

# Selected Topics from the Intersection of Insurance and Insolvency Law

## Edwards Wildman Team

Jonathan W. Young

John D. Hughes

Michael B. Kind

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# Bankruptcy Code is Divided Into Different “Chapters” that Address Distinct Types of Financial Rehabilitation

- ◆ Chapters 1, 3 and 5: Applicable to all chapters unless noted
- ◆ Chapter 7: Liquidation of individual assets or businesses
- ◆ Chapter 11: Reorganization or liquidation of individual assets or businesses
- ◆ Chapter 13: Individual debt adjustment plans
- ◆ Chapter 15: Foreign insolvency proceeding

# Chapter 7 Proceedings

- ◆ All assets are assembled into a single “bankruptcy estate,” and placed in the charge of a court-appointed Trustee
- ◆ Automatic stay brings a halt to all collection activity, lien perfection, policy cancellation and other enforcement activity directed against the Debtor and its assets
- ◆ Trustee has the power to assume or reject its unexpired contracts and leases
- ◆ Creditors and other claimants file proofs of claim, which are reconciled and paid in accordance with state laws of priority
- ◆ Trustee has power to bring lawsuits to claw back payments made within 90 days of the bankruptcy filing, and pre-bankruptcy payments made for inadequate consideration and intentional fraud

# Chapter 11 Proceedings

- ◆ Debtor remains in charge of its assets, and continues to operate its business under court supervision
- ◆ Automatic stay, treatment of unexpired contracts, proofs of claim and clawback lawsuits are all treated in the same fashion as they would be in Chapter 7
- ◆ Debtor has the right to propose a plan of reorganization or liquidation which, if accepted, becomes a binding contract between the Debtor and its creditors and equity holders
- ◆ Confirmation of plan requires demonstration that creditors are being treated at least as well as they would be in a Chapter 7 liquidation
- ◆ Issues and objections with Debtor's insurance programs are usually addressed through the inclusion of "insurance neutrality" provisions in the plan

# Chapter 15 Proceedings

- ◆ U.S. based proceeding that aids or furthers a foreign insolvency
- ◆ U.S. court appoints a representative of the foreign insolvency, who is then entrusted with the powers of a Chapter 7 Trustee relative to U.S. based assets
- ◆ Among other things, the foreign representative can operate the Debtor's business, use cash collateral and sell assets

# Chapter 15 Proceedings *(cont.)*

- ◆ Chapter 15 is generally used to protect the foreign Debtor's U.S. based assets, to establish orderly procedures for reconciling U.S. based claims, and to bind U.S. stakeholders to whatever restructuring plan is approved in the foreign proceeding
- ◆ Settlements in international cases must include a U.S. order in order to shield insurers and guarantee enforcement of the agreement.
  - ◆ *See, e.g., In re Lehman Brothers Australia Limited*, No. 12-10063, Docket No. 24 (U.S. order approving release and bar order relating to debtor's settlement with U.S. insurers).

# Insurer Standing in Bankruptcy Proceedings

- ◆ Though all parties must meet the requirements of Article III, standing in bankruptcy cases is also governed by the terms of 11 U.S.C. § 1109(b), which provides that a “party in interest . . . may raise and may appear and be heard on any issue in a case under this chapter.”
- ◆ The Third Circuit has explained that a party in interest is one who “has a sufficient stake in the proceeding so as to require representation” or “anyone who has a legally protected interest that could be affected by a bankruptcy proceeding.” *In re Global Indus.*, 645 F.3d, 201, 210 (3d Cir. Pa. 2011) (quoting *In re Amatex Corp.*, 755 F.2d 1034, 1042 (3d Cir. 1985) and *In re James Wilson Associates*, 965 F.2d 160, 169 (7th Cir. 1992)).

