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News

FIFTH CIRCUIT COURT OF APPEALS DELINEATES EXCEPTION FOR INSURANCE POLICY PROCEEDS IN BANKRUPTCY PROCEEDINGS

Newsbrief
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Recently, the Fifth Circuit in *In re OGA Charters, L.L.C.*, No. 17-40920, addressed a previously unresolved issue of bankruptcy law regarding the proceeds of a liability insurance policy. In policies where the proceeds are payable to the insured/debtor, such as property & casualty policies, the proceeds of such policies have been held to be property of the bankruptcy estate. Because the proceeds of a liability policy are not payable to the insured/debtor, however, they were historically held not to be property of the bankruptcy estate in the Fifth Circuit. *In re OGA Charters, L.L.C.* has now recognized an exception to the general rule, and has held, in certain circumstances, that proceeds of a liability policy will be deemed property of the bankruptcy estate. This ruling has potentially far-reaching implications on a liability insurer's rights under the *Soriano* doctrine to enter into settlements with some claimants and not others.

OGA Charters operated tour buses in the Rio Grande Valley. OGA was insured by New York Marine and General Insurance Company ("NYM") under a $5 million liability policy. While transporting a group to the Kickapoo Indian Lucky Eagle Casino near Laredo, Texas, an OGA bus overturned and killed 9 people and injured several others. In all, there were approximately 65 wrongful death, personal injury, and survivor claims arising out of the accident and the aggregate value of the various settlement demands exceeded $400 million.

Following a failed attempt to convene a global mediation in which all claimants would be required to participate, NYM advised counsel for the various claimants that it would entertain reasonable individual settlement offers. As a result, defense counsel was able to negotiate settlements with 14 of the claimants, including some of the wrongful death claims, which exhausted the policy proceeds. Before any of the settlements could be funded, however, the non-settling claimants filed a bankruptcy petition to place OGA into involuntary Chapter 7 bankruptcy. The non-settling claimants further obtained an injunction prohibiting the funding of any of the settlements. NYM ultimately placed the $5 million policy proceeds into the registry of the bankruptcy court.

The settling claimants argued that the settlements were valid under the *Soriano* doctrine, in which the Supreme Court of Texas held that "when faced with a settlement demand arising out of multiple claims and inadequate proceeds, an insurer may enter into a reasonable settlement with one of the several claimants even though such settlement exhausts or diminishes the proceeds available to satisfy other claims." *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 316 (1994).

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The non-settling claimants argued that the equitable considerations in bankruptcy should prevail, and that it was unfair for such a large number of claimants to be left without a remedy. The non-settling claimants sought to have the bankruptcy court take possession of the policy proceeds, manage the numerous claims, and arrive at an equitable settlement of all claims. To do so, however, would require the bankruptcy court to find that the proceeds of the NYM liability policy were property of the bankruptcy estate.

Prior to this case, the law in the Fifth Circuit was that proceeds of a liability insurance policy generally are not property of the debtor's bankruptcy estate, because the proceeds are not payable to the debtor. One of the leading cases in the Fifth Circuit was *In re Edgeworth*, 993 F.2d 51, 55-56 (5th Cir. 1993), in which the Court had held:

The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.

Under this framework, the policy itself was property of the Chapter 7 estate, but the proceeds of the policy were not. See also, *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391 (5th Cir. 1987).

The non-settling claimants argued that the proceeds of the NYM insurance policy should be considered property of the bankruptcy estate in this specific instance. Although the issue was not before the Court for decision in *Edgeworth*, the Fifth Circuit recognized that under certain fact-specific circumstances, such as where the policy proceeds were not sufficient to cover all of the claims, the policy proceeds might be deemed property of the estate.

In the OGA Charters matter, the Court adopted as the law in the Fifth Circuit the hypothetical exception it had discussed in *Edgeworth* regarding circumstances where the proceeds of a liability policy could be property of the estate, even though the debtor has no right to those proceeds:

We now make official what our cases have long contemplated: In the 'limited circumstances,' as here, where a siege of tort claimants threaten the debtor's estate over and above the policy limits, we classify the proceeds as property of the estate. Here, over $400 million in related claims threaten the debtor's estate over and above the $5 million policy limit, giving rise to an equitable interest of the debtor in having the proceeds applied to satisfy as much of those claims as possible.

Editorial Notes: It remains to be seen whether the settling claimants will seek en banc consideration of the case. Assuming that the OGA Charters opinion is now the law in the Fifth Circuit, it potentially has long-term implications that may impact a liability insurer's ability to settle claims early and to enter into settlements with fewer than all claimants. The opinion contains very little discussion as to how the holding reconciles with the *Soriano* doctrine, and provides no guidance as to how insurers should approach future settlements involving multiple claims and potentially inadequate insurance proceeds to satisfy all claims. The fallout from this case is that insurers who work diligently to reach settlements and avoid litigation run the risk of a recalcitrant, non-settling claimant simply undoing the settlements by putting the insured/defendant into involuntary bankruptcy.

In addition, the opinion does not discuss the *Stowers* doctrine and the obligations of an insurer to accept reasonable settlement demands within policy limits. Because the 14 claimants who reached settlements had made demands within policy limits that were deemed to be reasonable, NYM entered into those settlements to fulfill its *Stowers* duties to its insured, OGA Charters.