Two Cases Directly Impacting Insurers Are Currently Pending Before the United States Supreme Court

November 6, 2023
Insights for Insurers

Rulings by the United States Supreme Court profoundly impact insurers as businesses and corporate citizens. Additionally, decisions from the U.S. Supreme Court can also influence claims and policyholders' liabilities for which insurers may be called upon to defend or provide indemnification. It is fairly rare, however, for the U.S Supreme Court to wade into the area of insurance contracts or rights of insurers directly. Nonetheless, the nation's high court has taken up two cases directly impacting insurers this term.

First Case: Great Lakes Insurance SE v. Raiders Retreat Realty Co. LLC

On October 10, 2023, the justices heard arguments in *Great Lakes Insurance SE v. Raiders Retreat Realty Co. LLC*, which involves the issue of choice of law under a marine insurance policy. Great Lakes and yacht owner Raiders Retreat Realty Co. are arguing over a choice of law provision contained in a marine insurance policy.

Great Lakes is challenging the decision by the United States Court of Appeals for the Third Circuit ruling that a separate Pennsylvania insurance law favoring policyholders could trump a federal maritime choice of law provision. The U.S. Supreme Court may have occasion to promulgate a test for determining when choice of law provisions should be given effect as a matter of federal law. Depending upon the court's ruling and language, this decision could impact federal choice of law jurisprudence beyond maritime insurance.

As a matter of federal law, choice of law provisions are presumed to be valid and enforceable. Courts will refuse to apply a choice-of-law clause only where the parties have no substantial relationship to the chosen law (which is not the situation here) or where the chosen law violates public policy.

The Third Circuit decision subject to the appeal marked the first time a United States Court of Appeals held that a maritime choice-of-law clause was potentially unenforceable as a matter of state public policy. In this case, the issue is whether the public policy to be referenced in enforcing a choice of law provision is federal public policy, as the insurer argues and as traditionally applied, or is state public policy, as the policyholder advocates.

Attorneys

Scott M. Seaman

Service Areas

Insurance Agents & Brokers Liability

Many commercial contracts – insurance and other contracts – contain choice of law provisions. Choice of law clauses became more common in maritime contracts after the U.S. Supreme Court's 1955 decision in *Wilburn Boat Co. v. Fireman's Fund Ins. Co*. This case allowed state law to play a substantive role in maritime cases by filling the gaps without a federal statute or entrenched federal common law controls.

Parties to maritime contracts wanting the consistency and predictability of well-established law have come to include choice-of-law provisions that select the law of a state – such as New York – with a well-developed body of maritime law. The presumption of enforceability is a uniform federal rule, and the public-policy exception should be federal public policy. This has been the case for over 200 years, both before and after Wilborn Boat, until the Third Circuit decision in this case.

There are sound reasons why only a violation of federal policy should serve as a basis to undermine the parties' selection of applicable law, starting with the recognition that maritime law is a matter of federal law. Enforcing the parties' choice of law selection subserves the interests of predictability, uniformity, and international comity.

Allowing the public policy of one of fifty states – which may be determined after the time of contract, which may be difficult to ascertain, which may involve conflicting policies, and which may turn on the selection of the location of the lawsuit – threatens to interject uncertainty for the parties and frustrate the intent of sophisticated parties. It would take away parties' ability to manage their contractual obligations and could impact the price and availability of insurance coverage. It also would needlessly complicate things by inviting challenges based on a panoply of state law matters.

Some of my comments on this case are included in Daphne Zhang's article in *Bloomberg Law*, entitled "Yacht Owner's Fight With Insurer Tees Up Rare High Court Review" (October 5, 2023). It will be interesting to see what the Court decides.

Second Case: Truck Insurance Exchange v. Kaiser Gypsum Co. Inc.

In a separate case, the U.S. Supreme Court is considering whether an insurer has standing to object to a plan of reorganization. In *Truck Insurance Exchange v. Kaiser Gypsum Co. Inc.*, one of Kaiser Gypsum's insurers, Truck Insurance Exchange, objected to Kaiser Gypsum's Chapter 11 plan of reorganization. Facing substantial liability for asbestos personal injury claims under general liability policies issued over several years, the insurer objected to the plan on several grounds, particularly that insufficient protections against fraudulent and excessive claim payments were made for insured claims.

