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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:)	BAP No.	HI-06-1274-MoBK
)		
RODGER DALE BENZ and MARIA)	Bk. No.	05-04020
YIM-KING BENZ,)		
)		
Debtors.)		
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RODGER DALE BENZ; MARIA)		
YIM-KING BENZ,)		
)		
Appellants,)		
)		
v.)	O P I N I O N	
)		
DTRIC INSURANCE COMPANY,)		
)		
Appellee.)		
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Argued and Submitted on January 19, 2007
at Honolulu, Hawaii

Filed - March 28, 2007

Appeal from the United States Bankruptcy Court
for the District of Hawaii

Hon. Robert J. Faris, Chief Bankruptcy Judge, Presiding.

Before: MONTALI, BRANDT and KLEIN, Bankruptcy Judges.

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1 MONTALI, Bankruptcy Judge:

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3 Debtors, defendants in a pre-petition lawsuit pertaining to
4 their former residence, tendered defense of that action to their
5 insurer. After the petition date, the insurer informed the
6 debtors that it would no longer provide a defense to the lawsuit,
7 stating that the claims in the state court lawsuit were excluded
8 from the coverage of their homeowners' policy. The debtors filed
9 a contempt motion against the insurer, arguing that the
10 withdrawal of the defense and the communication thereof violated
11 the automatic stay. The bankruptcy court denied the motion, and
12 the debtors appealed. We make clear in this Opinion that a
13 party's communication to a debtor that the terms of a contract do
14 not obligate that party to perform certain acts is not, in and of
15 itself, a violation of the automatic stay. Accordingly, we
16 AFFIRM.

17 **I. FACTS**

18 Appellants Rodger and Maria Benz ("Debtors") held a
19 homeowners' insurance policy with appellee DTRIC Insurance
20 Company, Limited ("Insurer") with a term running from August 15,
21 2002 to August 15, 2003. On August 4, 2003, Debtors requested
22 that the policy be cancelled effective July 25, 2003, the date of
23 the recordation of a deed conveying title of their residence to
24 David and Patricia Knight (the "Knights").

25 On May 25, 2004, the Knights filed a state court lawsuit
26 against Debtors and others arising out of their purchase of
27 Debtors' former residence. In particular, the Knights alleged
28 that the property contained significant construction and other

1 defects resulting in injury to their son. The Knights asserted
2 claims of fraud and misrepresentation, breach of contract,
3 failure to disclose, construction defects and negligence, bad
4 faith, unfair and deceptive trade practices, and strict
5 liability.

6 Because the wrongful acts asserted by the Knights
7 purportedly occurred while Debtors' homeowners policy was still
8 effective, Debtors tendered the defense of the lawsuit to
9 Insurer. Insurer agreed to provide a defense to the lawsuit,
10 "subject to the following reservation of rights":

11 By paying for your defense, [Insurer] does not waive,
12 and will not be estopped from asserting, any of the
13 terms or conditions contained in the insurance policy
14 or any defenses [Insurer] may have to any alleged
15 liability under the policy, including but not limited
16 to any alleged liability to settle any claims made
17 against you or to indemnify you against any judgment
18 for damages. [Insurer] will not indemnify you for any
19 liability not covered under the insurance policy.
20 [Insurer] reserves the right to stop paying for your
21 defenses or to decline to participate in any settlement
22 of claims against you should it be determined that
23 there is no potential for [Insurer] to have to
24 indemnify you under the insurance policy.

25 (Emphasis added.) Insurer further stated:

26 Nothing in this letter should be construed or deemed to
27 be a waiver of any of [Insurer's] rights under your
28 insurance policy. [Insurer] reserves the right to
assert any other reason for non-coverage or forfeiture
of coverage which may be or may become apparent either
from further review of material already provided or
from additional information made available to or
obtained by [Insurer].

