the parties advancing the plan) had no incentive to include anti-fraud measures. Excluding Truck from the process effectively excluded the only party with any economic interest in advancing such protections.

The Court identified other circumstances in which insurers "with financial responsibility for bankruptcy claims can be directly and adversely affected by" Chapter 11 proceedings. Among other things, a reorganization plan can (1) "impair an insurer's contractual right to control settlement or defend claims;" (2) "abrogate an insurer's right to contribution from other insurance carriers;" or (3) "be collusive, in violation of the debtor's duty to cooperate and assist, and impair the insurer's financial interests by inviting fraudulent claims." For these reasons, it is possible for insurers to have a direct financial stake in a bankruptcy matter. And when that happens, the insurers are "parties in interest" that should have an opportunity to voice their objections in court.

What *Kaiser Gypsum* Means

Kaiser Gypsum further codifies insurer participation in the Chapter 11 process. The ruling will likely mean that insurers can more freely litigate their objections on the merits, rather than being denied the opportunity to object on procedural grounds. This change could result in debtors and creditors involving insurers earlier in the Chapter 11 process, which may change negotiation and settlement dynamics.

At the same time, the practical effects of the opinion may be limited in that the Court did not address the underlying merits of Truck's objection and remanded the case for further consideration. Whether an insurer can insist that a plan include provisions it deems necessary to protect against potential fraud remains to be seen and will likely turn on the specific facts of the case. As the Court explained, section 1109(b) "provides parties in interest only an opportunity to be heard—not a vote or a veto in the proceedings."

Hunton Andrews Kurth LLP - Geoffrey B. Fehling, Philip M. Guffy and Alex D. Pappas