

## District Court Denies Trustee's Motion to Refer Rescission Action to Bankruptcy Court

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The U.S. District Court for the District of Utah denied a bankruptcy trustee's motion to refer a pending rescission and coverage action to bankruptcy court, rejecting the trustee's contention that the action was a core proceeding and holding that judicial efficiency and fairness required that the action proceed in the district court. *Executive Risk Indem. Inc. v. Lewis, et al.*, Case No.: 2:04-CV-01115 PGC (Order, Dckt. No. 126, filed September 11, 2006). Wiley Rein & Fielding represents the insurer in this action.

The insurer issued a not-for-profit directors, officers and trustees liability policy to a non-profit organization. The policy was renewed. After the policy was renewed in 2004, the policyholder filed for bankruptcy, and a bankruptcy trustee was appointed by the bankruptcy court. Subsequently, the U.S. attorney for the district of Minnesota indicted the organization and certain of its directors and officers for allegedly participating in a scheme to defraud school districts and federally insured financial institutions. The attorney general of Ohio also filed a suit against the former directors and officers of the organization asserting claims of fraud, conspiracy and breach of fiduciary duty.

The insurer initially filed a rescission action against the directors and officers of the organization seeking a declaration that the policy was void *ab initio* based on misrepresentations in the renewal application process. The original complaint did not name the organization due to the automatic stay resulting from the organization's bankruptcy. Although the bankruptcy court denied the insurer's motion for relief from the automatic stay, the insurer and the bankruptcy trustee subsequently entered into a stipulation lifting the automatic stay, which the bankruptcy court then approved.

The stipulation permitted the insurer to name the trustee and the debtor as defendants in the instant coverage action. When the insurer filed an amended complaint in the district court naming the trustee and the organization, however, the trustee moved for an order referring the case back to the bankruptcy court. In denying the trustee's motion to refer the case to the bankruptcy court, the district court first held that the rescission action was not a core proceeding. The court reasoned that the insurer sought "to sever itself from any involvement with [the organization] or its estate, rather than claim[] any priority over assets or seek[] monetary benefit from the estate."

While the court noted that the insurer had previously conceded that at least a small part of the policy proceeds could be property of the estate due to the existence of entity coverage, it nonetheless reasoned the action was not core because the insurer's "amended complaint attacks the alleged material misrepresentations made to it before the bankruptcy" since "the parties are in dispute as to whether the policy was void *before* the bankruptcy filing." Further, the court noted that the bankruptcy court lifted the automatic stay to permit the rescission action to proceed in the district court and concluded that "the bankruptcy court has implicitly decided that even if the litigation is a 'core' proceeding, it could proceed first" in the district court.

The court also found that judicial efficiency and fairness required it to retain jurisdiction. In this regard, the court noted that several of the defendants had demanded a jury trial and that, were the court to refer the action to the bankruptcy court, it would immediately return to the district court because of the jury demands. Given that the automatic stay had been lifted and the presence of the jury demands, the court concluded that denial of the trustee's motion to refer the case to the bankruptcy court would increase judicial efficiency.