29 Insurer commenced its defense of the lawsuit, retaining
30 counsel to represent Debtors. More than one year later (on
31 October 14, 2005), Debtors filed their chapter 13 petition. The
32 Knights filed a motion for relief from stay, noting that

1 modifying the stay to allow prosecution of their lawsuit would
2 not harm Debtors or the estate since the Insurer was defending
3 the lawsuit and any recovery would be limited to insurance
4 proceeds. Appellants contend on appeal that they did not file a
5 substantive objection to the motion because Insurer was paying
6 for the defense of the lawsuit. The bankruptcy court granted the
7 Knights relief from the automatic stay on January 11, 2006, with
8 an order providing that

9 the automatic stay is hereby modified to permit
10 [Knights] to proceed with the state court action . . .
11 for the limited purpose of liquidating the claims
12 (i.e., allowing the state court to determine liability
13 and damages) against Debtors and pursuing recovery of
14 any available insurance proceeds from Debtors'
15 liability insurers, that is, limiting the ability of
16 Movants to enforce the judgment against Debtors to
17 Debtors' insurance coverage. Movants would not seek to
18 enforce any judgment against Debtors' bankruptcy estate
19 except through and with the permission of the
20 Bankruptcy Court.

21 The state court litigation progressed, with Insurer paying for
22 the defense.

23 On May 11, 2006, Insurer sent a letter to Debtors informing
24 them that it would no longer defend the lawsuit or indemnify them
25 for damages or expenses arising from the lawsuit. Insurer stated
26 that "the Knights' allegations of property damage in the
27 complaint and summons are excluded from coverage under exclusions
28 1a and 1b" and that some of the claims alleged by the Knights
were not "'occurrences' under a liability insurance policy."
Insurer further noted that punitive damages were not covered by
the policy and that "there is no indication that the Knights'
allegations of bodily injury and property damage occurred during
the policy period." Therefore, Insurer contended that it had no

1 obligation to defend or indemnify Debtors in connection with the
2 lawsuit.

3 Eleven days later, Debtors filed their Motion for Order to
4 Show Cause Why [Insurer] Should Not Be Held in Violation and
5 Contempt of the Automatic Bankruptcy Stay (the "Contempt
6 Motion"). Insurer opposed the Contempt Motion, arguing inter
7 alia that withdrawal of the defense did not fall within any of
8 actions stayed by 11 U.S.C. § 362(a).¹

9 At the hearing on the Contempt Motion, the court issued an
10 oral ruling: "For me, the starting point is what the statute
11 [section 362] actually says, what [C]ongress wrote about what the
12 automatic stay would be, not what we might think it ought to be
13 or logically should be, but what [C]ongress said it would be."
14 The court noted that withdrawal of the defense did not constitute
15 commencement or continuation of an action against Debtors and
16 further observed that withdrawal of the defense was not an act
17 "to obtain possession of property of the estate or of property
18 from the estate or to exercise control over property of the
19 estate." See 11 U.S.C. § 362(a)(3). The court analogized
20 Insurer's withdrawal of a defense to a party under the contract
21 informing a debtor that it owes Debtor nothing under that
22 contract:

23 And, basically, I don't think the automatic stay is
24 intended to prevent parties to contracts with the

25 ¹Unless otherwise indicated, all chapter, section and rule
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and
27 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as
28 enacted and promulgated prior to the effective date of The
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,
Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

1 debtor from saying to the debtor, I think I've
2 performed this contract; I don't think I owe you any
3 more under this contract. I don't think doing that is
4 a violation of the automatic stay and I think that's
the closest analogy that I can think of to what
[Insurer] did here. So I don't see a violation of the
automatic stay.

5 Finally, the bankruptcy court found that Debtors had not
6 demonstrated damages arising from a violation of the stay, even
7 if a violation had occurred.

8 The bankruptcy court indicated that it was possible that
9 Debtors might have a meritorious claim against Insurer for
10 wrongful denial of coverage, but that a wrongful denial of such
11 claim should not be confused with a violation of the automatic
12 stay. In other words, Insurer did not violate the automatic stay
13 by communicating its position regarding its liability or duty
14 under the insurance policy, although it may have violated a duty
15 of good faith or a duty to defend under the contract itself.
16 Breaches of the latter duties, however, are not violations of the
17 automatic stay.

18 The bankruptcy court entered an order denying the Contempt
19 Motion on August 3, 2006, and Debtors filed a timely notice of
20 appeal on the same date.

