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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 02-15045
	)	
GLIATECH, INC., et al.,	)	Chapter 11
	)	Jointly Administered
	)	
Debtors.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**MEMORANDUM OF OPINION**
	)	**REGARDING MOTIONS FOR**
	)	**RELIEF FROM STAY**

Prepetition, the debtors manufactured a product called Adcon-L for use in surgical procedures.[1] Movants Dorothy Lavender, Claire Prior, Barbara Carrington, Eileen O'Neill, and Jack and Carolyn Bunch allege that Adcon-L was used during their surgeries with resulting harm. They request relief from the automatic stay to allow them to prosecute their personal injury claims against Gliatech, Inc. in state court. If successful in such suits, they intend to recover only from the debtors' insurance. To reinforce this, they disclaimed any interest in recovering from the debtors' estate assets. (Docket 863, 865, 867, 869, 921).

The debtors and the creditors' committee argue the stay should remain in force. (Docket 904, 905, 906, 907, 910). The debtors' liability insurers, Medmarc Casualty Insurance Group and Federal Insurance Company, also contend the stay should be maintained. (Docket 908, 909). For the reasons stated below, the motions are granted.

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[1] The related debtors are Gliatech, Inc., Gliatech Medical, Inc., and GIC, Inc. The cases are being jointly administered.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered on July 16, 1984 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)(G).

FACTS

The parties stipulated to these facts:

1. On May 9, 2002, the . . . [d]ebtors filed voluntary petitions under chapter 11 of the bankruptcy code, and the [d]ebtors have operated their business as [d]ebtors in [p]ossession.

2. Prior to the commencement of their bankruptcy cases, the [d]ebtors developed, manufactured, marketed, and sold a medical device known as Adcon-L.

3. Eileen O'Neill . . . is an individual residing at 287 Essex Street, Holyoke, Hampden County, Massachusetts.

4. On September 25, 2000, O'Neill underwent a lumbar disc surgery at Mercy Hospital in Springfield, Massachusetts.

5. O'Neill alleges that Adcon-L was used during the course of [her] surgery.

6. O'Neill alleges that she developed a severe and life threatening infection, and suffered pain and permanent physical injury shortly after her surgery.

7. Clair Prior . . . is an individual residing in Hampden County, Massachusetts.

8. On September 1, 2000, Clair Prior underwent a lumbar disc surgery at Mercy Hospital in Springfield, Massachusetts.

9. Prior alleges that Adcon-L was used during the course of [her] surgery.

10. Prior alleges that she developed a severe and life-threatening infection, and suffered pain and permanent physical injury shortly after her surgery.

11. Barbara Carrington . . . is an individual residing in Hampshire County, Massachusetts.

12. On September 21, 2000, Barbara Carrington underwent lumbar disc surgery at Noble Hospital in Westfield, Massachusetts.

13. Carrington alleges that Adcon-L was used during the course of [her] surgery.

14. Carrington alleges that she was diagnosed as suffering from a severe and life-threatening infection, and suffered pain and permanent physical injury shortly after her surgery.

15. Dorothy Lavender . . . is an individual residing in Hampden County, Massachusetts.

16. On October 3, 2000, Lavender underwent a micro lumbar disectomy at Mercy Hospital in Springfield, Massachusetts.

17. Lavender alleges that Adcon-L was used during the course of [her] surgery.

18. Lavender alleges that she developed a severe and life-threatening infection, and suffered pain and permanent physical injury within days after her surgery.

19. Jack Bunch . . . and his spouse, Carolyn Bunch . . . are individuals residing in Jefferson County, Tennessee.

20. On December 13, 2000 . . . [Jack] Bunch underwent a right hemilaminectomy with L5-S1 mictrodiscectomy at Fort Sanders Regional Medical Center in Knox County, Tennessee.

21. [Jack] Bunch alleges that Adcon-L was used during the course of [his] surgery.

22. [Jack] Bunch alleges that he developed severe back pain within days after his surgery.

23. [Jack] Bunch further alleges that on August 6, 2002, upon examination at the Mayo Clinic in Jacksonville, Florida . . . he discovered that significant scarring in the area of the surgery was causing his pain.

24. All of the [m]ovants believe they have personal injury claims arising from the . . . described events, specifically arising from the alleged application of Adcon-L during each surgery.

