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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

FILED
03 DEC 17 PM 3:52
U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
CLEVELAND

In re:	)	Case No. 02-15045
GLIATECH, INC., et al.,	)	Chapter 11
Debtors.	)	Judge Pat E. Morgenstern-Clarren
MEDMARC CASUALTY INSURANCE COMPANY, et al.,	)	Adversary Proceeding No. 02-1416
Plaintiffs,	)	
v.	)	**MEMORANDUM OF OPINION REGARDING MOTION TO DISMISS AND CROSS MOTIONS FOR SUMMARY JUDGMENT**
GLIATECH, INC., et al.,	)	
Defendants.	)	

Plaintiffs Medmarc Casualty Insurance Co. and Federal Insurance Co. filed an amended complaint for declaratory relief regarding their obligation, if any, to provide coverage to the defendants Gliatech, Inc., Gliatech Medical, Inc., and GIC, Inc. (collectively "Gliatech") for punitive damage claims. The plaintiffs now move for summary judgment that they have no such obligation. The Gliatech defendants move to dismiss the complaint. Alternatively, they request summary judgment in their favor. The court heard oral argument on the motions on October 31, 2003. For the reasons stated below, Gliatech's motion to dismiss is denied, Medmarc and Federal's motion for summary judgment is denied, and Gliatech's motion for summary judgment is denied.[1]

[1] *See* docket 39, 40, 41, 42, 46, 51, 52, 53, 54, 60, 67, 68.

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JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(O).

FACTS

A.

These are the undisputed material facts based on the stipulations,[2] the pleadings, and the evidence:[3]

Gliatech, Inc., Gliatech Medical, Inc., and GIC, Inc. filed chapter 11 petitions on May 9, 2002.[4] Gliatech, Inc. is a Delaware corporation with its principal place of business in Ohio. Medmarc Casualty Insurance Co. is a mutual insurance company domiciled in Vermont, licensed to issue insurance in Ohio, and primarily doing business in Virginia. Federal Insurance Co. is an Indiana corporation which primarily does business in New Jersey.[5]

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[2] Docket 20.

[3] Medmarc and Federal asked the court to take judicial notice of their amended complaint, the defendants' answer, and certain documents related to a district court criminal matter. The latter included minutes of proceeding, Gliatech's plea agreement, and the criminal judgment against it. The documents have been provided, the defendants did not object, and the court will, therefore, take judicial notice of them. *See* FED. R. EVID. 201. The plaintiffs also requested that judicial notice be taken of all documents relating to them on file with the Ohio Department of Insurance and of all documents relating to the defendants and ADCON-L on file with the United States FDA. That request is denied because those documents were not provided. (Docket 40).

[4] The cases are being jointly administered.

[5] Counsel for Federal stated that its principal place of business is New Jersey; the stipulation, however, says Massachusetts. (Docket 20).

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Medmarc issued a series of commercial insurance policies to Gliatech which were renewed annually for several years.[6] Medmarc countersigned and issued the policies in Virginia. The policies include Ohio mandatory endorsements. (Plaintiffs' motion, exh. 11 at 51). The policies cover Gliatech's products-completed operations, including a medical product called ADCON-L which Gliatech developed, manufactured, and distributed throughout the United States and abroad. ADCON-L is a surgical gel designed to reduce scarring after lumbar back surgery. The policies obligate Medmarc to defend ADCON-L claims made against Gliatech to date.[7] Those claims (which include both lawsuits and claims which have not been reduced to suit) involve bodily injuries alleged to have been suffered as a result of defects in ADCON-L.[8] The alleged injuries occurred in several states.

Federal issued excess insurance policies to Gliatech in 2000 and 2001 that follow form to the Medmarc policies.[9] Gliatech has notified Federal that claims exist, but Federal has not been called upon or required to defend any ADCON-L claims.

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[6] The policies are: the 1995 policy (for the period July 1, 1995 to July 1, 1996); the 1996 policy (for the period July 1, 1996 to July 1, 1997); the 1997 policy (for the period July 1, 1997 to July 1, 1998); the 1998 policy (for the period July 1, 1998 to July 1, 1999); the 1999 policies (for the periods July 1, 1999 to October 11, 1999 and October 11, 1999 to July 1, 2000); the 2000 policy (for the period July 1, 2000 to July 1, 2001); and the 2001 policy (for the period July 1, 2001 to July 1, 2002).

