

# Validity of Conseco Coverage Decision Challenged in Bankruptcy Proceeding

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February 2003

Conseco has filed an adversary proceeding in its pending bankruptcy case in the U.S. Bankruptcy Court for the Northern District of Illinois, arguing that the continued litigation of an insurance coverage action filed by Conseco in Indiana state court and an order entered in that action (*see page 1 of this issue*) violated the automatic stay of the Bankruptcy Code. The bankruptcy court had not ruled on that motion when this issue of *The Executive Summary* went to press.

On November 26, 2002, an Indiana trial court presiding over the coverage litigation arising out of securities litigation against Conseco stated that it would grant the insurer's motion to dismiss in a telephonic status conference, although it did not issue the dismissal order at that time. Thereafter, the insurers each submitted a draft opinion and order to the trial court. On December 17, 2002, before the Indiana court had issued its order, Conseco filed a voluntary chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Illinois. On December 27, 2002, Conseco instituted, under Section 362 of the Bankruptcy Code, an adversary proceeding in the bankruptcy court seeking to enforce the automatic stay and to enjoin the coverage action. Four days later, the trial court issued an opinion and order dismissing the case. According to Conseco, the trial court signed the exact opinion and order submitted by one of the insurers.

Conseco's argument challenging the trial court's order in the coverage action is based on Section 362 of the Bankruptcy Code, which provides that the filing of a bankruptcy petition operates as a stay of the "commencement or continuation...of a judicial, administrative, or other action or proceeding against the debtor." 11 U.S.C. § 362. Although Section 362 on its face applies only to actions "brought *against* the debtor," and the Indiana action was "brought *by* the debtor," Conseco argued that because the coverage action was a declaratory judgment action, the roles of plaintiff and defendant are effectively reversed. Thus, according to Conseco, unlike an ordinary lawsuit, its assets are at risk in the coverage action, and an adverse ruling would effectively diminish the estate's assets by forcing Conseco to satisfy the settlement in the underlying securities litigation out of its own pocket.

In their responsive pleadings, the insurers made three arguments. First, the insurers argued that the automatic stay does not apply because the trial court had issued an oral ruling dismissing the coverage action three weeks before Conseco filed for bankruptcy protection. Thus, according to the insurers, the trial court's written opinion simply memorialized the oral order rendered by the court prior to Conseco's filing for bankruptcy.

Second, the insurers argued that the automatic stay is inapplicable because Conseco instituted the coverage action. The insurers relied on 7th Circuit precedent, such as *In re Hall*, 304 F.3d 743, 745 (7th Cir. 2002), that holds that claims brought by a debtor are not automatically stayed. Moreover, the insurers contended that Conseco was obligated to satisfy the settlement agreement pre-petition, and thus any judgment it obtained in the coverage action would expand the bankruptcy estate by reimbursing the estate for the amount it was already obligated to pay under the settlement agreement. Similarly, if Conseco was unsuccessful in the coverage action, it would remain in the same pre-petition posture – it would still be obligated to satisfy the settlement agreement. Conseco's assets therefore were not at risk in the coverage action. Finally, the insurers contended that even if the coverage action had been subject to the automatic stay, an order dismissing the case would not have violated the stay because the trial court took the motion to dismiss under advisement prior to the bankruptcy petition being filed.

For more information, please contact one of [WRF's Professional Liability Attorneys](#) at 202.719.7130.