WHEN JURISDICTIONS COLLIDE: DETERMINING JUDICIAL ROLES WHEN BANKRUPTCY COURT AND INSURANCE RECEIVERSHIP COURT RESPONSIBILITIES OVERLAP

Wm. Carlisle Herbert

A federal bankruptcy court and a state insurance receivership court[1] have a similar responsibility: to supervise a court-appointed trustee or receiver

1. In this article, the term "receivership" is used as a general term covering a court-ordered liquidation, conservation, or rehabilitation, and the term "receiver" correspondingly is used

Wm. Carlisle Herbert is a partner in the Chicago office of Foley & Lardner LLP, where he is a member of the Insurance Industry Team and Insurance Dispute Resolution Practice.

in the collection of assets belonging to a financially troubled or insolvent company and, if necessary, to supervise the equitable distribution of those assets to estate creditors in accordance with prescribed priorities. The courts also have a similar authority: they both exercise *in rem* jurisdiction, controlling the property that may be distributed to the creditors of the property owner. From time to time, the responsibilities of a bankruptcy court and an insurance receivership court overlap, and it is necessary for the courts to determine their respective responsibilities with regard to the matters in controversy.

Several doctrines have been invoked by parties contesting which court should handle a matter, and the courts at times have expressed varying attitudes about what the respective judicial responsibilities should be. At first glance, the result may appear to be a sprawl of case law, without firm boundaries or interior structure. When the issues are sorted into categories, however, it is apparent that the case law has produced a discernable landscape of guiding principles, narrowing the issues on which the courts have expressed differing views.

I. INTRODUCTION

This article breaks the issues into four basic categories: (1) issues presented when both a debtor in bankruptcy[2] and an insolvent insurer have claims to particular property; (2) issues presented when a debtor has a claim against an insolvent insurer; (3) issues presented when the receiver of an insolvent insurer has a claim against a debtor; and (4) issues presented when the interests of the debtor and of the insolvent insurer are involved in claims by or against third parties. When authorities are examined within these categories, it is possible to reach some tentative conclusions about the rules governing jurisdictional conflicts between federal bankruptcy courts and state insurance receivership courts.

Where both a debtor and an insolvent insurer have claims to particular property, the court in which an estate was first created generally has been given responsibility for determining which company has a valid claim to the property. This result is consistent with the long-standing first-assuming-jurisdiction doctrine developed by the U.S. Supreme Court. Lower federal courts, however, have recently addressed the issue by reaching differing

as a general term covering a court-appointed liquidator, conservator, or rehabilitator. Thus, the article adopts the meaning attributed to these terms by the National Association of Insurance Commissioners' Insurer Receivership Model Act ("IRMA"). *See* IRMA §§ 104.X and 104.Y. The general terms are employed here to simplify case descriptions where differences among the specific kinds of proceedings are not material to the discussion.

2. To simplify terminology, the term "debtor" will be used here to refer to a debtor in bankruptcy or a company that later becomes a debtor in bankruptcy.

conclusions about the efficacy of the McCarran-Ferguson Act[3] to limit the jurisdiction of a federal bankruptcy court. Further development of the case law will be necessary to determine whether the first-assuming-jurisdiction doctrine or the McCarran-Ferguson Act or neither properly governs this issue.

In many cases where a debtor has a claim against an insolvent insurer, a bankruptcy court will be required to yield responsibility for resolving the claim to an insurance receivership court by operation of a mandatory abstention provision applicable in some bankruptcy proceedings.[4] Moreover, a bankruptcy court has discretionary authority to abstain "in the interest of comity with State courts or respect for State law."[5] Case law suggests that the bankruptcy court is likely to abstain where a debtor's claim presents only state law issues on the ground that these issues are best resolved by the state court. On the other hand, common law abstention cases suggest that a bankruptcy court may retain jurisdiction if the debtor's claim presents federal issues and if the court concludes that the federal policies involved outweigh the benefits of centralized claims adjudication in the state receivership court.

Where an insolvent insurer has a claim against a debtor, it appears a bankruptcy court as a general rule will retain jurisdiction because the adjudication of this kind of claim falls within the court's core responsibilities. Case law suggests, however, that the bankruptcy court may yield jurisdiction if a specific issue presented by the insurer's claim falls within the core responsibilities of the insurance receivership court or if adjudication by the state court would be convenient for the bankruptcy court.

Where the interests of a debtor or of an insolvent insurer are involved in claims by or against third parties, considerations similar to those affecting claims between a debtor and an insolvent insurer appear likely to govern the question whether the bankruptcy court or the insurance receivership court will decide the claim. The case law suggests that a bankruptcy court will most likely yield jurisdiction to the insurance receivership court where adjudication of the claim falls within the core responsibilities of the receivership court.

II. BASIC DIVISION OF RESPONSIBILITIES

Before turning to the four categories listed above, it may be useful to note that a federal bankruptcy court and a state insurance receivership court do not have overlapping jurisdiction with respect to the companies over which they have responsibility. A bankruptcy court cannot acquire jurisdiction

3. 15 U.S.C. § 1012(b) (2000).
4. *See* 28 U.S.C. § 1334(c)(2) (2000).
5. 28 U.S.C. § 1334(c)(1) (2000).

over a domestic insurance company because this type of company is specifically excluded from the definition of "debtor" under the Bankruptcy Code and is thus excluded from the protection of the bankruptcy laws.[6]

The Bankruptcy Code alone does not eliminate any potential for conflict between a federal district court and a state court over control of an insolvent insurer. In *Penn General Casualty Co. v. Commonwealth of Pennsylvania ex rel. Schnader*,[7] a stockholder of a Pennsylvania insurer invoked the diversity jurisdiction of a federal district court and obtained an order restraining the company from permitting anyone to take possession of its property and enjoining all persons from interfering with it in any way. The U.S. Supreme Court held that, by its actions, the federal court had acquired *in rem* jurisdiction over the insurer to the exclusion of later receivership proceedings in a Pennsylvania state court. Where two suits are either *in rem* or *quasi in rem*, the Court stated that "requiring that the court or its officer have possession or control over the property which is the subject of the suit in order to proceed with the cause and to grant the relief sought, the jurisdiction of one court must of necessity yield to that of the other."[8] Moreover, the Court declared that "the court first assuming jurisdiction over the property may maintain and exercise that jurisdiction to the exclusion of the other."[9] As a result, the Pennsylvania state courts erred in seeking to exercise jurisdiction over the insurance company.

Penn General Casualty, decided in 1935, has not been overruled. Indeed, the first-assuming-jurisdiction doctrine continues to be recognized and applied as a viable principle of law.[10] *Penn General Casualty*, however, preceded the 1945 enactment of the McCarran-Ferguson Act, which provides that no federal statute shall be construed "to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."[11] The Supreme Court has held that a state's insurance liquidation statute is protected from federal interference by the McCarran-Ferguson Act to the extent that it serves to ensure that policyholders ultimately receive

6. 11 U.S.C. § 109(b)(2) (2006); Hawthorne Sav. F.S.B. v. Reliance Ins. Co. of Illinois, 421 F.3d 835, 841 (9th Cir. 2005), *opinion amended*, 433 F.3d 1089 (9th Cir. 2006).

7. 294 U.S. 189 (1935).

8. *Id.* at 195.

9. *Id.*; *accord* Princess Lida of Thurn and Taxis v. Thompson, 305 U.S. 456 (1939).

10. *See* Dailey v. The Nat'l Hockey League, 635 F.2d 960, 965–66 (2d Cir. 1980) (first-assuming-jurisdiction doctrine required the district court to yield its jurisdiction in an ERISA case in favor of a prior action filed in Canada because both suits involved the administration and restoration of the same trust funds); Munich Am. Reinsurance Co. v. Crawford, 141 F.3d 585, 594 n.6 (5th Cir. 1998) (court relied on the doctrine as a basis for rejecting the Ninth Circuit's conclusion that property became part an insolvent insurer's estate only if a court or arbitrator determined that the funds belonged to the insurer and thus declining to follow *Bennett v. Liberty National Fire Insurance Co.*, 968 F.2d 969, 972 (9th Cir. 1992)).

11. 15 U.S.C. § 1012(b) (2000).

payment on their claims.[12] If the issue were presented squarely today, it is possible that the Supreme Court would hold that federal courts may not exercise *in rem* jurisdiction over an insurance company to the exclusion of a state receivership court because this action would impair the state's insurance receivership statute as a whole and thus violate the McCarran-Ferguson Act.

It appears unlikely that the issue will be squarely presented, however. Even in *Penn General Casualty*, the Supreme Court noted that, although the federal district court had acquired jurisdiction,

> the end sought by the litigation in the state court is the liquidation of a domestic insurance company by a state officer. In the absence of a showing that the interests of creditors and shareholders would not be adequately protected by this procedure, the case was a proper one for the District Court, in the exercise of judicial discretion, to relinquish the jurisdiction in favor of the administration by the state officer.[13]

Given the Supreme Court's indication that the federal court should relinquish jurisdiction in favor of a state insurance receivership court, a party seeking to persuade a federal district court that it can and should exercise *in rem* jurisdiction over an insurance company to the exclusion of a state receivership court appears to have little prospect for success.

