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Be Careful What You Wish For, You Just Might GIT It

Law360, New York (June 7, 2011) -- The Third Circuit recently reached a sharply divided en banc decision concerning insurer standing to object to a debtor-policyholder's bankruptcy plan in In re Global Industrial Technologies Inc., No. 08-3650 (3d Cir. May 4, 2011) ("GIT"). Some insurers have portrayed GIT as a major reversal in the law recognizing limited insurer standing to object to policyholder bankruptcy plans. Upon analysis, however, GIT is a narrow ruling that is unlikely to be followed outside the Third Circuit. Indeed, courts outside of the Third Circuit may find that GIT's dissenting majority got the issue right.

Even if the insurers' broader reading of GIT were warranted, however, it may well turn out to be a decision those insurers rue, as it would likely result in substantially increased litigation of insurance-related issues, with increased risk to insurers, in asbestos-related bankruptcies.

In GIT, the Third Circuit reiterated its prior holding in Combustion Engineering, 391 F.3d at 200-01, that where a bankruptcy plan includes "insurance neutrality" language, insurers lack bankruptcy standing to object to portions of a bankruptcy plan that do not directly affect their interests. Slip. Op. at 26. The GIT court, however, found that a plan that gave life to dormant silica claims cannot be said to be insurance neutral. See id. ("The Plan's promise of an APG Silica Trust appears to have staggeringly increased — by more than 27 times — the pre-petition liability exposure" for silica claims.)

The court summed up the basis for its finding, writing that "when a federal court gives its approval to a plan that allows a party to puts its hands into other people's pockets, the ones with the pockets are entitled to be fully heard." Slip Op. at 6. This statement, however, fails to appreciate the distinction between obligations imposed by the plan and obligations imposed by the insurer's contracts.

The GIT plan did not permit the debtor to put its hands into any insurer's pockets. The plan's insurance neutrality provisions expressly preserved any defense to coverage that the insurer would have had in the absence of the bankruptcy.[1] Nothing in the bankruptcy plan specifically required the insurers to pay anything. Thus any obligation to pay derives directly and exclusively from the terms of the insurance contract.

Moreover, the GIT decision contradicts well-reasoned decisions of other courts that have addressed insurer bankruptcy standing. See, e.g., In re Quigley Company Inc., In re A.P.I. Inc., 331 B.R. 828, 859-60 (Bankr. D. Minn. 2005).

In Quigley, the bankruptcy court ruled that a debtor's insurers cannot challenge plan provisions that do not affect their interests directly and held that standing must apply on an issue-by-issue basis. In most, if not all, bankruptcy cases in this context, the insurers' interests are directly in conflict with the creditors' interests that they often seek to raise in an effort to gain leverage and stymie debtors' reorganization efforts.

Insurers in these cases regularly argue that, as in GIT, the very existence of the plan or future trust will increase the claims against the debtor (and therefore, the insurers' potential obligation to pay) and that this impact provides them broad standing to object on these bases.

The Quigley court ruled, however, that Quigley's insurers could not seek discovery or make plan objections related to, for instance, issues of classification and treatment of claims, the adequacy of funding for the trust, and solicitation and voting procedures. These, the court held, are "creditor" issues that may be raised by the affected parties, but not by noncreditor insurers. See also In re A.P.I. Inc., 331 B.R. 828 (Bankr. D. Minn. 2005) (holding that insurers can only object to the extent plan provisions impinge directly on the insurers' rights or contractual interests).

Nevertheless, GIT states at least the law in the Third Circuit, and certain insurers profess hope that it will be broadly applied to permit insurer standing on every issue in any bankruptcy case in which the proceeds of an

insurance policy are transferred to a trust to fund present and future liability. If their hopes are realized, however, insurers may come to lament their success.

Any current or prospective asbestos debtor faced with the potential for a broad application of GIT almost certainly would refuse to include in its plan any "insurance neutrality" provisions and would instead insist that the carriers be bound to certain routine bankruptcy court findings. By contrast, under "insurance neutrality" provisions insurers are regularly carved out from the impact of findings such as those regarding the good faith of the debtor in negotiating the plan and those regarding the reasonableness of provisions providing payment to tort claimants.

Other issues that are routinely reserved for future litigation outside of bankruptcy court through "insurance neutrality" clauses include the time at which the debtor's liability (and accordingly, the insurers' obligation to pay) for the claims discharged in the bankruptcy occurs and whether the insurers' obligation to pay turns on the amount of the debtor's discharged liability or the amount the bankruptcy trust is ultimately able to pay to claimants (the so-called "UNR issues"). These issues are likely to again be played out in bankruptcy courts.

Indeed, with no assurance that "insurance neutrality" provisions provide a predictable and speedy path to confirmation, debtors (and tort claimants) may well seek to gain the full measure of potential protection available in bankruptcy court, which includes estimating their likely total present and future liability and presenting the full amount of that liability to insurers for immediate payment.

The litigation of such issues may well create advantages for debtor-policyholders, and by extension the tort claimants — at least to the extent they are faced with the prospect of an ineffective neutrality provision — and create commensurate risks for insurers.

CONCLUSION

Although for the reasons stated it is unlikely that GIT will be adopted in jurisdictions outside the Third Circuit or given an expansive reading even within the Third Circuit, debtor-policyholders should be aware of the case in forming bankruptcy strategy and be prepared to engage in full-scale litigation of numerous insurance-related issues normally reserved for later litigation in the bankruptcy case.

The insurers, for their part, should approach asbestos bankruptcies with a wary eye, as their risk of litigation may have just increased substantially.

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[1] The sole exception to this was the so-called "assignment issue," as to which the debtors conceded the insurers had standing. The assignment issue is whether the plan breaches the insurance policies by assigning certain insurance rights to the debtor's successor trust. The Third Circuit in *Combustion Engineering* already has held that assignment of policy interests to an asbestos trust is appropriate. 391 F.3d at 203. This accords with other decisions. *See, e.g., In re Quigley Company, Inc.*, (holding that a debtor's insurers may raise the issue of whether the assignment of insurance rights breaches their policies because the insurers' rights are, in this context, directly implicated by the plan).