21 **II. ISSUE**

22 Did Insurer violate the automatic stay by withdrawing its
23 defense of the lawsuit and by communicating to Debtors its belief
24 that the claims in the lawsuit fell outside the scope of their
25 homeowners' policy and thus outside of any contractual obligation
26 to defend?

27 **III. STANDARD OF REVIEW**

28 "We review de novo whether the automatic stay provision of

1 [section] 362(a) has been violated." California Employment Dev.
2 Dep't v. Taxel (In re Del Mission Ltd.), 98 F.3d 1147, 1150 (9th
3 Cir. 1996), citing Chugach Timber Corp. v. N. Stevedoring &
4 Handling Corp. (In re Chugach Forest Prods., Inc.), 23 F.3d 241,
5 244 (9th Cir. 1994).

6 **IV. JURISDICTION**

7 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
8 §§ 1334 and 157(b). We have jurisdiction under 28 U.S.C.
9 § 158(a)(1) and (b)(1).

10 **V. DISCUSSION**

11 The parties have not cited any federal cases specifically
12 addressing the issue of whether an insurer violates the automatic
13 stay by communicating its belief that a claim asserted against an
14 insurance policy falls outside the scope of coverage and thus
15 refusing to pay or defend that claim. At least one such case
16 does exist, however. In Grochocinski v. Allstate Ins. Co. (In re
17 Lyckberg), 310 B.R. 881, 891 (Bankr. N.D. Ill. 2004), the court
18 found that an insurer's postpetition denial of a debtor's claim
19 under a policy "did not constitute a willful violation of stay,"
20 even though the insurer did violate the stay in issuing a demand
21 for the debtor to appear at a postpetition examination.

22 Although the Lyckberg decision does not contain an analysis
23 supporting this holding, we agree with its holding that an
24 insurer's postpetition denial of a claim does not violate the
25 automatic stay. Communication by an insurer of its position that
26 an insurance policy excludes or otherwise does not cover a claim
27 is not "an act to exercise control over property of the estate"
28 under section 362(a)(3) and no other provision of section 362

1 comes close to applying in this case. Congress clearly knew how
2 to identify acts requiring relief from the stay, but did not
3 include a provision staying a party's refusal to perform actions
4 not required by a contract or even staying breaches of a
5 contract.² We must apply section 362 as written (Gardenhire v.
6 Internal Revenue Service (In re Gardenhire), 209 F.3d 1145, 1152
7 (9th Cir. 2000)) and it stretches the plain meaning of section
8 362 to require a contracting party to obtain relief from the stay
9 before refusing to perform under a contract.

10 Debtors rely primarily on two federal cases and one state
11 case in support of their position that an insurer's denial of a
12 defense or refusal to pay a claim constitutes an "act to obtain
13 possession of property of the estate or of property from the
14 estate or to exercise control over property of the estate." 11
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17 ²In Computer Commc'ns, Inc. v. Codex Corp. (In re Computer
18 Commc'ns, Inc.), 824 F.2d 725 (9th Cir. 1987), the Ninth Circuit
19 held that the non-debtor contracting party may not unilaterally
20 terminate a contract without first obtaining relief from the
21 stay. In Computer Communications, the non-debtor party
terminated the contract pursuant to a bankruptcy default clause.
Subsequent cases have refused to extend the Computer
Communications holding to breaches of contract:

22 Nor has the Court found or have the Debtors
23 provided any cases in support of the proposition that a
24 creditor's mere breach of a contract requires relief
25 from the automatic stay. In addition, the holding of
26 Computer Communications is clear: unilateral
27 termination of a contract by a creditor requires relief
28 from the automatic stay. The Court declines to expand
the holding of Computer Communications to breaches of
contract not tantamount to a termination.

In re Bobbitt, 174 B.R. 548, 554 (Bankr. N.D. Cal. 1993). Again,
Insurer here was not terminating the policy.

