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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

In re: THE ROMAN CATHOLIC BISHOP OF OAKLAND, a California corporation sole, Debtor.	Case No. 23-40523 WJL Chapter 11 **DEBTOR'S BRIEF IN OPPOSITION TO THE COMMITTEE'S BRIEF REGARDING THE COURT'S JANUARY 21, 2025 MEMORANDUM** Judge: Hon. William J. Lafferty Date: March 3, 2025 Time: 1:30 p.m. (Pacific Time) Place: United States Bankruptcy Court 1300 Clay Street, Courtroom 220 Oakland, CA 94612

The Roman Catholic Bishop of Oakland, a California corporation sole and the debtor and debtor in possession (the "Debtor") in the above-captioned chapter 11 bankruptcy case (the "Chapter 11 Case"), hereby files this Brief in Opposition (this "Opposition") to *The Official Committee of Unsecured Creditors' Brief in Response to the Memorandum Concerning Certain Issues Raised During the January 21, 2025 Hearing on Approval of the Disclosure Statement* (the "UCC Brief") [Docket No. 1705], filed by the Official Committee of Unsecured Creditors (the "Committee"). This Opposition is filed in support of the Debtor's *Amended Disclosure Statement for Debtor's Amended Plan of Reorganization* dated January 3, 2025 [Docket No. 1595] (together with all schedules and exhibits thereto, and as may be modified, amended, or supplemented from time to time, the "Disclosure Statement"),[1] the *Debtor's Motion for Order (I) Approving Disclosure Statement; and (II) Establishing Procedures for Plan Solicitation, Notice, and Balloting* [Docket No. 1453] (the "Motion"),[2] and in response to the Court's *Memorandum Concerning Certain Issues Raised During the January 21, 2025 Hearing on Approval of the Disclosure Statement* [Docket No. 1673] (the "Memorandum").

I. ARGUMENT

The question presently before the Court is whether the Disclosure Statement provides sufficient information regarding the Plan, including any risks inherent therein, such that Holders of Claims may make an informed decision whether to vote yes or no on the proposed Plan. The answer to this question is "yes." The Disclosure Statement thus meets the standard set forth in 11 U.S.C. § 1125 and the Court should approve it. In its Memorandum regarding the Disclosure Statement's treatment of risks associated with the alleged fate of potential causes of action in bad faith against the Insurers post-confirmation, the Court posed two questions to the Parties. Memorandum, 6:1-5. First, the Court asked whether "in light of the uncertainties inherent in the current structure of the Plan and the resulting disagreement concerning the effect of confirmation, it would ever be appropriate to have creditors vote on such a Plan." *Id*., 6:1-4.

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[1] The Debtor will file a further amended Disclosure Statement on February 18, 2025 (the "Second Amended Disclosure Statement''), to address certain objections the Committee raised in motions and other filings concerning the Disclosure Statement and the Court's comments concerning the same, and to include certain changes negotiated with the Committee and the Insurers through the process of the Disclosure Statement hearings.

[2] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Disclosure Statement and Motion.

Second, the Court asked "what language might appropriately apprise creditors of the risks that confirmation of the Plan may eliminate valuable rights under applicable non-bankruptcy law." *Id*, 6:4-5. The Debtor answers the first question affirmatively and discusses the disclosure language that will appear in its forthcoming Second Amended Disclosure Statement, in turn, below.

A. The Effect of Confirmation on Potential Bad Faith Causes of Action Under the Plan is Sufficiently Certain to Permit Creditors to Vote.

The Committee falsely claims "the Plan threatens to release at least two distinct categories of rights that are essential to Survivors' recovery from the Insurers in post-confirmation coverage litigation." UCC Brief, 5:14-16. Those alleged categories are (1) ***direct*** bad faith causes of action Holders of Claims may have against an Insurer post-confirmation for the Insurer's bad faith refusal to pay a covered judgment ("Bad Faith Failure to Pay a Judgment") and (2) bad faith causes of action that only the insured can hold, which the insured can then ***assign to*** Holders of Claims, for an Insurer's bad faith refusal to accept a reasonable, within-policy limits settlement ("Bad Faith Failure to Settle"). *Id*., 5:17-6:14. The first category creates minimal uncertainty and, to the extent uncertainty remains, it is easily disclosed. The second category raises an undecided question of California law. That fact alone, however, is not disqualifying. The Second Amended Disclosure Statement can and will adequately disclose the risk that a California court could rule one way or the other on this point.