The Supreme Court's *Penn General Casualty* decision is instructive because it highlights the importance of the abstention doctrine as a means of allocating responsibilities between a federal court and a state court in connection with an insurance insolvency. Indeed, *Penn General Casualty* approves federal abstention specifically in connection with insurance insolvency proceedings. The case, however, does not have a direct bearing on the question of which court, as between a bankruptcy court and a state receivership court, is the proper forum for insolvency proceedings concerning a domestic insurer. Because domestic insurers have been excluded from the protection of the Bankruptcy Code, a bankruptcy court does not have jurisdiction with respect to an insolvent insurer.

III. WHEN A DEBTOR AND AN INSOLVENT INSURER CLAIM THE SAME PROPERTY

While a bankruptcy court and an insurance receivership court may not have jurisdiction over the same company, they may have overlapping jurisdiction with respect to the same items of property claimed by separate companies under their control. Where property owned by a company placed in bankruptcy has been transferred to an insurance company placed in receivership

12. U.S. Dep't of Treasury v. Fabe, 508 U.S. 491 (1993).
13. 294 U.S. at 197.

or where property has been transferred by the insurer in receivership to the company in bankruptcy, both companies may claim ownership.[14] Similarly, a holding company in bankruptcy and an insurance subsidiary in receivership both may have claims to a tax refund under a tax allocation agreement.[15] Where a holding company has entered bankruptcy and an insurance subsidiary has entered receivership, it may be difficult because of inadequate or missing records to determine whether the holding company or the insurance subsidiary owns particular property, such as a computer system used by both companies. In these cases, both the federal bankruptcy court and the state insurance receivership court may have a sound basis for regarding the contested property as part of the estate over which it has *in rem* jurisdiction.

The commencement of a bankruptcy case typically creates an estate, comprised in general of all the debtor's interests in property, and federal law expressly provides that the district court in which the case is filed has exclusive jurisdiction over the debtor's property, wherever it is located.[16] Several courts have noted that a bankruptcy court has jurisdiction to decide what constitutes property of the bankruptcy estate.[17] Moreover, the Bankruptcy Code provides that the bankruptcy petition operates as a stay of any action by any person to obtain possession of or control property of the bankruptcy estate.[18] Thus, if the Supremacy Clause[19] alone governed the relationship between a bankruptcy court and a state insurance receivership court, the state court could exercise jurisdiction over property claimed by a company in bankruptcy only to the extent that the bankruptcy court relinquished jurisdiction to the state court.

Several bankruptcy courts, however, have held that they lack jurisdiction to determine whether a piece of property, claimed both by an insurer in insolvency proceedings and by the debtor in bankruptcy, belongs to the insurer or to the debtor. They have reached this conclusion in: (1) a case in

14. *See* Logan v. Credit Gen. Ins. Co. (*In re* PRS Ins. Group, Inc.), 294 B.R. 609 (Bankr. D. Del. 2003) (bankruptcy trustee alleged that property of holding company in bankruptcy was fraudulently transferred to an insurer in receivership); Advanced Cellular Sys., Inc. v. Mayol (*In re* Advanced Cellular Sys.), 235 B.R. 713 (Bankr. D. Puerto Rico 1999) (debtor in bankruptcy filed complaint against receiver of insurer, demanding turnover of a certificate of deposit that had been tendered to the insurer as collateral for a bond); State *ex rel*. Paula Flowers v. Tennessee Coordinated Care Network, No. M2003-01658-COA-R3-CV, 2005 WL 427990 (Feb. 23, 2005) (receiver of HMO sought return of funds transferred by the HMO to a company that later filed for bankruptcy, alleging that HMO made the transfer after having been denied permission to do so by the state insurance department).

15. *See* Wagner v. Amwest Ins. Group, Inc. (*In re* Amwest Ins. Group, Inc.), 285 B.R. 447 (Bankr. C.D. Cal. 2002).

16. 11 U.S.C. § 541(a) (2000); 28 U.S.C. § 1334(e)(1) (2000).

17. *See Logan*, 294 B.R. at 610; *Wagner*, 285 B.R. at 451; *see* Gardner v. United States, 913 F.2d 1515, 1518 (10th Cir. 1990) (determination whether property was part of the bankruptcy estate and was a "core proceeding" under the Bankruptcy Code).

18. 11 U.S.C. § 362(a)(3) (2000).

19. U.S. Const. art. VI, § 2 (laws of the United States are supreme notwithstanding

which a bankruptcy trustee sought to avoid asset transfers made to an insurer placed under court-ordered supervision, claiming that the transfers were fraudulent or constituted preferences;[20] (2) a case in which a debtor demanded turnover of a certificate of deposit held by the receiver of an insolvent insurer;[21] (3) a case in which property had been transferred by a health maintenance organization to a debtor after the HMO had been placed under administrative supervision by a state insurance department and after the department had denied the HMO permission to make the transfer;[22] and (4) a case in which both a holding company in bankruptcy and its insurance subsidiary in receivership made claims to the same tax refund.[23]

In reaching this conclusion, the courts relied on the McCarran-Ferguson Act, which provides that no federal statute shall be construed "to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."[24] Federal courts have said that, when a federal statute has this effect on a state law, the federal statute is "reverse-preempted" by the state law under the McCarran-Ferguson Act. The courts generally have identified three requirements for such preemption: (1) the federal statute must not relate specifically to the business of insurance; (2) the state statute must be a law enacted for the purpose of regulating the business of insurance; and (3) application of the federal statute would invalidate, impair, or supersede the state statute.[25] The courts have had little difficulty concluding (1) that the Bankruptcy Code does not relate specifically to the

anything in state laws to the contrary). The Supreme Court has held that, in certain cases, federal statutes can displace state insurance liquidation laws under the Supremacy Clause. *See, e.g.*, U.S. Dep't of the Treasury v. Fabe, 508 U.S. 491, 508 (1993) (federal creditor priority statute preempted provisions of state insurance liquidation priority statute to the extent that the state provisions furthered the interests of creditors other than insurance policyholders); Morris v. Jones, 329 U.S. 545, 552 (1947) (federal statute implementing the Full Faith and Credit Clause (currently codified at 28 U.S.C. § 1738) preempted state law that insurance liquidator was entitled to possession of insurer's property irrespective of the process of another state's court).

20. *Logan*, 294 B.R. at 610.

21. Advanced Cellular Sys., Inc. v. Mayol (*In re* Advanced Cellular Sys.), 235 B.R. 713 (Bankr. D. Puerto Rico 1999).

22. The bankruptcy court's decision is reported in *State ex rel. Paula Flowers v. Tennessee Coordinated Care Network*, No. M2003-01658-COA-R3-CV, 2005 WL 427990 (Tenn. Ct. App. Feb. 23, 2005).

23. Wagner v. Amwest Ins. Group, Inc. (*In re* Amwest Ins. Group, Inc.), 285 B.R. 447 (Bankr. C.D. Cal. 2002).

24. 15 U.S.C. § 1012(b) (2000).

25. *See, e.g.*, U.S. Dep't of Treasury v. Fabe, 508 U.S. 491, 500–01 (1993); Davister Corp. v. United Republic Life Ins. Co., 152 F.3d 1277, 1279 n.1 (10th Cir. 1998); Munich Am. Reinsurance Co. v. Crawford, 141 F.3d 585, 590 (5th Cir. 1998); *Logan*, 294 B.R. at 612. Some courts have added a fourth element to the test, namely whether the activities that brought

business of insurance and (2) that state insurance receivership statutes in general are enacted for the purpose of regulating the business of insurance.[26] The cases thus have turned on whether, in a court's view, application of the federal statute would impair the state insurance receivership statute.

The bankruptcy courts that have concluded the McCarran-Ferguson Act deprived them of jurisdiction have provided several explanations for their conclusion. One court noted that its adjudication of the debtor's claim would violate specific provisions of Puerto Rico insurance law providing that no lawsuit could be brought against an insurance liquidator and that the receivership court had exclusive jurisdiction over all insurer delinquency proceedings.[27] Another bankruptcy court concluded that its adjudication of the issue presented might conflict with the receivership court's decision on the same issue and thus impair the progress of an orderly liquidation.[28] And a third court noted that the debtor's suit might recover funds that would otherwise be paid to creditors of the insolvent insurer and would thus frustrate the state policy of maximizing the return to the insolvent insurer's policyholders.[29]

These holdings, however, have been placed in doubt by a ruling of the U.S. Court of Appeals for the Tenth Circuit that a bankruptcy court did have jurisdiction over competing claims by the debtor and an insolvent insurer over the same property. In *Strong v. Western United Life Assurance Co. (In re Tri-Valley Distributing, Inc.)*,[30] certain real estate owned by a debtor in Chapter 11 proceedings was transferred to a third party without bankruptcy court authorization, and the third party used the property as collateral for a loan by an insurer, which thereafter foreclosed on the property. After the insurer was placed in receivership by a Washington court, the debtor's bankruptcy examiner claimed that the transfer of property to the insurer

about the cause of action constituted "the business of insurance." *See In re* Agway, 357 B.R. 195 (Bankr. N.D.N.Y. 2006) (citing *In re* Rubin, 160 B.R. 269, 279 (Bankr. S.D.N.Y. 1993)).

