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How the U.S. Supreme Court's Rulings on Kaiser and Purdue Pharma Affect Insurers' Rights and Interests in Chapter 11 Cases

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On June 6, 2024, the United States Supreme Court issued its decision on an insurer's standing in its policyholders' Chapter 11 bankruptcy proceeding in *Truck Exchange v. Kaiser Gypsum Co*., 144 S. Ct. 1414 (2024). The decision represents a significant victory for insurers, affording them an opportunity to raise issues and participate in proceedings that may impact their interests. This decision resolves a split of authority and sends a clear message going forward.

Later in June, the United States Supreme Court also decided in *Harrington v. Purdue Pharma L.P.*, 219 L. Ed. 2d 721 (2024), that the bankruptcy code does not authorize a release and injunction as part of a plan of reorganization under Chapter 11 that effectively would have discharged claims against a non-debtor (members of the Sackler family) without the consent of affected claimants. As a result, the $6 billion settlement of OxyContin opioid claims was tanked, and several questions remain outstanding regarding so-called non-consensual third-party releases that present challenges for parties and their counsel in bankruptcies involving mass tort claims.

The *Kaiser* Decision

The District Court Decision

This case involves a section 524(g) Chapter 11 plan of reorganization driven by thousands of asbestos claims against Kaiser Gypsum Co. and its affiliate Hanson Permanente Cement. One of Kaiser's insurers, Truck Insurance Exchange, issued primary policies for several years. Under the policies, Truck is contractually obligated to defend each covered asbestos bodily injury claim and to indemnify the Kaiser debtors for up to $500,000 per claim. The Kaiser debtors must pay a $5,000 deductible per claim and assist and cooperate with Truck in defending the claims.

Truck objected to the plan of reorganization (the "Plan"), arguing that it treats insured and uninsured claims differently, requiring insured claims to be filed in the tort system for the benefit of the insurance coverage, while uninsured claims are submitted directly to the Trust for resolution. Truck also argued that the Plan exposes it to millions of dollars in fraudulent claims because the Plan does not require the same disclosures and authorizations for insured claims as it does for uninsured claims. The district court determined that Truck was not a "party in interest" and lacked standing to challenge the Plan mainly on the basis of an insurance neutrality provision contained in it.

The Fourth Circuit Decision

On appeal, the Fourth Circuit ruled that Truck lacked standing to object to the Plan. First, the court rejected the insurer's argument that the debtor's duty to "cooperate" and to "assist in effecting settlements [and] securing and giving evidence" require the debtor, in this bankruptcy proceeding, to help the insurer secure the disclosures and authorizations it considers necessary to combat potential fraud in litigating insured claims in the tort system.

The Fourth Circuit agreed with the district court that the provision requires the debtors to assist and cooperate with Truck only in relation to "Truck's defense efforts in individual suits" and did not extend to bankruptcy plan negotiations. See also *Admiral Ins. Co. v. Grace Industries, Inc.*, 409 B.R. 275, 283 (E.D. N.Y. 2009) (holding that a cooperation clause required the debtor only to assist its insurer in the ultimate disposition of the actual claims, not to make an insurer a partner in its own bankruptcy proceeding).

The Fourth Circuit also found that the insurer was not a "party in interest" and lacked standing to object to the Plan because the Plan was insurance neutral. The court noted that the Plan includes an "Insurance Neutrality" provision expressly preserving Truck's pre-petition coverage defenses.

The court determined that, by not instituting Truck's desired anti-fraud measures, the Plan in no way alters Truck's pre-bankruptcy "quantum of liability."

The Fourth Circuit further found that Truck does not have standing as a creditor because it does not raise any objections relating to its interests as a creditor, and its only claim is fully satisfied under the Plan.

The U.S. Supreme Court Decision

The U.S. Supreme Court granted certiorari and reversed, holding an insurer with financial responsibility for bankruptcy claims is a "party in interest" under §1109(b) of the Bankruptcy Code and, as such, it "may raise and may appear and be heard on any issue" in a Chapter 11 case. As an initial matter, the Court noted this understanding aligns with the ordinary meaning of the terms "party" and "interest," which together refer to entities that are potentially concerned with, or affected by, a proceeding.

The historical context and purpose of §1109(b) also support this interpretation. Congress consistently has acted to promote greater participation in reorganization proceedings. The expansion of participatory rights continued with the enactment of §1109(b). Broad participation promotes a fair and equitable reorganization process.

The Court recognized that Truck would have to pay the vast majority of the Trust's liability. The 524(g) channeling injunction, which stays any action against the debtors, means that Truck would stand alone in carrying that financial burden. According to Truck, a Plan that lacks the disclosure requirements for the insured claims risks exposing Truck to millions of dollars in fraudulent tort claims.

