Insurance and the Personal Injury Stay Movant

- When determining whether to grant a personal injury claimant relief from the automatic stay, the court should not give consideration to the wishes of the debtor's insurance company. In re Sonnax Industries, Inc., 907 F.2d 1280 (2d Cir.1990) ("where a plaintiff seeks relief from the stay to pursue a claim in another forum, the interests or desires of the insurance company which provides coverage of the claim are not considered in determining whether the stay should be lifted.").

- The Court of Appeals for the Third Circuit has expressly concluded that an insurance policy is property of the estate within the meaning of § 541, even if the policy has not matured, has no cash value, or is otherwise contingent. Estate of Lellock v. Prudential Insurance. Co. of Am., 811 F.2d 186, 189 (3d Cir.1987). Cited in In re Federal-Mogul Global Inc., 385 B.R. 560 (Bankr. D.Del. 2008). While the insurance policy belongs to the debtor's estate, proceeds from the policy may not be assets or property of the estate, depending on who is named as the insured. "When the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate." Matter of Edgeworth, 993 F.2d 51 (5th Cir. 1993); In re Louisiana World Exposition, Inc., 832 B.R. 1391 (5th Cir. 1987); but see, Federal-Mogul, 385 B.R. at 566 n.21 (The Court of Appeals for the Third Circuit's conclusion is consistent with those reached by the majority of other courts of appeals. See e.g., Homsy v. Floyd (In re Vitek, Inc.), 51 F.3d 530, 535 (5th Cir.1995) (insurance policies covering debtors' liability vis-a-vis third parties are estate property, as are the proceeds of those policies)).

- Policy language: The debtor's commercial liability insurance policy provides the Debtor with $2,000,000 in coverage, subject to exhaustion of the $750,000 SIR. The policy also states:

> The insured has the duty to defend any "suit." The insured's duty to defend shall be teminated only by (i) the insurer's exercise of [its] right to assume control of the defense of any specific claim or "suit" ... ; or (ii) the settlement, final adjudication or other termination of such claim or "suit"; or (iii) assumption of the defense by another insurer.
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> In the event a final default judgment is entered because of the insured's negligent or intentional failure to defend a "suit" to which [the] policy applies, all insurance provided under [the} policy for such "suit" shall be void.

- Bankruptcy savings clause: "[b]ankruptcy or insolvency of the insured or of the insured' estate will not relieve us of our obligations under SECTION I - COVERAGES to pay damages in excess of the 'Self-Insured Amount' to which the policy applies".

- "Courts have consistently held that insurance policies where the policy coverage period has expired prior to the insured's bankruptcy are not executory contracts despite ongoing obligations of the debtor." Beloit Liquidating Trust v. United Ins, Co., 287 B.R, 904 (N.D. Ill. 2002); In re Sudbury, Inc., 153 BR 776 (N.D. Ohio 1993) (holding that insurance contracts were not executory); Firearms Import and Export Co. v. United Capital Ins. Co., 131 B.R. 1009, 1013 (Bankr. S.D. Fla. 1991) (holding that "If an insurance contract is expired at the time of the filing of the debtor's petition in bankruptcy and the debtor has only the duty to pay for retrospective premiums, the contract is not executory.").

- Post-petition breaches of non-executory contracts, such as insurance policies, do not void insurers' obligations under the policies. See, e.g., Am. Safety Indem. Co. v. Official Comm. of Unsecured Creditors, No. 05 CV 5877, 2006 WL 2850612, at *4 (E.D.N.Y. Oct. 3, 2006) ("parties to a contract may receive less than they bargained for when the other party goes bankrupt"). Instead:

  > [C]ase law interpreting § 365 of the Bankruptcy Code makes it clear that ... the failure of a bankrupt insured to fund a self-insured retention does not relieve the insurer of the obligation to pay claims under the policy. This is so because where (as in this case) an insured debtor has paid the policy premium in full, the insurance policy is not an executory contract for purposes of § 365 of the Bankruptcy Code, even where the debtor has continuing obligations, such as the payment of a self-insured retention, a deductible, or a premium.

  In re Vanderveer Estates Holding, 328 B.R. 18, 25 (Bankr. E.D.N.Y 2005); see also Argonaut Ins. Co. v. Ames Dep't Stores, No. 93 Civ. 4014, 1995 WL 311764 at *3 (S.D.N.Y. May 18, 1995) (post-petition breach for failing to pay defense costs did not void policy, but gave rise to "at best a prepetition claim for any defense cost [insurer] chooses to expend"). See also In re FF Acquisition Corp., 422 B.R. 64, 61 (Bankr. N.D. Miss. 2009) ("Bankruptcy courts have consistently held that the failure of a bankrupt insured to fund an SIR will not excuse the insurer's performance under the contract.") (citing cases); see In re FF Acquisition Corp., 2010 WL 1027405 (Bankr. N.D. Miss. Mar. 18, 2010) (denying motion for reconsideration).