26. *See, e.g.*, Strong v. W. United Life Assurance Co. (*In re* Tri-Valley Distrib., Inc.), 350 B.R. 628 (table), 2006 WL 2583247 (B.A.P. 10th Cir. 2006); *Logan*, 294 B.R. at 610 (Bankr. D. Del. 2003). In *Munich American Reinsurance Co. v. Crawford*, 141 F.3d at 592–93, the Fifth Circuit noted that the Oklahoma insurance receivership statute as a whole appeared to regulate the business of insurance and held that particular provisions vesting exclusive original jurisdiction of delinquency proceedings in the Oklahoma state court were enacted for the purpose of regulating the business of insurance.

27. *Advanced Cellular Sys.*, 235 B.R. at 723–27. The bankruptcy court in *Flowers* similarly noted that its adjudication would impair Tennessee provisions that granted exclusive jurisdiction over all insurance receivership proceedings to the receivership court. 2005 WL 427990, at *5–6.

28. *Wagner*, 285 B.R. at 455.

29. *Logan*, 294 B.R. at 613.

30. 350 B.R. 628 (table), 2006 WL 2583247 (B.A.P. 10th Cir. 2006) (unpublished disposition). Under the Tenth Circuit's rules, an unpublished decision is not binding precedent, but it may be cited for persuasive value with respect to a material issue that has not been addressed in a published opinion. 10th Cir. R. 8018-6.

was fraudulent, and the examiner and the insurer's receiver entered into a stipulation that proceeds of a sale of the property would be retained in an account under their joint supervision, pending an order of the bankruptcy court. The insurer nevertheless moved to dismiss the adversary proceeding, contending that the bankruptcy court lacked jurisdiction over the examiner's claim because of the McCarran-Ferguson Act. The bankruptcy court denied the motion to dismiss, and the insurer appealed.

The Tenth Circuit held that the bankruptcy court's jurisdiction was not preempted by the McCarran-Ferguson Act, concluding that the exercise of jurisdiction would not impair Washington's insurance receivership laws.[31] The court noted that the Washington statutes contemplated that certain claims related to an insolvent insurer might be resolved in forums other than the Washington receivership court, citing provisions that authorized the receivership court to allow actions to be tried in courts outside the state and authorized the receiver to sue or defend on behalf of the insolvent insurer.[32] The court also noted that the receiver had acted in accordance with his powers when he stipulated that the bankruptcy court would decide the disposition of proceeds after sale of the property.[33]

The bankruptcy court decisions, on one hand, and the Tenth Circuit's decision, on the other, reflect a disparity of views that appear in many cases regarding the potential impact of a federal court's decision on the integrity of proceedings before a state insurance receivership court. Some federal courts have taken a broad view of state policies underlying the consolidation of insolvency-related proceedings in the receivership court, emphasizing the efficiency and consistency afforded by such proceedings and expressing concern that federal court proceedings might be used to circumvent priorities given to policyholders in the state court proceedings. Other federal courts, however, have taken a narrow view of the scope of the state receivership court's exclusive jurisdiction, emphasizing that an adjudication of the rights of an insurer's creditor against the insurer does not necessarily interfere with the receivership court's control of the insurer's property or change the priority of the creditor's claim against the estate of the insolvent insurer. This disparity of views appears most conspicuously in cases concerning *in personam* claims of a federal plaintiff against an insolvent insurer, where no immediate claim is made against specific property. Nevertheless, as the cases above suggest, it remains to be seen whether the broad view or the narrow view of exclusive state receivership jurisdiction will prevail in cases concerning competing claims for specific property.

31. *Id.* at *4–5.
32. *Id.*
33. *Id.*

It is possible that the controlling principle with respect to claims for specific property will not be found in the terms of the McCarran-Ferguson Act. The Tenth Circuit's holding in *Strong* would be consistent with the Supreme Court's first-assuming-jurisdiction doctrine because the bankruptcy court acquired jurisdiction over the debtor before the debtor's property was transferred to the third party. It surely did not assist the insurer's case that the property was transferred out of the bankruptcy estate without the bankruptcy court's approval when the bankruptcy court had jurisdiction over the property. Conversely, in the bankruptcy court decisions, a receivership court or the state insurance department appears to have had jurisdiction over the property in dispute before the bankruptcy court acquired jurisdiction over the debtor.[34] The holdings in these cases thus also appear to be consistent with the first-assuming-jurisdiction doctrine, and application of this doctrine may provide a uniform basis for the results reached by these courts, notwithstanding the differing views they have expressed about proper application of the McCarran-Ferguson Act.

The first-assuming-jurisdiction doctrine, however, can provide an invitation for a race to the courthouse where a debtor and an insurer both have claims to property that would constitute a major part of the estate's value. The Seventh Circuit has expressed an aversion to such forum shopping, stating, "The use of the Bankruptcy Code to obtain a favorable forum should not be encouraged."[35] The terms of the McCarran-Ferguson Act offer principles that may be applied irrespective of which *in rem* proceeding is begun first and thus may provide a valuable alternative to rules that would encourage forum shopping.

It is possible, however, that neither the first-assuming-jurisdiction doctrine nor the McCarran-Ferguson Act ultimately will be held to limit the jurisdiction of a bankruptcy court with respect to the ownership of property claimed by the debtor and an insurer in receivership.

34. In *Wagner*, the insurer's holding company filed its Chapter 11 case after the insurer had been placed in liquidation and the contested tax refund had become "part of the liquidation estate." Wagner v. Amwest Ins. Group, Inc. (*In re* Amwest Ins. Group, Inc.), 285 B.R. 447, 451 (Bankr. C.D. Cal. 2002). In *Flowers*, the debtor filed for bankruptcy after the insurer was placed in receivership and the receiver had filed a petition seeking recovery of the HMO's funds from the debtor. State *ex rel*. Paula Flowers v. Tennessee Coordinated Care Network, No. M2003-01658-COA-R3-CV, 2005 WL 427990, at *1–3 (Tenn. Ct. App. Feb. 23, 2005). In *Logan*, an involuntary Chapter 7 case was filed against the insurer's holding company after the insurer was placed under state supervision by a state court. Logan v. Credit Gen. Ins. Co. (*In re* PRS Ins. Group, Inc.), 294 B.R. 609, 611 (Bankr. D. Del. 2003). In *Advanced Cellular Systems*, it is not possible to determine whether the state receivership court or the bankruptcy court first acquired jurisdiction over the property in question because the court did not reveal when the debtor's bankruptcy petition was filed. Advanced Cellular Sys., Inc. v. Mayol (*In re* Advanced Cellular Sys.), 235 B.R. 713 (Bankr. D.P.R. 1999).

35. *In re* U.S. Brass Corp., 110 F.3d 1261, 1265 (7th Cir. 1997).

If neither applies, the Supremacy Clause may give the bankruptcy court unlimited jurisdiction to decide the ownership of property claimed by a debtor.

Bankruptcy courts nevertheless may defer to insurance receivership courts with respect to such controversies. First, as noted above, even where a federal district court assumed jurisdiction over a financially troubled insurer, the Supreme Court noted that the court could properly relinquish its jurisdiction in favor of a later state liquidation proceeding.[36] Second, bankruptcy courts are expressly authorized to abstain "in the interest of comity with State courts or respect for State law ...."[37] And third, two of the bankruptcy courts that held the McCarran-Ferguson Act limited their jurisdiction also held that they would abstain from hearing the debtor's claims.[38] These rulings are consistent with a body of case law, discussed below, under which federal courts have deferred to state receivership courts in cases that might impair a basic function of the insurance receivership proceeding.

IV. WHEN THE DEBTOR HAS A CLAIM AGAINST THE INSOLVENT RECEIVER

A substantial body of case law has been developed on the question whether a federal court or an insurance receivership court should determine the validity and amount of a federal plaintiff's claim against an insolvent insurer. These cases have addressed both jurisdictional issues and the question whether the federal court should abstain in favor of an adjudication by the receivership court.

