Insurance Issues in Bankruptcy

American College of Coverage Counsel
2021 Annual Meeting

Intercontinental Chicago
September 22-24, 2021

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INTRODUCTION[1]

This paper discusses several of the issues that liability insurers and their insureds may encounter in a corporate bankruptcy. Section I of this paper provides an overview of the federal bankruptcy process, highlighting some of the areas in which insurance disputes could arise. Section II of this paper discusses how courts have resolved disputes as to whether defense expenses paid under a debtor's liability insurance policy constitute property of the bankruptcy estate that are subject to the automatic bankruptcy stay. Section III of this paper discusses the standards that apply to whether the settlement of a coverage dispute between an insurer and its insured is reasonable and, therefore, will be approved by the bankruptcy court. Section IV of this paper discusses the effect on coverage when a bankrupt insured is unable to satisfy a self-insured retention ("SIR").

I. The Role of Insurance in the Federal Bankruptcy Process

The United States Bankruptcy Code, 11 U.S.C. § 101, *et seq*. ("Bankruptcy Code") provides for two types of corporate bankruptcies: a "reorganization" bankruptcy brought under chapter 11 of the Bankruptcy Code and a "liquidation" bankruptcy brought under chapter 7 of the Bankruptcy Code.

A. Chapter 11 Bankruptcy

When a company files a chapter 11 bankruptcy case, its goal is to obtain court approval of a plan of reorganization by which the company will pay its creditors with its assets, thereby

[1] The authors' views are their own and not that of their firms or their clients. Further, each individual author does not necessarily agree with everything in this paper, which is a joint project and which necessarily contains portions that were authored by the other panelist.

discharging its pre-filing debts and liabilities. *See* 11 U.S.C. § 1101, *et seq*. During the chapter 11 bankruptcy process, the debtor will continue to operate its business. However, upon the filing of a bankruptcy case, an automatic stay applies to current and future litigation against the debtor. *See* 11 U.S.C. §362(a). While the stay is in effect, no person or entity may seek possession or control over estate property, including disbursement of the debtor's insurance assets, without relief from the automatic stay. *See id*. Disputes as to whether a particular insurance asset constitutes property of the bankruptcy estate can pose challenges for a debtor's liability insurers that may be obligated to make payments under a policy but want to avoid violating the stay.

The bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Courts are in agreement that a debtor's insurance policies are considered property of the bankruptcy estate. *See,e.g., In re Diocese of Buffalo, N.Y.*, 626 B.R. 866, 869 (Bankr. W.D.N.Y. 2021); *In re Federal-Mogul Global Inc*., 385 B.R. 560 (Bankr. D. Del. 2008). Indeed, insurance policies are often the most valuable asset of a bankruptcy estate. *See In re Louisiana World Exposition*, 832 F.2d 1391, 1399 (5th Cir. 1987). However, in determining whether the proceeds of an insurance policy are property of the bankruptcy estate, courts will consider "the language and scope of the specific policies at issue." *In re MF Glob. Holdings Ltd*., 469 B.R. 177, 190 (Bankr. S.D.N.Y. 2012). Courts also will consider "the facts of each particular case, focusing primarily upon the terms of the actual policy itself." *In re Medex Reg'l Labs., LLC*, 314 B.R. 716, 720 (Bankr. E.D. Tenn. 2004).

A company that is facing significant mass tort liabilities may file a chapter 11 bankruptcy case to manage those liabilities. In a chapter 11 bankruptcy involving asbestos claims, the debtor can seek to invoke the protections of section 524(g) of the Bankruptcy Code, 11 U.S.C. § 524,

which permits the debtor to resolve its asbestos liabilities by channeling present and future claims into a trust funded by the debtor and other enjoined parties. The debtor's tort-related assets, including its liability insurance policy proceeds, will be transferred to the trust to provide funding for the channeled tort claims after the debtor's plan is confirmed. The protection of a channeling injunction can extend to the debtor's insurers in addition to the debtor. *See* 11 U.S.C. § 524(g)(4)(A)(ii)(III).

Although section 524(g) applies only to asbestos claims, trusts and channeling injunctions may also be available to debtors facing mass torts that do not include exposure to asbestos or a product of the debtor that contains asbestos. Such injunctions are issued pursuant to section 105 of the Bankruptcy Code, 11 U.S.C. § 105. As a general matter, a debtor's non-asbestos liabilities can be channeled under section 105(a) in "extraordinary circumstances," if such an injunction is: (1) fair; (2) necessary for the reorganization; and (3) specific findings of fact support these conclusions. *See Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 214 (3d Cir. 2000).

