Most insurance policies today require the policyholder to share a portion of the future financial risk covered by the policy—either through deductibles, self-insured retentions (“SIRs”) or retrospective premiums. When the policyholder seeks protection under the Bankruptcy Code, however, the insurance policy becomes property of the estate and subject to interpretation in light of the principles underlying the Bankruptcy Code. Bankruptcy protection is intended to give debtors breathing room to cure contractual defaults and reorganize financial obligations. Bankruptcy courts must balance these interests against those of insurers and third-party claimants as they oversee the distribution of the policyholder’s assets. This balancing may enable the policyholder to obtain the full benefit of its insurance coverage even though it is unable to pay its deductible, SIR or retrospective premium.

Because insurance policy proceeds may constitute a significant asset of the policyholder’s estate, and possibly the only source of distributions to certain creditors, the policyholder should consider in advance the impact that a bankruptcy petition will have on its effort to maximize recovery of insurance proceeds. The first part of this article discusses the treatment of policies with deductibles and SIRs in the bankruptcy context. The second part of the article addresses some special considerations that apply to retrospectively rated policies.

I. Deductibles and Self-Insured Retentions

Most liability insurance policies require the policyholder to pay a deductible or self-insured retention before the insurer is obliged to pay any amounts. And many policies require the policyholder to pay the entire claim first and to then seek reimbursement from the insurer. Almost by definition, however, insolvent policyholders are unable to make these up-front payments. Indeed, in many cases, the policyholder’s inability to do so in the face of a deluge of litigation was the principal cause of the insolvency in the first place.

A. Types of Pay First Provisions

Liability insurance policies requiring up-front payments by the policyholder (in addition to the standard premium) take several forms, but courts tend to treat them similarly once the policyholder
becomes insolvent. First, policies with deductible provisions generally require the policyholder to pay the first portion of the claim, up to the deductible amount, after which the insurer pays amounts in excess of the deductible up to the limits of liability. The deductible is considered to be within the limits of liability, and the insurer may or may not have a duty to defend the policyholder for claims that fall entirely within the deductible. Second, policies with SIRs require the policyholder to shoulder all expenses, including defense costs, until the SIR is exhausted. The SIR is not considered to be within the limits of the policy, and the insurance coverage is effectively excess rather than primary. Third, reimbursement policies provide coverage only after the policyholder has become legally obligated to pay and has actually paid the entire amount of the claim. Nevertheless, many courts ignore these distinctions and treat deductibles, SIRs, and reimbursement provisions in virtually the same way.

“...if the insolvent policyholder were required to pay deductibles, SIRs, or the entire claim before accessing insurance policy proceeds, then the insolvency of the policyholder would automatically relieve the insurer of its coverage obligations...”

These pay-first requirements conflict with two important purposes of the Bankruptcy Code: to give the debtor breathing room to reorganize its financial obligations and to protect the interests of third-party creditors. For many debtors in bankruptcy, liability insurance coverage is the most likely source of distributions to unsecured creditors. But if the insolvent policyholder were required to pay deductibles, SIRs, or the entire claim before accessing insurance policy proceeds, then the insolvency of the policyholder would automatically relieve the insurer of its coverage obligations—a result that most debtor-policyleholders, creditors, and bankruptcy courts consider wholly unsatisfactory.

B. The Bankruptcy Clause

As a result, a number of states have enacted legislation requiring insurance policies to contain a clause stating that the policyholder’s bankruptcy or insolvency shall not relieve the insurer of its obligations under the policy. Nevertheless, the clause does not specifically address the consequences of a policyholder’s failure or inability to satisfy its initial payment obligations. Insurers argue that the “bankruptcy” clause has no effect on the policyholder’s obligations to fund initial losses as an absolute precondition to coverage, and that any other interpretation would impose additional obligations on them to which they never consented. Debtors argue that the “bankruptcy” clause should be construed as excising the deductible, SIR, and reimbursement provisions from the policy. Neither position is entirely correct. Requiring insurers to provide coverage despite the debtor’s failure initially to pay the claim, deductible or SIR need not impose additional obligations on insurers. It may force them to pay claims sooner than they would otherwise, but it does not necessarily increase the limits of their liability. On the other hand, the “bankruptcy” clause should not operate to cancel out the deductible or SIR altogether upon the policyholder’s insolvency.

