High Court Should Endorse Insurer Standing In Bankruptcy

By Frank Perch (March 6, 2024)

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Insurers are at the center of any mass tort Chapter 11 bankruptcy.

The goal of every mass tort case is to achieve a global resolution of claims, with releases of the debtor and its affiliates, by centralizing the adjudication of claims, and creating a fund for payment of claims with contributions from the debtor and its liability insurers.

Maximizing insurer dollars available for paying claims, and minimizing insurers' abilities to dispute coverage or challenge claim valuations, are key objectives.

As a result, mass tort bankruptcy plans inherently have wide-ranging impacts on the insurer-insured relationship. Despite anti-assignment provisions in most policies, policies are assigned to a trust. Trustees are responsive to trust advisory committees which are usually populated by representatives of claimants' interests.

Claims are evaluated through streamlined processes that do not involve full discovery and an aggressive defense by counsel selected by the insurer.

The process "ultimately realigns the interests of the debtor with those of the claimants in obtaining the plan's approval"[1] — to quote an amicus curiae brief filed by the American Property Casualty Insurance Association and Complex Insurance Claims Litigation Association in Truck Insurance Exchange v. Kaiser Gypsum Go. Inc., now before the U.S. Supreme Court — and may leave little incentive to weed out invalid, fraudulent or inflated claims.

Debtors, committees and claimants frequently use standing arguments to block insurer objections to plan and trust terms. They ask courts to accept their assertion that the plan is "insurance neutral" as a conversation-stopper, foreclosing inquiry into the terms on which debtors and claimant committees propose to spend the insurers' dollars.

In Hanson Permanente Cement Inc. v. Kaiser Gypsum Co. last year,[2] the U.S. Court of Appeals for the Fourth Circuit held that an insurer lacked standing to object to a plan that the insurer contended violated its rights by facilitating the filing of fraudulent or meritless claims, and by precluding the insurer from raising the debtor insured's lack of cooperation in setting claims criteria as a defense to coverage.

By granting certiorari in Kaiser Gypsum,[3] the Supreme Court opened the door to a rationalization of bankruptcy standing doctrine as applied to insurers in mass tort cases.

This article examines the often result-oriented jurisprudence on insurer standing and proposes that a correct view of bankruptcy standing will recognize the inherent interests of insurers in mass tort cases and encourage courts to focus on the merits of insurer objections rather than setting up insurance neutrality as a standing hurdle to prejudge issues without granting affected insurers an opportunity to be heard.

Kaiser Gypsum and the Three- or Four-Part Insurer Standing Test

Section 1109(b) of the Bankruptcy Code seems to specify all that is required to have standing to be heard in a Chapter 11 case:

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.

Although Section 1109(b) has been construed broadly,[4] courts have diverged in how to read Section 1109(b) in conjunction with the constitutional and prudential standing tests in federal jurisprudence.

Constitutional, or Article III, standing requires the party to demonstrate an "injury in fact" that is "concrete," "distinct and palpable," and "actual or imminent," or put another way, to have a "personal stake in the outcome of [the] litigation."[5]

Prudential standing "merely requires the party raise its own legal rights and cannot rest their claim on the legal rights or interests of third parties," according to the U.S. Bankruptcy Court for the District of New Jersey in In re: Diocese of Camden in 2023.[6]

Kaiser Gypsum places before the Supreme Court an apparent split between the circuits as to whether the party-in-interest requirement under Bankruptcy Code Section 1109(b) merely restates, in a bankruptcy context, the constitutional and prudential tests, or imposes an additional, third requirement.

The U.S. Court of Appeals for the Third Circuit treats Section 1109(b) as coterminous with the constitutional and prudential standards. The U.S. Court of Appeals for the Seventh Circuit, and the Fourth Circuit in Kaiser Gypsum, treat Section 1109(b) as requiring something further.