25. O'Neill, Prior, and Carrington allege that on April 18, 2002 [they], by and through counsel, mailed a written notice to Gliatech, Inc., notifying Gliatech of each of their respective personal injury claims (the "Notice") . . . The [d]ebtors are currently investigating this claim and anticipate filing a supplemental stipulation upon verifying the accuracy of this allegation.

26. O'Neill, Prior, and Carrington were listed as creditors in the [d]ebtors' bankruptcy schedules, and have received written notices from the [d]ebtors with respect to the bankruptcy case, including timely written notice of the bar date April 11, 2003 (the "Bar Date") established by this Court.

27. At no time prior to August 2003 did Lavender or the Bunches notify Gliatech of their personal injury claims.

28. Lavender and the Bunches were not listed as creditors in the [d]ebtors' bankruptcy schedules, and have not received written notices from the [d]ebtors or this Court with respect to the bankruptcy case.

29. The [d]ebtors published notice of the Bar Date in the national edition of The Wall Street Journal on February 28, 2003.

30. The [d]ebtors have insurance coverage from [Medmarc] Casualty Insurance Group. . . and Federal Insurance . . . insuring them with respect to products liability personal injury claims. . . (the "Insurance Policies"). The Insurance Policies are "claims made" policies. . . [.]

31. The [d]ebtors, Medmarc and [Federal] are currently in litigation before this Court regarding whether the Insurance Policies cover punitive damages.

32. The chart attached . . . as Exhibit F reflects the policy against which Medmarc and [Federal] have informed the [d]ebtors the [m]ovants may have claims against, as well as similar information regarding claims of those parties that filed proofs of claim against the [d]ebtors prior to the Bar Date.

33. None of the [m]ovants have filed a proof of claim in the [d]ebtors' bankruptcy cases. None of the [m]ovants are asserting or will assert a claim to share in the distribution from the [d]ebtors' estates.

(Docket 979).

THE PROCEDURAL POSTURE OF THE CHAPTER 11 CASES

The debtors filed these chapter 11 cases about one and a half years ago. They have been liquidating their assets with court authority ever since. The debtors recently proposed a liquidating plan of reorganization which has not yet been confirmed. (Docket 1050). At a hearing to consider whether the amended disclosure statement should be approved for distribution to creditors, the court asked debtors' counsel if the issue of relief from stay should be held and addressed in connection with the debtors' plan. Counsel replied that the two issues were being handled separately and so the court will decide this issue without awaiting the confirmation hearing.

THE POSITIONS OF THE PARTIES

The movants ask for relief from the stay to prosecute their personal injury claims against the debtors in state court with any recovery limited to amounts available under the debtors' insurance. In other words, the movants propose that the debtors will be nominal defendants with no liability for any judgment the movants may win. They argue that including the debtors in such suits will not adversely affect the chapter 11 cases and that they will be unfairly prejudiced if they are further delayed in prosecuting their claims because bankruptcy courts do not have jurisdiction over personal injury claims. The debtors and the creditors' committee counter that the movants are not entitled to relief because they did not file timely proofs of claim in the bankruptcy cases and because the debtors and their estates will be prejudiced if the movants are allowed to go

forward in another forum.

DISCUSSION

I. The Proof of Claim Requirement

The objectors argue that relief from stay should not be granted because none of the movants has filed a claim and the time for doing so has elapsed. This argument misses the mark. A chapter 11 creditor who wishes to share in the estate assets must file a proof of claim, with exceptions not at issue here. Some creditors choose not to file a claim for a variety of reasons.[2] A creditor who does not file a proof of claim still has a cause of action against the debtor, but the bankruptcy code restricts what can be done with it. In this case, the movants stipulated that they will not share in any distribution of the estate assets. The issue then is whether the automatic stay should be lifted to allow them to proceed against the debtors for the sole purpose of obtaining a judgment which will be collected only from the debtors' insurers.

There is ample authority for the proposition that the failure to file a proof of claim does not prevent a claimant from recovering against a debtor's insurer. *See, for example, Chapman v Bituminous Ins. Co. (In re Coho Res , Inc),* 345 F.3d 338, 343 (5th Cir. 2003) (the failure to file a proof of claim in bankruptcy proceedings is "a bar to continued prosecution of claims against [the debtor], [but] it does not affect . . . claims against non-debtors, such as general liability insurers."); *Int'l Bus. Machs. v. Fernstrom Storage and Van Co. (In re Fernstrom Storage and Van Co),* 938 F.2d 731, 733-34 (7th Cir. 1991) (the failure to file a proof of claim does not bar an action against the debtor to establish liability that will be satisfied by an insurer). *See also* 11 U.S.C. § 524(e)

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[2] One frequently cited reason is a creditor's reluctance to submit to general bankruptcy court jurisdiction.

