Creative Solutions for Insurance Challenges

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Complex insurance structures are relatively commonplace for large business operations, including manufacturers and health care entities. If those entities file for bankruptcy, issues arise as to the treatment of claims covered by insurance as well as the protection of the insured. Depending on the nature of the debtor's business operations and scope of third-party claims covered by insurance (such as medical malpractice, products liability and other large tort claims), treatment of insured claims and the ability to maintain insurance can be factors affecting the debtor's restructuring or liquidation process.

Stay Relief

Steve Korf

One of the first issues relates to the type of insurance in place. There is a stark difference between a third-party insured entity and a debtor who is a self-insured entity. Businesses commonly choose either to maintain insurance coverage from a third party or self-insure (which can also include self-insurance up to a specified amount of risk and buying insurance that covers a high self-insured retention or deductible). In bankruptcy, the type of insurance held by the debtor can be crucial because if the debtor is an entity that purchased third-party insurance, claimants may have the opportunity to recover on their claims from the nondebtor third-party insurer within policy parameters. Such an option is not available for a self-insured debtor because the claim lies directly against the debtor's estate. One area where the difference in insurance becomes relevant—even at the inception of the bankruptcy case—concerns the automatic stay.

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Since under § 362 of the Bankruptcy Code the automatic stay operates to stay the commencement or continued prosecution of claims arising pre-petition against the debtor[1] because the claim is against the debtor (whether covered by insurance or not), claimants must move for relief from the automatic stay to continue the prosecution of their claims against third-party insurers. If the continued prosecution of these claims does not risk diluting the debtor's available insurance coverage, debtors may choose not to oppose such motions (provided that limitations on the continued prosecution of the claims are set, including waivers of deductibles or self-insured retention payments otherwise required of the debtor).[2] If a case could involve tens, if not hundreds, of these types of motions for relief, such motion practice causes an unnecessary administrative burden on the debtor's estate and the courts.

Alternatively, to expedite the process and save administrative expense, a debtor could implement a protocol whereby claimants make an informal request to lift the automatic stay to the debtor (without first filing a motion), and to the extent that adequate third-party insurance coverage was available, the debtors would enter into stipulations with the claimants allowing them to lift the stay. These stipulations commonly require the claimants to agree to limit their recovery solely to the third-party insurance proceeds and waive all claims against the estate.[3] Not only does this process function to resolve potentially large numbers of claims on an informal basis, but once these claims are resolved by stipulation, the debtor will be able to expunge the resolved claims. This serves to reduce the number of motions before the court and results in savings for both the estate and the tort claimants.

Adam Rogoff

Similarly, chapter 11 plans may provide claimants that were discharged under the plan to continue the prosecution of their actions against third-party insurance post-discharge.[4] Generally, the confirmation of a chapter 11 plan acts to discharge all claims arising prior to confirmation, after which creditors may no longer look to the debtor for further recovery on these claims. The "discharge injunction" operates like the automatic stay, enjoining actions arising from preconfirmation against the debtors *after* discharge. While § 524(e) of the Code provides that a discharge of claims against the debtor does not discharge claims against other entities (for example, an insurance company), courts disagree as to whether a creditor must seek relief from the discharge injunction before proceeding against the insurance company.[5] Including language in a plan that claims against insurers survive discharge obviates the need to resolve these issues.

Creation of a Tail Fund

Some insurance policies can be divided into two categories of policies: claims-made and occurrence-based. While *occurrence-based* policies cover claims that *occur* within a given policy year (regardless of when the claims are reported to the insurance company), *claims-*

1 11 U.S.C. § 362(a).

2 This analysis does not account for possible distraction of the debtors' management in the prosecution of these lawsuits. Economic costs aside, this should be a factor in determining how to proceed.

3 *See, e.g., In re St. Vincent's Catholic Med. Ctrs. of N.Y.*, No. 10-11963 (Bankr. S.D.N.Y.) (Stipulation, ECF No. 1734, June 20, 2011).

4 *See, e.g., In re The Brooklyn Hospital Ctr.*, No. 05-26990 (Bankr. E.D.N.Y. July 20, 2007) [Docket No. 916].

