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This Time Is Different: Core Bankruptcy Jurisdiction for Insurance Coverage Lawsuits for Coronavirus-Related Claims

By Mark D. Silverschotz and Bruce Strong

When bankruptcy lawyers consider legal issues associated with how a debtor's insurance assets are treated in a typical Chapter 11 reorganization (or even a Chapter 7 liquidation), they're usually confronted with how to handle claims that might be covered by so-called "third-party" insurance policies. That is, in toxic tort cases (asbestos, medical device, other products liability matters), a debtor's "general liability" insurance will provide coverage for claims against the debtor's estate. In these cases, insurance policies are often placed into a reorganization trust for the benefit of creditors who are then left to fend for themselves against often recalcitrant insurance companies.

In the new world of COVID-19 business disruption, however, the insurance issues presented to current and not-yet debtors more commonly focus on first-party insurance policies. Those policies are designed to protect the actual "property" of the policyholder, and to provide a measure of safety so that business interruptions caused by covered events don't result in the failure of their business. Similarly, companies that organize conferences, tournaments, and other commercial gatherings often purchase "event cancellation" insurance policies. Those policies are designed to provide direct payment to the policyholder for a covered "occurrence," and consequently keep the policyholder company alive.

It will come as no shock to anyone familiar with the insurance industry that on occasion, when presented with an ostensibly covered claim, some insurance companies will declare the loss is not covered, or, even if initially covered, is nevertheless subject to an "exclusion" preventing payment. In cases of improper or "bad faith" insurance company recalcitrance, where denying a claim payment causes failure or material damage to the policyholder, that policyholder can claim damages for:

- breach of the insurance company's statutory obligation to deal in good faith with policyholders,

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- breach of the contractual covenant of "good faith and fair dealing" (whether express or implied), or
- some combination of the above.[1]

In insurance litigation jargon, among policyholder attorneys, such causes of action are sometimes referred to as "death of the company" claims, and the foundation for such claims (tort, contract, statute) will depend on which state's laws are applicable. In the bankruptcy context, whether these claims can be brought — and kept — in the bankruptcy court is often a direct function of whether the claims are based upon tort, contract, or statutory rights, but mostly depends on when the acts and transactions complaints arose. This article focuses on the treatment of death-of-the-company claims and identifies when post-petition bad faith conduct gives rise to a bankruptcy estate's lawsuit that falls within the "core" jurisdiction of the bankruptcy court.[2]

Insurance Coverage Lawsuits for Post-Petition Bad Faith Are Core Proceedings

An adversary proceeding respecting insurance coverage may arguably be a core proceeding[3] if:

- it is an action respecting the administration of the estate,
- it arises principally out of defendants' post-petition misconduct, or
- defendants impliedly consented to the jurisdiction of the bankruptcy court by committing post-petition torts against the debtor, or by filing a proof of claim.[4]

Post-petition conduct can confer core jurisdiction in the bankruptcy courts even when the conduct complained of would normally be governed by state law.[5]

A core proceeding may exist where the conduct complained of is the *post*-petition bad faith and breach of contract of the defendants with respect to *pre*-petition contracts of insurance. Bad faith claims, again, may have a tort, contract, or statutory basis. As stated in *Columbia Gas*, an insurance company's failure to proceed in good faith is "intertwined with reorganization issues," because an insurance company's failure to honor its commitments will either materially damage an estate post-petition, or force the debtor into liquidation.

The decision in *Baltimore Motor Coach* is instructive. There, the debtor, which had been in the business of providing transportation, was the beneficiary of a pre-petition insurance policy. After the debtor's filing for Chapter 11 protection, its insurer notified the debtor-in-possession that it would not renew the debtor's liability policy. The debtor could no longer operate its business without insurance, and was forced into liquidation.[6]

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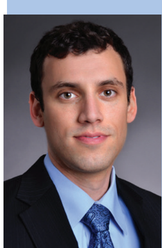

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The Chapter 7 trustee then sued the insurance company in tort, alleging "that the actions of the defendant [insurer] were intentional, malicious and in bad faith and as a direct and proximate result thereof the debtor suffered damages that resulted in the eventual closing of the business."[7] The court found that the trustee's action was core, holding that a "complaint filed by the trustee in bankruptcy *under either tort or contract theory* against insurers for postpetition misconduct committed against a debtor while it was a debtor-in-possession is a core proceeding . . . ."[8]