# Insurer Standing in Bankruptcy Proceedings *(cont.)*

- ◆ In *Global Industrial*, the debtors filed a chapter 11 plan of reorganization which sought to address the debtors' mass tort liabilities pursuant to section 524(g) of the Bankruptcy Code by channeling asbestos-related and other claims to specific trusts established to assess and resolve such claims.
- ◆ The insurers had standing to object, even if the “quantum of liability” was unaffected, because the Plan had triggered the explosion of new claims and made an entirely new set of administrative costs.
  - ◆ *Global Industrial* also relied on the questions raised implicating “the integrity of the bankruptcy process.”
- ◆ *Global Industrial* represents a broad view of insurer standing.



# Insurer Standing in Bankruptcy Proceedings *(cont.)*

- ◆ In a subsequent opinion, the Third circuit held that an insurer did not have standing because the alleged injury was too speculative.
  - ◆ See *W.R. Grace & Co. v. Garlock Sealing Techs., LLC*, 532 Fed. Appx. 264, 267 (3d Cir. Del. 2013)
  - ◆ Alleged injury was that the plan may reduce future contribution payments and setoff amounts
- ◆ Recent Seventh circuit opinion held that excess insurer lacked standing to challenge a settlement between the debtor and another party because insurer could only show “it may suffer collateral damage” from the settlement.
  - ◆ See *In re C.P. Hall Co. v. Columbia Casualty Co.*, 2014 U.S. App. LEXIS 7741 (7th Cir. Ill. Apr. 24, 2014).

# Insurer Standing in Bankruptcy Proceedings *(cont.)*

- ◆ Insurer Standing in light of *Global Industrial, W.R. Grace, and C.P. Hall*
- ◆ Key factor for insurer standing = direct pecuniary interest
  - ◆ Allegations of increased claims or administrative costs (*Global Industrial*)
  - ◆ Direct interference or abrogation of contractual rights (see *In re Thorpe Insulation Co.*, 677 F.3d 869 (9th Cir. 2012))
- ◆ No insurer standing where speculative future injury is alleged or debtor's action is not intended to affect insurer
  - ◆ See *W.R. Grace* and *C.P. Hall*

# “Insurance Neutrality” of a Plan

- ◆ Sample “Insurance Neutrality” Provision from *In re Combustion Eng'g, Inc.*, 391 F.3d 190, n.26 (3d Cir. Del. 2004) –
  - ◆ “Nothing in the Plan or in the Confirmation Order shall preclude any Entity from asserting in any proceeding any and all claims, defenses, rights or causes of action that it has or may have under or in connection with any Subject Insurance Policy or any Subject Insurance Settlement Agreement. Nothing in the Plan or the Confirmation Order shall be deemed to waive any claims, defenses, rights or causes of action that any Entity has or may have under the provisions, terms, conditions, defenses and/or exclusions contained in the Subject Insurance Policies and the Subject Insurance Settlement Agreements, including, but not limited to, any and all such claims, defenses, rights or causes of action based upon or arising out of Asbestos PI Trust Claims that are liquidated, resolved, discharged, channeled, or paid in connection with the Plan.”

## “Insurance Neutrality” of a Plan *(cont.)*

- ◆ Such a provision represents that the Plan does not alter insurers’ existing obligations under the relevant insurance policies.

### Implications for Insurer Standing

- ◆ In *Combustion Engineering*, the court held “that certain insurers there did not have appellate standing to challenge a plan calling for them to fund an asbestos trust because the plan, through its ‘neutrality’ provision, neither increased the insurers’ pre-petition obligations nor impaired their pre-petition contractual rights under the subject insurance policies.” *Global Industrial*, 645 F.3d at 212 (discussing *Combustion Engineering*).
  - ◆ The plan was insurance neutral because it did not “materially alter the quantum of liability that the insurers would be called to absorb.” *Id.*

# Application of Automatic Stay to Insurance Programs and Policies

- ◆ Insurance policies are generally deemed to be assets of the bankruptcy estate, while the proceeds of those policies may or may not be estate property
- ◆ First party claims—where the Debtor is the claimant (*i.e.*, property policies)—must continue to be handled and paid in the ordinary course
- ◆ Third party claims—where the Debtor is the defendant—generally cannot be litigated, settled or paid absent further order of the court; however, there are some safety valves and exceptions
- ◆ Directors & officers liability claims present a hybrid scenario: first party claims asserted by the Debtor, and third party claims asserted by the directors and officers