In a mass tort bankruptcy, the reorganization plan must account for claims brought by current and unknown future tort claimants. After a chapter 11 bankruptcy case is filed, the Office of the United States Trustee will likely form an official tort claimants' committee consisting of individual claimants with tort claims against the debtor. A separate committee may be formed to represent the interests of future tort claimants who have not manifested an injury due to the debtor's alleged tortious conduct, but may do so in the future. The committees' members owe fiduciary obligations to all tort claimants represented by the committee.

Debtors in mass tort cases often seek to use the proceeds of commercial general liability ("CGL") policies to fund the trust that will be used to pay present and future tort claims.

Because CGL policies are triggered if bodily injury occurs during the policy period, regardless of when the claim is made, policies issued many years before the chapter 11 filing often will be included in the trust. Coverage disputes among claimants' committees, the debtor, and its insurers regarding trigger of coverage, number of occurrences, applicability of aggregates and deductibles, availability of excess coverage, allocation of losses across multiple policy periods, and numerous other issues are common.

Insurers may also be willing to negotiate a policy buy-back settlement with the debtor to secure finality through the protection of a channeling injunction. Any such settlement must be approved by the bankruptcy court. Disputes among the various bankruptcy stakeholders, such as the debtor, its creditors, and current and future tort claimant committees, can complicate the approval process.

Depending on the terms of the plan, the creditors' committees may be entitled to proceed directly against the debtor's liability insurance policies. Also, a bankruptcy court may lift the automatic stay before a plan is confirmed to permit a pre-petition tort claimant to continue its suit against the debtor to the extent of the debtor's liability insurance coverage. This situation can lead to coverage disputes that are unique to bankruptcy, such as whether the debtor's inability to satisfy an SIR relieves the insurer of its coverage obligations.

B. Overview of the Chapter 7 Process

As an alternative to a chapter 11 bankruptcy, a debtor can bring a bankruptcy case under chapter 7 of the Bankruptcy Code, 11 U.S. Code § 701 *et seq*. In a chapter 7 bankruptcy, the bankruptcy court will appoint a trustee to liquidate the debtor's unencumbered assets to pay its creditors and the debtor will cease operations. Because the trustee essentially "steps into the debtor's shoes," the trustee holds all of the rights of the insured under the debtor's insurance

policies and also has a claim to receive any payments that the debtor would have received. *See In re Minh Vu Hoang,* 469 B.R. 606, 616 (D. Md. 2012).

As with a chapter 11 bankruptcy, an automatic stay applies to current and future litigation and any act to obtain possession of estate property. *See* 11 U.S.C. §362(a). A bankruptcy court may lift the automatic stay to permit a pre-petition tort claimant to continue its suit against the debtor to the extent of the debtor's liability insurance coverage. *See Home Ins. Co. of Illinois v. Hooper*, 294 Ill. App. 3d 626, 629 (1st Dist. 1998).

II. Payment or Advancement of Defense Costs

The bankruptcy trustee, creditors, and/or claimants against the insureds may challenge payment or advancement of defense costs under the debtor insured's policy, arguing that the policy and its proceeds are estate property under 11 U.S.C. § 541(a)(1) and therefore subject to the automatic stay. Section 541(a) of the Bankruptcy Code defines property of the estate as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Section 362(a)(3) of the Bankruptcy Code stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). The automatic stay in bankruptcy applies to any action in connection with estate property, which will require relief from the automatic stay by the bankruptcy court before making any payments of estate property. The automatic stay will remain in effect until case closure or until the stay is terminated and replaced as part of a bankruptcy plan.