1. Bad Faith Failure to Pay a Judgment.

The California Court of Appeals recognized in *Hand v. Farmers Ins. Exch.*, 23 Cal. App. 4th 1847 (Cal. Ct. App. 1994) that "unlike the duty to settle . . . the duty not to withhold in bad faith payment of adjudicated claims runs not only in favor of the insured but also in favor of a judgment creditor such as plaintiff here." *Hand*, 23 Cal. App. 4th at 1858 (internal citations omitted). The Court thus held that "***with respect to the specific good faith duty to pay adjudicated claims***, a judgment creditor like plaintiff, under section 11580, enjoys the contractual status, rights, and posture that vest such a cause of action." *Id*. at 1861. The Committee has expressed concern that one can read Section 5.14 of the Plan to foreclose Holders of Claims' ability to assert a cause of action for Bad Faith Failure to Pay a Judgment against a Non-Settling Insurer. *See* UCC Objection to Am. Disclosure Statement [Docket No. 1624], at 10:21-11:5. The Debtor and the Insurers have made clear, however, that they do not read or intend Section 5.14 to

mean what the Committee suggests. Given the Parties' collective intent that Section 5.14 of the Plan does not foreclose a direct cause of action for Bad Faith Failure to Pay a Judgment on the part of Holders of Claims, the Insurers proposed, and the Debtors accepted, language resolving this issue. The Debtor's Second Amended Plan, which will be filed on February 18, will contain explicit language, set forth below in substantially final form, clarifying that Section 5.14 does not foreclose any such cause of action as recognized in *Hand*.[3]

> ***5.14. Additional Terms Regarding Class 4 and Class 5 Claims.*** Except as otherwise provided herein, terms for resolution of and distribution in connection with Abuse Claims in Class 4 or Class 5 shall be as provided in the Survivors' Trust Documents. For the avoidance of doubt, (i) any such Holder of an Abuse Claim shall not recover in the aggregate from the Survivors' Trust and any Non-Settling Insurer an amount greater than the amount of the judgment issued by the applicable court of competent jurisdiction on the underlying Abuse Claim, (ii) any such Holder of an Abuse Claim is not barred by this Section 5.14 from seeking extracontractual damages under the holding of *Hand v. Farmers Ins. Exchange*, 23 Cal. App.4th 1847 (1994) ("*Hand*"), and (iii) all defenses and the rights of any Non-Settling Insurer to oppose any such claim by a Holder of an Abuse Claim under *Hand* are fully preserved, including that *Hand* is not a correct statement of applicable law and that it would not apply to any such asserted claim.

There is thus no uncertainty regarding the impact of confirmation on causes of action for Bad Faith Failure to Pay a Judgment under *Hand*. All such potential rights will be explicitly reserved.

2. <u>*Bad Faith Failure to Settle*</u>

Under California law an insured may have a claim for Bad Faith Failure to Settle against its insurer if the insurer refuses a reasonable, within-limits settlement offer thereby exposing the insured to an excess-of-policy-limits judgment. *See Murphy v. Allstate Ins. Co.*, 17 Cal. 3d 937, 941 (1976). An insured that holds such a claim can assign it to the plaintiff. *See Hamilton v. Maryland Cas. Co.*, 27 Cal. 4th 718, 725 (2002). The Committee claims the Plan risks extinguishing such a cause of action—and thus preventing its assignment to the Holders of Claims—because of the discharge inherent in the Plan. *See, e.g.*, UCC Objection to the Am. Disclosure Statement [Docket No. 1624], at 11:25-28 ("[T]he Amended Plan appears to eliminate this right because the Debtor receives an immediate discharge against all abuse claims rather

[3] The Insurers have reserved the right to raise any defenses to a future bad faith claim against them, including that *Hand* was wrongly decided and misapplies California law. The forthcoming Second Amended Disclosure Statement explains the Insurers' reservation of rights and arguments in this regard.

than a covenant not to execute. According to the Non-Settling Insurers, the result of this immediate discharge is that the Debtor will be unable to assign any bad faith excess judgments to Abuse Claimants"); *see also* UCC Brief, 5:18-20 ("Because of the timing of the discharge and the damages cap on Survivors' recovery, bad faith claims the Debtor may hold against the Insurers (that could otherwise be assigned to Survivors) will be released."). The Insurers, similarly, have argued "there can be no breach of the duty to settle . . . where the insured has 'no interest, no financial stake in the outcome of the litigation, and no assets . . . exposed to risk by a failure of [the insurer] to settle[]' . . . Here, any confirmed plan will provide Debtor with a discharge and Debtor then will not be at any future risk of having to pay an excess-of-limits verdict." [Docket No. 1584, 15:21-16:2 (quoting *Shapero v. Allstate Ins. Co.*, 14 Cal. App.3d 433, 438 (1971)) (other internal citations omitted)]