[7] Claims related to ADCON-L have been made against Gliatech and there are lawsuits pending in various states. Some of the claimants were named as defendants in this adversary proceeding.

[8] In December 2000, the FDA placed Gliatech on its Application Integrity Policy list based on irregularities in the reporting of clinical trials of ADCON-L. In January 2001, Gliatech voluntarily withdrew the product from the market.

[9] The policies are: the 2000 policy (for the period July 1, 2000 to July 1, 2001) and the 2001 policy (for the period July 1, 2001 to July 1, 2002).

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Gliatech secured these policies through its broker, Britton-Gallagher & Associates of Cleveland, Ohio. The negotiations for the policies were conducted by telephone, fax, and electronic mail in Ohio, Virginia, and Massachusetts. The policies were delivered to Gliatech through Britton-Gallagher in Ohio. Gliatech forwarded the premiums from its Ohio headquarters to Britton-Gallagher, which in turn forwarded them to the insurers.

All of the policies provide worldwide coverage. The 1995, 1996, and 1997 Medmarc policies include this provision explicitly excluding coverage for punitive damages:

> We agree that this policy does not apply to a claim of or indemnification for punitive or exemplary damages whether in the form of fines, penalties, multiplication of compensatory awards or damages, or in any other form whatsoever.

(Plaintiffs' motion, exhs. 1, 2, 3).

In July 1997, Britton-Gallagher asked Medmarc to drop the punitive damage exclusion from the 1997 policy. (Defendants' motion, exh. 3). Medmarc's underwriter, Jeff Stroud, responded by fax that, "We can delete the punitive damages exclusion for a premium charge of 10%." Nothing came of this exchange, however, and the punitive damage exclusion remained in effect for the 1997 policy. (Defendants' motion, exh. 4). Gliatech paid a $43,286.00 premium for the 1997 policy.

B.

At this point in the history of the dispute, the parties' versions of the facts diverge.

In July 1998, in connection with the 1998 policy renewal, Britton-Gallagher again requested a change in punitive damage coverage. Sheree Bartos, Gliatech's account manager at Britton-Gallagher, faxed correspondence to Stroud stating that punitive damage coverage was

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important to her client and asking what the charge would be for that coverage. (Defendants' motion, exh. 5). Stroud responded that Ohio would not approve an insurance filing which included coverage for punitive damages. (Plaintiffs' motion, exh. 10 at 75-76). Stroud also told Bartos that Medmarc offered a policy which included a "most favored venue" endorsement. (Plaintiffs' motion, exh. 11 at 76).

The parties agree that the punitive damage exclusion did not appear in the 1998 policy or any later ones. They also agree that those policies did not contain a specific provision covering punitive damages. It is Bartos's understanding that this change in policy terms was done in exchange for a 10% premium charge. (Defendants' motion, exh. 2 at 147-48). The evidence, however, does not provide a sufficient basis to determine whether this is so. The premium paid for the 1998 policy appears to have been increased to $49,940.00; however, there is no evidence as to how this was calculated and whether it includes the 10% premium. At deposition, Bartos testified that it was her understanding based on conversations with Stroud that dropping the punitive damage exclusion resulted in Gliatech being insured against punitive damage awards in any state where such insurance was permitted by law. (Defendants' motion, exh. 2 at 77-79). That is not, however, Stroud's understanding. According to Stroud, dropping the punitive damage exclusion left the issue of punitive damage coverage to the determination of any court with jurisdiction over the policy. (Plaintiffs' motion, exh. 12 at 47). Also according to Stroud, the 10% premium would have been charged only for affirmative coverage and not for merely dropping the punitive damage exclusion from the policy. (Plaintiffs' motion, exh. 12 at 77).