In the third party liability context, cases finding that a debtor that qualifies as an insured under a liability policy has an equitable interest in the proceeds have generally done so through

one or more of three general theories.[2] First, the language of a particular policy might afford the inured an equitable interest if the proceeds of that policy are payable directly to the debtor. *See, e.g., Unsecured Creditors Disbursement Comm. v. Antill Pipeline Constr. Co.* (*In re Equinox Oil Co., Inc.*), 300 F.3d 614, 619 (5th Cir. 2002). Second, a court might conclude that the debtor has an equitable interest in the insurance policy based simply on the fact that the debtor is the named insured on the policy. *See, e.g., Homsy v. Floyd* (*In re Vitek. Inc.*), 51 F.3d 530, 534 (5th Cir. 1995) ("[V]irtually every court to have considered the issue has concluded that the policies—and clearly the proceeds of those policies—are part of debtor's bankruptcy estate, irrespective of whether those policies also provide liability coverage. . . . Most courts do not even recognize a technical distinction between ownership of insurance policies and ownership of the proceeds of those policies: They simply conclude that such policies—and, by implication, the proceeds of such policies—are valuable properties of debtors' bankruptcy estates.") (citations omitted). Third, a court could determine that the estate is worth more with the insurance policy proceeds included than without, and therefore the debtor has an equitable interest in seeing that the proceeds are paid and applied to claims against the estate. *See, e.g., A.H. Robins Co. v. Piccinin* (*In re A.H. Robins Co.*), 788 F.2d 994, 1001-02 (4th Cir. 1986) ("Any action in which the judgment may diminish this 'important asset' is unquestionably subject to a stay. . . .").

This issue is largely settled for Side A coverage in the D&O context, which the majority of courts have concluded is not property of the estate. *See, e.g., In re La. World Exposition, Inc.*, 832 F.2d 1391, 1399 (5th Cir. 1987); *see also In re Youngstown Osteopathic Hosp. Ass'n*, 271 B.R. 544, 548-550 (Bankr. N.D. Ohio 2002) ("Courts have held… that if a debtor does not have

[2] In the first party context, policies and their proceeds are property of the bankruptcy estate because the proceeds are paid directly to the debtor. *See, e.g., Hous. v. Edgeworth* (*In re Edgeworth*), 993 F.2d 51, 55 (5th Cir. 1993).

a direct interest in the proceeds of the insurance policy, the insurance proceeds are no longer property of the debtor's estate."; "D & O policies are obtained for the protection of individual directors and officers. Indemnification coverage does not change this fundamental purpose.") (quotations omitted). However, individualized analysis of the D&O coverage and respective rights remains necessary otherwise. *See, e.g.*, *In re Medex Reg'l Labs., LLC*, 314 B.R. 716, 720 (Bankr. E.D. Tenn. 2004) ("In making its determination, the court must analyze the facts of each particular case, focusing primarily upon the terms of the actual policy itself."); *In re CyberMedica, Inc.*, 280 B.R. 12, 16 (Bankr. D. Mass. 2002) ("Whether the proceeds of a D & O liability insurance policy is property of the estate must be analyzed in light of the facts of each case.")

To the extent that the automatic stay in bankruptcy impacts the insurer's ability to pay defense costs, the insurer and defense counsel for the insured will often coordinate with respect to a motion to the bankruptcy court to approve paying or advancing the defense costs. The so-called "comfort order" might be for a specified amount of defense costs, necessitating seriatim comfort orders as the defense invoices exhaust the approved amounts, or require periodic reporting. *See, e.g.*, *In re Bos. Reg. Med. Ctr., Inc.*, 285 B.R. 87, 94 (Bankr. D. Mass. 2002) (expressly authorizing only an interim payment of expert costs); *In re IFC Credit Corp*., 422 B.R. 659, 665 (Bankr. N.D. Ill. 2010), *aff'd sub nom. In re IFC Credit*, 458 B.R. 911 (N.D. Ill. 2011) (requiring periodic accounting of amounts requested and policy proceeds disbursed).

III. Settlement of Claims Involving Debtor's Policy

If the debtor settles a claim or is otherwise providing a release, the debtor must seek bankruptcy court approval pursuant to Bankruptcy Rule 9019. Bankruptcy Rule 9019(a) provides, in relevant part, that: "[o]n motion by the trustee and after notice and a hearing, the

court may approve a compromise or settlement." Fed. R. Bankr. P. 9019(a). Compromises and settlements are "a normal part of the process of reorganization." *See Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968) (quoting *Case v. L.A. Lumber Prods. Co*., 308 U.S. 106, 130 (1939)).

