

District Court Declines to Withdraw Reference to Bankruptcy Court for Coverage Litigation Concerning I v. I Exclusion

May 2004

The United States District Court for the Northern District of Illinois declined to withdraw the reference to the bankruptcy court of a declaratory judgment action concerning an I v. I exclusion in a D&O policy, holding that prompt and efficient resolution of the matter would be served by allowing the bankruptcy court to decide the matter. *In re HA 2003, Inc.*, 2004 WL 609799 (N.D. Ill. March 24, 2004).

The insured company filed for bankruptcy. After the company sued its former CEO, alleging that his breach of fiduciary duty precipitated the company's bankruptcy, the district court referred that lawsuit to the bankruptcy court. The CEO sought coverage from the company's D&O insurers, and the insurers reserved their rights under the applicable insurance policies based on, among other things, the I v. I exclusion. The company then brought a declaratory judgment action in the bankruptcy court seeking a determination that the I v. I exclusion was inapplicable to its claim. At that point, the insurers filed a motion with the district court to withdraw the reference of the declaratory judgment action from the bankruptcy court.

The district court denied the insurers' motion to withdraw the reference, holding that the declaratory judgment action should proceed in the bankruptcy court. The court explained that it may withdraw a reference "for cause shown," which is determined based on a variety of factors, including judicial economy and efficiency, as well as whether the proceeding is core or non-core. Although the court first found that the declaratory action was a non-core bankruptcy proceeding because it did not arise under the Bankruptcy Code, it reasoned that a number of other factors militated in favor of declining to withdraw the reference. The court explained that judicial economy and efficiency would be hindered by a withdrawal of its reference since the bankruptcy court was familiar with the parties and the coverage issues involved and was already overseeing discovery in the case. The court further opined that the declaratory judgment action, though "non-core," raised some Bankruptcy Code interpretation issues including whether the insured could act on behalf of creditors and whether the I v. I exclusion contained an exception in the case of bankruptcy. Finally, the court stated that it was no more competent than the bankruptcy court to resolve issues of state insurance law.

For more information, please contact us at 202.719.7130.