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DISCUSSION

Medmarc and Federal brought this action seeking a declaration that they are not required to provide Gliatech with coverage for punitive damages. The dispute focuses on the 2001 and 2002 policies.[10] The policies do not have a choice of law provision. The law to be applied is critical because some states do not permit an insurance policy to cover punitive damage claims as a matter of public policy. Ohio is one such state. Medmarc and Federal argue that Ohio law should govern the policies, which would result in a finding that punitive damage coverage is not included.[11]

Gliatech responds with three positions. First, it asks that the complaint be dismissed on the ground that a declaratory judgment request is discretionary and the court should not exercise its discretion in this case. Alternatively, Gliatech requests summary judgment that Virginia law governs the Medmarc policies and Indiana law governs the Federal policies. According to Gliatech, Virginia law does not prohibit coverage for punitive damages and Indiana law is undecided. As a further alternative, Gliatech argues that the law of the state where each injury occurred should govern the policies with respect to those claims. In that case, the result would vary depending on state law.

I.

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[10] The plaintiffs concede that no claims or lawsuits are asserted against the policies for 1995 through June 30, 2000. (Plaintiff's motion at 3, n.1). (Docket 39).

[11] *See* Ohio Rev. Code § 3937.182(B) ("[N]o . . . policy of casualty or liability insurance that is covered by sections 3937.01 to 3937.17 of the Revised Code and that is so issued shall provide coverage for judgments or claims against an insured for punitive or exemplary damages."). *See also, State Farm Mut. Ins. Co. v. Blevins,* 49 Ohio St.3d 165, 168, 551 N.E.2d 955, 958 (Ohio 1990) (noting that § 3937.182(B) reflects a strong public policy against insurance coverage for punitive damages).

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Motion to Dismiss

Jurisdiction to grant declaratory relief is discretionary. *See Aetna Cas. & Sur. Co. v. Sunshine Corp.*, 74 F.3d 685, 687 (6th Cir. 1996) (citing *Grand Trunk Western R.R. Co. v. Consol. Rail Corp.*, 746 F.2d 323, 325 (6th Cir. 1984)). Gliatech asks this court to decline to exercise jurisdiction and to dismiss the complaint.[12] Medmarc and Federal oppose the request.

"The general tests applied in determining whether to exercise jurisdiction in a declaratory judgment action are whether the judgment 'will serve a useful purpose in clarifying and settling the legal relationships in issue' and whether it 'will terminate and afford relief from the uncertainty, insecurity, and controversy giving rise to the proceeding'." *Id.* (quoting *Grand Trunk Western R.R.*, 746 F.2d at 326). Specific considerations include whether the declaratory action: (1) will settle the controversy; (2) will serve a useful purpose in clarifying the legal relations in issue; (3) is being used merely for the purpose of procedural fencing or as an arena for a race for res judicata; (4) will increase friction between federal and state courts and improperly encroach on state jurisdiction; and (5) is less effective than an alternative remedy. *See Grand Trunk Western R.R.*, 746 F.2d at 326.

Applying these factors to this case establishes that declaratory relief is appropriate. A decision will clarify the legal issues and definitively settle the controversy over Medmarc's and Federal's liability to provide coverage to Gliatech for punitive damages. The plaintiffs were able to file this action in bankruptcy court as a result of the Gliatech chapter 11 filings and did not shop around for a federal forum. Consequently, declaratory relief from this court will not cause

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[12] At oral argument, Gliatech withdrew its argument that the case should be dismissed for lack of jurisdiction because there was no actual controversy.

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friction with the state courts. Also, because a ruling will determine only the issue of the plaintiffs' liability to Gliatech under the policies, it is clear that declaratory relief is not being sought merely to provide an argument for res judicata in other forums. This court will exercise its jurisdiction under these facts and the defendants' motion to dismiss is, therefore, denied.

II.

Summary Judgment Motions

Each party moves for summary judgment in its favor. Medmarc and Federal request a determination that Ohio law governs their contracts and a judgment declaring that they do not have an obligation to provide coverage to Gliatech for punitive damages. Gliatech, on the other hand, requests a judgment determining that the Medmarc policies are to be construed under Virginia law and the Federal policies are to be construed under Indiana law or, alternatively, that the law of the state where each injury occurred should govern the policies with respect to those claims.

A.

