

ELEVENTH CIRCUIT BANKRUPTCY DECISION MARKS SIGNIFICANT IMPLICATIONS FOR INSURANCE COMPANIES, THEIR COUNSEL

The Eleventh Circuit recently ruled that an insurer’s effort to intervene in an underlying wrongful death action was subject to the automatic stay and that the insurer was not deprived of due process as a consequence.

Significant to insurers and their counsel was the portion of the opinion dedicated to due process concerns raised on appeal by the insurer, and in particular, the opportunities that the Court felt the insurer had exhausted and those that it miscalculated. The Court’s review of the automatic provisions of the United States Bankruptcy Code as applied to insurers is a useful reference for those who practice at the intersection of bankruptcy and insurance law. *In re Gaime*, No. 20-12240, 2021 WL 5321974, at *2–3 (11th Cir. Nov. 16, 2021).

BACKGROUND

The facts of the case are heartbreaking. A mother drugged her two young sons and then attempted to kill herself and her children in a garage with their car running. The mother was convicted of second degree murder for one of her sons. She had automobile and homeowners insurance with the insurer. The estate of the dead child, his brother and father (“Survivors”) filed a wrongful death and bodily injury suit against the mother in state court. Although initially agreeing to defend the mother, the insurer filed a parallel declaratory judgment action in state court to determine that the policies didn’t cover the incident and that it had no duty to defend or indemnify her.

The Survivors filed a fourth amended complaint in the wrongful death suit, and the mother filed a motion to dismiss, on which the state court reserved ruling until the coverage and duty to defend questions were resolved. Around the same time, the Survivors were in settlement discussions with the attorney the insurer had appointed to represent the mother. In the later appeal from the Bankruptcy Court opinion, the Survivors alleged that the insurer had rejected a

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settlement offer the mother wished to accept that would have allowed her to avoid subsequent liability.

The state court ruled in the insurer's favor in the declaratory judgment actions, holding that the insurer's policies didn't cover the incident and that the insurer had no duty to defend the mother. The insurer thereafter withdrew its defense of the mother in the wrongful death lawsuit. The Survivors filed an untimely fifth amended complaint in the wrongful death action. The mother, still imprisoned, didn't respond to the complaint resulting in the state court entering a default judgment against her on the issue of liability, and the case proceeded to a jury trial on damages. The jury entered a verdict in favor of the Survivors in the amount of almost \$505 million. The Survivors filed an involuntary bankruptcy against the mother, the petition went unanswered, and the Court approved the petition and appointed Dawn Carapella as the trustee. The only liability in the mother's bankruptcy was the half-billion-dollar verdict, and the sole assets were the bankruptcy estate's claims against the insurer for bad faith and malpractice for rejecting the settlement offer. The Chapter 7 trustee sued the insurer in state court for bad faith.

The insurer sought to intervene, post-judgment, in the wrongful death action against the mother in order to vacate the half-billion-dollar judgment against the mother on the ground that the fifth amended complaint was untimely and that the default judgment was therefore void. The Eleventh Circuit states in its opinion that it presumed the insurer hoped that if it could successfully vacate the state court judgment against the mother, then there would be nothing for the Survivors to pursue in the Bankruptcy Court and, thus, no bad faith claim against it. The insurer filed a stay relief motion to allow it to file its motion to intervene and motion to vacate. Both the Bankruptcy Court and the District Court on appeal denied stay relief.

THE ELEVENTH CIRCUIT DECISION

The Eleventh Circuit found little support for the insurer's arguments that the automatic stay did not apply to the underlying motion to intervene. The Court noted the wrongful death action was filed before the bankruptcy petition was filed, and the motion to intervene seeking to vacate the judgment was filed against an interest of the Debtor. Further, the Court held an insurer is exactly the type of entity to which the stay applies.