5 4 *Collier on Bankruptcy* ¶ 524.05 (15th ed. rev. 2006) (noting disagreement). *Compare Green v. Welsh*, 956 F.2d 30, 36 (2d Cir. 1992), *with Walker v. Wilde (In re Walker)*, 927 F.2d 1138, 1143-44 (10th Cir. 1991), and *In re Catania*, 94 B.R. 250, 252-53 (Bankr. D. Mass. 1989).

made policies provide coverage for the given policy year in which the claims are *reported* (regardless of when the incident giving rise to the claim occurred).[6]

Anupama Yerramalli

Claims-made policies present interesting challenges in a liquidation case because once a determination is made to cancel a policy as part of the wind-down of the estate, an issue arises as to how to treat "tail claims." Tail claims represent claims that arose during the initial coverage period (before the policy was terminated, for example, while the covered professional was still providing services), but were not commenced or reported until after the insurance policy would be terminated. Generally, when an insurance policy is terminated, the insurance companies are statutorily required to extend coverage for 60 days, during which time the "covered person" (*i.e.*, the nondebtor person who is covered for claims asserted against the policy) under those policies has the option to purchase tail coverage on an individual basis, or otherwise be subject to claims brought after the extended-coverage period ends without coverage.[7] The debtor may have less concern over these future claims, which could be addressed by bar dates and ultimately if timely claims are not asserted as part of the winddown are simply unrecoverable.

The issue can arise when nondebtor-covered parties raise concerns over the necessity to continue insurance (such as purchasing tail coverage) to cover their potential claims against the debtor for indemnification. In an ideal world, sufficient funding would exist to simply purchase tail insurance (whether paid by the debtor or nondebtor-covered parties). Alas, the ideal world and bankruptcy rarely live in harmony together. In reality, purchasing tail coverage can be costly. One creative solution is the establishment of a fund to cover tail claims.[8] Under this approach, covered persons (which can include the debtor) would contribute funds to the creation of a dedicated pool used to administer and satisfy claims otherwise covered by insurance. In essence, the tail fund becomes a self-insurance pool. People having claims against the debtor or covered party would be "tail claimants." Nondebtor-covered parties would be given the opportunity to either "opt-in" or "opt-out" of the fund within a defined notice period (*e.g.*, 45 days of receiving notice). Those covered parties that chose to opt out would thereafter be required to either purchase their own tail coverage (if the extended time period for purchasing coverage still remained) or otherwise be potentially subject to liability without coverage. Those opting in would have their liability claims paid *pro rata* from the tail fund.

The amount of contributions made by an opt-in participant can either be shared *pro rata* by all participants or can vary on a sliding scale determined by risk. For example, in a health care case, nondebtor physicians may contribute different amounts based on each individual's risk of exposure (*i.e.*, physicians in high-risk specialties could be required to contribute more than those in low-risk specialties).[9] This process is aided by actuarial input as to the amount of liability for which funding would be required. The debtor, in turn, would negotiate whether to match the amounts paid by the nondebtor parties or pay a different amount (if any) into the fund.

The creation of the tail fund should also address the process for claims resolution. For example, the debtor can set a bar date for tail claims and seek to use a mediation process for each tail claimant to have its claim settled and liquidated. Through a mediation process, the mediator and claims administrator could be appointed, and the mediator could establish procedures and timetables. A debtor should seek to place a cap on the maximum settlement amount of each claim—a critical factor for ensuring that reserved funds would be adequate for all tail claims rather than depleted by a few large claims. In the event that a tail claimant disagrees with a mediator's recommendation, the process should address the claimant's ability to lift the stay to liquidate the claim in a non-bankruptcy court,[10] with the resulting judgment channeled to the fund, still subject to the per-claim limitation under the fund.

Rachael Ringer

An additional issue to be considered relates to interim relief pending implementation of a tail fund structure, including extending the automatic stay for covered participants. As such, a debtor should consider extending the automatic stay to encompass nondebtor-covered persons that would otherwise be subject to litigation. The court's authority to extend the automatic stay stems from § 105(a) of the Code, which gives the court the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]."[11] Pursuant to this authority, a court may extend the automatic stay to nondebtor parties if they find that there is a sufficient "identity of interest" between the debtor and nondebtor such that a judgment against the nondebtor would, in essence, bind the debtor to that judgment as well.[12] A court may also extend the automatic stay if the contingent indemnification obligation could directly affect the *res* (property) of the estate.[13] Because extending the automatic stay to a nondebtor party will enjoin all actions against that party, courts utilize the standards for a preliminary injunction in determining whether an extension is appropriate under the circumstances.[14] Absent such relief, parties would be able to obtain a judgment against a nondebtor that would affect the debtors' assets, in direct contravention of the purpose of the automatic stay, which seeks to provide the debtors with a "breathing spell" from creditors obtaining such judgments against them. Courts have found that such an identity of interest exists to extend the stay to nondebtor parties where a debtor has an obligation to indemnify the nondebtor parties.[15]

Ultimately, the goal is to have the tail fund act to "channel" the claims against the debtors and the covered persons to the fund. The process would seek to limit the

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6 *See, e.g.*, 11 N.Y. Comp. Codes R. and Regs., tit. 11, § 73.1(a) and (j); *see also Appalachian Ins. Co. v. Liberty Mutual Ins. Co.*, 676 F.2d 56, 59 (3d Cir. 1982).