# Does the Insurance Policy Belong to the Bankruptcy Estate?

- ◆ **General Rule: Yes**

- ◆ *In re Vitek*, 51 F.3d 530, 533 (5th Cir. 1995)

- ◆ *MacArthur v. Johns-Manville Corp.*, 837 F.2d 89 (2d Cir. 1988)

# Why Does the Insurance Policy Generally Belong to the Bankruptcy Estate?

- ◆ Reasons underlying the general rule:
  - ◆ *In re Titan Energy, Inc.*, 837 F.2d 325 (8th Cir. 1988)
  - ◆ *First Fidelity Bank v. McAteer*, 985 F.2d 114 (3d Cir. 1993)
  - ◆ *In re Soliz*, 77 B.R. 93 (Bankr. N.D. Tex. 1987)

# Do the Proceeds of the Policy Belong to the Estate?

- ◆ Ownership of the Policy Doesn't Necessarily Mean Ownership of Proceeds:
  - ◆ *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391, 1399 (5th Cir. 1987)
- ◆ Test: Does Debtor Have Right to Receive and Keep Proceeds When Insurer Pays Claim?
  - ◆ *In re: Edgeworth*, 993 F.2d 51 (5th Cir. 1993)



# Types of Policies

- ◆ **Property Insurance:**

- ◆ *Bradt v. Woodlawn Autoworkers, F.C.U.*, 757 F.2d 512 (2d Cir. 1985)
- ◆ *Holland America Ins. Co. v. Succession of Roy*, 777 F.2d 992 (5th Cir. 1985)
- ◆ *In re Woods*, 97 B.R. 850 (Bankr. W.D. Va. 1989)

# Types of Policies *(cont.)*

- ◆ **Liability Insurance:**

- ◆ *Baez v. Med. Liab. Mut. Ins. Co.* (Bankr. S.D.N.Y. 1992)
- ◆ *First Fidelity Bank v. McAteer* (3d Cir. 1993)
- ◆ *Trignali v. Hathaway Machinery Co.* (1<sup>st</sup> Cir. 1986)

# Director and Officer Liability Insurance Proceeds

- ◆ Insurance policies, even for D/O Insurance, are property of the debtor's bankruptcy estate pursuant to section 541.
- ◆ However, the proceeds of the D/O insurance may be used for directors' and officers' legal fees in shareholder litigation, notwithstanding the company's bankruptcy case. *See In re MF Global Holdings Ltd.*, 469 B.R. 177 (Bankr. S.D.N.Y. 2012).
  - ◆ In MF Global class action plaintiffs sought to reserve such insurance proceeds to satisfy any judgment obtained in the litigation against the directors and officers for wrongdoing.
  - ◆ The court held in favor of the directors and officers because, *inter alia*, the primary purpose of the policies was to protect their interest and not corporate protection.

# Types of Policies *(cont.)*

- ◆ D&O Insurance
- ◆ Side A & Side B Coverage: Policy Proceeds Payable To Ds & Os – Not Assets of Estate
  - ◆ *In re Louisiana World Exposition, Inc.*, **832 F.2d 1391, 1399** (5th Cir. 1987)
  - ◆ *In re Minoco Group*, 799 F.2d 517 (9th Cir. 1989)

# Types of Policies *(cont.)*

- ◆ D&O Insurance
  - ◆ Side A, Side B & Side C Coverage: Policy Proceeds Payable to Debtor – Assets of Estate; Stay Has to be Modified
    - ◆ *In re CyberMedica, Inc.* (Bankr. D. Mass. 2002)
    - ◆ *In re Adelphia Communications Corp.*, 285 B.R. 580, 593 (Bankr. S.D.N.Y. 2002) (rev'd 298 B.R. 49) (S.D.N.Y. August 25, 2003). (On remand, the Bankruptcy Court enjoined the declaratory judgment action commenced by Adelphia's insurers with respect to rescission and discovery issues, but rested its decision on Bankruptcy Code Section 105(a) rather than Section 362. 2003 WL 22945634 (Bankr. S.D.N.Y. Dec. 5, 2003)).
    - ◆ *In re Eastwind Group, Inc.*, 303 B.R. 743 (Bankr. E.D. Pa. 2004)