A. *Jurisdiction*

In the case of a claim by a debtor in bankruptcy against an insolvent insurer, it has been contended that the bankruptcy court has exclusive jurisdiction to adjudicate the claim because the claim constitutes property of the debtor's estate. Federal courts have repeatedly declared that the causes of action owned by a debtor "become property of the estate."[39] Moreover, federal law gives a bankruptcy court exclusive jurisdiction over a debtor's property.[40] In *In re U.S. Brass Corp.*, however, the Seventh Circuit held that the coverage claim of a debtor was "not the kind of 'property' to which the

36. Penn Gen. Cas. Co. v. Commonwealth of Pennsylvania *ex rel.* Schnader, 294 U.S. 189, 197 (1935).

37. 28 U.S.C. § 1334(c)(1) (2000).

38. *Advanced Cellular Sys.*, 235 B.R. at 726–27; *Wagner*, 285 B.R. at 456.

39. Celotex Corp. v. Edwards, 514 U.S. 300, 307 n.5 (1955); Arnold v. Garlock, Inc., 278 F.3d 426, 434 (5th Cir. 2001); and bankruptcy cases cited in Collett v. Chatham County (*In re* Collett), 297 B.R. 321, 323–24 (Bankr. S.D. Ga. 2003).

40. 28 U.S.C. § 1334(e)(1) (2000).

statute refers."[41] The court acknowledged that an insurance policy was the insured's property but noted that the issue presented by the debtor's claims was "the *scope* of the insurance policies, an issue of contractual interpretation, not their ownership."[42] The statute giving the bankruptcy court exclusive jurisdiction over all of a debtor's property had "no application to a dispute between the debtor and its insurers over the scope of coverage."[43]

The insurance receivership court also does not have exclusive jurisdiction over the debtor's claim against the insolvent insurer. When an insolvent insurer is placed in receivership, the state receivership court typically enjoins all creditors from pursuing any lawsuits against the insurer and requires them to pursue their claims by filing proofs of claim in the receivership proceeding. This injunction, however, has little force with respect to a debtor's claim against the insurer in bankruptcy court. The U.S. Supreme Court has held that state courts have no power to enjoin parties from pursuing *in personam* claims in federal court.[44] In *Gross v. Weingarten*,[45] the Fourth Circuit specifically rejected an insurance receiver's contention that the receivership court could exercise its *in rem* jurisdiction to create an exclusive forum for claims against the insolvent insurer's estate, noting that there was no bar to federal jurisdiction in a case where the plaintiff merely sought "an adjudication of his right or his interest as a basis of a claim against a fund in a state court."[46]

For the same reason, the McCarran-Ferguson Act does not appear to provide a strong argument that a bankruptcy court lacks jurisdiction to hear a debtor's claim against an insolvent insurer. In *Hawthorne Savings F.S.B. v. Reliance Insurance Co. of Illinois*,[47] the Ninth Circuit rejected an insolvent insurer's contention that, because of the McCarran-Ferguson Act, the federal district court lost jurisdiction over a coverage dispute when the insurer was placed in receivership proceedings. The court held that

41. 110 F.3d 1261, 1268 (7th Cir. 1997).

42. *Id*.

43. *Id*.; *accord* Collett v. Chatham County (*In re* Collett), 297 B.R. 321, 325 (Bankr. S.D. Ga. 2003) (the exclusive jurisdiction of the bankruptcy court was limited to its "*in rem* jurisdiction over real estate or personal property of the bankruptcy estate").

44. Donovan v. City of Dallas, 377 U.S. 408, 412–13 (1964); *accord* Hawthorne Sav. F.S.B. v. Reliance Ins. Co. of Illinois, 421 F.3d 835, 850–51 (9th Cir. 2005), *opinion amended*, 433 F.3d 1089 (9th Cir. 2006); Bodine v. Webb, 992 S.W.2d 672, 676 (Tex. App. 1999).

45. 217 F.3d 208 (4th Cir. 2000).

46. *Id*. at 221 (quoting Princess Lida of Thurn and Taxis v. Thompson, 305 U.S. 456, 466 (1939)); *accord* Law Enforcement Ins. Co., Ltd. v. Corcoran, 807 F.2d 38, 42 (2d Cir. 1986) (the exclusive jurisdiction of an insurance liquidation court was not implicated where the plaintiff "could obtain in federal court the declaration it seeks and then present its claim to the New York liquidation court").

47. 421 F.3d 835 (9th Cir. 2005), *opinion amended*, 433 F.3d 1089 (9th Cir. 2006).

the federal case would not impair the state receivership law because the insured still would have to present claims in the receivership proceedings to recover on any federal judgment; its claim would be satisfied subject to the orders of the receivership court and to the priorities established by state law.[48] The state forum thus retained "exclusive jurisdiction over the liquidation" of the insurer "and the disposition of its assets."[49]

B. *Mandatory Abstention*

In many cases, however, the bankruptcy court may be required to abstain from hearing the debtor's claim against an insolvent insurer, effectively giving the state receivership court exclusive authority to consider the claim. The Bankruptcy Code requires the bankruptcy court to abstain from hearing a state law claim that is related to a bankruptcy case if the claim can be timely adjudicated in a state forum.[50] The proceeding must not be a "core" bankruptcy proceeding,[51] such as a proceeding on a claim against the debtor.[52] The case also must be based solely on the jurisdiction provided specifically to the bankruptcy court, not on diversity jurisdiction or federal question jurisdiction.[53] An action must be pending or initiated in state court in which the claim can be timely adjudicated,[54] and a party must timely move the bankruptcy court for abstention.[55]

For an ordinary coverage claim, these requirements may well be met. A claimed right to insurance coverage is "a creation of state contract law."[56] Proceedings "related to" bankruptcy include "causes of action owned by the debtor."[57] The state receivership proceeding is one in which the claim

48. *Id*. at 842–43.

49. *Id*. at 843 (following Gross v. Weingarten, 217 F.3d 208, 222 (4th Cir. 2000)).

50. 28 U.S.C. § 1334(c)(2) (2000). The provision specifically refers to "a proceeding based upon a State law claim or State law cause of action . . . ." *Id*.

51. In the terms of the provision, the claim must be in a proceeding that is "related to a case under title 11 but not arising under title 11 or arising in a case under title 11." *Id*. Proceedings that arise under title 11 or arise in a case under title 11 are "core" proceedings. 28 U.S.C. § 157(b)(1) (2000); *see also* Wood v. Wood (*In re* Wood), 825 F.2d 90, 97 (5th Cir. 1987) (a proceeding that arises only in bankruptcy is a core proceeding).

52. 28 U.S.C. § 157(b)(2)(B) (2000).

53. In the terms of the provision, it must be an action that "could not have been commenced in a court of the United States absent jurisdiction under" 28 U.S.C. § 1334 (2000).

54. The provision requires that "an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction." *Id*.

55. The provision specifically requires a "timely motion of a party." *Id*.; *see also* Beneficial Nat'l Bank USA v. Best Reception Sys., Inc. (*In re* Best Reception Sys., Inc.), 220 B.R. 932, 942 (Bankr. E.D. Tenn. 1998) (mandatory abstention was inapplicable to proceedings in which no abstention motion was filed).

56. *In re* U.S. Brass Corp., 110 F.3d 1261, 1268 (7th Cir. 1997).

57. Celotex Corp. v. Edwards, 514 U.S. 300, 307 n.5 (1955); Arnold v. Garlock, Inc., 278 F.3d 426, 434 (5th Cir. 2001); *see also* City of Liberal, Kansas v. Trailmobile Corp., 316 B.R. 358 (Bankr. D. Kan. 2004) (debtor's repossession action).

may be timely adjudicated. And there may be no diversity of citizenship or federal question that would provide an alternative basis for federal jurisdiction.[58] Thus, for many coverage claims by debtors against insolvent insurers, the bankruptcy court may be required to abstain in favor of the state receivership court.

C. *Uniform Insurers Liquidation Act*

Where there is diversity of citizenship between the debtor and the insolvent insurer and where the forum state has adopted the Uniform Insurance Liquidation Act,[59] a bankruptcy court may be required to yield jurisdiction to an insurance receivership court, because a federal court in a diversity case must apply the law of the forum state.[60] Several federal courts and state courts have concluded that, where a forum state has adopted the Uniform Act and where an insurance receivership proceeding is pending in a "reciprocal state" under the Uniform Act involving an insurer domiciled in that state, a claim against the insurer must be proved in the domiciliary state under the law of that state.[61] In reaching this conclusion the New York Court of Appeals noted that the Uniform Act was adopted with a primary purpose of providing "a uniform system for the orderly and equitable administration of the assets and liabilities of defunct multistate insurers."[62]

The Ninth Circuit, however, has adopted a more limited interpretation of the Uniform Act. In *Hawthorne Savings F.S.B. v. Reliance Insurance Co. of Illinois*,[63] that court held that the Uniform Act did not bar a court from determining the liability of an insurer placed in receivership in a reciprocal state because this adjudication alone would not involve the enforcement of a judgment against the estate of the insolvent insurer. Courts giving a

58. *See U.S. Brass*, 110 F.3d at 1264 & 1268 (mandatory abstention applied to four cases in which there was no diversity of citizenship).

