

Suit Involving Rescission and Coverage Issues Held to Be Non-Core

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The U.S. Bankruptcy Court for the Southern District of Ohio has held that an adversary proceeding between a policyholder and its excess insurer regarding whether directors and officers insurance policies were obtained through misrepresentations by the insureds and, if not, regarding the proper allocation of policy proceeds between competing claimants is non-core under 28 U.S.C. § 157. *In re Nat'l Century Fin. Enters.*, 312 B.R. 344 (S. D. Ohio July 23, 2004).

The policyholder purchased primary and excess D&O policies from two separate insurers. After voluntarily filing for relief under chapter 11 of the Bankruptcy Code, the policyholder exercised an option to purchase a one-year extended discovery period for the policy. The policyholder later filed an adversary proceeding in bankruptcy court against the insurers, seeking relief including a declaration that the policies were not void on the basis of misrepresentations in the applications, a declaration seeking a "fair and equitable procedure" for determining allocation of policy proceeds to competing claimants, and a declaration of the proportional share of each claimant to policy proceeds. The excess insurer asserted counterclaims for rescission and fraud, and subsequently filed a motion with the federal district court to withdraw the reference to the bankruptcy court pursuant to 28 U.S.C. § 157(d). The district court concluded that the bankruptcy court should make the initial determination of whether the adversary proceeding was core, and dismissed the motion to withdraw as premature.

The bankruptcy court concluded that the parties' claims and counterclaims were non-core. In so ruling, the court rejected the policyholder's argument that the adversary proceeding must be core because it lacked most of the characteristics of non-core proceedings, as set forth in *In re Hughes-Bechtol*, 141 B.R. 946 (Bankr. S.D. Ohio 1992). The court emphasized that the action did not fall within the specific core proceedings identified in 28 U.S.C. § 157(b)(2)(B) through (N). The court then considered whether the cause of action would continue to exist independent of the provisions of Title 11, and rejected the policyholder's argument that the matter directly related to the assets ultimately available to creditors and thus was necessarily a core dispute.

According to the court, "a more accurate description is that [the dispute] involves a claimed right to insurance coverage and allocation created by state contract law and one that could be vindicated [] in an ordinary breach of contract suit if [the policyholder] was not bankrupt." The court also noted that there was no indication that the bankruptcy filing had affected any of the parties' rights and/or obligations under the

policies at issue, further supporting the conclusion that the dispute was non-core. Accordingly, the court concluded that the adversary proceeding "does not involve a proceeding created or determined by a statutory provision of Title 11, nor is it a proceeding that by its very nature could arise only in a bankruptcy court." The court therefore held that the adversary proceeding was non-core.

The court also rejected the policyholder's argument that the adversary proceeding was core because it purportedly concerned the administration of the estate and affected the liquidation of the estate's assets. The court relied in part on case law concluding that the "better reasoned view is that state law contract-type actions...which literally fall within the broad catchall language of 28 U.S.C. § 157(b)(1)(2)(A) and (O), are non-core, 'related' proceedings." The court also noted that the same precedents also stated that overly-broad constructions of the catchall language in § 157(b) would result in a derogation of the constitutional principles set forth by the Supreme Court in *Northern Pipeline v. Marathon*, 458 U.S. 50 (1982).

The court stated that although other courts had properly concluded that certain other matters fell within the catchall provisions of § 157(b), the adversary proceeding was different because although "[t]here is little doubt that [its] resolution...may be related to liquidation of the assets of the estate...the nexus in and of itself is insufficient to warrant classifying the matter as a core proceeding." Although the policies at issue potentially would increase the estate's assets for distribution, the court concluded that the effect that it would have on the administration of the estate was "insufficient to render the proceeding core," reasoning that "[the policyholder] has yet to articulate how the [excess policy] is a necessity or an integral part to its successful reorganization." Further in that regard, the court observed that the adversary proceeding did not have a "close nexus" to the bankruptcy, concluding that the policyholder had failed to show that the policies were "linchpin or integral to the reorganization effort." According to the court, even if the proceeding relates to, or implicates the distribution of, the estate's assets, "the invocations of 'implications' and 'relationships' by themselves do not make a demonstrable nexus between the [adversary proceeding] and the bankruptcy that warrants classifying the matter as core."

Finally, the court rejected the policyholder's argument that the matter was core because it arose from post-petition contracts (because the discovery periods were purchased post-petition). The court reasoned that the purchase of the one-year discovery period extended the original policies rather than creating new contracts, and thus did not constitute post-petition contracts, whose interpretation would necessarily be core matters.

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