(the discharge of a debtor's debt does not effect the liability of any other entity on such debt). The sound reasoning behind these decisions is this: where the debtor is a nominal defendant and the plaintiff agrees to recover only from insurance, proceeding with such a suit does not reduce the debtor's assets, interfere with the bankruptcy administration, or impede the debtor's fresh start. *See Fernstrom Storage*, 938 F.2d at 734. To conclude otherwise would mean that an insurance company that bargained to cover a risk would be relieved from its responsibilities simply because its insured filed for bankruptcy. There is no bankruptcy code section that supports such a result nor is there any public policy reason to give the insurance company that kind of a windfall. This court, therefore, finds that the movants' failure to file a timely proof of claim does not bar them from prosecuting their personal injury claims against the debtors to the extent of their insurance coverage.

The objectors argue that Sixth Circuit law precludes this result. *See Citibank N A v White Motor Corp. (In re White Motor Credit)*, 761 F.2d 270, 274-75 (6th Cir. 1985). *White Motor* was one of the first cases decided under the then-newly enacted bankruptcy code. The Sixth Circuit focused its discussion on the abstention doctrine, considering whether the district court had authority under the code to leave personal injury cases in their home forum for liquidation before they were paid from a reserve fund created for such creditors under a confirmed plan of reorganization. After holding that the court did have that authority, the Sixth Circuit went on to hold in a rather summary fashion that it was error for the district court "to permit personal injury actions with respect to which no claim was filed . . . to continue to judgment against White and collection of such judgment against White's insurers [because] all pre-petition claims and post-petition claims against White which [had] not been filed [were] barred by the statute and the

orders of the lower courts." *Id.* The objectors contend that this court is bound by existing Sixth Circuit law. This is, of course, true with respect to controlling precedent. A careful analysis of the *White Motor* decision, however, shows that it is not controlling here.

In particular, the facts of *White Motor* are quite different from the facts of this case. The critical distinctions are: (1) the terms of the *White Motor* chapter 11 confirmed plan; and (2) the type of discharge that the *White Motor* debtor received. First, in *White Motor* the debtor had a confirmed plan of reorganization that established an insurance and reserve compensation fund devoted to paying personal injury claims. *Id.* at 271. Logically enough, the Circuit stated that the claimants were limited by prior court orders creating such a fund.[3] The present case does not involve a confirmed plan with an established means for addressing such claims. In fact, the debtors stated that they did not want to link this issue to confirmation issues.

The second, related distinction is that the *White Motor* debtor received a discharge, while the *Gliatech* debtors will not. All debtors initially enjoy the benefit of the § 362 automatic stay; that stay, however, eventually is lifted in all cases. When the stay is lifted, a debtor generally gets a discharge of its debts which is enforced through a permanent injunction against collection. 11 U.S.C. § 524(a). There is an important exception. A corporate debtor does not get this protection if: (1) the plan provides for the liquidation of all or substantially all of the estate property; (2) the debtor does not engage in business after consummation of the plan; and (3) the debtor would be denied a discharge under § 727(a). *See* 11 U.S.C. § 1141(d)(3).

In *White Motor,* the confirmed plan was a traditional reorganization where a restructured

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[3] As the movants point out, the analysis cannot go much further on this point because the court did not spell out the contents of the prior controlling orders. In any event, there are no such orders here.

entity emerged from the bankruptcy to do business going forward. The reorganized debtor received a statutory discharge of its debts, enforced by a permanent injunction, so that it could go about its business unimpeded by the discharged liabilities. *White Motor,* 761 F.2d at 274. *See also* 11 U.S.C. § 524(a) and the discharge provisions of 11 U.S.C. § 1141(d)(1). The personal injury claimants in that case could not, therefore, pursue any claims against the debtor outside of the confirmed plan provisions that controlled personal injury claims.