Contrary to the Committee's and the Insurers' positions, however, California courts ***have not ruled one way or the other*** on whether a debtor receiving a plan discharge, much less an assignee of the debtor's insurance coverage rights, loses the ability to assert a future Bad Faith Failure to Settle cause of action against its carriers. Nor have California courts been presented with a situation like this one, where neither the factual predicate to such a cause of action nor the litigation underpinning it have occurred. Neither the Committee nor the Insurers have cited a single California case addressing this question.

Shapero, for instance, on which the Insurers rely, is distinguishable. There, the administrator of a deceased insured's estate attempted to assign to the insured's injured claimant a cause of action against the insured's insurer for failure to settle, thereby exposing the insured's estate to a judgment in excess of policy limits. *Shapero*, 14 Cal.App.3d at 434-46. The insured "left no estate whatever" other than the liability policy and a policy covering funeral expenses. *Id*. at 436. The California Court of Appeal held "Allstate could not be found guilty of bad faith for accepting as a working hypothesis . . . that the estate had no interest, no financial stake in the outcome of the litigation, and no assets which would be exposed to risk by a failure of Allstate to settle." *Id*. at 438. Thus, the insured had no Bad Faith Failure to Settle cause of action capable of assignment. *Id*. However, the *Shapero* court took pains to note that its holding was tied to the specific facts of that case. Indeed, the *Shapero* court expressly did not foreclose the possibility that such claims could be assigned in other circumstances. *See id*. at 438, n.1 ("This is not to

say, however, that an insolvent estate may never recover on such a cause of action. ***Where assets exist, the interests of the estate are involved, and it may be subjected to financial harm to the detriment of the general creditors***. But we do not have that situation here.") (emphasis added). Courts have recognized that *Shapero*'s holding is limited to circumstances where an insured has no assets that could be exposed to an excess judgment to the insured's creditors' detriment. *See, e.g., McDaniel v. GEICO Gen. Ins. Co.*, 55 F. Supp. 3d 1244, 1268 (E.D. Cal. 2014), *rev'd on other grounds sub nom. McDaniel v. Gov't Emps. Ins. Co.*, 681 F. App'x 614 (9th Cir. 2017) (holding because "the Estate had assets worth approximately $12,500 exclusive of the GEICO policy at the time of the August 2011 judgment . . . the Court cannot conclude that the Estate had no assets. Therefore, GEICO's liability is ***not extinguished*** under *Shapero*.") (emphasis added). The Debtor and the Survivors' Trust, which under the plan will receive cash contributions and inherit all of the Debtor's rights and obligations under its insurance policies, have assets. On that basis alone, *Shapero* does not squarely apply to this case. The reasoning in *McDaniel* may be more appropriate.

The Insurers no doubt will argue the Plan nevertheless extinguishes any potential Bad Faith Failure to Settle cause of action under *Shapero* because, even though the Debtor will still have assets post-confirmation, the Plan's discharge feature has the same effect (in the Insurers' likely view) as the Debtor having no assets. This argument by analogy, however, has not been tested. Further, there are important differences between an assetless insured and an insured that has obtained a Chapter 11 plan discharge. The details and mechanics of the plan in question, for example, matter. In this case, the Survivors' Trust may arguably serve as the "insured" for purposes of *Shapero* and its progeny post-confirmation, having received assignment of all of the Debtor's insurance rights and obligations. The Survivors' Trust, like the Debtor, will have assets and may be harmed by an excess judgment because, for example, Section 9.8.4 (which will remain in the Plan's next amendment) of the Plan permits Litigation Claimants to recover up to the reserve amount against the Survivors' Trust for any portion of a judgment obtained that is not covered by insurance. Debtor's Amended Plan of Reorganization [Docket No. 1594], §§ 9.8.4.2-9.8.4.5. The Survivor's Trust, as the assignee of the Debtor's coverage rights, may therefore be seen to have a direct financial stake in the outcome of the litigation and, unlike the probate estate in *Shapero*, arguably

could be harmed by a Bad Faith Refusal to Settle to the detriment of its creditors. *See Shapero*, 14 Cal.App.3d at 438, n.1 (distinguishing the circumstance were "general creditors" of the estate would be affected). Thus the question of whether the Debtor or the Survivors' Trust will lose the ability to hold and assign a cause of action for Bad Faith Failure to Settle post-confirmation is not uncertain, per se, but rather is undecided under California law. The Debtor believes there are strong arguments on both sides of this issue and does not take a position regarding how a California court would ultimately rule. The Debtor's position is only that this open question of law is capable of adequate disclosure, despite its uncertainty.