To approve a compromise and settlement under Bankruptcy Rule 9019, a bankruptcy court must find that the compromise and settlement is fair and equitable, reasonable and in the best interests of the debtor's estate. *See, e.g.*, *In re Ionosphere Clubs, Inc*., 156 B.R. 414, 426 (S.D.N.Y. 1993), *aff'd*, 17 F.3d 600 (2d Cir. 1994) (citations omitted). The decision to approve a particular settlement lies within the sound discretion of the bankruptcy court. *Nellis v. Shugrue*, 165 B.R. 115, 122-23 (S.D.N.Y. 1994). In exercising its discretion, the bankruptcy court must make an independent determination that the settlement is fair and reasonable. *Id*. at 122. The court may consider the opinions of the debtor in possession and its counsel that the settlement is fair and reasonable. *Id*.; *see In re Purofied Down Prods. Corp*., 150 B.R. 519, 522 (S.D.N.Y. 1993).

In deciding whether a particular settlement falls within the "range of reasonableness," courts consider the following factors:

(a) the probability of success in the litigation;

(b) the difficulties associated with collection;

(c) the complexity of the litigation, and the attendant expense, inconvenience and delay; and

(d) the paramount interests of creditors.

Id. (citing *Drexel v. Loomis*, 35 F.2d 800, 806 (8th Cir. 1989)); *Six W. Retail Acquisition, Inc. v. Loews Cineplex Ent. Corp*., 286 B.R. 239, 248 n.13 (S.D.N.Y. 2002); *Ionosphere Clubs*, 156

B.R. at 428 ("The 'reasonableness' of a settlement depends upon all factors, including probability of success, the length and cost of the litigation, and the extent to which the settlement is truly the product of 'arms-length' bargaining, and not of fraud or collusion.").

The bankruptcy court may hold an evidentiary hearing to address the required reasonableness factors and any objections to the proposed settlement. *See, e.g., In re Health Diagnostic Lab., Inc.*, Case No. 15-32919 (Bankr. E.D. Va. Oct. 14, 2016) (describing testimony offered by counsel for the Liquidating Trustee at the evidentiary hearing on the motion to approve settlement). Nonetheless, it is often stated that the court is not required to hold a full evidentiary hearing or mini-trial on the merits of the underlying action for the purposes of the settlement approval. *See, e.g., In re Neshaminy Off. Bldg. Assoc's.*, 62 B.R. 798, 803 (Bankr. E.D. Pa. 1986). While it is generally sufficient that the settlement not be "below the lowest point in the range of reasonableness," *United States ex rel. Rahman v. Oncology Assocs., P.C.*, 269 B.R. 139, 149-50 (D. Md. 2001), quoting *Cosoff v. Rodman* (*In re W.T. Grant Co.*), 699 F.2d 599, 608 (2d Cir. 1983), approval is not a foregone conclusion. *See, e.g., Bath Iron Works Corp. v. Congoleum Corp.* (*In re Congoleum Corp.*), 2021 Bankr. LEXIS 10, 2021 WL 28396 (Bankr. D.N.J. Jan. 4, 2021) (denying debtor's motion for approval of settlement agreement pursuant to Bankruptcy Rule 9019, which was conditioned on the Court making findings that could impact litigation in another court).

Objections by the bankruptcy trustee or litigation trustee will not necessarily preclude the Court from approving a proposed settlement, particularly where the basis for the trustee's objections is that the trustee is a competing claimant. *See, e.g., Miller v. McDonald* (*In re World Heath Alts., Inc.*), 369 B.R. 805 (Bankr. D. De. 2007).

To better secure finality, settling parties, including any insurer, may want a "bar order" or injunction as a condition of the settlement. A bar order, which may also be referred to as a "nonconsensual third-party release," or simply as an injunction, is a permanent injunction that prohibits any party from suing a settling defendant for the damages or claims that have been resolved. The purpose of the request for a bar order is to notify all creditors and parties in interest who may have had claims against the insureds that are deemed property of the debtor's estate. Creditors and parties in interest who have claims of the type being settled with the debtor and other insureds can come forward and present their claims or objections before the settlement is finalized and any policy proceeds are distributed. The settlement agreement usually states that it is contingent upon entry of the bar order.