59. *See, e.g.*, 215 Ill. Comp. Stat. 5/221.1-.13 (2007) (Illinois provisions); Uniform Insurers Liquidation Act, 13 U.L.A. 321 (1986 & Supp. 2002) ("the Uniform Act"). The Uniform Act, which was adopted in 1939, was withdrawn from recommendation for enactment by the National Conference of Commissioners on Uniform State Laws in 1981, on the ground that it was obsolete. Nevertheless, the Uniform Act previously had been enacted in thirty-two states, and its provisions remain in the laws of many states. *See* John N. Gavin, *Competing Forums for the Resolution of Claims Against an Insolvent Insurer*, 23 Tort & Ins. L. J. 604, 606 (1988).

60. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938); Ragan v. Merchs. Transfer & Warehouse Co., 337 U.S. 530, 532 (1949).

61. *See* Sears, Roebuck & Co. v. Northumberland Gen. Ins. Co., 617 F. Supp. 88 (N.D. Ill. 1985); Emons Indus., Inc. v. Liberty Mut. Fire Ins. Co., 545 F. Supp. 185, 191 (S.D.N.Y. 1982); Ins. Affiliates, Inc. v. O'Connor, 522 F. Supp. 703, 705–06 (D. Colo. 1981); G.C. Murphy Co. v. Reserve Ins. Co., 429 N.E.2d 111, 114–16 (N.Y. 1981); Clark v. Standard Life & Accident Ins. Co., 386 N.E.2d 890, 899 (Ill. App. Ct. 1979).

62. *G.C. Murphy Co.*, 429 N.E.2d at 115. Considerations supporting a broad reading of the Uniform Act are discussed in Gavin, *supra* note 59, at 604–09.

63. 421 F.3d 835, 854–56 (9th Cir. 2005), *opinion amended*, 433 F.3d 1089 (9th Cir. 2006).

broad interpretation to the Uniform Act have focused on provisions that expressly allow proof of a creditor's claim against an insolvent insurer only in the receivership proceeding conducted in the domiciliary state or in an ancillary receivership proceeding conducted in a reciprocal state. The Ninth Circuit, on the other hand, focused on a provision that explicitly precludes an action or proceeding against the insolvent insurer only if it is in the nature of an attachment, garnishment, or execution.[64] The Ninth Circuit concluded that the purpose of the Uniform Act was "to bar claimants from directly interfering with liquidation proceedings" and that the Uniform Act accordingly did not preclude a court in the forum state from making a determination of *in personam* legal rights.[65]

The differing interpretations of the Uniform Act found in these cases reflect the same divergence of views on the scope of an insurance receivership court's core responsibilities that are found in case law on the McCarran-Ferguson Act and a bankruptcy court's jurisdiction, discussed above. The same divergence of views also is found in case law concerning a federal court's exercise of the power to abstain from deciding claims against the estate of an insolvent insurer, discussed below. All of these cases highlight the unsettled nature of the question whether state law calls for the resolution of all claims against an insolvent insurer in a consolidated proceeding before the receivership court.

D. *Discretionary Abstention*

Where there is diversity of citizenship between the debtor and the insolvent insurer, a bankruptcy court also may abstain from hearing a debtor's claim against an insolvent insurer through the exercise of its statutory authority to abstain "in the interest of comity with State courts or respect for State law."[66] Case law has not provided a simple test for whether a bankruptcy court will abstain from hearing a particular proceeding. Bankruptcy courts have identified several factors that may govern the decision. One list of factors cited by several courts includes (1) the effect of remand on the efficient administration of the estate; (2) the extent to which state law issues predominate over bankruptcy issues; (3) the difficult or unsettled nature of the applicable law; (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court; (5) the jurisdictional basis,

64. *Id*. at 854–55. In this interpretation, the Ninth Circuit followed the holding of the Wyoming Supreme Court in *Hoiness-LaBar Insurance v. Julien Construction Co*., 743 P.2d 1262, 1268–69 (Wyo. 1987).

65. *Hawthorne Sav. F.S.B*., 421 F.3d at 854–55.

66. 28 U.S.C. § 1334(c)(1) (2000). While a decision by a bankruptcy court that it is not required to abstain is reviewable, a bankruptcy court's decision to abstain or not to abstain "in the interest of comity with State courts or respect for State law" is not reviewable "by appeal or otherwise" by the courts of appeals or by the Supreme Court. *Id*. § 1334(d).

if any, other than bankruptcy court jurisdictional provisions; (6) the degree of relatedness of the proceeding to the bankruptcy case; (7) the substance rather than the form of an asserted "core" proceeding; (8) the feasibility of severing state law claims from core bankruptcy matters; (9) the burden on the bankruptcy court's docket; (10) the likelihood that the proceeding involves forum shopping; (11) the existence of a right to jury trial; and (12) the presence of nondebtor parties.[67]

In *U.S. Brass Corp. v. California Union Insurance Co.*,[68] a bankruptcy court exercised its discretionary authority to abstain with respect to several coverage suits for which there was diversity of citizenship between the insured and its liability insurers. Affirming the bankruptcy court's order, the district court noted that the proceedings involved the "interpretation of insurance policies under state law only; there are no federal issues."[69] Moreover, the court noted that the proceedings involved unsettled questions of state law and approved the bankruptcy judge's conclusion that these issues were "best resolved by the Illinois courts rather than the federal courts."[70]

Common law abstention cases suggest that a request for abstention is particularly strong where a claimant seeks a federal adjudication that might impair a basic function of the insurance receivership. Thus, the Third Circuit approved abstention where the plaintiff sought to rescind an asset transfer made to the insolvent insurer's estate because it would "affect directly and adversely what the Liquidator is attempting to achieve through her proceedings: the protection of the policyholders."[71] Similarly, the Fifth Circuit approved abstention where the plaintiffs sought an injunction that would prevent the insolvent insurer from using funds claimed by the plaintiffs, noting that the case would allow the claimant "to preempt others in the distribution of [the insurance company's] assets."[72] Also, the Second Circuit approved abstention with respect to a claim by the retired employees of an insolvent insurer that the liquidator's termination of their retirement benefits violated their contract rights, noting that the liquidator acted under a statutory duty to liquidate the assets of the insolvent insurer and to cancel its outstanding contracts as mandated by the state court's liquidation order.[73]

67. *See, e.g.*, Oakwood Acceptance Corp. v. Tsinigini, 308 B.R. 81, 87–88 (Bankr. D.N.M. 2004); Beneficial Nat'l Bank USA v. Best Receptions Sys., Inc. (*In re* Best Reception Sys., Inc.), 220 B.R. 932, 953 (Bankr. E.D. Tenn. 1998), and the cases cited therein. Other courts have presented shorter lists. *See, e.g.*, Shared Network Users Group, Inc. v. Worldcom Techs., Inc., 309 B.R. 446, 450–51 (Bankr. E.D. Pa. 2004); Wagner v. Amwest Ins. Group, Inc. (*In re* Amwest Ins. Group, Inc.), 285 B.R. 447, 455–56 (Bankr. C.D. Cal. 2002).

68. 198 B.R. 940 (N.D. Ill. 1996), *affirmed in part, vacated in part by In re* U.S. Brass Corp., 110 F.3d 1261 (7th Cir. 1997).

69. *Id.* at 948.

70. *Id.* at 948–49.

71. Feige v. Sechrest, 90 F.3d 846, 849 (3d Cir. 1996).

72. Clark v. Fitzgibbons, 105 F.3d 1049, 1051 (5th Cir. 1997).

73. Levy v. Lewis, 635 F.2d 960, 961–62, 968 (2d Cir. 1980).

However, the courts of appeals are divided on whether abstention is appropriate where a claimant in a diversity case merely seeks to establish an insolvent insurer's liability to the claimant. Some courts have approved abstention, emphasizing the importance of unified adjudication of claims against an insolvent insurer. The Second Circuit has noted that centralizing claims in a single forum permits them to be "efficiently and consistently disposed of."[74] The Third Circuit has stated that a chief purpose of a centralized claims process "would be lost if an insurer in liquidation had to dissipate its funds defending unconnected suits across the country."[75] That court also observed that a receiver can interpret the identical provisions in many insurance policies in a manner that permits "the fair and equitable distribution of assets to all of the insureds," noting that a contrary interpretation by a federal court could provide the federal plaintiff with "more on its claim than other similarly situated claimants."[76]

In other diversity cases, however, courts have rejected dismissal and stay requests[77] made by insurance receivers on abstention grounds, noting that the plaintiff's claim that the insurer was liable: (1) did not "directly relate" to the insurer's assets;[78] (2) would not disturb the receivership court's "exclusive jurisdiction over the property and the liquidation" of the insolvent insurer;[79] and (3) while "potentially giving rise to an additional claim against the insolvent insurance company," would not "discombobulate local proceedings" or frustrate the regulatory system of that particular state.[80] These courts have adopted a more restrictive view of a receivership court's core responsibilities than the view adopted by the Second Circuit and the Third Circuit. In a 1947 case, the Supreme Court adopted a similarly restrictive view when it required a liquidation court to give full faith and credit to a judgment that had been obtained by a plaintiff in a foreign state court after the insurer was placed in liquidation.[81] The Court noted that the case presented "[n]o question of parity of treatment of creditors, or the lack thereof" and said that the

74. Law Enforcement Ins. Co., Ltd. v. Corcoran, 807 F.2d 38, 44 (2d Cir. 1986).

75. Lac D'Amiante du Quebec, LTEE v. Am. Home Assurance Co., 864 F.2d 1033, 1045 (3d Cir. 1988).

76. *Id*. at 1045–46.