Summary Judgment Standard

Summary judgment is appropriate only where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. *See* FED. R. CIV. P. 56(c) (made applicable by FED. R. BANKR. P. 7056); *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). The movant must initially demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett,* 477 U.S. at 323. Summary judgment "shall be rendered . . . if the pleadings, depositions, answers to interrogatories, and admissions on

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file, together with the affidavits, if any, show there is no genuine issue as to any material fact[.]" FED. R. CIV. P. 56(c).

Once the movant has met its burden, the burden shifts to the nonmoving party to show the existence of a material fact which must be tried. *Id.* The nonmoving party must oppose a proper summary judgment motion "by any of the kinds of evidentiary material listed in Rule 56(c), except the mere pleadings themselves . . . ." *Celotex Corp. v. Catrett,* 477 U.S. at 324. All reasonable inferences drawn from the evidence must be viewed in the light most favorable to the party opposing the motion. *Hanover Ins. Co. v. Am Eng'g Co.*, 33 F.3d 727, 730 (6th Cir. 1994). The issue at this stage is whether there is evidence on which a trier of fact could reasonably find for the nonmoving party. *Street v. J.C. Bradford & Co.*, 886 F.2d 1472, 1477 (6th Cir. 1989).

B.

Choice of Law

When a contract does not have a choice of law provision, the court must determine which state substantive law governs. Ohio's choice of law rules control this determination. *See Bianco v. Erkins (In re Gaston & Snow),* 243 F.3d 599, 605 (2d Cir. 2001) (stating that the choice of law rules of the forum state apply in bankruptcy court unless federal bankruptcy policy is implicated); *Amtech Lighting Servs. Co. v. Payless Cashways, Inc. (In re Payless Cashways)*, 203 F.3d 1081, 1084 (8th Cir. 2000) (noting that a bankruptcy court applies the choice of law rules of the state in which it sits); *Rubenstein v. Ball Bros., Inc. (In re New England Fish Co.),* 749 F.2d 1277, 1280-81 (9th Cir. 1984) (stating that a bankruptcy court applies the choice of law rules of the state in which it sits). *See also, Corzin v. Fordu (In re Fordu)*, 201 F.3d 693, 700 (6th Cir. 1999) ("[I]t is well-settled that a debtor's property rights are created and defined by state law."). Ohio's

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"choice-of-law rules 'do not themselves determine the rights and liabilities of the parties, but rather guide decision as to which local law rule will be applied to determine these rights and duties'." *Ohayon v. Safeco Ins. Co. of Illinois*, 91 Ohio St.3d 474, 476, 747 N.E.2d 206, 208 (Ohio 2001) (quoting Restatement (Second) Conflicts of Laws § 2, Comment (a)(3)).

In the absence of a contractual choice of law provision, Ohio's choice of law rules:

> mandate that the law of the state with the more significant relationship to the contract should govern disputes arising from it. To determine which state has the more significant relationship to the contract, Ohio law has adopted the test set forth in the Restatement (Second) of Conflict of Laws § 188.

Nat'l Union Fire Ins. Co. v. Watts, 963 F.2d 148, 150 (6th Cir. 1992) (citations omitted). *See also, Nationwide Mut. Ins. Co. v. Ferrin*, 21 Ohio St.3d 43, 44-45, 487 N.E.2d 568, 569 (Ohio 1986) (applying Ohio's contractual choice of law analysis to insurance policies).

Restatement § 188 provides that:

> (1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.
>
> (2) In the absence of an effective choice of law by the parties . . . the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:
>
> (a) the place of contracting;
> (b) the place of negotiation of the contract;
> (c) the place of performance;
> (d) the location of the subject matter of the contract; and
> (e) the domicile, residence, nationality, place of incorporation, and place of business of the parties.

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These contacts may be given different weight depending on their relative importance in the case at hand. RESTATEMENT (SECOND) CONFLICT OF LAWS § 188 (2003). Section 188 refers to the principles in Restatement § 6. That section states:

> (1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.
>
> (2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include:
>
> (a) the needs of the interstate and international systems,
> (b) the relevant policies of the forum,
> (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
> (d) the protection of justified expectations,
> (e) the basic policies underlying the particular field of law,
> (f) certainty, predictability and uniformity of result, and
> (g) ease in the determination and application of the law to be applied.