Decisions in the U.S. Court of Appeals for the Ninth Circuit arguably go both ways. Although the U.S. Court of Appeals for the Second Circuit has not weighed in on the question, the influential U.S. Bankrtupcty Court for the Southern District of New York stated in In re: Old Carco in 2013 that "section 1109(b) of the Bankruptcy Code does not satisfy or replace the constitutional and prudential limitations on standing. Rather, a party must establish both."[7]

For insurers, however, the battleground goes beyond a technical debate about the relationship between Section 1109(b) and the prudential and constitutional standing tests.

Insurers objecting to plan and trust terms which affect their rights have a personal stake in the outcome and are raising their own interests, not those of third parties.

Even Kaiser Gypsum recognized that insurers could also be parties in interest under the broad standard cited by other courts, of "anyone who has a legally protected interest that could be affected by a bankruptcy proceeding."[8]

However, that was not enough in Kaiser Gypsum to confer standing on the insurer, Truck Insurance Exchange. In effect, courts have imposed a fourth standing hurdle on insurers, the insurance neutrality test.

In Kaiser Gypsum, the Fourth Circuit held that the bankruptcy court did not have to hear Truck's objections to the plan because, in the court's determination, the plan left Truck's rights unaltered, and therefore, because the plan was insurance neutral, Truck was not really a party in interest.

The insurance neutrality rubric is not unique to Kaiser Gypsum or to the Fourth Circuit. Indeed, even decisions from the circuits that are said to be liberal on insurer standing employ insurance neutrality as an analytical framework in reaching their decisions.[9]

Treating insurance neutrality as a fourth standing hurdle can have a profound impact on when and how, and on what argument and evidence, the determination is made that a plan is insurance neutral.

In the Fourth Circuit's view, and the view of other courts that use insurance neutrality as a standing test, a court can determine that a plan is insurance neutral, and was proposed in good faith, based solely on the say-so of the plan proponents, without hearing from the very insurers whose rights may be affected.

This may not be immediately apparent from the Fourth Circuit's opinion in Kaiser Gypsum because, after all, the opinion indicates the court considered Truck's arguments as to why its rights were adversely affected.

However, a look at events in a still-pending Catholic diocesan reorganization illustrates both the attempted use of the insurance neutrality doctrine to prevent insurers from even arguing that their interests were affected, and the reality that, despite the plan proponents' vigorous protestations to the contrary, the plan was far from insurance neutral and could not be confirmed.

The Camden Diocese Case and the Importance of Insurer Standing

The Chapter 11 bankruptcy case of the Diocese of Camden, New Jersey, is one of dozens of Chapter 11 cases filed by Catholic dioceses seeking to resolve, through the bankruptcy process, tort claims by survivors of childhood sexual abuse.

As in other mass tort bankruptcies, the Camden Diocese looked to its insurers to fund payments to abuse survivors through a plan trust. The diocese proposed a plan which assigned the diocese's liability policies to a trust that had the power to determine the values of claims through an abuse claim reviewer selected by the tort claimants' committee and a neutral selected by the trust administrator, who in turn would be chosen by the claimants' committee.

The insurers sought discovery regarding aspects of the plan which affected their rights. The diocese and the claimants' committee responded by asking the court to determine that the plan was insurance neutral, before any objection to confirmation had been filed, and that the insurers had no standing to object to the plan and no right to take discovery.[10]

In other words, the plan proponents argued that the court should accept their assurance that "there's nothing to see here, let's move on," and bar the insurers from taking any discovery to establish facts relevant to their objections, and to block them from even filing, much less litigating, any objection to the plan.

Fortunately, the court declined to rule that the insurers had lost the game before the first pitch was thrown.

Instead of making a summary judgment determination on insurance neutrality, the court ruled that the insurers had made nonfrivolous allegations that the plan and the trust distribution procedure contained provisions that could impair the insurers' rights, on which they had the right to take discovery and be heard.

The court's decision turned out to be wise: There was in fact something to be seen.

Once the insurers were permitted to rebut the proponents' self-serving allegations of neutrality, the court determined that the plan did impair insurers' rights, because the neutral would be selected by claimant interests, claims would be evaluated using a method that inflated claim values, and there was no ability to test the validity of claims electing a fixed expedited payment. As a result, the court denied confirmation of the plan.[11]

Indeed, the story of the Camden Diocese plan did not end there. In an oral ruling on Dec. 15, 2023, the court once again declined to confirm the plan, finding that proposed modifications did not fully address the concerns raised in the court's August decision.