7 11 N.Y. Comp. Codes R. and Regs., tit. 11, §§ 73.3(d) and 73.5(b)(3) (2011).

8 This was done in *St. Vincent's* in connection with a settlement of a motion seeking allowance of an administrative-expense claim equal to the estimated cost to provide tail coverage.

9 Physicians also agreed to contribute the proceeds of their allowed priority and administrative-expense claims (including severance claims) up to the required contribution based on their categorized risk. *See St. Vincent's*, Settlement, ECF No. 1066, Oct. 29, 2010.

10 The liquidation or estimation of personal-injury tort or wrongful-dealth claims is excluded from "core proceedings" under 28 U.S.C. § 157(b)(2)(B), and thus is a "noncore" proceeding. Further, under 28 U.S.C. § 157(b)(5), the district court shall order that personal-injury tort and wrongful-death claims "be tried in the district court in which the bankruptcy case, or in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending."

11 11 U.S.C. § 105(a).

12 *See A.H. Robins Co. v. Piccinin (In re A. H. Robins Co.)*, 788 F.2d 994, 999-1001 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986).

13 *See In re FairPoint Commc'ns Inc.*, No. 11 Civ. 946, 2011 WL 1533178, at *8 (S.D.N.Y. Apr. 19, 2011).

14 This requires the moving party to show (1) a threat of immediate irreparable harm to the reorganization process, (2) a likelihood of a successful reorganization, (3) a balance of harms that tips in favor of the moving party and (4) that the public interest weighs in favor of an injunction. *Haw. Structural Ironworkers Pension Trust Fund v. Calpine Corp.*, No. 06-CV-5358, 2006 WL 3755175, at *4 (S.D.N.Y. Dec. 20, 2006).

15 *See, e.g., Am. Imaging Servs. v. Eagle-Picher Indus. Inc. (In re Eagle-Picher Indus., Inc.)*, 963 F.2d 855, 860-61 (6th Cir. 1992).

tail claimants' recovery to the tail fund and permanently enjoin such claimants from thereafter recovering against the debtor or the covered persons on account of those claims. This would be analogous to a "channeling injunction," similar to those traditionally implemented in the context of asbestos or mass tort liability claims. A channeling injunction serves to "channel" a large amount of future claims (representing uncertain liabilities) to a fund set aside for those future claimants' recovery. The creation of a pool of funds for the benefit of certain creditors is not a novel concept. As early as the 1980s, bankruptcy courts confirmed chapter 11 plans containing channeling injunctions.[16] Historically, the power to create and implement a channeling injunction was derived from § 105(a) of the Code. However, § 524(g) was added to the Bankruptcy Code in 1994, providing statutory authority for the approval of channeling injunctions in the context of asbestos claims.[17]

From the debtor's viewpoint, a tail fund can fix the amount that the estate needs to contribute on account of any alleged indemnification claims or other obligations relating to the continuation of insurance. Nondebtor-covered parties would contribute funds as consideration for having tail claims channeled to the fund and obtaining releases.

16 *See, e.g., In re Johns-Manville Corp.*, 68 B.R. 618, 626 (Bankr. S.D.N.Y. 1986), *rev'd on other grounds*, 78 B.R. 497 (S.D.N.Y. 1987).

17 11 U.S.C. § 524(g).

Conclusion

This is just the tip of the iceberg for understanding the various insurance issues that may arise in bankruptcy cases. Debtors with potentially large and ongoing tort claims should be prepared to address these insurance issues throughout the bankruptcy case, and an efficient, streamlined resolution of these claims is in a debtor's best interest, as claimants can be voluminous in number, and claims substantial in amount. The creation of a pool of funds for the benefit of future or disputed claimants can provide a potential vehicle to resolve claims covered by insurance in any type of case. Resolving claims in this manner is particularly advantageous where the cost of maintaining insurance coverage is prohibitive. ■