# Bankruptcy of a Primary Insurer and the Effect on Excess Coverage

- ◆ What are the coverage obligations of an Excess Insurer when a Primary Insurer files for bankruptcy?
- ◆ When will an Excess Insurer be required to “drop down” its coverage limits to make up for an insolvent Primary Insurer’s coverage?

# General Rule

- ◆ When a Primary Insurer becomes insolvent, the issue of whether an Excess Insurer is liable only for a claim amount in excess of the retained limits or whether the Excess Insurer's coverage "drops down" to that of the Primary Insurer is to be determined by the language of the Excess Policy.

# Two General Scenarios Prompting “Drop Down” Coverage Analysis

- ◆ The language of the Excess Policy contemplates the possibility of the Primary Insurer’s insolvency, OR
- ◆ The language of the Excess Policy is silent on the possibility of the Primary Insurer’s insolvency.



# When the Excess Policy Contains Language Insurer Contemplating a Primary Insurer's Insolvency

- ◆ Generally, courts will respect Excess Policy provisions articulating the rights and obligations of the parties in the event of a Primary Insurer's insolvency.

# Example: Policy Language Expressly Forbidding “Drop Down” Coverage

- ◆ *Louisiana Ins. Guar. Ass’n v. Int’l Ins. Co.*, 551 So.2d 50 (La. Ct. App. 1989):
  - ◆ In the event there is no recovery available to the insured as a result of the bankruptcy or insolvency of the underlying insurer, the coverage hereunder shall apply in excess of the applicable limit of liability.

# Example: Policy Language Expressly Forbidding “Drop Down” Coverage *(cont.)*

- ◆ *Gibson v. Kreihs*, 538 So.2d 1057 (La. Ct. App. 1989):
  - ◆ In the event there is no recovery available to the insured as a result of the bankruptcy or insolvency of the underlying insurer, the coverage hereunder shall apply in excess of the applicable limit of liability [\$1,000,000] specified in the Schedule A.

# When the Excess Policy Insurer Is Silent on a Primary Insurer's Insolvency

- ◆ Split in Authority:
  - ◆ Majority view: Absence of express language excluding “drop down” coverage is insufficient to create ambiguity to be resolved in favor of Insured.
  - ◆ Minority view: Language concerning “collectible” underlying insurance is ambiguous so as to be interpreted in favor of the Insured.

# Majority View: Absence of “Drop Down” Language Does Not Create Ambiguity

- ◆ *Metropolitan Leasing, Inc. v. Pacific Employers Ins. Co.*, 633 N.E.2d 434 (Mass. App. Ct. 1994):
  - ◆ “[A] mere failure of the excess policy to deal with the consequences of insolvency does not, by itself, create ambiguity.”
  - ◆ Follow form language “means only that the policy covers the same risks as the underlying insurer, and has nothing to do with the excess policy’s lower limits or the events which trigger its applicability.”

# Minority View: “Collectible Insurance” Language Creates Ambiguity

- ◆ *Alabama Ins. Guar. Ass’n v. Magic City Trucking Service, Inc.*, 547 So.2d 849 (Ala. 1989):
  - ◆ Definition of Underlying limit: “an amount equal to the limits of liability indicated beside the underlying insurance listed in the schedule of underlying insurance, plus the applicable limits of any other underlying insurance *collectible* by the insured.”
  - ◆ Holding: If there is no *collectible* underlying coverage, then the excess coverage “drops down” to fill the gap.

# Majority View: Absence of “Drop Down” Language Does Not Create Ambiguity *(cont.)*

- ◆ *Alaska Rural Elec. Co-op Ass’n, Inc., v. INSCO Ltd.*, 785 P.2d 1193 (AK 1990):
  - ◆ If other *valid and collectible insurance*, which is written by another insurer is available to the Insured covering a loss also covered by this policy, other than insurance that is in excess of this policy, the insurance afforded by this policy shall be in excess of and shall not contribute with such other insurance.