The Court aptly borrowed a quote from the Third Circuit, noting where 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." In re *Global Indus. Technologies, Inc.* 645 F.3d 201, 204 (3rd Cir. 2011).

The Court recognized that the Plan eliminates the Kaiser debtors' ongoing liability, and claimants similarly have little incentive to propose barriers to their ability to recover from Truck. Truck may well be the only entity with an incentive to identify problems with the Plan.

The Court criticized the Fourth Circuit's approach of looking exclusively at whether the Plan altered Truck's contract rights or its "quantum of liability." This approach, known as the "insurance neutrality" doctrine, is conceptually wrong and makes little practical sense. Conceptually, the doctrine conflates the merits of an objection with the threshold party in interest inquiry. The §1109(b) inquiry asks whether the reorganization proceedings might affect a prospective party, not how a particular reorganization plan actually affects that party.

The Court emphasized that the doctrine was too limited in its scope. By focusing on the insurer's prepetition obligations and policy rights, the doctrine wrongly ignores all the other ways in which bankruptcy proceedings and reorganization plans can alter and impose obligations on insurers and debtors.

The Court recognized "[a] reorganization plan can impair an insurer's contractual right to control settlement or defend claims," "abrogate an insurer's right to contribution from other insurance carriers," "violat[e] ... the debtor's duty to cooperate and assist," or "impair the insurer's financial interests by inviting fraudulent claims . . . The list goes on." The fact that Truck's financial exposure may be directly and adversely affected by a plan is sufficient to give Truck a right to voice its objections.

The Court rejected arguments about the risks of allowing "peripheral parties" to delay and derail a reorganization as a "parade of horribles" argument that cannot override the statute's text. It noted that §1109(b) provides parties in interest only an opportunity to be heard, not a vote or a veto in the proceedings. The Court noted that difficult cases may require courts to evaluate whether truly peripheral parties have a sufficiently direct interest to be heard. This case is not one of them because insurers such as Truck, which has financial responsibility for claims, are not peripheral parties.

Key Takeaways

Prior to the U.S. Supreme Court's decision, courts were split on the issue of insurer standing, with most decisions limiting insurer standing. The *Kaiser Gypsum* decision was an 8-0 ruling authored by Justice Sotomayor, with Justice Alito recusing himself. It is clear to anyone reading the decision or listening to the oral argument that the Court had little difficulty reaching what the justices viewed as an obvious and fair result.

The arguments against allowing insurer standing—namely that it could delay and detail confirming a plan—were properly rejected by the Court as a "parade of horribles." Indeed, various factions in a bankruptcy proceeding (the debtor, creditors, and creditor committees, the trustee, the future representative, etc.) assert positions, participate in discussions and negotiations, interpose objections, and otherwise take steps to protect their interests and delay common results.

It is disquieting that so many trial judges and appellate court justices were willing to deny insurers standing and their opportunity to be heard on issues that impacted their interests regarding claims they will be required to pay. With respect to many issues—such as standing, abstention, and jurisdiction—insurers are too often treated as second-class citizens.

In the wake of the Supreme Court decision, it is clear that insurers shall be afforded a seat at the table in Chapter 11 proceedings and have a right to be heard on matters that impact their interests. However, it does not guarantee that insurers' positions will prevail, nor does it prevent a court from controlling proceedings or preventing abuses or unwarranted delays.

Insurance neutrality provisions are not always truly neutral and do not always adequately protect insurers' interests. Nor are they an adequate substitute for an insurer having the opportunity to be heard on issues that impact its rights. The Court had made clear that these provisions cannot be misused by debtors, claimants, and courts to deny insurers standing to be heard on issues that impact them.

Nonetheless, insurance neutrality provisions still have a role to play. Properly drafted and employed, insurance neutrality provisions can add clarity and eliminate some objections insurers may have to a Plan. These provisions may prevent the parties from inadvertently altering their rights under insurance contracts by virtue of provisions contained in long and complex Plans.

For years, the plaintiff's bar has used bankruptcies to drain insurer resources and promote fraud, excessive recoveries, and even recoveries by individuals not actually injured. The Court properly recognized that, in the context of settlements in bankruptcy, debtors do not have the incentive to defend against claims as their interests become aligned with claimants. Although the ruling is not a panacea for all the ills potentially involved in bankruptcy, allowing insurers to be involved in negotiations will help in the formation of agreements that minimize fraud.

Indeed, "[a] contrary ruling would have undermined confidence in the bankruptcy process, permitted insurer rights to be stomped on, and allowed bankruptcy to be used as a superhighway for fraud and abuse.

The *Purdue Pharma* Decision

The opioid epidemic represents "one of the largest public health crises in this nation's history." *In re Purdue Pharma L.P.*, 69 F. 4th 45, 56 (2d Cir. 2023). Between 1999 and 2019, approximately 247,000 people in the United States died from prescription opioid overdoses, in *re Purdue Pharma L.P.,* 635 B. R. 26, 44 (S.D.N.Y. 2021). The U. S. Department of Health and Human Services estimates that the opioid epidemic has cost the country between $53 and $72 billion annually. Purdue Pharma sits at the center of this tragedy.