The Fourth Circuit found in February 2023 that the North Carolina federal judge correctly determined that Truck Insurance lacked standing under the U.S. Bankruptcy Code since it determined that the reorganization had no adverse impact on the insurer and that the insurer lacked standing under Article 3 of the U.S. Constitution. The primary basis for the court's determination is the presence of an "insurance neutrality" provision in the Chapter 11 plan of reorganization.

By way of background, as a matter of state contract law, an insurance contract generally cannot be modified without all parties' consent, and bankruptcy law generally does not authorize a debtor to unilaterally modify its contracts. Nonetheless, debtors and creditors (particularly claimant committees) often propose plans of reorganization that alter or adversely impact insurers' rights or interests in various ways.

In bankruptcy reorganizations involving companies with large asbestos or mass tort liabilities, often a trust is established to resolve and pay claims against the debtor, and channeling injunctions are issued to protect parties other than the debtor, including settling insurers, co-insureds, and affiliates of the debtor. Generally, the trust is responsible for administering a court-approved procedure for resolving claims, commonly called trust distribution procedures or TDPs. The TDPs generally include medical and other criteria (such as requirements regarding exposure to the debtor's products), categories and levels of injury or impairment that will be compensated, and claim values or ranges.

The procedures typically include requirements that claimants submit claim forms to the trust that contain specified information and that are reviewed by personnel retained by the trustee to determine whether or not the claim will be allowed and how much will be paid. The TDPs generally include mediation, arbitration, or litigation procedures for claims not resolved by the matrix criteria. Often, insurers – particularly those not agreeing to fund the trust – are not involved in negotiating or approving the TDPs.

The payment of claims through a trust alters the dynamics substantially because the policyholder is not aligned with its insurers in defending against claims as it had in the tort system. Instead, the policyholder effectively turns the keys to store to the claimants' representatives. The claims are paid in accordance with the TDPs, and the trust, effectively compelled by plaintiffs' asbestos lawyers, is making determinations and overseeing the process.

A bankruptcy plan of reorganization that sets out an alternative procedure for determining and liquidating a debtor's liability through TDPs directly affects the insurer's monetary and contractual interests.

In an attempt to avoid plan confirmation litigation about impairment of insurer contractual rights, debtors often include so-called "insurance neutrality" provisions in their plans that purport to neither increase the insurers' pre-petition obligations nor impair their pre-petition contractual rights under the insurance policies. These "insurance neutrality" provisions generally are included in an attempt to limit the insurers' standing to object to the plan (or related events) to challenging the adequacy of the insurance neutrality language.

In some instances, if the language of the neutrality provision is acceptable and the plan is otherwise acceptable to the insurers, the insurers may not object to the plan. However, even where the insurance neutrality language is acceptable in many instances, other plan provisions adversely impact insurers' rights.

Even well-intended insurance neutrality provisions are no panacea for insurers. These provisions can protect insurers depending on the plan, the bankruptcy, and the issue. Still, they often fail to provide adequate protections to insurers, leaving them adversely impacted by the realities that a plan will visit upon them, particularly in asbestos or mass-tort-driven bankruptcies with trust distribution procedures that do not provide adequate protections against unsubstantiated, excessive, or fraudulent claims.

Fraud is no stranger to mass tort claims and greatly contributes to social inflation. For years, the plaintiffs' bar has used Section 524(g) of the Bankruptcy Code as a superhighway to drain resources from insurers and their policyholders. Courts have been called to impose anti-fraud and related measures to limit these abuses.

There is a split among the circuits as to standing in this context of challenging plans of reorganization, which likely accounts for the Court's decision to hear the case. It seems reasonable that the party who must pay an insurer should stand and be considered a "party in interest" and be afforded a meaningful opportunity to be heard, at least where it can articulate specific ways its interests are impaired.

Indeed, depriving the parties of the financial incentive to raise issues under these circumstances may undermine the integrity of the bankruptcy process. More thoughts on this case are captured in Shane Dilworth's *Law360* article, "Justices' Ruling On Insurer Standing Could Spark Sea Change" (*subscription required).*