In contrast, the debtors in this case have from the start pursued a liquidating plan. There will be no reorganized debtor and so the debtors will not receive the permanent injunction and discharge protections. There is nothing in the *White Motor* case to suggest that an allegedly injured party whose claim against the debtor will not be discharged at the end of the case is barred from prosecuting an action to recover solely from insurance proceeds. Based on these distinctions, the *White Motor* decision does not require a different result here.[4] *See In re Harrison,* 205 B.R. 910, 912 (Bankr. E.D. Tenn. 1997) (finding in a somewhat different context that *White Motor* was decided based on the confirmation order particular to that case).

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[4] The objectors also cite an unpublished decision, *Moor v. Madison County Sheriff's Dep't,* 30 Fed. Appx. 417 (6th Cir. 2002) that is also distinguishable. In that case, the plaintiffs filed a civil rights suit against deputy M.T. Arthur, the sheriff, and the sheriff's department. Arthur filed a chapter 7 bankruptcy. The plaintiffs did not seek to lift the automatic stay or object to Arthur's discharge. The district court granted a summary judgment in favor of the defendants that apparently did not address the bankruptcy issues. On appeal, the plaintiffs may have argued that they should be able to go forward against the debtor despite his discharge because he would only be a nominal defendant in their efforts to recover against the sheriff's department. (The opinion is not clear on this point). If the plaintiffs offered reasons in support of this position, the opinion does not cite them. In response, the court simply stated that the *White Motor* decision precluded "a rule that a creditor can proceed nominally against a debtor[.]" Again, the context is critical: *Moor* involved a creditor who was trying to proceed against a chapter 7 individual debtor who had received a § 524 discharge. There were no insurance issues discussed.

II. Relief from the Automatic Stay

The debtors' interest in the Medmarc and Federal policies is property of the estate. *See Lindsey v. O'Brien, Tanski, Tanzer and Young Health Care Providers of Connecticut (In re Dow Corning Corp.)*, 86 F.3d 482, 495 (6th Cir. 1996). When the debtors filed their bankruptcy petitions, it triggered an automatic stay that prevented parties from taking certain actions against the debtors and property of the bankruptcy estate. 11 U.S.C. § 362(a). The movants request relief from the stay under § 362(d)(1) which provides:

> (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay –
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest [.]

11 U.S.C. § 362(d)(1). The term "cause" under 362(d)(1) is not defined beyond the reference to lack of adequate protection. The decision whether to grant relief is, therefore, left to the court's sound discretion and is to be made based on the facts of each case. *See Laguna Assocs Ltd. P'ship v. Aetna Cas. & Sur. Co. (In re Laguna Assocs. Ltd. P'ship)*, 30 F.3d 734, 737 (6th Cir. 1994).

To determine whether cause exists to allow litigation involving a debtor to proceed in a non-bankruptcy forum, this court must "balance the potential prejudice to the debtor, to the bankruptcy estate, and to the other creditors against the hardship to the moving party if it is not allowed to proceed[.]" *Wiley v. Hartzler (In re Wiley)*, 288 B.R. 818, 822 (B.A.P. 8th Cir. 2003). *See also In re Laguna Assocs. Ltd. Partnership,* 30 F.3d at 737 (noting that § 362(d) provides for relief from stay because the automatic stay provisions "may impose unfair hardship on particular

creditors"). Many factors may be considered on this issue. *See, for example, Sonnax Indus., Inc. v. Tri Component Prods. Corp. (In re Sonnax Indus., Inc.)*, 907 F.2d 1280, 1286 (2d Cir. 1990) (discussing the factors to be weighed in deciding whether litigation should be permitted to continue against a debtor); *In re United Imports, Inc.*, 203 B.R. 162, 166-67 (Bankr. D. Neb. 1996) (listing factors which have been considered relevant by courts when balancing the equities).

The relevant factors include: (1) whether relief would result in a partial or complete resolution of the issues; (2) lack of any connection with or interference with the bankruptcy case; (3) whether the other proceeding involves the debtor as a fiduciary; (4) whether a specialized tribunal with the necessary expertise has been established to hear the cause of action; (5) whether the debtor's insurer has assumed full responsibility for defending it; (6) whether the action primarily involves third parties; (7) whether litigation in another forum would prejudice the interests of other creditors; (8) whether the judgment claim arising from the other action is subject to equitable subordination; (9) whether movant's success in the other proceeding would result in a judicial lien avoidable by the debtor; (10) the interests of judicial economy and the expeditious and economical resolution of litigation; (11) whether the parties are ready for trial in the other proceeding; and (12) the impact of the stay on the parties and the balance of harms. *In re Lamberjack*, 149 B.R. 467, 470 (Bankr. N.D. Ohio 1992) (citations omitted).

