

Declaratory Action to Determine Coverage before Litigation of Underlying Action Is Not Ripe

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A federal bankruptcy court in New Jersey has dismissed a chapter 11 debtor's declaratory judgment action against its D&O insurer seeking a determination whether the policy afforded coverage, holding that the lawsuit was not ripe because no concrete facts regarding liability had been established in the underlying action. *In re Grand Court Lifestyles, Inc.*, 2004 WL 965890 (Bankr. D.N.J. Mar. 24, 2004).

The insurer issued a D&O policy to a company that acquired, managed and sold senior living communities. The company eventually filed for chapter 11 bankruptcy protection. During the pendency of the bankruptcy, the committee of unsecured creditors (the Committee) filed suit against the directors and officers of the company for allegedly overstating property values. The insurer agreed to advance defense costs subject to a reservation of rights.

The confirmed bankruptcy plan enjoined litigation against the directors and officers unless "the actions and the officers and directors are covered by the [company's] Directors and Officers Liability Insurance or similar insurance policies which coverage actually defends, holds harmless and completely protects the affected [directors and officers] from any and all costs and liability." The company filed a declaratory judgment against the insurer, arguing that it was necessary to determine whether coverage existed as a predicate to the Committee continuing its action against the directors and officers.

The bankruptcy court granted the insurer's motion to dismiss on ripeness grounds. The court initially outlined three principles to be considered in determining ripeness in a declaratory judgment action:

- (i) The adversity of the interest of the parties,
- (ii) The conclusiveness of the judicial judgment and
- (iii) The practical help, or utility, of the judgment.

Applying these principles, the court first determined that the insurer and the company did not currently possess adverse interests because, while there was a possibility that a coverage dispute might arise based on certain exclusions in the policy, the probability was not yet real or substantial. The court explained that "adversity will only exist if the litigation of the [Underlying] Action results in findings about the Directors and Officers to which the D&O Policy exclusions might apply." Therefore, adversity could not be established because at this stage "it is simply not possible to know what facts will be established regarding [the directors and officers conduct]." The court also rejected the company's contention that a determination regarding coverage was necessary in order to comply with the confirmed bankruptcy plan. The court reasoned that because the insurer was advancing defense costs consistent with its contractual obligation, any judgment regarding coverage at this point would be at odds with the insurance contract.

With respect to the second factor, the court stated that "there are simply no concrete facts from which this Court can determine that [the insurer] is obligated to indemnify [the company] or the Directors and Officers." Finally, as to any utility the declaratory judgment action might provide, the court held that "[t]his criteria plainly cannot be met because it[] is presently sheer speculation whether any liability will be found which will give rise to a covered liability."

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