Whether the bankruptcy court has authority to enter such an order in connection with the settlement agreement may be disputed, depending on the potential operation of the proposed bar order and the test applied in the relevant jurisdiction. *Compare In re Munford*, 97 F.3d 449, 452 (11th Cir. 1996) ("11 U.S.C. §105(a) and Federal Rules of Civil Procedure, Rule 16, authorize bankruptcy courts to enter bar orders to facilitate settlements.") *with In re FairPoint Commc'ns Inc*., 452 B.R. 21, 29 (S.D.N.Y 2011) ("a bankruptcy court has jurisdiction to enjoin third party non-debtor claims, *but only to the extent* that those claims 'directly affect' the res of the bankruptcy estate") (emphasis added) *and In re W.R. Grace & Co*., 591 F.3d 164, 172 (3d Cir. 2009) ("that a potential indemnification claim under common law is not enough to establish a bankruptcy court's subject matter jurisdiction.").

For example, in *In re Fraser's Boiler Service, Inc.*, No. 18-41245-BDL (Bankr. W.D. Wash. July 18, 2018), the bankruptcy court approved a "supplemental injunction" as part of settlement agreement to bar non-settling insurers from seeking contribution from settling insurer

that had negotiated for a policy buy-back. However, the district court reversed the bankruptcy court's order and dissolved the injunction, ruling that the Bankruptcy Court's injunction of the non-settling insurers' contribution claims "was inconsistent with § 524(e), which 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.'" *In re Fraser's Boiler Serv., Inc*., No. 3:18-CV-05637-RBL, 2019 WL 1099713, at *3 (W.D. Wash. Mar. 8, 2019), quoting *In re Am. Hardwoods, Inc*., 885 F.2d 621, 625 (9th Cir. 1989). *See also In re CS Dip, LLC*, No. 3:12-bk-01573, Dkt. No. 863, at 17 (Bankr. M.D. Tenn. Oct. 9, 2015) (injunction that would bar bad faith claims by non-debtors was too broad for purposes of court's authority to approve settlement); *In re Arter & Hadden, LLP*, 373 B.R. 31, 37 (Bankr. N.D. Ohio 2007) (holding that the bankruptcy court lacked jurisdiction to approve injunction as part of settlement agreement when several provisions of a settlement agreement were "too pervasive and . . . request[ed] relief far in excess of [the] Court's jurisdiction [] where it [sought] to enjoin actions by any person against non-debtor parties.").

In addition, a channeling order can work together with the bar order so that any future actions against the settling insureds relating to the debtors are brought at any time in the future, they must be initiated in the bankruptcy court. A channeling injunction may also be used to channel future tort claimants to pursue claims solely from a litigation trust funded by the settling parties. *See, e.g.*, *In re TK Holdings*, 17-11375-BLS, Dkt. No. 2120, (Bankr. D. Del. Feb. 21, 2017) (channeling personal injury and wrongful death claims arising from Takata air bags through bankruptcy but expressly not channeling pure economic loss claims); *Class Five Nev. Claimants v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648 (6th Cir. 2002) (approving channeling injunction for purposes of future silicone breast implant claims).

IV. Impact on Coverage of Debtor's Failure to Satisfy SIR

One definition of "SIR" is "[t]he amount of an otherwise-covered loss that is not covered by an insurance policy and that . . . must be paid [by the insured] before the insurer will pay benefits." *Fireman's Fund Ins. Co. v. OneBeacon Ins. Co.*, 495 F. Supp. 3d 293, 297 (S.D.N.Y. 2020) (quoting BLACK'S LAW DICTIONARY (10th ed. 2014)). In the bankruptcy context, the debtor often cannot pay the SIR. In that instance, excess insurers often argue that their coverage obligations have not been triggered because payment of an SIR is a condition precedent to coverage. Whether a debtor's failure to satisfy an SIR relieves the insurer of its coverage obligations often depends on the relevant policy language, state law, and public policy.

Insurance policies often contain "bankruptcy clauses" worded similarly to the following provision: "[b]ankruptcy or insolvency of the named insured . . . shall not relieve the company of any of its obligations hereunder." Courts considering policies containing bankruptcy clauses typically will reject the argument that a bankrupt insured's failure to pay its SIR relieves the insurer of its coverage obligations. *See Gulf Underwriters Ins. Co. v. Burris*, 674 F.3d 999, 1005 (8th Cir. 2012) ("Our research revealed that every court to consider the issue in a State that has enacted such statutes has rejected [the insurer] interpretation of its SIR as a matter either of public policy or of policy interpretation.").