C. The Caselaw

Some courts grappling with these issues have taken extreme positions on the other side. For example, one district court has held that the $250,000 SIR was an absolute precondition to coverage and, because the policyholder never satisfied that precondition, the insurer’s obligations were never triggered. Similarly, the Second Circuit Court of Appeals has held that, under the reimbursement provision of a maritime liability policy, the insurer was released by the bankrupt policyholder’s failure to pay the loss. In at least one case, no party raised the issue of the policyholder’s insolvency, and the court simply assumed without analysis that the policyholder’s satisfaction of the aggregate deductible was a necessary predicate for coverage. At the other extreme, some courts have suggested that “fronting” policies, in which the deductible is equal to the limits of liability, only insure against the risk of the policyholder’s insolvency and therefore expose insurers to liability for the full amount of the deductible of an insolvent policyholder.

“An insurer cannot pocket premiums and then refuse coverage every time its policyholder becomes insolvent and unable to pay the deductible or SIR. Nor can a policyholder force its insurer to cover claims that fall entirely within the deductible or SIR.”

Most courts addressing this issue, however, have taken a middle ground, rejecting both the “absolute condition precedent” approach advocated by insurers and the policyholder’s argument that insurance should “drop down” and cover claims that fall within the deductible or SIR. An insurer cannot pocket premiums and then refuse coverage every time its policyholder becomes insolvent and unable to pay the deductible or SIR. Nor can a policyholder force...
its insurer to cover claims that fall entirely within the deductible or SIR. 8

Attempting to harmonize insurers’ contract rights with the purposes of the Bankruptcy Code, courts usually require insurers to provide coverage in excess of the deductible or SIR, up to the limits of liability, notwithstanding the policyholder’s failure to pay the deductible or SIR. 9 These insurance payments often must be made into the bankruptcy estate rather than directly to the claimants. This will leave a shortfall in the amount of the deductible or SIR that the policyholder was unable to pay. If there are no other sources of funding this shortfall, the bankruptcy court will then determine how to apportion the insurance funds, usually by distributing them proportionately across all claims. 10 Each third-party claimant will have a general unsecured claim against the estate for his or her share of the shortfall. 11 If the insurer has advanced funds within the deductible or SIR under a pre-petition policy, the insurer also will have a general unsecured claim against the bankruptcy estate. 12 Whether asserted by claimants or insurers, the shortfall is most likely to be funded by the estate at pennies on the dollar, if at all.

**D. Other Named Insureds May Have to Fund Shortfall**

Although few reported decisions discuss the issue, third-party claimants and insurers may be able to compel other solvent parties to make up the deductible or SIR shortfall. Many insurance policies identify several entities as named insureds, and sometimes other entities are not specifically named but qualify as “additional insureds” through contractual or other relationships with the principal named insured. Depending on the policy language regarding the deductible or SIR obligation, specifically named “other insureds” may be obliged to pay deductible or SIR amounts on behalf of the insolvent policyholder, even though the “other insured” has not asserted a claim against the policy. 13 The same is not true, however, for additional insureds not specifically identified in the policy. 14 In one case involving an insolvent partnership, the individual non-debtor partners were not required to fund the SIR even though their conduct may have given rise to the claims. 15

Deductibles and SIRs serve as a financial incentive for policyholders to operate their businesses in a manner that minimizes the number of claims asserted against them. Once the policyholder becomes insolvent, that incentive has little or no effect. So long as the dollar amount of the insurer’s exposure remains the same, requiring the insurer to pay claims sooner than it otherwise would be required to do seems an acceptable compromise between the contract rights of the insurer and the interests of third-party claimants as well as the bankrupt policyholder.

**II. Retrospective Premiums**

Retrospective premium policies originated as a way for insurers to shift some risk to the policyholder and thereby reduce costs. Generally, under such policies, the insurer charges an initial estimated premium at the beginning of each policy period, called the “deposit premium” or “standard premium.” Six months to a year after the policy expires and annually thereafter, the insurer recalculates the premium based upon the actual claims experience of the policyholder. If the policyholder has experienced few claims, its premiums will be low (and may result in a refund); if there have been many claims, the premiums will be high. By setting premiums retroactively, based upon the policyholder’s actual loss experience, insurers can charge less up front. Retrospective premiums have been most commonly used in fields where neither the insurer nor the policyholder can accurately predict risks, such as with general liability and worker’s compensation policies. 16

In addition to the benefit of reducing up-front costs, retrospective premiums provide an economic incentive for businesses to minimize claims, for example, by maintaining a safe work environment. Conversely, however, retrospective premiums allow unscrupulous insurers to settle claims for unreasonable amounts because the policyholder ultimately pays through increased premiums. As a result, courts have imposed a duty upon insurers to act reasonably in settling claims and setting premiums. 17