# Self-Insured Retentions and “Drop Down”

- ◆ Insurers are not generally required to “drop down” and pay a self-insured retention when the Insured declares bankruptcy.
  - ◆ *Kleban v. National Union Fire Ins. Co. of Pittsburgh*, 771 A.2d 39 (Pa. Super. Ct. 2001)

*Home Ins. Co. of Illinois v. Hooper*, 691 N.E.2d 65, 294 Ill. App. 3d 626 (Ill. App. 1998)



# Preclusive Effect of Filing A Proof of Claim

- ◆ Insurers have routinely made the argument that a creditor's filing of a proof of claim in a bankruptcy proceeding, or its failure to do so, has a preclusive effect on subsequent attempts to reach and recover from available insurance.
- ◆ 3 Scenarios
  - ◆ i) a creditor fails to file a proof of claim
  - ◆ ii) a claim is filed, but subsequently disallowed by the bankruptcy court; and
  - ◆ iii) a claim is allowed during the course of the bankruptcy proceedings

# Preclusive Effect of Filing A Proof of Claim *(cont.)*

- ◆ It has widely been held that the allowance or disallowance of a claim is considered a final judgment for purposes of *res judicata*.
  - ◆ See *In re Los Gatos Lodge, Inc.*, 278 F.3d 890, 894 (9th Cir. 2002) (“Proofs of claims themselves are not final judgments giving rise to *res judicata*, but the bankruptcy court’s allowance or disallowance of a proof of claim is a final judgment.”); *Bank of Lafayette v. Baudoin (In re Baudoin)*, 981 F.2d 736, 742 (5th Cir. 1993).
- ◆ However, no preclusive effect is given to a disallowed proof of claim when the debtor’s bankruptcy case is dismissed without discharge. See *Mirzai v. Kolbe Foods, Inc. (In re Mirzai)*, 271 B.R. 647, 652 (C.D. Cal. 2001).

# Preclusive Effect of Filing A Proof of Claim *(cont.)*

- ◆ Interpreting the disallowance of a claim as extinguishing the underlying debt on which the insurer could be liable, **some** courts bar creditors whose claims have been disallowed from commencing actions against the debtor's insurer.
  - ◆ *See Bursch v. Beardsley & Piper*, 971 F.2d 108, 114 (8th Cir. 1992) (“Where a claim is disallowed, however, the debt is not recognized and the creditor is unable to share in any distribution of the debtor’s assets. . . . In this situation, an insurer cannot be derivatively liable for the debt because the debtor was never principally liable for it.”).
- ◆ **Other** courts have permitted the claimant to proceed nominally against the debtor to collect available insurance proceeds even where a claim has been disallowed by the bankruptcy court.
  - ◆ *See Hawxhurst v. Pettibone Corp.*, 40 F.3d 175, 179 (7th Cir. 1994).

# Preclusive Effect of Filing A Proof of Claim *(cont.)*

- ◆ Distinguishing between disallowance of a claim on the merits, as opposed to procedural disallowance
  - ◆ The doctrine of *res judicata* applies when an action has been previously adjudicated on the merits.
    - ◆ See *Hawxhurst*, 40 F.3d at 180 (“In order for *res judicata* to apply, there must be (1) a final judgment on the merits in a prior action; (2) identity of the cause of action in both the prior and subsequent suits; and (3) identity of the parties or privies in these suits.”).

# Preclusive Effect of Filing A Proof of Claim *(cont.)*

- ◆ Distinguishing between disallowance of a claim on the merits, as opposed to procedural disallowance
  - ◆ *Res judicata* does **not** apply when, as in *Hawxhurst*, the claim was disallowed **on procedural grounds as untimely**, and therefore, the Bankruptcy Court never adjudicated the claim on the merits.
    - ◆ See also *U.S. v. Coast Wineries, Inc.*, 131 F.2d 643, 648-49 (9th Cir. 1942) (“[T]he distinction must be noted between disallowance of a claim because the creditor had a nonprovable debt and disallowance because he had no debt at all. Disallowance on the former ground decides nothing as to the merits of the claim.”).