- Admiral Ins. Co. v. Grace Indus., Inc., 341 B.R. 399, 403 (Bankr. E.D.N.Y. 2006) ("[D]ebtors' failure to pay the retrospective premium claimed to be due, or failure to fund

the costs of, or any awards resulting from, these personal injury actions to the extent of the self-insured retention amount, does not relieve [the insurer] of its obligation to pay under the Policy."), *aff'd* 409 B.R. 215 (E.D.N.Y. 2009) ("Admiral's argument that the policy's SIR endorsement should supersede the policy's bankruptcy clause is unavailing. New York insurance law provides that a policy and an endorsement should be read together unless they are so contrary that they cannot be reconciled. More importantly, all else notwithstanding, if a policy or contractual provision is made in contravention of law, that contract or contractual provision is void.").

Admiral Insurance Co. v. Grace Industries, Inc. (In re Grace Industries, Inc.), 341 B.R. 399 (Bankr. E.D. N.Y. 2006); judgment aff'd as modified, 409 BR 275 (E.D.N.Y. 2009)

Proposition: The failure of a debtor to fund its self-insured retention (SIR) under its insurance coverage will not relieve its insurer of fulfilling the insurer's obligations under the policy.

Background: Insurer of chapter 11 debtor sought a declaratory judgment that it had no obligation to defend any actions against the debtor until the debtor paid its $50,000 self-insured retention ("SIR") under the policy. Because it was insolvent, the debtor was incapable of funding the SIR, much less paying out a covered claim.

Due to the debtor's inability to fund the SIR under the policy, the insurer argued it was forced to either: (1) defend the claims within the SIR (before the costs reached the $50,000 SIR ceiling), or (2) wait until such claims eventually exceed the SIR because they were not defended or settled by the debtor. The insurer also argued that the debtor breached the policy's cooperation clause by agreeing to lift the automatic stay pertaining to state court personal injury actions against it.

Legal Question: Is a debtor's insurer relieved of its obligations under an insurance policy if the debtor cannot pay its self-insured retention (SIR)?

Decision: The bankruptcy court issued an order stating that the insurer was obligated to defend and indemnify the insured to the extent that claims covered under the policy exceeded the SIR.

On appeal, the District Court affirmed, opining that "a post-petition directive requiring [the debtor] to actually fund, much less exhaust, the SIR would put [the insurer] in a better position than [the debtor's] other creditors - an outcome that stands in direct contravention to the purpose and intent behind the bankruptcy law and which cannot be compelled either by contract or state law." 409 B.R. at 281.

Court's Rationale: The Bankruptcy Court did not find an insurer's decision to defend

the claims that fell within the SIR amounted to an increase in the insurer's obligations, stating that "[being] put in the position of making a choice between the less financially undesirable of two alternatives is not the same as being legally compelled to make payment." 341 B.R. at 404.

> [The insurer's] obligations will be exactly what they would be in the absence of [the debtor's] bankruptcy—to pay claims to the extent of the policy limits, and to the extent the claims exceed the amount of the self-insured retention.

341 B.R. at 404.

The bankruptcy court also found the insurer's argument that the debtor breached the policy's cooperation clause by agreeing to lift the automatic stay pertaining to state court personal injury actions unavailing. The bankruptcy court identified that the purpose of the automatic stay is to protect property of the estate from individual creditors, so that the assets will be available for proper distribution to the creditor body. Noting that the personal injury plaintiffs in the instant case agreed to not seek recovery from the estate's assets, the court found no basis existed to continue the automatic stay. 341 B.R. at 404.

> [W]here a plaintiff seeks relief from the stay to pursue a claim in another forum, the interests or desires of the insurance company which provides coverage of the claim are not considered in determining whether the stay should be lifted.

341 B.R. at 405 (internal citation omitted).

The district court agreed that the insurer's decision to assume costs within the SIR was not an obligation the insurer was required to fulfill under the insurance policy. "[The insurer] is free (or not) to save itself money by paying what would have been [the debtor's] obligation rather than playing out all of the litigation cards with their attendant risks." 409 B.R. at 280. The district court stated that "[s]ection 365 of the Bankruptcy Code makes it clear that even in the absence of an applicable statutory provision ... the failure of a bankrupt insured to fund a self-insured retention does not relieve the insurer of the obligation to pay claims under the policy." 409 B.R. at 280.

Further, the District Court identified that under state law (New York), insurance policies are statutorily required to include "[a] provision that the insolvency or bankruptcy of the person insured, or the insolvency of his estate, shall not release the insurer from the payment of damages for injury sustained or loss occasioned during the life of and within the coverage of such policy or contract." 409 B.R. at 281. See New York Ins. Law § 3420.