The insurer argued that the stay, and thus both the bankruptcy and district court decisions, deprives them of a forum to adjudicate the validity of the wrongful death judgment. The Eleventh Circuit noted: "At oral argument, [the insurer] directed our attention to a December 2020 order of the Hillsborough County Circuit Court holding, in the context of the trustee's bad faith lawsuit, that [the insurer] lacked 'standing' under Florida law to challenge the underlying default judgment against a third party. . . ." *In re Gaime*, No. 20-

12240, 2021 WL 5321974, at *3 (11th Cir. Nov. 16, 2021)(quoting *Dawn Carapella v. State Farm Fla. Ins. Co.*, No. 18-CA-007981 (13th Fla. Cir. Ct. Dec. 28, 2020).

The Eleventh Circuit held that the insurer had a due process right to be heard “at a meaningful time and in a meaningful manner” but due process “does not guarantee success.” *In re Gaime*, No. 20-12240, 2021 WL 5321974, at *3-4 (11th Cir. Nov. 16, 2021)(quoting *Armstrong v. Manzo*, 380 U.S. 545, 552, 85 S. Ct. 1187, 14 L. Ed. 2d 62 (1965) (quotation marks omitted); see also *Grannis v. Ordean*, 234 U.S. 385, 394, 34 S.Ct. 779, 58 L.Ed. 1363 (1914)). The Eleventh Circuit stated that the insurer was given two opportunities to contest the validity of the wrongful death judgment. First, in the wrongful death action, from which it withdrew from defense, and second, as a defense in the bad faith lawsuit brought by the trustee, which the insurer lost.

The Eleventh Circuit found that the insurer was motivated by wanting to unwind either the prior unfavorable decisions it made or the unfavorable consequences resulting from those decisions. In particular, the insurer made the decision to seek declaratory judgments regarding coverage and then, while that action was pending, advised the mother to reject the Survivors’ settlement offer. Then, once the insurer had the favorable declaratory judgments, the insurer terminated its defense of the mother in the wrongful death lawsuit. Notably, the Eleventh Circuit stated that “[w]hen [the insurer] advised [the mother] to reject the settlement offer while seeking to alleviate itself of the duty to defend, it assumed the risk that it might later face a bad faith lawsuit.” *In re Gaime*, No. 20-12240, 2021 WL 5321974, at *4 (11th Cir. Nov. 16, 2021).

The Eleventh Circuit also focused on the arguments made by the insurer in the trustee’s bad faith action, particularly that the untimeliness of the Survivors’ fifth amended complaint violated the mother’s due process rights, rendering the wrongful death judgment void. On this, the Eleventh Circuit held that just because the state court found that the insurer lacked standing to assert that argument did not mean the insurer was deprived of due process. Again, the Eleventh Circuit articulated that due process did not “guarantee success” just the meaningful opportunity to present claims. *In re Gaime*, No. 20-12240, 2021 WL 5321974, at *4 (11th Cir. Nov. 16, 2021)(citing *Am. Nat’l Bank & Tr. Co. v. City of Chicago*, 826 F.2d 1547, 1550 (7th Cir. 1987)). The Eleventh Circuit also noted that the insurer had appeal rights in the state court system where it could challenge the lack of standing order in the bad faith action on due process, or any other basis.

The Eleventh Circuit also was not swayed by the insurer’s arguments that the automatic stay did not apply to its motion to intervene in the underlying wrongful death suit because its seeking to vacate the judgment would benefit the estate. The insurer’s argument was inconsistent with the plain language of the bankruptcy statute, which doesn’t care if the stay relief is being sought to



defend or protect the estate, just whether the proposed action is against the Debtor's estate or its interests.

What did impact the Eleventh Circuit was the idea that the insurer would be getting a "second bite at the apple," which would increase the costs to the bankruptcy estate while denial would not prejudice the insurer as it already had several opportunities to be heard. While hindsight is always acute, and strategic decisions do not always result in a legal victory, the Eleventh Circuit provides some solid guidance on how to navigate bankruptcy considerations in a coverage dispute.

Please contact your regular AT attorney, or one of the authors below, should you have any questions or wish to discuss any matter at the intersection of bankruptcy and insurance coverage.