# Preclusive Effect of Filing A Proof of Claim *(cont.)*

- ◆ With respect to claims which have been **allowed** by a bankruptcy court, while hardly a universal rule, one court has held that such allowance does not bind the debtor's insurer in a subsequent action on either liability or damages.
  - ◆ See *Wolkowitz v. Redland Ins. Co.*, 112 Cal. App. 4th 154, 165-66 (Cal. Ct. App. 2003) (“A liability insurer has no obligation to appear in bankruptcy court on its own behalf and in its own name to object to a claim against an insured debtor. An insurer’s obligation under a liability insurance policy is to defend and indemnify the insured in accordance with the provisions of the policy. If the insured elects to not oppose or defend against a bankruptcy claim and the bankruptcy trustee agrees with the claimant that the claim should be allowed, the insurer has no obligation to object to the claim on its own behalf.”).

# Preclusive Effect of Filing A Proof of Claim *(cont.)*

- ◆ With respect to claims which have been **allowed** by a bankruptcy court, while hardly a universal rule, one court has held that such allowance does not bind the debtor's insurer in a subsequent action on either liability or damages.
  - ◆ *See also First Fidelity Bank v. McAteer*, 985 F.2d 114, (3d Cir. 1993) (where the amount of a debt owed to a creditor was crammed down in the debtor's plan, the Third Circuit held that "the creditor remains free to collect the full amount of the original obligation from any non-debtor party such as a guarantor or insurer").

# Preclusive Effect of Filing A Proof of Claim *(cont.)*

## ◆ Summary

- ◆ the failure of a party to file a proof of claim in the bankruptcy proceedings will not preclude the party from filing a subsequent action against the debtor, nominally, in order to pursue recovery from available insurance proceeds.
- ◆ Regarding claims allowed and disallowed during the course of the bankruptcy proceedings, the chief consideration is whether the claim was adjudicated **on the merits**, or whether it was allowed or disallowed **as a matter of procedure**.
- ◆ In the case of the former, the insurer will have a significantly more persuasive argument that a subsequent action against the debtor and insurer should be barred by the doctrine of *res judicata*.



# Discharge, Post-confirmation Injunctions, and Non-Debtor Releases

- ◆ Section 1141(d)(1) of the Bankruptcy Code provides, among other things, that the confirmation of a plan “discharges the debtor from any debt that arose before the date of such confirmation.” 11 U.S.C. § 1141(d)(1).
- ◆ Section 524(a) enjoins against the commencement or continuation of an action to recover any debts that have been discharged in the bankruptcy case.

# Discharge, Post-confirmation Injunctions, and Non-Debtor Releases *(cont.)*

- ◆ However, section 524(e) of the Bankruptcy Code specifically provides that “discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.” 11 U.S.C. § 524(e).
- ◆ Accordingly, the discharge and injunction granted to a debtor under a chapter 11 plan do not prevent the debtor’s creditors from seeking recovery against related parties, such as directors, officers, shareholders, guarantors, sureties, or joint-tortfeasors—or the debtor’s insurers.
- ◆ See, e.g., *Bituminous Ins. Co. v. Chapman (In re Coho Resources)*, 345 F.3d 338, 342-43 (5th Cir. 2003) (“The discharge and injunction . . . are expressly designated to protect only the debtor”); *Green v. Welsh*, 956 F.2d 30, 35 (2d Cir. 1992) (““§ 524 permits a plaintiff to proceed against a discharged debtor solely to recover from the debtor’s insurer.”).