77. In 1996, the Supreme Court held that a federal court could not properly dismiss a damages action on abstention grounds because the court's authority to take this action was limited to cases in which the court had "discretion to grant or deny relief." Quackenbush v. Allstate Ins. Co., 517 U.S. 706, 718 (1996). However, the Court noted that a federal court could apply abstention principles to stay actions at law, postponing adjudication of the dispute. *Id*. at 718–21.

78. Hawthorne Sav. F.S.B. v. Reliance Ins. Co. of Illinois, 421 F.3d 835, 847 (9th Cir. 2005) (quoting and relying on Tucker v. First Md. Sav. & Loan, Inc., 942 F.2d 1401, 1406 n.3 (9th Cir. 1991)), *opinion amended*, 433 F.3d 1089 (9th Cir. 2006).

79. Gross v. Weingarten, 217 F.3d 208, 224 (4th Cir. 2000).

80. Fragoso v. Lopez, 991 F.2d 878, 884 (1st Cir. 1993).

81. Morris v. Jones, 329 U.S. 545 (1947).

"establishment of the existence and amount of a claim against the debtor" did not disturb "the possession of the liquidation court" or affect "title to the property."[82] The Court saw no reason for discharging a liquidator from "the responsibility for defending pending actions."[83]

In contrast to federal district courts in diversity cases, a bankruptcy court is expressly authorized to abstain "in the interest of comity with State courts or respect for State law."[84] The common law abstention cases suggest, however, that the outcome of a specific dispute over whether a bankruptcy court or a state receivership court should resolve a debtor's claim against an insolvent insurer, where there is diversity of citizenship, may depend on the strength of the receiver's argument that state law calls for a centralized insurance claims process and the potential that the debtor's specific claim holds for interference with the state receivership function.

The cases also suggest that the presence of a federal question on the merits of the debtor's claim may persuade or require a bankruptcy court to reject an abstention request. The Supreme Court has noted that "the presence of federal-law issues must always be a major consideration weighing against surrender" of a federal court's jurisdiction.[85] Moreover, the courts of appeals have held that a federal court may not abstain with respect to a claim within its exclusive jurisdiction, "for otherwise the right alleged would never be fully adjudicated."[86]

V. WHEN THE RECEIVER OF THE INSOLVENT INSURER HAS A CLAIM AGAINST THE DEBTOR

A. *Jurisdiction*

In the case of a claim by an insurance receiver against a debtor in bankruptcy, it has been contended that the receivership court has exclusive jurisdiction to adjudicate the claim because the claim falls within the *in rem* jurisdiction of the receivership court. In *In re Agway*,[87] the receiver contended in bankruptcy court that the receivership had exclusive jurisdiction over such a claim under the first-assuming-jurisdiction doctrine, noting that the receivership had begun before the debtor had filed for bankruptcy. The court, however, rejected this contention as "untenable on its face" because

82. *Id*. at 548–49.
83. *Id*. at 550.
84. 28 U.S.C. § 1334(c)(1) (2000).
85. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 26 (1983).
86. Levy v. Lewis, 635 F.2d 960, 967 (2d Cir. 1980) (the federal court could not abstain on the question whether the defendant insurance receiver was an ERISA fiduciary); *accord* Gross v. Weingarten, 217 F.3d 208, 224 (4th Cir. 2000) (claims based on federal securities laws could not be dismissed on abstention grounds).
87. 357 B.R. 195 (Bankr. N.D.N.Y. 2006).

it would signify that all claims of the insurer pending in any federal court or state court anywhere in the country would be subject to the exclusive jurisdiction of the state receivership court.[88] The court held that the first-assuming-jurisdiction doctrine applied only where two courts exercised jurisdiction "with respect to substantially the same subject matter," and it declared that the bankruptcy court and the state receivership did not "share the requisite identity of subject matter."[89]

A more specific explanation may be that the state receivership court does not have *in rem* or *quasi in rem* jurisdiction over the claim of an insolvent insurer against a debtor. The Supreme Court has noted that *in rem* jurisdiction concerns "the interests of all persons in designated property."[90] A bankruptcy court, for example, determines "all claims that anyone, whether named in the action or not, has to the property or thing in question. The proceeding is 'one against the world.'"[91] *Quasi in rem* jurisdiction concerns the interests of particular persons in designated property, and it has two forms. In one, the plaintiff seeks "to secure a pre-existing claim in the subject property," excluding the claims of others; and, in the other, the plaintiff "seeks to apply what he concedes to be the property of the defendant to the satisfaction of a claim against him."[92]

It appears that a claim by which one party seeks to impose personal liability on another does not constitute the kind of property to which *in rem* or *quasi in rem* jurisdiction attaches.[93] In *Bodine v. Webb*,[94] the Texas Court of Appeals concluded that a state court's exclusive jurisdiction extended only to the limit of its *in rem* jurisdiction and did not extend to the court's authority to adjudicate an action *in personam*, "a proceeding brought against a person to enforce personal rights or obligations."[95] The *in personam* proceeding sought "a judgment against the person, rather than a judgment against property to determine its status."[96] In *Bodine*, the court

88. *Id*. at 205.
89. *Id*.
90. Schaffer v. Heitner, 433 U.S. 186, 199 n.17 (1977).
91. Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 448 (2004).
92. *Schaffer*, 433 at 199 n.17. The Supreme Court has distinguished between (1) "private-rights disputes," which "lie at the core of the historically recognized judicial power," and (2) the "restructuring of debtor-creditor relations," which lies "at the core of the federal bankruptcy power." Granfinanciera S.A. v. Nordberg, 492 U.S. 33, 56 (1989) (holding that the defendant in a fraudulent conveyance action brought by a bankruptcy trustee had a right to jury trial).
93. *Cf. In re* U.S. Brass Corp., 110 F.3d 1261, 1268 (7th Cir. 1997) (debtor's coverage claim against insurer was not the kind of "property" with respect to which the bankruptcy court had exclusive jurisdiction).
94. 992 S.W.2d 672 (Tex. App. 1999).
95. *Id*. at 676.
96. *Id*.

held that a state insurance receivership court did not have authority to enjoin a federal lawsuit brought by former employees of an insolvent insurer against the receiver of the insolvent insurer and other defendants, demanding that the court both impose a constructive trust on plan assets and require the defendants who damaged the plan to make refunds. Noting that the plaintiffs' request was not limited to a recovery of receivership property but also sought to impose liability on individual defendants, the court concluded that the federal lawsuit was *in personam* and that the state court lacked power to enjoin it.[97] Applying the court's rationale, the *in rem* jurisdiction of the state receivership court also would not appear to extend to a receiver's *in personam* action against a debtor in bankruptcy.

To the contrary, the Supreme Court has declared that the discharge of a debt by a bankruptcy court is an *in rem* proceeding of the bankruptcy court, representing an exercise of the bankruptcy court's jurisdiction over the debtor's property.[98] "The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a *res*."[99] This is true whether a claim is "rejected in toto" or "reduced in part."[100]

In accordance with its *in rem* jurisdiction, a bankruptcy court may ensure that any claims against the debtor are filed and adjudicated in the bankruptcy court. The Bankruptcy Code provides that the filing of a bankruptcy petition stays any judicial proceeding to recover on a claim against the debtor that has arisen before the commencement of the case.[101] Thus, unless the bankruptcy court modifies the stay,[102] an insolvent insurer may pursue a claim against the debtor only by filing a proof of claim in the bankruptcy proceeding, an act that submits the claimant to the jurisdiction of the bankruptcy court.[103] The Bankruptcy Code expressly includes the "allowance or disallowance of claims against the estate" among the "core proceedings" that bankruptcy judges may hear and determine.[104] While the bankruptcy court must abstain in certain proceedings related to a bankruptcy case, abstention is not required with respect to core proceedings.[105]

Indeed, filing a proof of claim to establish the liability of the debtor tends to undercut an insurance receiver's argument that the receivership