Where a debtor or trustee sues an estate's insurance company, alleging tortious *post*-petition bad-faith acts that damaged the estate or forced the debtor to liquidate rather than reorganize as a going concern, a core proceeding will exist. In the event that the misconduct "straddles" the petition date and, as a consequence, the debtor or trustee also alleges *pre*-petition tortious acts, the consequences of the *post*-petition acts will likely predominate. As stated in *O'Sullivan's Fuel*:

> [W]hen the postpetition acts complained of heavily dominate in terms of *frequency, significance and effect* compared to the prepetition acts, a proceeding brought to attach liability based on the totality of such acts will be considered a core matter.[9]

To be sure, there is case law suggesting that purely pre-petition bad faith acts will not necessarily convert a non-core proceeding into a core one,[10] but where bad faith conduct occurs post-petition, or "straddles" the bankruptcy petition date, that may be sufficient foundation to proceed under the bankruptcy court's core jurisdiction.

As the insurance industry begins to argue that the insurance policies it sold to its customers — designed to provide coverage for exactly the sort of disaster individuals and businesses are currently facing — now, magically, are not available to respond to the COVID-19 crisis, policyholders and their counsel need to realize this is nonsense, and if they end up in bankruptcy, with the insurance company's unjustified recalcitrance continuing post-petition, they may bring a "core" lawsuit in the bankruptcy courts, seeking to vindicate their rights.

ENDNOTES

1 *As a technical matter, in many states one need not necessarily prove actual damages to state a viable bad faith cause of action. Further, space considerations prevent discussion of specific insurance policy coverages and exclusions.*

2 *Simply put, in a "core" proceeding the bankruptcy court may issue final judgments. In non-core proceedings (matters merely "related to" the bankruptcy case), the court may only issue proposed findings of fact and conclusions of law subject to plenary review in the district court. Such "related to" proceeding are also subject to material risk of abstention by the bankruptcy court. See generally, 28 U.S.C. §157 and 28 U.S.C. §1334(c)(2).*

3 *Pursuant to 28 U.S.C. § 157(b)(2)(A)*

4 *Some cases suggest that something more than jurisdiction under 28 U.S.C.§157(b)(2)(A) and (O), respecting case administration and the "adjustment" of debtor-creditor relations, is required to confer core jurisdiction. That interesting debate is for another time and place.*

5 *See In re Ben Cooper, 896 F.2d 1394, 1400 (2d Cir. 1990), vacated on other grounds, 498 U.S. 964 (1990), opinion reinstated, 924 F.2d 36 (2d Cir.1991) (bankruptcy court has core jurisdiction over contract claims when contract is entered into post petition); Matter of Columbia Gas System, Inc., 164 B.R. 883, 885 (Bankr. D. Del. 1994)("Columbia Gas") (action based on debtor-employer's post-petition conduct relating to a pre-petition contract was a core proceeding because the "factual and legal issues raised in the proceeding [we]re intertwined with reorganization issues"); In re Baltimore Motor Coach Co., 103 B.R. 103 (Bankr. D. Md. 1989).*

6 *103 B.R. at 104-05*

7 *Id. at 105*

8 *28 U.S.C. § 157(b)(2)(A) at 106 (emphasis supplied).*

9 *In re O'Sullivan's Fuel Oil Co., 88 B.R. 17, 20-21 (D. Conn. 1988)(emphasis supplied) Other courts have similarly ruled. See Germain v. Connecticut Nat'l Bank, 988 F.2d 1323, 1328 (2d Cir. 1993)(affirming core jurisdiction finding, while focused upon availability of jury*

trial)("While Bankruptcy Code provisions may be implicated here, the essence of the Trustee's allegations is that CNB's actions were inconsistent with its role as the debtor's primary lender and that as a consequence the debtor's business was destroyed."); In re Scrima, 116 B.R. 951,952 (Bankr. W.D. Mich. 1990)("The claim of Scrima against Transamerica is a core proceeding, as it relates to the enforcement of the provisions of an insurance policy for a post-bankruptcy petition loss. Pursuant to 28 U.S.C. 157(b)(1), the Court may enter a final order.").

10 *cf., In re Guenther, 65 B.R. 650 (Bankr. D. Colo. 1986),*