On Feb. 16, after objections were filed to the diocese's further modifications, the court once again found the plan could not be confirmed, and requested a third round of changes. As of this writing, the parties are awaiting the court's ruling on whether those changes satisfy the objectors' concerns.

The Insurance Neutrality Bankruptcy Standing Doctrine Is Analytically Bankrupt

In opposition to Truck's petition for certiorari, both Kaiser and the committee argued that differences in standing decisions among the circuits reflect different facts, not application of different standing tests.[12]

To the extent they are correct, their argument simply serves to demonstrate that standing is not a useful analytical framework for distinguishing meritorious from unmeritorious insurer objections.

The insurance neutrality standing test imposes a requirement uniquely on insurers of having to preliminarily establish the merits of their objections in order to be granted the right to investigate and argue their objections.

Nothing in the Constitution or in the Bankruptcy Code requires this of objecting insurers. The Camden Diocese case demonstrates that self-serving assertions by debtors and claimants that a mass tort plan does not adversely affect insurers need to be tested by the adversarial process.

The Supreme Court has an opportunity in Kaiser Gypsum, which is scheduled for argument on March 19, to eliminate spurious standing roadblocks to resolving insurer objections on their merits.

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Disclosure: White and Williams represents an insurer in the Camden Diocese case.

general information purposes and is not intended to be and should not be taken as legal advice.

[1] Truck Ins. Exch. v. Kaiser Gypsum Co., No. 22-1079 (U.S.), Brief of Amicus Curiae American Property Casualty Insurance Association and Complex Insurance Claims Litigation Association, at 15.

[2] Hanson Permanente Cement, Inc. v. Kaiser Gypsum Co. (In re Kaiser Gypsum Co.), 60 F.4th 73 (4th Cir. 2023).

[3] Truck Ins. Exch. v. Kaiser Gypsum Co., U.S., 2023 U.S. LEXIS 4149 (Oct. 13, 2023).

[4] See, e,g., Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 677 F.3d 869, 884 (9th Cir. 2012); In re Global Indus. Techs., 645 F.3d 201, 211 (3d Cir. 2011).

[5] In re Old Carco LLC, 500 B.R. 683, 690 (Bankr. S.D.N.Y. 2013); In re Diocese of Camden, 2022 Bankr. LEXIS 2244, at *9 (Bankr. D.N.J. Aug. 12, 2022).

[6] Diocese of Camden, 2022 Bankr. LEXIS 2244, at *9; see also Old Carco, 500 B.R. at 690-91.

[7] Old Carco, 500 B.R. at 690, quoting Parker v. Motors Liquidation Co. (In re Motors Liquidation Co.), 430 B.R. 65 (S.D.N.Y. 2010).

[8] Kaiser Gypsum, 60 F.4th at 83, quoting In re James Wilson Assocs. , 965 F.2d 160, 169 (7th Cir. 1992).

[9] See, e.g., In re Global Indus. Techs., Inc. , 645 F.3d 201 (3d Cir. 2011); In re Combustion Eng'g, Inc. , 391 F.3d 190 (3d Cir. 2004).

[10] Diocese of Camden, The Plan Proponents' and Other Catholic Entities' Brief (I) in Support of Their Motions for a Protective Order; and (II) in Opposition to the Memorandum of Insurers in Support of Their Standing to Object to the Plan and Take Plan Discovery in Connection Therewith and in Further Support of the Insurers' Letter Briefs Concerning Discovery (Dkt. No. 2014, filed July 14, 2022).

[11] In re Diocese of Camden, 653 B.R. 309, 358-361 (Bankr.D.N.J. 2023).

[12] Kaiser Gypsum, Brief of Official Committee of Asbestos Personal Injury Claimants and Future Claimants' Representative in Opposition to Petition for Writ of Certiorari, at 10; Brief of Kaiser Gypsum Company, Inc. and Hanson Permanente Cement, Inc. in Opposition to Petition for Writ of Certiorari, at 20.