On June 27, 2024, in a 5-4 decision in *Purdue Pharma*, the United States Supreme Court ruled that the bankruptcy code does not authorize a release and injunction as part of a plan of reorganization under Chapter 11 that effectively would have discharged claims against a non-debtor (members of the Sackler family) without the consent of affected claimants. As a result, the $6 billion settlement of OxyContin opioid claims is vitiated.

More than 95 percent of voting opioid claimants and other creditors voted to support the plan. The Trustee and thousands of opioid plaintiffs, however, opposed the nonconsensual releases afforded the Purdue Pharma owners, members of the Sackler family.

The United States Bankruptcy Court for the Southern District of New York overruled the objections to the plan and confirmed it with third-party releases for the benefit of the Sackler family. The United States District Court for the Southern District of New York reversed the bankruptcy court's decision, but the United States Court of Appeals for the Second Circuit reinstated the bankruptcy court's confirmation order. The Supreme Court granted review.

According to the Court, a debtor can win a discharge of its debts if it proceeds honestly and puts virtually all its assets on the table for its creditors. The debtor in this case, Purdue Pharma L.P., filed for bankruptcy after facing a wave of litigation for its role in the opioid epidemic. Purdue's long-time owners, members of the Sackler family, also confronted a growing number of lawsuits. But instead of declaring bankruptcy, they chose a different path.

They sought and obtained an order extinguishing vast numbers of existing and potential claims against them. They obtained all this without securing the consent of those affected or placing anything approaching their total assets on the table for their creditors. The question confronting the Court was whether the bankruptcy code authorizes a court to issue an order like that.

The majority ruled that Section 1123(b) of the Bankruptcy Code, the catchall provision, which affords bankruptcy courts broad discretion to approve any other appropriate provision consistent with the Bankruptcy Code, does not authorize a third-party release in a Chapter 11 plan that purports to discharge claims against a non-debtor in the absence of the consent of the affected claimants.

The majority pointed out that Congress has not added to the Bankruptcy Code special rules for opioid-related bankruptcies as it has for asbestos-related cases with §524(g). The Trustee urged the Court to consider the ramifications of other cases. Nonconsensual third-party releases allow tortfeasors to obtain immunity from the claims of their victims, including for claims (like wrongful death and fraud) they could not discharge in bankruptcy and do so without placing anything approaching all of their assets on the table. The Trustee argued that endorsing that maneuver would provide a "roadmap for corporations and wealthy individuals to misuse the bankruptcy system' in future cases 'to avoid mass-tort liability."

Confining itself to the question presented, the Court held only "that the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a non-debtor without the consent of affected claimants." The majority made it clear that nothing in the decision calls into question consensual third-party releases offered in connection with a bankruptcy reorganization plan, and its decision does not express a view on what qualifies as a consensual release. Further, the Court made it clear that its decision does not address whether the Bankruptcy Code would justify unwinding reorganization plans that have already become effective and have been substantially consummated.

According to the dissent, the majority decision is "wrong on the law and devastating for more than 100,000 opioid victims and their families." The dissent believed that the majority decision "rewrites the text of the Bankruptcy Code and restricts the long-established authority of bankruptcy courts to fashion fair and equitable relief for mass-tort victims." According to the dissent, the Bankruptcy Code vests bankruptcy courts with broad discretion to approve "appropriate" plan provisions. 11 U. S. C. §1123(b)(6). It criticized the majority for failing to address all pertinent issues.

Key Takeaways

Prior to the United States Supreme Court's decision in *Purdue Pharma*, the circuits were split on third-party releases. The Second and Third Circuits allowed third-party releases upon a showing of special circumstances, while the Fifth, Ninth, and Tenth Circuits did not permit such releases.

In the months following the decision, Purdue Pharma has struggled to propose another Plan. Lawyers and courts, in several other cases, are grappling with creative ways to work within the limitations of *Purdue Pharma*. In addition to obtaining consensual releases, potential strategies may include opt-in mechanisms, seeking a "gatekeeping injunction" pursuant to which claimants are required to seek bankruptcy court approval prior to pursuing claims against third parties (but this is not expressly authorized by the Bankruptcy Code), using exculpatory provisions, or not filing Chapter 11 proceedings. Congress could pass legislation to authorize nonconsensual third-party releases.

It will take time to determine the full impact of *Purdue Pharma* as various workarounds are attempted, and court rulings may alter venue selection decisions. The ruling is not necessarily favorable or unfavorable for insurers as a whole. Insurers may support or oppose a particular plan and take different positions on the nature of the releases and other elements of a Plan in different matters.