Insurance and Bankruptcy: Self-Insured Retention Issues in Bankruptcy Cases With Personal Injury Claims - *New Jersey Law Journal*

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By: Michael Medved, Warren Martin Jr., Kimberly Pageau

Bankruptcy filings with personal injury claims can pose complex challenges where self-insured retention obligations of the debtor under its insurance policies are unfulfilled as of the filing date.

Introduction to Self-Insured Retention Provisions

A self-insured retention (SIR) in an insurance policy requires the insured (in our case, a bankrupt debtor) to pay the first dollars settled or awarded on a covered plaintiff's claim, up to a predetermined amount, e.g., $100,000 or $250,000 (or whatever amount is negotiated with the insurer). The insurance company becomes obligated to pay the remainder of the claim—up to its per claim or per policy limits—only after the insured has met its SIR obligation. SIRs benefit the insured/debtor via decreased policy premiums insofar as the insurance company sits further away from risk of payment. It benefits the insurance company by ensuring that the insured has “skin in the game,” insofar as the insured becomes the first line of defense and thereby is incented to resolve claims below the SIR exposure.

The Conundrum When a Company With a Self-Insured Retention Files for Bankruptcy

When a debtor files for bankruptcy, legal issues arise in connection with the SIR. The automatic stay, codified at 11 U.S.C. Section 362, prevents a debtor from paying prepetition claims; yet, the insurance contract requires the debtor to do just that in order to trigger the insurer's obligation to pick up the remainder owed to the plaintiff. Bankruptcy law also requires fairness in treatment among similarly situated creditors. Paying a plaintiff the SIR amount, while other creditors remain unpaid, would violate this principle. Thus the conundrum arises, i.e., a legal and contractual standoff between bankruptcy law and contract law—an insurance contract that requires satisfaction of the SIR before the insurer's obligation to pay arises.

How Courts Have Addressed the Conundrum

Statutory and Public Policy Bases for Resolving the Conundrum

Some courts have resolved this conundrum by invoking public policy considerations. These decisions typically hinge on whether or not the applicable jurisdiction has a statute requiring that bankruptcy filings by insured parties do not absolve insurers from fulfilling policy obligations and requiring that all insurance agreements include a clause that an insured's bankruptcy filing will not relieve the insurance company for damages or losses under an existing policy. For example:

- In *Admiral Insurance v. Grace Industries*, 409 B.R. 275, 282 (E.D.N.Y. 2009), the court ruled that an insurer's liability persists even when the insured cannot exhaust self-insured retention obligations due to the bankruptcy, citing New York Insurance Law Section 3420, (“Bankruptcy does not relieve the insurance company of its obligation to pay damages for injuries or losses covered under an existing policy.”); See *Diocese of Camden, New Jersey*, 653 B.R. 309, 351 (Bankr. D.N.J. 2023) (noting in a decision on whether an insurance policy is executory that "there is caselaw finding that payment of the SIRs are not prerequisites to the Insurers obligation to pay, and instead merely set a floor on the claim amounts below which the Insurers have not agreed to make any payments.").

- In *Vanderveer Estates Holding*, 328 B.R. 18, 24 (Bankr. E.D.N.Y. 2005), *aff'd sub nom. American Safety Indemnity v. Official Committee of Unsecured Creditors*, No. 05 CV 5877 ARR, 2006 WL 2850612 (E.D.N.Y. Oct. 3, 2006) (applying Illinois law), the court underscored the Illinois public policy which prioritized compensation for injured parties, irrespective of the debtor's ability to pay its SIR. ("The plain language of section 388 [under the Illinois Insurance Code] 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 . . . the operative effect of the language of the self-insured provision is 'directly contrary to the public policy as declared by the legislative enactment of section 388 [of the Illinois Insurance Code].'") (*Home Insurance of Illinois v. Hooper*, 294 Ill. App. 3d 626, 632, 691 N.E.2d 65, 70 (1998)).

However, even in jurisdictions that do not have a prevailing statute governing the insurer's liability, courts still have found that public policy concerns dictate that a bankruptcy filing does not relieve the insurer of its liability even if the debtor-insured cannot satisfy its SIR obligations. See *Sturgill v. Beach at Mason Limited Partnership*, 2015 WL 6163787, at *2 (S.D. Ohio Oct. 20, 2015) (holding that even in the absence of an Ohio statute requiring the inclusion of bankruptcy clauses, an insurance policy that contains a bankruptcy provision still requires insurer to satisfy amounts above the SIR).