**A. Executory Contracts**

When a business goes bankrupt, it may remain entitled to continuing coverage under retrospective premium policies despite its inability to pay the ongoing retrospective premiums. The availability of such coverage rests on whether the insurance policy is classified as executory under the Bankruptcy Code. The Bankruptcy Code does not define executory contracts, but most courts have relied on Professor Countryman’s definition of an executory contract

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The quote is: “Depending on the policy language . . . specifically named “other insureds” may be obliged to pay deductible or SIR amounts on behalf of the insolvent policyholder, even though the “other insured” has not asserted a claim against the policy.”
as one “under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.” Thus, if an insurance policy is classified as executory, non-payment of premiums by the debtor constitutes a breach of contract, allowing the insurer to cancel any remaining obligations. On the other hand, if the policy is not executory, the insurer must continue to perform under the policy because there has been no material breach by the debtor. In addition, because of the automatic stay imposed upon the filing of a bankruptcy petition, the insurer cannot collect any pre-petition debts or obtain possession of property of the estate.

Under section 365(a) of the Bankruptcy Code, a debtor possesses the right to assume or reject an executory contract. If the contract is assumed, the third party must perform, and the debtor must also render its performance at full value. Section 365 is designed to give the debtor the option of assuming contracts where performance by a third party will benefit the estate, or rejecting contracts that are burdensome. Additionally, the third party to an executory contract may petition the bankruptcy court to order the debtor to assume or reject the contract within a specified time to expedite the decisionmaking process. Thus, an insurer can cancel its remaining coverage of a bankrupt policyholder only if the policy is deemed executory.

A debtor in bankruptcy has an interest in maximizing its estate assets to facilitate reorganization. A debtor’s estate is worth more with its insurance policies than without, so it is in the estate’s interest to prevent the insurer from canceling its policy. Perhaps with this incentive in mind, courts have held that a debtor’s ongoing obligation to pay retrospective premiums alone is not sufficient to render a contract executory. Rather, insurance policies are generally only considered executory if there is a continuing obligation to make standard premium payments.

Determining whether a policy is executory depends on timing, specifically, whether:

1. The policy term expired pre-petition with only retrospective premiums remaining due,
2. The policy term expired post-petition but before confirmation of a reorganization plan,
3. The policy term is ongoing, with standard premium payments still due.

Each scenario requires a closer look in light of the foregoing bankruptcy principles.

B. Policy Expired Pre-Petition

A policy with ongoing retrospective premiums that expires pre-petition is not executory. The mere obligation to pay money by one party to a contract is not enough to render the contract executory. In addition, a debtor’s ongoing duty to cooperate under an expired retrospective premium policy does not render the contract executory. For these reasons, the debtor’s failure to pay retrospective premiums alone is not sufficient to constitute a material breach excusing performance by the insurer. Despite the debtor’s nonpayment of retrospective premiums due, the insurer must continue to cover losses incurred during the policy period.

Applying this principle, a recent Illinois case held that an insurance policy with ongoing retrospective premiums was not executory because it had expired pre-petition and contained bankruptcy clauses that provided for continued coverage by the insurer in the event of the policyholder’s bankruptcy. The court observed: “Courts have consistently held that insurance policies where the policy coverage period has expired prior to the insured’s bankruptcy are not executory contracts despite ongoing obligations of the debtor.” The only remaining obligation of the debtor in this case was payment of retrospective premiums, not enough to excuse the insurer’s performance.

C. Policy Expired Post-Petition

If an insurance policy expires post-petition and before the debtor has assumed or rejected it, courts will likely hold that it is not executory so long as all standard premiums have been paid. In this case, as with pre-petition policies, the insurer will be obligated to continue covering claims from the policy period, even though the debtor does not pay accruing retrospective premiums. See, e.g.,

In Texscan, for example, the Ninth Circuit Court of Appeals held that a policy which expired five weeks after the debtor filed for bankruptcy was not executory. The contract expired before either party filed a motion under 11 U.S.C. § 365(a) for assumption or rejection. In addition, the debtor had paid all deposit premiums and only owed retrospective premiums. The Bankruptcy Appellate Panel explained:
“It is axiomatic that before 11 U.S.C. § 365 can apply a contract must exist. If a contract has expired by its own terms then there is nothing left to assume or reject.” The Ninth Circuit Court of Appeals affirmed the holding that the policy was not executory, but for a different reason. The court noted that the insurer was required to continue to provide coverage because of a state statute, like those described earlier in this article, requiring insurance policies to contain a bankruptcy clause. Because the bankruptcy clause required the insurer to continue to perform notwithstanding the policyholder’s insolvency, the court held the policy could not be considered executory under Professor Countryman’s definition.