1 U.S.C. § 362(a)(3). Neither federal case is on point.

2 Both federal cases hold that an insurer's postpetition
3 cancellation of insurance policies violates section 362(a)(3)
4 because the policies themselves are property of the estate and
5 cancellation is an act to exercise control over property of the
6 estate. See Minoco Group of Cos., Ltd. v. First State
7 Underwriters Agency of New England Reinsurance Corp. (In re
8 Minoco Group of Cos., Ltd.), 799 F.2d 517, 518-19 (9th Cir. 1986)
9 (policies insuring debtor against indemnity claims made by its
10 officers and directors were property of estate and cancellation
11 of policies was stayed by section 362(a)(3)); Scrima v. John
12 DeVries Agency, Inc., 103 B.R. 128, 132 (W.D. Mich. 1989) ("Under
13 § 541(a) a debtor's insurance policies generally comprise
14 property of the estate. . . . Thus, § 362(a)(3) stays
15 postpetition cancellation of insurance policies that are property
16 of the estate.").

17 In contrast, Insurer is purporting to honor the policy and
18 merely is making a contractually-permitted determination
19 regarding its scope. Thus, Minoco and Scrima are inapplicable.
20 Insurer is not attempting to cancel the policy; rather, Debtors
21 had cancelled the policy before the petition date. Here --
22 unlike the insurers in Minoco and Scrima -- Insurer was simply
23 communicating its position regarding its duties and liabilities
24 under the contract.

25 Debtors do cite, however, a Hawaii state court case holding
26 that an insurer's commencement of a suit for rescission and for a
27 declaratory judgment that it was not obligated to defend a
28 lawsuit against a debtor constituted a violation of section

1 362(a)(3) (but not section 362(a)(1), which prohibits the
2 commencement of actions against a debtor).³ See Island Ins. Co.,
3 Inc. v. Santos, 86 Haw. 363, 949 P.2d 203, 207-08 (Haw. Ct. App.
4 1997). Stating that the "question is whether an insurer's duty
5 to defend and/or duty to provide insurance coverage is considered
6 'property' of a debtor's estate" and relying on Minoco, the state
7 court held that an insurance contract is property of the estate
8 and thus the commencement of an action by the insurer to
9 determine its obligation to defend a postpetition lawsuit based
10 on postpetition occurrences violated the automatic stay. Santos,
11 949 P.2d at 207-08.

12 Santos is neither binding nor persuasive. First, the state
13 court did not thoroughly analyze whether the "duty to defend" is
14 property of the estate; instead, it simply relied on policy
15 cancellation cases holding that the policy itself is property of
16 the estate. Minoco and other cases clearly provide that
17 cancellation or termination of a contract requires relief from
18 the stay. But that is not the situation here; Insurer is not
19 attempting to cancel or terminate a contract but is simply
20 refusing to perform actions that it believes are not required by
21 the contract.

22 In addition, the state court in Santos overlooked an
23 important concept of bankruptcy law: the property of the estate
24 cannot exceed whatever interests a debtor holds at the
25

26 ³The state court found that section 362(a)(1) did not apply
27 because the insurer's action could not have been commenced prior
28 to the petition date, because all of the pertinent events
occurred postpetition.

1 commencement of a case. Foothill Capital Corp. v. Clare's Food
2 Market, Inc. (In re Coupon Clearing Serv., Inc.), 113 F.3d 1091,
3 1099 (9th Cir. 1997) ("the estate [has] no greater rights in
4 property than those held by the debtor prior to bankruptcy");
5 Gendreau v. Gendreau (In re Gendreau), 122 F.3d 815, 819 (9th
6 Cir. 1997) ("filing bankruptcy cannot give a debtor a greater
7 interest in an asset than that which he owned pre-bankruptcy").

8 Here (and in Santos), Debtors held the right under their
9 insurance policy to submit claims and tender defenses, subject to
10 Insurers' right to refuse to pay or defend non-covered claims.
11 Nothing in the insurance policy mandated coverage if the claims
12 fell outside the scope of the policy or contract; to the
13 contrary, the policy lists specific exclusions to coverage.
14 Therefore, the estate's "property interest" is whatever benefits
15 flow from the contract, subject to the insurer's determination
16 that certain claims (or "benefits") are excluded from coverage.
17 The exercise of the insurer's determination thus cannot violate
18 the automatic stay, as the debtor's property interest is subject
19 to that contractual limitation in the first place.