A minority view holds in certain instances where there is no prevailing bankruptcy statute, a court may enforce the plain language of an insurance policy that states that insurer obligations will only be triggered upon satisfaction of the SIR. In particular, applying Alabama law, a bankruptcy court held that an insurer's duty to defend and indemnify was only triggered after the SIR was satisfied. *Apache Products,* 311 B.R. 288, 293 (Bankr. M.D. Fla. 2004). "Where the language in an insurance policy is unambiguous and does not offend against public policy, it must be accorded its plain meaning and it must be enforced as written."(*Criterion Insurance v. Anderson*, 347 So.2d 384, 388 (Ala.1977)). Absent a governing statute addressing the impact of a bankruptcy on a SIR policy, these courts have determined that based on the plain language of the SIR clause, the insurer has no liability until the SIR amount has been exhausted. "One cannot escape the plain language of the Lexington policy. Apache must exhaust the SIR amount before Lexington's obligation to defend arises." *Apache Products*, 311 B.R. at 297. However, the court specifically left open the issue of payment once there was an adjudication against the debtor in excess of the SIR that the debtor would be unable to "apply" or "exhaust." 298 ("This court is equally satisfied that the issue is not ripe for consideration of whether or not *Wheelwright* is applicable once there is an adjudication against Apache in excess of the $100,000 SIR as set forth in the Lexington policies for which Apache is unable to 'apply' or 'exhaust' as a result of its filing for Chapter 11 relief and what effect, if any the filing of the bankruptcy case has on this provision of the Lexington policy.").

In *Pak-Mor Manufacturing v. Royal Surplus Lines Insurance*, 2005 WL 3487723 (W.D. Tex. Nov. 3, 2005), a court applying Texas law held that an insurer is not obligated to pay anything until the insured pays the retained limit where the policy states that the insurer's obligations will not "attach or arise" unless or until the SIR is satisfied. The court in *Pak-Mor*, however, did not define what constitutes satisfaction, leaving open the question as to whether "satisfaction" of an allowed general unsecured claim on the SIR would trigger insurer liability: "Yet the plain meaning of 'pay' does not indicate a required method of payment. To the contrary, the standard dictionary definition leaves it open: 'to discharge indebtedness for.' Common usage does as well; people often speak of paying by check or money order, paying in cash, and paying by credit card. Even Black's Law Dictionary fails to confuse the matter: 'performance of an obligation by the delivery of money or some other valuable thing accepted in partial or full discharge of the obligation.'"

Courts may find that a debtor has satisfied its SIR obligations if a Chapter 11 plan treats the SIR obligations consistent with the underlying policy and allows claimants an unsecured claim for the SIR portion of their recovery. That claim could arguably be “satisfied,” for example, by a partial distribution of funds under the bankruptcy plan, and a discharge of the remaining amount of the claim under the confirmation order. See, generally, the “dictionary definition of “satisfied” cited in *Pak-Mor,* above. For example, in one case, a debtor had two contested malpractice claims pending and each claimant was separately classified with an allowed unsecured claim. See *Keck, Mahin & Cate*, 241 B.R. 583 (Bankr. N.D. Ill. 1999). The prevailing insurance policy included a SIR obligation of $1 million. 595-96. The insurer alleged that the plan would allow the debtor to avoid its SIR obligations. The court ruled that the SIR was satisfied by the debtor's allowance of an unsecured claim for the SIR and the claimants acceptance of the plan. "The SIRs are to be satisfied in exactly the same way as every other unsecured claim against the debtor. The policy condition to ALAS's liability that the debtor 'pay' costs and amounts due on the claim 'as they become due' up to the amount of the SIR will be satisfied under the plan. An obligation to pay is satisfied when something of value is given and accepted in full discharge of that obligation."

Must the Insurer Pay the Debtor's Unpaid SIR to a Plaintiff?

Courts that have allowed a plaintiff to proceed against the insurance company despite the bankrupt insured's SIR amount not being otherwise exhausted have made it clear that the insurance company is not required to pay out the self-insured retention amount in any settlement or judgment entered with or for the plaintiffs. Instead, courts have held the insurer liable solely for all damages over and above the SIR amount and then relegated the injured party to an unsecured claim against the bankrupt debtor for the SIR amount. See *Kleban v. National Union Fire Insurance of Pittsburgh, Pa.*, 771 A.2d 39 (Pa. Super. Ct. 2001) (determining that to the extent any award against the debtor was within the SIR, the injured party could assert an unsecured claim against the debtor or its estate. If the amount was above, the insurer would satisfy that amount less the SIR.); See *Amatex*, 107 B.R. 856 (Bankr. E.D. Pa. 1989) (denying a debtor's request that the insurer cover the full policy limit and file an unsecured claim against the debtor for the SIR amount, noting that “the self-insured retention is therefore not an amount that is owed by the debtor to Stonewall but rather, represents the threshold of Stonewall's liability to the debtor.”); *The Bureau of Oceans and International Environmental and Scientific Affairs*, 319 B.R. 266, 269 (Bankr. M.D. Fla. 2004) (finding that the stay should be lifted to allow the injured party to proceed with its claim against the insurer but that the insurer's liability was only as to the amounts over and above the SIR amount and that the injured party would be limited to filing an unsecured claim against the debtor for amounts up and until the SIR was exhausted).

Conclusion

Whether rooted in statutory analysis of state law, or public policy concerns, a majority of courts hold that insurance companies must step up and pay amounts due and owing over and above SIR amounts, even where a bankruptcy debtor is unable to pay. The courts do, however, continue to navigate the balance between public policy considerations present in bankruptcy matters, e.g., a fair distribution among creditors, and the explicit terms of insurance agreements.