RESTATEMENT (SECOND) CONFLICT OF LAWS § 6 (2003).

Read together, these two Restatement sections provide a general frame work for courts to use to resolve choice of law issues in the insurance contract setting. The court must use this framework to "balance principles, policies, factors, weights, and emphases to reach a result, the derivation of which in all honesty, does not proceed with mathematical precision." *Int'l Ins. Co. v. Stonewall Ins. Co.*, 86 F.3d 601, 606 (6th Cir. 1996). The list of factors provided is not exclusive and they need not be given equal weight in every circumstance. *Id.*

Each side argues for a different result under Ohio's choice of law provisions. As noted above, Ohio law calls for the court to consider the justified expectations of the parties to the insurance contract. Gliatech, which emphasizes this factor, argues that to construe the policies as Ohio contracts would frustrate the justified expectations of the parties. In support, Gliatech cites

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to the circumstances surrounding the removal of the punitive damage exclusion from the 1998 policy.[13] Medmarc and Federal argue that this evidence cannot be considered because the policies are not ambiguous and they cannot be made ambiguous with parole evidence. This argument is faulty because the evidence is not being offered to alter the policy terms, but rather to establish a factual basis for this court's decision on the issue of choice of law. This evidence is clearly relevant to the issue of the parties' justified expectations and can be considered for that purpose. *See for example, Nat'l Starch and Chem. Corp. v. Great Am. Ins. Cos.*, 743 F. Supp. 318, 325-26 (D. N.J. 1990) (considering the parties' understanding as to choice of law issues at the time of contracting). The error in the plaintiffs' argument is further shown by the fact that the applicability of the parole evidence rule is itself determined under the choice of law considerations set forth in Restatement § 188. *See* RESTATEMENT (SECOND) CONFLICTS OF LAW § 140 (2003) ("Whether a contract is integrated in a writing and, if so, the effects of integration are determined by the local law of the state selected by application of the rules of §§ 187-188").

As noted, the parties to this dispute have offered conflicting evidence about their expectations. There is, therefore, a genuine issue of material fact which makes summary judgment (for any party) inappropriate. At trial, the parties will be able to present their evidence in support of their positions as well as to challenge the opposing side's version of the facts, including the credibility of the witnesses. There are a number of different possible results: the plaintiffs' version may prevail, the defendants' version may prevail, the court may find that each

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[13] Gliatech overstates its position by arguing that the policies cannot be governed by Ohio law based on the parties' justified expectations, because as noted this is only one factor to be considered in the choice of law analysis. Gliatech also argues that the defendants are estopped from arguing that Ohio law applies. Gliatech did not provide legal support for this argument.

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party had a different expectation as to how punitive damages would be handled, or the court may find that neither party had any expectation on this issue. In any event, this is clearly a factual issue to be determined at trial.

CONCLUSION

The plaintiffs' motion for summary judgment is denied. The defendants' motion to dismiss or for summary judgment is also denied. A separate judgment reflecting this decision will be entered.

Date: 17 December 2003

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Diana Thimmig, Esq.
Donald Erickson, Esq.
Mark Porter, Esq.

By: Joyce L Gordon Secretary
Date: 12/17/03

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GLIATECH, INC., et al.,	)	Chapter 11
	)	
Debtors.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	
MEDMARC CASUALTY INSURANCE COMPANY,	)	Adversary Proceeding No. 02-1416
	)	
Plaintiff,	)	
	)	
v.	)	**ORDER**
	)	
GLIATECH, INC., et al.,	)	
	)	
Defendants.	)	

For the reasons stated in the memorandum of opinion filed this same date, the motion of the plaintiffs for summary judgment is denied. (Docket 39). The defendants' motion to dismiss or for summary judgment is also denied. (Docket 41).

The dates set in the trial scheduling order will remain in effect.

IT IS SO ORDERED.

Date: 17 December 2003

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Diana Thimmig, Esq.
Donald Erickson, Esq.
Mark Porter, Esq.

By: Joyce L. Gordon, Secretary
Date: 12/17/03