Bankruptcy clauses are required by statute in many states. *See, e.g.*, Ark. Code Ann. § 23-89-102(a); Fla. Stat. § 324.151(c); 215 Ill. Comp. Stat. § 5/388; Md. Code. Ann., Ins. § 19-102(b); Minn. Stat. § 60A.08(6); N.Y. Ins. Law § 3420(a)(1); Va. Code Ann. § 38.2- 2200(1). By way of example, the Illinois Insurance Code provides that an insurance policy cannot be issued in Illinois "unless it contains in substance a provision that the insolvency or bankruptcy of the insured shall not release the company from the payment of damages for injuries sustained or

death resulting therefrom or loss occasioned during the term of such policy . . . .” 215 ILCS § 5/388.

In finding that a bankrupt insured’s failure to satisfy an SIR does not preclude coverage, courts often rely, in part, on state statutes requiring bankruptcy clauses. In one such case, the court in *Home Insurance Co. v. Hooper*, 294 Ill. App. 3d 626 (1st Dist. 1998), held that section 388 of the Illinois Insurance Code, quoted above, precluded an insurer for denying coverage due to its bankrupt insured’s inability to satisfy its SIR. The policy in *Hooper* contained an SIR provision stating that:

> With regard to such insurance as is afforded by this policy, it shall be a condition precedent to the company's liability under this policy that the Named Insured make actual payment, by way of settlement or judgment of damages, of the amount(s) stated in the declarations and in any endorsements thereto as the Named Insured's Self-Insured Retention(s).

See id. at 626. The policy also stated that “[b]ankruptcy or insolvency of the named insured . . . shall not relieve the company of any of its obligations hereunder.”

When the insured in *Hooper* became bankrupt and was unable to satisfy its SIR, the insurer argued that payment of the SIR was a condition precedent to its obligation to pay damages in excess of the SIR. *See id*. at 628. The court disagreed, holding that the insurer was liable for amounts in excess of the SIR, up to the policy limit. *See id.* at 633. In support of its holding, the *Hooper* court observed that enforcing the SIR as a condition precedent to coverage would be “directly contrary to the public policy as declared by the legislative enactment of section 388.” *Id.* at 632. Even though the SIR provision in the policy was “unambiguous,” the court noted that enforcing that language would impermissibly relieve the insurer of its coverage obligations due to the bankruptcy of the insured. As the court continued, “[t]he plain language of section 388 makes clear the legislative intent to prevent insurers from using the insured's

bankrupt condition and resulting inability to make actual payment to satisfy a judgment or any portion thereof as grounds to avoid payment on a policy." *Id*.

Other courts also have held that where a policy contains a bankruptcy clause that is required by state statute, as in *Hooper*, a bankrupt insured's failure to satisfy an SIR will not relieve the insurer of its coverage obligations. *See Admiral Ins. Co. v. Grace Indus., Inc.*, 409 B.R. 275 (E.D.N.Y. 2009) (considering New York statute); *In re Vanderveer Estates Holdings, LLC*., 328 B.R. 18 (Bankr. E.D.N.Y. 2005) (considering Illinois statute); *In re Federal Press Co*., 104 B.R. 56, 62 (Bankr. N.D. Ind. 1989) (considering Indiana statute).

Courts also have considered statutes permitting a tort claimant to sue a bankrupt insured's liability insurer (often referred to as "direct action" statutes) in holding that a bankrupt insured's failure to satisfy its SIR does not relieve the liability insurer of coverage obligations to the tort claimant. *See, e.g., Rosciti v. Ins. Co. of Pennsylvania*, 659 F.3d 92 (1st Cir. 2011). The policy at issue in *Rosciti* stated that the insurer's coverage obligations arose "only after there has been a complete expenditure of [the insured's] retained limit(s) by means of payments for judgments, settlements, or defense costs." *Id*. at 94. The policy also stated that the insured's "bankruptcy, insolvency or inability to pay . . . shall not relieve [the insurer] from the payment of any claim covered by this Policy . . . ." *Id*.

The plaintiff in *Rosciti* was a tort claimant who had sued the insured in a product liability action. When the insured filed for bankruptcy, the claimant brought a direct action against the bankrupt insured's insurer pursuant to a Rhode Island statute that permitted "[a]ny person, having a claim because of damages of any kind caused by the tort of any other person" to sue the alleged tortfeasor's liability insurer "whenever the alleged tortfeasor files for bankruptcy . . . ." *Id*. at 94. As a defense to the tort claim, the insurer argued that it had no coverage obligations

because the bankrupt insured had not satisfied the self-insured retention. The *Rosciti* court disagreed, holding that to permit the insurer to avoid its coverage obligations in a tortfeasor's direct action would violate Rhode Island public policy as set forth in the direct action statute.