In addition, the risk that California courts will decide the Debtor or Survivors' Trust cannot assert a cause of action for Bad Faith Failure to Settle post-confirmation is not so dire as the Committee would have the Court believe. Under California law only an insured can assert a cause of action for Bad Faith Failure to Settle. *See Murphy v. Allstate Ins. Co.*, 17 Cal. 3d 937, 941 (1976). That is because an insurer's duty to accept a reasonable, within-limits settlement offer exists ***only*** to protect its insured from an excess judgment. *Id*. at 944 ("[T]he duty to settle is intended to benefit the insured and not the injured claimant.") The Committee claims a cause of action for Bad Faith Failure to Settle somehow serves a policy purpose of protecting an injured claimant (in this case, the Survivors) from protracted litigation against the judgment debtor's insurers, providing injured claimants leverage over the insurers to incentivize them to settle with injured claimants. *See, e.g*., UCC Brief at 4:24-27 ("[The Plan] will eviscerate all bad faith remedies, and in doing so, strip Survivors of any leverage to affect fair settlements with the Insurers in a reasonable amount of time. In other words, the Plan will remove the normal state-law tools that a claimant could use to ensure that insurers do not improperly engage in years of litigation to avoid liability."); UCC Mot. to Lift the Automatic Stay [Docket No. 1460], at 11:15-17 (same); UCC Reply in Support of Mot. to Lift the Automatic Stay [Docket No. 1603], at 10:11-12 (same), 13:17-20 ("In California, a tort claimant has the right to demand that an insurer reasonably settle a claim"); UCC Objection to Disclosure Statement [Docket No. 1518], at 16:18-17:2 (same).

The Committee is incorrect. California law ***expressly disavows*** any right or public policy interest on the part of an injured claimant to compel an insurer to negotiate or settle with them. *See, e.g.*, *Zahn v. Canadian Indem. Co.*, 57 Cal. App. 3d 509, 514 (1976) ("Whatever rights may inure to the injured party

as a third party beneficiary of a contract of liability insurance, ***they do not include any right to require the insurer to negotiate or settle with him*** prior to the establishment of the insured's liability.") (emphasis added); *see also Murphy*, 17 Cal. 3d at 941 ("The insurer's duty to settle does not directly benefit the injured claimant. In fact, he usually benefits from the duty's breach"); *Hand*, 23 Cal. App. 4th at 1857 (recognizing "*Murphy* disallows such a [would-be insurance contract third-party] beneficiary from claiming the benefits of a duty under the implied covenant that was not implied or posited to protect its interests under the contract"); *Nw. Mut. Ins. Co. v. Farmers' Ins. Grp.*, 76 Cal. App. 3d 1031, 1042 (1978) (recognizing that under *Murphy* "an injured claimant may not enforce the insurer's duty to effect reasonable settlement arising out of the implied covenant of good faith and fair dealing because it was intended to benefit the insured, not the injured claimant."). Indeed, for all its claims that the Survivors stand to lose a vital right and point of leverage by way of the Plan, the Committee fails to cite ***a single case*** holding an injured claimant has any right to wield such leverage over the Debtor's insurers. That is because California law expressly denies the existence of such a right.

The Plan's effect on potential future Bad Faith Failure to Settle causes of action is thus not uncertain. It does, however, raise undecided questions of California law. The parties may, in the future, advance diverging arguments about how a California state court would decide these questions, as is the parties' right to protect their diverse interests. However, a Plan's implication of undecided questions of state law is capable of adequate disclosure, and the Second Amended Disclosure Statement will adequately disclose this risk. Moreover, the risk to be disclosed is not so grave such that it would be inappropriate to expect Holders of Claims to vote yes or no on the Plan upon adequate disclosure of that risk. Indeed, the risk is the potential loss of a windfall to the Survivors based on hypothetical, future bad faith by the Debtor's insurers. It is not the loss of a state law right on the part of the Survivors. Far from depriving the Survivors of any rights or interests under the law, the Plan in fact gives the Survivors ***more rights*** than they have today by assigning all the Debtor's insurance rights to the Survivors' Trust and, in turn, to the Survivors themselves.

