

Bankruptcy Court Lacks Jurisdiction over WaMu Coverage Lawsuit

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The United States Bankruptcy Court for the District of Delaware has dismissed an insurance coverage action against several traditional directors and officers liability and "Side A" insurers, finding a lack of bankruptcy jurisdiction. *Washington Mutual, Inc. v. XL Spec. Ins. Co.*, Adv. No. 12-50422 (Bankr. D. Del. Oct. 4, 2012). Wiley Rein represented the primary traditional D&O and Side A insurers.

Washington Mutual, Inc., as debtor-in-possession, filed the lawsuit against the insurers, alleging breach of contract and breach of the duty of good faith based on the insurers' denial of coverage for a demand by Washington Mutual and a creditors committee against the company's former directors and officers. The company sought also to equitably subordinate or to disallow any claims by the insurers for subrogation to the rights of the former directors and officers for indemnification.

The bankruptcy court found that subject matter jurisdiction was lacking for the breach of contract and implied duty of good faith counts. According to the court, the only possible jurisdictional category in which the case might have fallen is "related to" bankruptcy jurisdiction. Following confirmation of a chapter 11 bankruptcy plan, "related to" jurisdiction is narrowed to cases having a "close nexus" to the bankruptcy plan or proceeding.

The plaintiff argued that jurisdiction existed because creditors would receive "more money sooner" if the action were adjudicated in bankruptcy court. The plaintiff cited in support a reserve being held for defense costs for the underlying claim, which, it alleged, would be released depending on the outcome of the coverage litigation. The court rejected this argument, noting that the confirmed bankruptcy plan called for approximately \$7 billion to be distributed to various creditors and shareholders, including payment in full (with interest) to most unsecured creditors. Accordingly, the impact of releasing the defense cost reserve would be *de minimus* in comparison to the \$7 billion distributed under the plan, and the assets of the post-confirmation trust would not be augmented or diminished significantly by any decision regarding coverage. The court also rejected the plaintiff's argument that the case required interpretation of the confirmed bankruptcy plan and the confirmation order because any interpretation would not be essential to the integrity of the plan and its implementation. Moreover, the court found that the plan and confirmation order could be interpreted by other courts. The court further disagreed with the plaintiff's argument that jurisdiction could be found based on the plan itself because the case did not otherwise present a "close nexus."

The court also dismissed counts seeking declaratory judgment that the defendant insurers could not be subrogated to claims by the insured directors and officers for indemnification of defense costs from the company or that any such claims should be equitably subordinated. The court found that no "actual controversy" existed with respect to these counts because the insurers could assert claims for subrogation only to the extent of actual payment under the policies. Accordingly, the court found the subrogation and equitable subordination counts to be "far too hypothetical and speculative to constitute an actual controversy at this stage" and dismissed the counts for lack of jurisdiction.