In the absence of a bankruptcy insurance statute or a direct action statute, the issue of whether an insured's failure to satisfy its SIR constitutes a coverage defense will depend on the language in the insurance policy at issue. *See, e.g., Pinnacle Pines Cmty. Ass'n v. Everest Nat. Ins. Co.*, No. CV-12-08202-PCT-DGC, 2014 WL 1875166, at *4 (D. Ariz. May 9, 2014) (rejecting insured's argument that "it would offend public policy to permit an insurer to avoid its obligations for a judgment in excess of the SIR when an insured cannot satisfy the SIR due to bankruptcy" because the insured "has not identified—and the Court has not found—such a statute or public policy in Arizona."). Where a policy contains a bankruptcy clause, however, courts typically will not permit an insurer to avoid its coverage obligations due to the insured's failure to satisfy its SIR, even in the absence of a controlling statute. *See id.*; *see also Sturgill v. Beach at Mason Ltd. Partnership*, No. 1:14CV0784 (WOB), 2015 WL 6163787, (S.D. Ohio Oct. 20, 2015) (same).

Not all courts follow the *Pinnacle Pines* approach, with some courts finding that the lack of a statute requiring a bankruptcy clause or allowing a direct action against a bankrupt insured's liability insurer require the court to enforce the SIR provision as drafted, even if that results in a loss of coverage for third-party claimants. *See, e.g., Pak-Mor Mfg. Co. v. Royal Surplus Lines Ins. Co.*, No. SA-05-CA-135-RF, 2005 WL 3487723 (W.D. Tex. Nov. 3, 2005). The *Pak-Mor* policy's bankruptcy condition stated that:

> Bankruptcy, insolvency or any other inability of the insured or of the insured's estate or any other insured to pay the 'Retained Limit' will not increase or otherwise change our obligations under this Coverage Part and our obligations shall continue to apply only in excess of the 'Retained Limit'.

2005 WL 3487723 at *17. The *Pak-Mor* court found this language to be enforceable because Texas had not enacted any statutes addressing the impact of an insured's bankruptcy on its insurer's obligations. Accordingly, unless the debtor could satisfy the SIR, the insurer would not be liable to provide coverage. As the *Pak-Mor* court explained, the analysis under Texas law was different than the analysis of the cases discussed above because "[i]n all those cases, the courts' decisions were virtually compelled by applicable statutes in those states that required insurers to assume liability in the bankruptcy context just as they would outside the bankruptcy context, regardless of what the policies themselves said." *Id*. at *25. As the court continued, "[u]nder Texas law, insurers are free to issue policies that relieve them of liability in the bankruptcy context. This Court is thus not constrained by statutory law in interpreting particular policies that claim to so relieve insurers." *Id*. at *25.

Also applying Texas law, the court in *Associated Electric & Gas Insurance Services Ltd. v. Border Steel Rolling Mills, In*c., No. EP-04-CV-00389-KC, 2005 WL 3068787 (W.D. Tex. Sept. 27, 2005), held that an insurer was relieved of its coverage obligations when its bankrupt insured could not satisfy the SIR. *See id*. at *11. The *Border Steel* court found significant that the policy states that it "shall be excess over the stated limits of the underlying insurance . . . whether collectible or not . . . and regardless of insolvency," and the stated limits included the insured's SIR limits. *Id.* As a result, it concluded that the insurer had no liability absent payment of the SIR, notwithstanding insolvency. *See id.* A court applying Ohio law, which also does not contain a statute addressing an insurer's obligations when a bankrupt insured could not pay the SIR, similarly found that the insurer was not required to provide coverage because the SIR had not been satisfied. *See In re Kismet Prod., Inc*., No. 04-25167, 2007 WL 6872750, at *7 (Bankr. N.D. Ohio Aug. 28, 2007), report and recommendation adopted sub nom. *Kismet Prod.*

v. HCC Benefits Corp., No. 1:07-MC-66, 2007 WL 4180654 (N.D. Ohio Nov. 20, 2007).