20 Finally, to hold that the "duty to defend" is property of
21 the estate, as the Santos court did, assumes that all asserted
22 claims fall within the parameters of the policy's coverage. In
23 other words, it expands the terms of the contract and provides
24 the debtor and the estate with new contractual rights: a
25 presumption that all claims are covered and must be paid or
26 defended. But the Bankruptcy Code does not and should not grant
27 a debtor "greater rights and powers under the contract than he
28 had outside of bankruptcy." White Motor Corp. v. Nashville White

1 Trucks, Inc. (In re Nashville White Trucks, Inc.), 5 B.R. 112,
2 117 (Bankr. M.D. Tenn. 1980).

3 We therefore decline Debtors' invitation to extend Santos
4 and instead agree with the holding in Lyckberg, not only as a
5 matter of law but also as a matter of policy. If deciding and
6 communicating that one's performance is not due under the terms
7 of a contract violates the automatic stay, or if refusing to
8 perform an act (such as defense of a lawsuit) not required by the
9 contract were a violation of the automatic stay, all insurers
10 would be stymied in their day-to-day processing and adjusting of
11 claims.

12 For example, under Debtors' theory, a provider of health
13 insurance would not be able to deny the claim of an out-of-
14 service provider without obtaining relief from the stay in the
15 patient's/insured's bankruptcy, even though the insurer believes
16 that the claim is excluded from the policy. Similarly, an
17 insurer presented with a casualty claim by a debtor for water
18 damage could not reject that claim as falling within flood
19 exclusions without first obtaining relief from the stay.

20 The Bankruptcy Code simply does not require an insurer to
21 obtain relief from the stay to assert its position under a
22 contract. If the insurer wrongfully rejects a claim, or
23 wrongfully refuses to assume the defense of a claim, the insured
24 has multiple options for pursuing relief. Seeking sanctions for
25 violation of the automatic stay is not one of them.⁴

26
27 ⁴Debtors note that Insurer did not object when the Knights
28 filed a motion for relief from stay on the grounds that recovery
(continued...)

1 **VI. CONCLUSION**

2 Under section 362 as written, an insurer does not violate
3 the automatic stay when it determines its obligations under a
4 policy and acts accordingly.⁵ We therefore agree with the
5 bankruptcy court that Insurer's withdrawal of defense pursuant to
6 its reading of the insurance policy did not violate the automatic
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8 ⁴(...continued)
9 would be limited to proceeds from Debtors' policy and on the
10 grounds that Debtors would not be paying for the defense of the
11 state court action. Regardless of whether these facts might be
12 relevant in an action for wrongful denial of coverage, they are
13 not relevant to whether Insurer violated the automatic stay.

14 We express no opinion on the effect of the subsequent denial
15 of coverage on the order "modif[ying]" the automatic stay for the
16 "limited purpose" of determining liability and damages and
17 "pursuing recovery of any available insurance proceeds from
18 Debtors' liability insurers, that is, limiting the ability of
19 Movants to enforce the judgment against Debtors to Debtors'
20 insurance coverage." Order Granting Creditors [Knights'] Motion
21 for Relief from Automatic Stay filed on November 29, 2005 (Jan.
22 11, 2006). Nor do we express a view on whether a judgment
23 obtained pursuant to that order could be enforced against the
24 debtors as a personal liability in the event they do not receive
25 a discharge of the debt or, instead, whether they would be
26 entitled to relitigate liability and damages. Such issues lurk
27 in the background whenever there is a conditional relief from
28 stay as to which the condition fails, but they have not been
presented to us by the parties and need not be decided.

29 We do, however, question how Debtors could have incurred
30 damages because of Insurer's denial of coverage (as opposed to
31 damages arising from Insurer's purported bad faith denial of
32 coverage, which is a matter to be resolved separately) after the
33 stay was modified. Moreover, so long as they complete their
34 confirmed chapter 13 plan, we assume the debt will be discharged.

35 ⁵The insurer may be violating other statutes or law (such as
36 state law imposing good faith in deciding coverage issues), but
37 it is not violating the automatic stay unless it files suit or
38 performs another act specifically identified in section 362(a).

1 stay. Accordingly, we AFFIRM.

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