3. The Committee's Proposed "Solution" Accomplishes Nothing

The Committee proposes alternate Plan language that it believes would alleviate the alleged defect under the current Plan of extinguishing a cause of action for Bad Faith Failure to Settle post-discharge. UCC Brief, 3:3-16. Setting aside the Debtor's strong disagreement that the current Plan suffers from such a defect, the language the Committee proposes is hopelessly ambiguous and therefore unworkable. At best, it accomplishes the same thing as the current Plan by permitting the Survivors to recover against Non-Settling Insurers for their covered claims while shielding the Debtor from any such liability. At worst, it eliminates the discharge at the core of the Plan and the Chapter 11 Case, exposing the Debtor to potential liability. If the Committee intends the former interpretation, the same questions of California law as to whether such a Plan would extinguish a future Bad Faith Failure to Settle cause of action apply, as the Debtor would be protected from an above-limits judgment. The California cases the Committee and Insurers cite turn on the practical reality of an insured probate estate with no assets, not the existence of a discharge. The Committee has not explained how delaying the Debtor's discharge would resolve the problem it claims exists, if the Debtor is not at risk from an over-limits judgment. On the other hand, if the Committee intends the latter interpretation, exposing the Debtor to ongoing risk from an over-limits judgment, that would defeat the purpose of the Debtor seeking the protections of Chapter 11 and the fundamental principles underlying a Chapter 11 discharge. The Debtor will never agree to that.

B. The Forthcoming Second Amended Disclosure Statement Will Adequately Advise Creditors of Risks Associated with Bad Faith Claims as Required Under 11 U.S.C. 1125.

The Bankruptcy Code requires the Disclosure Statement to provide "adequate information" to creditors voting on the Plan. 11 U.S.C. § 1125(a), (b). Adequate information means "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records … that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan." *Id.* Thus, the Bankruptcy Code expressly places limits on what is "reasonably practicable." *Id.* Differently put, the Code does not require that unsettled questions of state law be resolved before the Disclosure Statement can be approved.

As discussed *supra*, the Second Amended Disclosure Statement will contain language to disclose the risk of arguments the Insurers may make contesting whether the Survivors may assert causes of action

for bad faith and the relative position of the parties with respect thereto. The Executive Summary will also notify readers that the Insurance Assignment entails certain risks and will direct readers to the relevant disclosure language.

In addition, as described above, the Debtor proposes amending the language to Section 5.14 of the Plan to clarify that it is not intended to foreclose direct bad faith causes of action as contemplated under the *Hand* decision. The Second Amended Disclosure Statement will likewise disclose the risk that the Insurers will argue California law does not permit the Debtor (or the Survivor's Trust as assignee) to hold or assign a cause of action for Bad Faith Failure to Settle post-confirmation. Disclosure of this unsettled area of California law is sufficient to apprise Holders of Claims that an additional source of additional funds ***unrelated*** to any interests the Survivors hold, but nonetheless potentially available to them should the Debtor's Insurers engage in certain bad faith conduct in the future, may be deemed unavailable depending on California courts' answers to these undecided questions of state law. But that issue will be decided by another court in another case. Section 1125 of the Code only requires this Court to evaluate the disclosure of the legal question, not to answer the legal question.

Ultimately, the purpose of a disclosure statement is to provide adequate information so voting creditors can make their own decisions to vote for or against a plan. Disclosure statements routinely include information on relevant risk factors. While the Debtor recognizes the Court's concern that the risk regarding Bad Faith Failure to Settle claims is distinct because of the impact confirmation itself may have on such claims, the same principle should apply. The Disclosure Statement should apprise Holders of Claims in Class 4 and Class 5 of the risk inherent in the unsettled issues of state law and the Insurer's position on those issues, and the Holders should be able to make their own decision as to whether to accept that risk by voting on the Plan. The Court should overrule the Committee's objection that the Insurance Assignment renders the Plan patently unconfirmable.

The Insurance Assignment does not violate California law in any respect. Because the effect of a discharge on hypothetical future Bad Faith Failure to Settle claims is an unsettled question under California law, the Insurance Assignment as currently written cannot possibly render the Plan patently unconfirmable.

II. CONCLUSION

For the foregoing reasons, the Court should approve the Disclosure Statement, as amended, and allow Holders of Claims to vote on the Plan. The language in the Debtor's forthcoming Second Amended Disclosure Statement will be adequate to disclose the risks associated with the Plan's effect on bad faith causes of action and meets the standard articulated under 11 U.S.C. § 1125.

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