The parties here have focused on the balance of harm factor. The movants argue that they should not be deprived of the ability to assert their claims to the extent there is insurance coverage. They have not filed proofs of claim and will not receive any distribution from the debtors' estates. It is, therefore, clear that they will be harmed if they are not permitted to pursue their claims against the insurance coverage at this time. The question is whether this harm is

outweighed by the harm which relief from stay will cause to the debtors and other creditors.

To show harm, the objectors argue there is a risk that any judgment obtained by the movants will be enforced directly against the debtors' assets if the insurance policies do not cover their claims.[5] This is an ephemeral concern, however, because the movants stipulated they will not share in any estate distribution. *See* Stipulation 33. Similarly, the objectors argue they will be prejudiced because the insurance policies include a self-insured retention provision. They did not provide details on this argument. Generally, a self-insured retention is a potential loss that is not insured and it is somewhat akin to a deductible. The debtors argue without elaboration that these provisions could lead to administrative costs. Again, the movants have stipulated that they will not assert claims to the debtors' assets; presumably, this includes any liability the debtors might ultimately have to the movants based on the self-insured retention amounts.[6]

The next argument against lifting the stay has its origins in the bankruptcy code's policy of treating similarly situated creditors in an equal fashion. The automatic stay implements this policy by requiring creditors to stand still unless and until the court permits them to go forward against estate assets. The debtors here argue that lifting the stay will permit the movants to recover on the insurance policies when other similarly situated creditors may not share in those proceeds. The Medmarc policy limits are $10,000,000.00 and the Federal excess policy amount is $5,000,000.00. Since there are several claimants and they allege serious injury, it is possible that these movants could recover substantial sums of insurance while others who are similarly situated

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[5] Medmarc and Federal specifically assert that no coverage exists for the Lavender claims.

[6] Medmarc filed an administrative claim based on the self-insured retention provisions, but again did not provide any reasoning for why lifting the stay would affect this claim.

will receive nothing. The defense costs will also be charged against the policy limits, thus reducing the amount available to pay creditors. To address this concern, the debtors suggest that relief should not be granted until, at a minimum, the value of all the claims against the insurance has been determined. This argument is unconvincing, in part because other creditors have been given relief from stay to litigate their product liability claims in state court. *See* Docket 116 (agreed order granting motion of Norman Woods for relief from stay to proceed to judgment only). Also, this court cannot liquidate the personal injury claims because it is barred by statute from doing so. *See* 28 U.S.C. § 157(b)(5). Further, the debtors have not proposed a mechanism for preserving the insurance proceeds to allow for their equitable distribution to all allegedly injured parties. What the debtors and objectors are really suggesting is that, a year and a half after the bankruptcy cases were filed and at a time when the cases may be drawing to a close, the movants should still be barred from going forward to liquidate their claims and, if successful, to recover from the insurance. This would surely be an inequitable result.

Finally, the debtors claim prejudice because they have made case administration decisions since the claims bar date, based in part on the claims that were filed. This argument cannot be assessed or considered because the debtors did not specify the decisions made and the manner in which those decisions would be impacted by lifting the stay.

While these are the factors discussed by the parties, there are other factors that weigh in favor of granting relief from stay. Any litigation which the movants file will involve the debtor nominally and not in its fiduciary capacity. Also, the preliminary bankruptcy issues have all been resolved. The debtors have proposed a liquidating plan and the cases are nearing completion. Since it is a liquidating plan, the automatic stay will soon expire by its own terms and it will not

be replaced by a discharge injunction. *See* 11 U.S.C. § 1141(d)(3). At that point, the movants would be free to proceed without court order. Granting relief from stay under these facts will not, therefore, interfere with the chapter 11 cases.

Under the facts presented by the parties, cause exists under § 362(d)(1) to lift the stay to permit the movants to prosecute their personal injury claims against the debtor, Gliatech, Inc., to the extent of the insurance coverage.

CONCLUSION

For the reasons stated, the motions of Dorothy Lavender, Claire Prior, Barbara Carrington, Eileen O'Neill, and Jack and Carolyn Bunch for relief from the automatic stay are granted. Separate orders will be entered in accordance with this decision.

Date: 11 July 2004

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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