# Discharge, Post-confirmation Injunctions, and Non-Debtor Releases *(cont.)*

- ◆ Even where a party has failed to file a proof of claim in a debtor's bankruptcy case, courts have held that the party may still pursue a state court action against the debtor, nominally, to recover against insurance policy proceeds.
  - ◆ See *In re Jet Florida Systems, Inc.*, 883 F.2d 970, 976 (11th Cir. Fla. 1989) (“[P]ursuant to section 524(e), a plaintiff may proceed against the debtor simply in order to establish liability as a prerequisite to recover from another, an insurer, who may be liable.”)
  - ◆ See also *Bituminous Ins. Co. v. Chapman (In re Coho Resources)*, 345 F.3d at 343 (5th Cir. 2003) (explaining that, while a party's failure to file a proof of claim barred his claims against the debtor personally, “it does not affect his claims against non-debtors, such as general liability insurers”).

# Discharge, Post-confirmation Injunctions, and Non-Debtor Releases *(cont.)*

- ◆ However, some bankruptcy courts have approved releases of claims against non-debtor third parties in the context of approving settlement agreements with the debtor.
  - ◆ *See, e.g., McArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89 (2d Cir. 1988).
- ◆ In certain circumstances, these settlements have also enjoined claimants from bringing suits against the non-debtor, third-party releasees, where the claims are derivative of the debtor's own claims that are being settled. *See, e.g., In re Energy Corp., Inc.*, 886 F.2d 921, 929 (7th Cir. 1989) (“The power of the court under [section 105(a)] . . . includes the power to issue an injunction enjoining third parties from pursuing actions which are the exclusive property of the debtor estate and are dismissed pursuant to a settlement agreement.”).

# Discharge, Post-confirmation Injunctions, and Non-Debtor Releases *(cont.)*

- ◆ Additionally, the debtor's plan of reorganization and bankruptcy court's order confirming the plan may enjoin suits against non-debtor parties, including insurers. *See, e.g., Menard-Sanford v. Mabey (In re A.H. Robins Co., Inc.)*, 880 F.2d 694 (4th Cir. 1989).

# Discharge, Post-confirmation Injunctions, and Non-Debtor Releases *(cont.)*

- ◆ On the other hand, the Ninth and Tenth Circuit Courts of Appeal read Section 524(e) as precluding a bankruptcy court from granting third party releases and injunctions unless specifically authorized under the Bankruptcy Code.
  - ◆ See *In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995); *In re Western Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990) (temporary, but not permanent, injunctive relief may be granted).
- ◆ The Fifth Circuit also appears to agree with the Ninth and the Tenth, holding that while temporary injunctions may be allowed, Section 105(a) may not be used to impose a permanent third-party injunction or releases.
  - ◆ See *In re Zale Corp.*, 62 F.3d 746, 761 (5th Cir. 1995).

# Post-*Stern* Litigation Issues

- ◆ The Supreme Court decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011) requires that pure state law claims be decided by an Article III court or appropriate state court.
- ◆ Thus, a bankruptcy court may not enter a final judgment in a “state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor’s proof of claim in bankruptcy.” *Stern*, 131 S. Ct. at 2611.
- ◆ Bankruptcy courts arguably lack constitutional authority to issue final judgments with respect to state law breach of contract claims and state statutory claims in 2-party disputes. *Id.*

## Post-*Stern* Litigation Issues *(cont.)*

- ◆ Bankruptcy courts may not have constitutional authority to enter final judgments in disputes relating to insurance coverage of certain claims.
  - ◆ *See, e.g., Salem Baptist Church of Jenkintown v. Fed. Ins. Co. (In re Salem Baptist Church of Jenkintown)*, 455 B.R. 857, n.6 (Bankr. E.D. Pa. 2011)



# Contact Us



**Jonathan W. Young**  
Edwards Wildman Palmer LLP  
Chicago, IL  
312.201.2662  
[jyoung@edwardswildman.com](mailto:jyoung@edwardswildman.com)



**John D. Hughes**  
Edwards Wildman Palmer LLP  
Boston, MA  
617.951.3373  
[jhughes@edwardswildman.com](mailto:jhughes@edwardswildman.com)



**Michael B. Kind**  
Edwards Wildman Palmer LLP  
Chicago, IL  
312.201.2392  
[mkind@edwardswildman.com](mailto:mkind@edwardswildman.com)