97. *Id*.
98. Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 447 (2004).
99. Gardner v. State of New Jersey, 329 U.S. 565, 574 (1947).
100. *Id*.
101. 11 U.S.C. § 362(a)(2) (2000).
102. *See* 28 U.S.C. § 157(b)(2)(G) (2000) (bankruptcy court has authority to modify the automatic stay).
103. *See*, *e.g.*, Gulf States Exploration Co. v. Manville Forest Prods. Corp. (*In re* Manville Forest Prods. Corp.), 896 F.2d 1384, 1389 (2d Cir. 1990) (by filing a proof of claim a creditor submits itself "to the equitable power of the bankruptcy court to disallow its claim").
104. 28 U.S.C. §§ 157(b)(1) and (b)(2)(B).
105. Core proceedings either arise under title 11 of the U.S. Code or arise in a case under title 11, 28 U.S.C. § 157(b)(1), and abstention is not mandatory with respect to a proceeding

court has exclusive jurisdiction to rule on the receiver's claim against the debtor. In *In re Agway*,[106] the insurer's receiver argued that it filed a proof of claim only to fulfill its fiduciary obligations and contended that the bankruptcy court did not have jurisdiction over the claim notwithstanding its proof of claim. Noting that a creditor who files a proof of claim thereby submits itself to the equitable power of the bankruptcy court to disallow the claim,[107] the court said the receiver's contention "did not even rise to the level of a colorable argument."[108]

B. *Abstention*

As an alternative to contending that the bankruptcy court lacks jurisdiction to rule on an insolvent insurer's claim, the insurer's receiver may request the bankruptcy court to abstain from exercising its jurisdiction. As noted above, a bankruptcy court is expressly authorized to abstain from hearing a bankruptcy proceeding "in the interest of justice, or in the interest of comity with State courts or respect for State law."[109]

Notwithstanding this authority, where an insurance receiver is pursuing a claim against a debtor in bankruptcy, existing case law suggests that abstention will be the exception rather than the rule. As a general matter, the bankruptcy court is likely to be reluctant to yield responsibility for an issue that lies in its core jurisdiction. Thus, in a case where a creditor had brought an action against the debtor in state court, the debtor had removed the action to bankruptcy court and the creditor had requested the bankruptcy court to abstain, the bankruptcy court denied the creditor's request, noting specifically that the claims were "core proceedings" and

arising under title 11 or arising in a case under title 11, 28 U.S.C. § 1334(c)(2) (2000). *See* Wood v. Wood (*In re* Wood), 825 F.2d 90, 97 (5th Cir. 1987) (a proceeding that arises only in bankruptcy, such as "the filing of a proof of claim," is a core proceeding); Beneficial Nat'l Bank USA v. Best Reception Sys., Inc. (*In re* Best Reception Sys., Inc.), 220 B.R. 932, 944 (Bankr. E.D. Tenn. 1998) (where a party has filed a proof of claim in a debtor's case, any action asserted by that party against the debtor that raises the same issues as those encompassed by the proof of claim is a core proceeding); Farm Credit Bank of Wichita v. Bott (*In re* Stigge), 167 B.R. 961, 966 (Bankr. D. Kansas 1994) (only permissive abstention, not mandatory abstention, is applicable to a core proceeding).

106. 357 B.R. 195 (Bankr. N.D.N.Y. 2006).

107. *Id*. at 202 (citing Gulf States Exploration Co. v. Manville Forest Prods. Corp. (*In re* Manville Forest Prods. Corp.), 896 F.2d 1384, 1389 (2d Cir. 1990)).

108. *Id*. at 206 n.9. The court also held that its exercise of jurisdiction was not barred by the McCarran-Ferguson Act, noting that the state insurance law claimed by the receiver to preempt the bankruptcy law specifically authorized the receiver to bring actions in other jurisdictions. *Id*. at 203; *accord* Strong v. W. United Life Assurance Co. (*In re* Tri-Valley Distrib., Inc.), 350 B.R. 628 (table), 2006 WL 2583247, at *4–5 (B.A.P. 10th Cir. 2006) (state insurance law, which authorized receiver to sue in forums outside state, was not impaired by bankruptcy court's exercise of jurisdiction).

109. 28 U.S.C. § 1334(c)(1) (2000). As noted above, bankruptcy courts have listed a large number of factors that may play a role in the exercise of this authority. *See*, *e.g.*, Oakwood Acceptance Corp. v. Tsinigini, 308 B.R. 81, 87–88 (Bankr. D.N.M. 2004) (listing 12 factors).

that remand of such a proceeding "would impede the efficient administration of the bankruptcy estate."[110]

A bankruptcy court may find that deference to a state receivership court is justified with respect to certain issues raised by an insurance receiver's claim, but the case law suggests that such issues are likely to be rare and limited to questions that fall within the receivership court's core responsibilities. In *Grimes v. Crown Life Insurance Co.*,[111] an insurance receiver sought a declaratory judgment with respect to a reinsurer's obligations to the insolvent insurer, seeking the court's interpretation of an insolvency clause in the reinsurance agreement and of a state statute defining the reinsurer's right of offset in the receivership proceeding. The Tenth Circuit held that the federal district court should have abstained with respect to these issues, noting that the meaning of the insolvency clause, which state law required be included in reinsurance agreements, was an important question of state policy and that the meaning of the reinsurer offset statute similarly presented issues that were "inseparably related to a state liquidation proceeding."[112] Such action by a bankruptcy court would be supported by its statutory authority to abstain "in the interest of comity with State courts or respect for State law."[113]

Insurance receivers, however, generally have not found federal courts receptive to requests for deference where they themselves have initiated litigation against a defendant who is entitled to invoke federal court jurisdiction. In *Melahn v. Pennock Insurance, Inc.*, for example, the Eighth Circuit denied such a request noting that "the federal courts' obligation to adjudicate claims within their jurisdiction [is] 'virtually unflagging.'"[114] In that case, the receiver sought abstention with respect to an action against an agent for unearned commissions. The Eighth Circuit held that abstention was inappropriate. The court said it was not persuaded that a decision on the merits would interfere with the receiver's control of the insolvent insurer or undercut the receivership court's equitable adjustment of claims against the insolvent insurer.[115]

Melahn adopted a narrow view of the scope of a state receivership court's core responsibilities. An even more restrictive view was adopted by the

110. Shared Network Users Group, Inc. v. Worldcom Techs., Inc., 309 B.R. 446, 451 (Bankr. E.D. Pa. 2004) (quoting *In re* RBGSC Inv. Corp., 253 B.R. 369, 382 (E.D. Pa. 2000)).

111. 857 F.2d 699 (10th Cir. 1988).

112. *Id.* at 705–06.

113. 28 U.S.C. § 1334(c)(1) (2000).

114. 965 F.2d 1497, 1507 (8th Cir. 1992) (quoting New Orleans Pub. Serv., Inc. v. Council of New Orleans, 491 U.S. 350, 359 (1989)).

115. *Id.* at 1506–07. The court also deemed it significant that the receiver had brought a second action against the agent in the agent's home state, raising in another court the issues that the receiver contended should be heard only by the state receivership court. *Id.*

First Circuit in *Sevigny v. Employers Insurance of Wausau*,[116] in which the court declined to abstain with respect to one of the issues that the Tenth Circuit in *Grimes* held should be left to the state receivership court. In *Sevigny*, an insurance receiver sought abstention with respect to an action challenging a reinsurer's attempt to assert setoff rights against the insolvent insurer under state law. The First Circuit held that abstention was inappropriate because the statutory construction issue appeared to be "conventional," did not require "discretionary policy or administrative judgments" and "could arise in any common-law action."[117] While the issue might be difficult, the court said, "difficult state law questions alone are not enough" to justify abstention.[118] Moreover, although "answering the setoff question here will likely affect the amount of money left for policyholders . . . [,] the financial effects on the liquidation cannot be enough."[119] In sum, the court said, "the issues presented by the removed case are not so intertwined with issues of agency authority or state regulatory policy that their federal-court resolution would imperil a complex regulatory scheme."[120]

Melahn and *Sevigny* suggest that, where an insurance receiver brings an action for which the defendant seeks federal court review on diversity of citizenship grounds, the federal courts will be reluctant to reject the defendant's resort to a federal forum on the ground that the state receivership court is a better forum for the receiver's action. Only a strong case that the specific issues fall within the state receivership court's core responsibilities is likely to suffice. In contrast to a federal district court considering common law abstention, a bankruptcy court has statutory authority to abstain "in the interest of comity with State courts or respect for State law."[121] Nevertheless, where an insurance receiver initiates a claim that could reduce the assets of the bankruptcy estate, it appears that only a strong case is likely to persuade a bankruptcy court that the specific issues fall within the core responsibilities of the state receivership court instead of the core responsibilities of the bankruptcy court.

