

S.D.N.Y.: D&O Insurance Coverage Action a Core Proceeding

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The United States District Court for the Southern District of New York has denied an insurer's motion to withdraw the reference of an insurance coverage adversary proceeding, holding that action was a core proceeding. *Cohen, et al. v. Forman, et al. (In re County Seat Stores, Inc.)*, No. 01 Civ 2966 (JGK), 2002 U.S. Dist. LEXIS 1555 (S.D.N.Y. Jan. 31, 2002). The decision is inconsistent with a recent decision by a bankruptcy judge. See *Two Massachusetts Federal Judges Conclude That Insured v. Insured Exclusion Does Not Apply to Bankruptcy Trustee* (this issue, page 2).

The action arose out of a claim for coverage under a D&O policy for an adversary proceeding brought by a Chapter 11 trustee against former directors and officers of the debtor. The insurer determined that the claim was barred by the insured v. insured exclusion and demanded that the directors and officers arbitrate the coverage dispute. The Trustee responded by filing a coverage action against the insurer in the bankruptcy court, seeking a declaration that the D&O policy is property of the bankruptcy estate, that the insured v. insured exclusion does not apply, and that the insurer's demand for arbitration violated the bankruptcy court's automatic stay. The directors and officers intervened in the insurance coverage action and moved for summary judgment on the insured v. insured exclusion. In response, the insurer moved to withdraw the reference of the coverage action from the bankruptcy court to the district court.

The district court denied the insurer's motion on the grounds that coverage action filed by the Trustee was a core proceeding. The court observed that "whether a contract proceeding is a core proceeding depends on: (1) whether the contract is antecedent to the reorganization petition and (2) the degree to which the proceeding is independent of the reorganization." The court noted that the coverage action involves a pre-petition insurance contract. However, the court analogized the case to *In re United States Line, Inc.*, 197 F.3d 631 (2d Cir. 1999), and held that the action was core because "the bankruptcy court could not easily proceed with its core function of effecting an equitable reorganization without deciding the coverage dispute in the case." A factor weighing in favor of finding that the action is a core proceeding, the court held, was that the coverage action would decide whether the debtor would be required to indemnify its former directors and officers, potentially depleting the bankruptcy estate. Moreover, the court asserted that the insurance proceeds might be the most valuable asset of the estate.

The court also found that considerations of judicial economy weighed in favor of finding that the coverage action was a core proceeding. The bankruptcy court had already invested significant time and resources in the action. Likewise, the bankruptcy court was familiar with the procedural history and facts of the case. Lastly, the resolution of the applicability of the insured v. insured exclusion would require the expertise of the bankruptcy court.