In contrast, the district court in In re Transit Group, Inc. held that a delinquent retrospective premium policy that expired three days after the bankruptcy filing was executory, excusing the insurer from performance. Unlike in Texscan, the debtor in Transit still owed standard premiums, in addition to retrospective premiums, when it filed for bankruptcy protection. The court reasoned: “[P]ayment of the underlying premiums is an essential obligation under the Policies. [Debtor’s] failure to pay the premiums due under the Policies would be a material breach and would excuse [insurer’s] performance under the Policies.” Indeed, the court further observed that “the only basis for holding that an insurance policy is executory is if the insured had a continuing obligation to make premium payments under the policy.” While the court did not specifically distinguish between the effect of unpaid standard premiums versus retrospective premiums, other opinions suggest that nonpayment of the standard premiums is what rendered this contract executory.

D. Ongoing Policy

Unexpired insurance policies, where the insurer has a continuing obligation to provide coverage and the debtor has a continuing obligation to pay standard premiums, are executory contracts. In other words, if the debtor does not pay its premiums, the insurer can cancel the policy. The existence of retrospective premiums makes no difference in this analysis.

E. Treatment of Insurers’ Claims

As with the issue of continuing policy coverage in bankruptcy, the classification of insurers’ claims for past due retrospective premiums hinges on the timing of filing for bankruptcy and the status of the insurance contract. Under Bankruptcy Code § 503(b)(1)(A), a creditor may file a request for an administrative expense for the “actual, necessary costs and expenses of preserving the estate.” An administrative expense claim generally takes priority over all other unsecured claims and will most likely be paid in full. Such claims arise post-petition through dealings with the debtor’s estate. Furthermore, 28 U.S.C. § 959(b) requires a chapter 11 debtor-in-possession to continue to operate its business in accordance with any applicable state laws. Maintaining adequate insurance coverage is often mandated by state law. Thus, many courts have held that an insurer is entitled to assert a priority administrative expense claim for unpaid post-petition premiums.

Treatment of claims arising from retrospective premium policies therefore depends on the period of time from which those claims arise. Retrospective premiums related to a pre-petition coverage period will generally be classified as general unsecured claims. Conversely, those retrospective premiums arising from post-petition coverage will generally be treated as priority administrative claims.

III. Conclusion

A policyholder considering filing for bankruptcy should evaluate its insurance promptly and ensure that it is taking all steps necessary to maximize its recovery of insurance proceeds. Notwithstanding the policyholder’s failure to pay the deductible or SIR, most courts require insurers to provide coverage in excess of the deductible or SIR, up to the limits of liability. If the debtor’s policies are retrospectively rated, then timing is critical. With proper planning, a debtor may be able to avoid cancellation of the policy and continue to receive coverage even though it is unable to pay accumulating retrospective premiums. Furthermore, a company that files for bankruptcy at the right time may relegate an insurer’s claims for such unpaid premiums to general unsecured status.


9 E.g., In re Keck, Mahin & Cate, 241 B.R. 583, 596 97 (Bankr. N.D. Ill. 1999); In re Federal Press Co., 104 B.R. 56, 64 (Bankr. N.D. Ind. 1989).


11 Keck, Mahin & Cate, 241 B.R. at 596.


15 Keck, Mahin & Cate, 241 B.R. at 596.


22 See In re Wheeling-Pittsburgh Steel Corp., 54 B.R. 772, 779 (Bankr. W.D. Pa. 1985) (holding that unexpired retrospective premium policies were executory).

23 Sudbury, 153 B.R. at 778; Placid Oil, 72 B.R. at 139; Wisconsin Barge Line, 76 B.R. at 697.


25 Sudbury, 153 B.R. at 779.


27 Beloit Liquidating Trust, 287 B.R. at 906.


29 Texscan Corp., 976 F.2d at 1273.


31 Texscan Corp., 976 F.2d at 1273 and n.1.


35 Texscan Corp., 976 F.2d at 1272.


38 In re Mammoth Mart, Inc., 536 F.2d 950, 954 55 (1st Cir. 1976).


42 In re MEI Diversified, Inc., 106 F.3d 829, 832 (8th Cir. 1997); Texscan Corp., 107 B.R. at 230 n.4.