It is also possible that a bankruptcy court will abstain if adjudication by a state court would serve the purposes of judicial economy. In *Beneficial National Bank USA v. Best Reception Systems, Inc. (In re Best Reception Systems, Inc.)*,[122] the bankruptcy court acquired jurisdiction over a multitude of lawsuits against the debtor and other parties after the lawsuits were removed from several state jurisdictions. The court regarded the remand of

116. 411 F.3d 24 (1st Cir. 2005).
117. *Id.* at 28.
118. *Id.* at 29.
119. *Id.*
120. *Id.*
121. 28 U.S.C. § 1334(c)(1) (2000).
122. 220 B.R. 932 (Bankr. E.D. Tenn. 1998).

most of the lawsuits to their original courts as conducive to orderly administration of the estate, noting that the state courts would be able to resolve the actions more expeditiously than the bankruptcy court "simply because of the division of labor" and because of the state courts' familiarity with applicable state law.[123] The bankruptcy court retained jurisdiction only over a few cases in which a creditor had brought a lawsuit against the debtor alone and in which the creditor also had filed a proof of claim, noting that these were "exclusively core proceedings."[124] The extraordinary circumstances that led to abstention in this case indicate that an insurance receiver seeking bankruptcy court abstention with respect to an insolvent insurer's claim against the debtor is likely to face an uphill challenge.

VI. CLAIMS INVOLVING THIRD PARTIES

A. *Jurisdiction*

The question whether a bankruptcy court or an insurance receivership court is the proper forum may arise with respect to claims against parties other than the debtor or the insolvent insurer. The forum question may arise, for example, in cases where a debtor has brought a claim against a party related to an insolvent insurer. The bankruptcy court has jurisdiction over a separate case if it is "related to" the bankruptcy proceeding, and the most commonly accepted test for a "related" proceeding is whether "the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy."[125] The bankruptcy court plainly would have jurisdiction over any claim brought by the debtor because it may have an effect on the estate.[126]

The forum question also could arise in a case in which an insolvent insurer brings a claim against a party with rights of indemnification or contribution by the debtor. In general, a bankruptcy court does not have jurisdiction in a case where a debtor is not a party.[127] An exception exists, however, where a debtor may be liable for indemnification or contribution to a party in the case.[128] The court would have jurisdiction over the case as a "related" proceeding because the outcome could have an effect on the bankruptcy estate.

123. *Id*. at 953.

124. *Id*. at 955–56.

125. Pacor, Inc. v. Higgins (*In re* Pacor, Inc.), 743 F.2d 984, 994 (3d Cir. 1984), *quoted in* Robinson v. Michigan Consol. Gas Co., 918 F.2d 579, 583 (6th Cir. 1990), *and* Gardner v. United States (*In re* Gardner), 913 F.2d 1515, 1518 (10th Cir. 1990); Wood v. Wood (*In re* Wood), 825 F.2d 90, 93 (5th Cir. 1987).

126. *See* Celotex Corp. v. Edwards, 514 U.S. 300, 307 n.5 (1955); Arnold v. Garlock, Inc., 278 F.3d 426, 434 (5th Cir. 2001); City of Liberal, Kansas v. Trailmobile Corp., 316 B.R. 358 (Bankr. D. Kan. 2004).

127. Sanders Confectionery Prods., Inc. v. Heller Fin., Inc., 973 F.2d 474, 483 (6th Cir. 1992); *Pacor*; *Inc*., 743 F.2d at 995–96; *Beneficial Nat'l Bank USA*, 220 B.R. at 947–49.

128. Lindsey v. O'Brien, Tanksi, Tanzer and Young Health Care Providers (*In re* Dow

B. *Abstention*

In all these cases, the bankruptcy court would have discretion to abstain in favor of the insurance receivership court "in the interest of comity with State courts or respect for State law."[129] Case law has revealed several factors that may play a prominent role in the decision.

As in the case of claims against the insolvent insurer itself, claims against parties related to the insolvent insurer may raise issues that affect the basic functions of the insurance receivership proceeding. Courts of appeals applying common law abstention principles have approved abstention in cases that raise such issues. These have included (1) a case in which an insurance agency sued several reinsurers of the insolvent insurer, seeking reinsurance proceeds that the court determined were assets of the insolvent insurer, owned solely by the receiver;[130] (2) a case in which the plaintiff brought a claim against the insolvent insurer's board chairman that was derivative of the rights of the insolvent insurer, the court noting that the receiver was "the appropriate party to bring all such claims" and that the state court was "the appropriate forum to exercise jurisdiction over all such claims;"[131] and (3) a case brought against the corporate parent of the insolvent insurer that would require the court to determine the amount of the deficiency remaining after the insurer's assets were applied to its liabilities, an issue the court said should be decided by the state receivership court.[132]

Where a plaintiff asserted certain claims against companies related to an insolvent insurer that were derivative of claims that had been made by the receiver and other claims that were different from the receiver's claims, the Third Circuit approved a stay of the entire case based on abstention grounds. The court held that, after the state proceedings were concluded, the plaintiff could pursue any or all of the claims not satisfied through the receivership proceedings by prosecuting them in the federal court.[133]

These cases suggest that, where a debtor brings a claim that is derivative of the rights of an insolvent insurer or depends for its resolution on a determination made by the state receivership court, a request for abstention by the insurer's receiver will be strong. On the other hand, where a

Corning Corp.), 86 F.3d 482, 493 (6th Cir. 1996); *Beneficial Nat'l Bank USA*, 220 B.R. at 947–49.

129. 28 U.S.C. § 1334(c)(1) (2000).

130. Martin Ins. Agency v. Prudential Reinsurance Co., 910 F.2d 249, 255 (5th Cir. 1990).

131. Barnhardt Marine Ins., Inc. v. New England Int'l Sur. of Am., Inc., 961 F.2d 559, 530–32 (5th Cir. 1992).

132. Hartford Cas. Ins. Co. v. Borg Warner-Corp., 913 F.2d 419, 426–27 (7th Cir. 1990).

133. Gen. Glass Indus. Corp. v. Monsour Med. Found., 973 F.2d 197, 203–04 (3d Cir. 1992).

case does not require an adjudication that would impair the receivership process or where it presents issues that are subject to exclusive federal jurisdiction, a bankruptcy court may be reluctant to yield jurisdiction.

For example, in a case where policyholders of an insolvent insurer brought claims against the insurer's auditor that were not derivative of the insolvent insurer's rights, the Third Circuit held that common law abstention was inappropriate. The policyholders claimed that they suffered losses because they relied on the auditor's false and misleading certification of the insurer's financial statements. The court noted that the claims were brought for the alleged breach of duties owed directly to the policyholders, not to the insurer.[134]

Similarly, where plaintiffs asserted claims under the federal securities laws against officers and directors of an insolvent insurer, the Third Circuit held that the district court could not abstain from hearing the plaintiffs' case.[135] The court noted that the plaintiffs' claims were not derivative of the insolvent insurer's rights, but instead were based on losses they suffered directly as a result of their purchases of annuities from the insolvent insurer, and the court noted that the claims were exclusively subject to federal jurisdiction.[136] The court acknowledged that the action might interfere with the receivership process, stating that it was "troubled" by the possible diversion of funds from policyholders of the insolvent insurer, but it concluded that this interference could not justify abstention over claims exclusively subject to federal jurisdiction.[137]

VII. CONCLUSION

The broad picture that emerges from these authorities is that the bankruptcy estate and the insurance receivership estate each operate as a center of gravity for the adjudication of certain claims. As a general rule, claims that may subject an insolvent insurer's estate to additional liabilities are likely to be adjudicated in the receivership court, unless there are federal policies that would be undermined by the bankruptcy court's yielding

134. Univ. of Maryland at Baltimore v. Peat Marwick Main & Co., 923 F.2d 265, 273–74 (3d Cir. 1991). The court also held that an auditor's connection to the state regulatory mechanism governing insolvency proceedings was "simply too attenuated" to justify common law abstention, contrasting the auditor with the insurer's receiver, corporate parent and officers. *Id*. at 271. Given the important role played by auditors in the state regulation of insurers and the statutory basis for the bankruptcy court's authority to abstain in the interest of comity with state law, it is uncertain whether this specific holding would be persuasive to a bankruptcy court. Nevertheless, the holding suggests that a request for abstention may be weak where a connection between the person sued by a debtor and the state law governing an insurance insolvency is absent or unclear.

135. Riley v. Simmons, 45 F.3d 764, 774–76 (3d Cir. 1995).

136. *Id*.

137. *Id*. at 776.

jurisdiction. Similarly, as a general rule, claims that may subject a debtor's estate to additional liabilities are likely to be adjudicated in the bankruptcy court, unless adjudication by the bankruptcy court would impair the insurance receivership process.

Where a debtor and an insolvent insurer each have claims to a particular piece of property, the case law reflects an inclination of bankruptcy courts to leave the determination of ownership issues to state receivership courts. Several of these courts have found in the McCarran-Ferguson Act a federal policy of avoiding interference with state insurance receiverships. While it remains to be seen whether these courts have properly concluded that they lacked jurisdiction to consider issues with respect to the ownership of property claimed both by a debtor and by an insolvent insurer, their authority to abstain in the interest of comity with state court law or respect for state law appears to provide a sound alternative basis for their rulings.