Significance of the Case: The decision contributes to existing case law supporting the proposition that the failure of a debtor to fund its SIR under its insurance coverage will not relieve its insurer of fulfilling the insurer's obligations under the policy.

- There is an alternative view, however, which is based on strictly interpreting the language of the insurance contract. Such was the case in Rosciti v. Liberty Mutual Insurance Co., 2010 WL 3432305 (D.R.I. Aug. 30, 2010) *rev'd and remanded sub nom* Rosciti v. Ins. Co. of Pa., 659 F3d. 1592 (1st Cir. 2011).

  The plaintiffs in Rosciti brought suit against a bankrupt motor coach seller's insurers under Rhode Island's direct action statute for mould contamination. The debtor-tortfeasor had liquidated under Chapter 7, so would never be able to pay the $500,000 SIR in the policy. The plaintiffs contended the insured's insolvency rendered inapplicable the requirement that the underlying self-insured retention be exhausted before the excess insurer became liable. The plaintiffs argued that the exhaustion requirement clashed with a separate bankruptcy clause providing that insolvency of the insured did not relieve the insurer of its obligations under the policies and created an ambiguity that should be resolved in the insured's favor. Rejecting this argument, the Rhode Island District Court said:

  > The problem with the [plaintiffs'] view is that it leaves no way to make all the contract terms work together. Accepting Plaintiffs' interpretation would mean that the "complete expenditure" language in [the policy] must disappear in the event of the insured's bankruptcy. Yet, the Court should not labor to "read ambiguity into a policy where none is present." ... On the contrary, it must strive to make sense of the "instrument as a whole."

  The Court went on to find, "no 'irreconcilabl[e] conflict' between the 'complete expenditure' rule and the preservation of coverage during bankruptcy," because there were "any number of scenarios" whereby insolvency might not prevent exhaustion. The court found that the liquidation of the insured (and its corresponding failure to pay the $500,000 SIR) meant that the carrier could escape liability and that the victims were simply out of luck, even if they secured a verdict in excess of the SIR. The court essentially acknowledged that its ruling read the "bankruptcy exclusion" in the insurance policy out of the contract in most circumstances, claiming instead that "it is common for contract boilerplate to regurgitate case law." The court understood the impact of its ruling, because (as it described) "(e]xhaustion may be impossible in the majority of bankruptcies involving policyholders with self-insured retentions, and both parties agree that it cannot happen here."

  The plaintiffs in Rosciti argued in the alternative that Rhode Island's direct action statute nullified the exhaustion clause. In rejecting the plaintiffs' position as being equivalent to a strict liability standard, the Court stated:

> An insurer could never object, for example, that its policy was not in effect when the tort occurred, or that the insured did not provide notice of a claim within the period stated by the contract. In effect, all the words in the policy would vanish, leaving only a cap on damages, and thus no preconditions to coverage except the plaintiff's burden of proof on the tort claim. There is no reason to assume the statute works that way.

The Court refused to void common policy terms and conditions, noting there was "no hook in the statutory language that could pull the [exhaustion] clause out of the contracts."

Finally, the Court specifically rejected the plaintiffs' claim that it was not seeking to require the excess insurer to "drop down" in coverage as belying the "economic reality" that the excess insurer's money would be the first dollars secured by the plaintiffs in the event of an adverse verdict and the result would be "no different" that if the excess insurer had been the primary insurer and the plaintiffs had only proven damages within the self-insured retention limit. "If excess insurers knew they faced the possibility of dropping down in the context of bankruptcy, they would charge higher premiums for bearing that risk." The "net effect" of holding that the statute voided the exhaustion clause "would be to reverse the contractual allocation of risk."

See also Pak-Mor Mfg. Co. v. Royal Surplus Lines Ins. Co., No. SA-05-CA-135-RF, 2005 WL 3487723 (W.D. Tex. 2005) (finding that bankruptcy clause "plainly says that the retained limit requirement applies in the bankruptcy context...;" "Under Texas law, insurers are free to issue policies that relieve them of liability in the bankruptcy context..;" debtor could satisfy SIR by payment in any form, including non-dischargeable promissory note); cf. In re Kismet Products, Inc., 2007 WL 6872750 (Bankr. N.D. Ohio, Aug. 28, 2007).

- However, the First Circuit reversed on grounds that the bankruptcy savings clause did not conflict with policy provisions and public policy precluded enforcement of policy's exhaustion provision. Rhode Island public policy prevents insurance companies from avoiding their obligations when an insolvent insured cannot make an expenditure towards discharging liability. As to Pak-Mor, the First Circuit noted that Texas does not have a direct action statute or comparable insurance public policy concerns as evidenced in Rhode Island.