When Negligent Doctors go Bankrupt: Avoiding the Automatic Stay in a Medical Malpractice Case

By

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I. Introduction

In a recent medical malpractice case, one of the defendant doctors filed for Chapter 7 bankruptcy in the United States District Court for the District of New Hampshire, which automatically stayed the malpractice action pending in the superior court pursuant to 11 U.S.C. §362(a).[2] To continue our malpractice case, we filed a motion for relief from the automatic stay with the bankruptcy court to allow the malpractice plaintiff to prosecute and liquidate his pending state court claims and to collect any damages awarded to the extent of the defendant doctor's liability insurance coverage. Courts consistently grant relief for personal injury plaintiffs to continue their state court actions against the debtor-defendant under these circumstances. This article will explore how courts determine whether cause for relief exists and it will discuss the material factors that guide their inquiry.

II. Determining §362(d) "Cause"

Bankruptcy courts have authority to grant relief from the automatic stay "for cause."[3] The moving party bears the burden of establishing that "cause" for relief exists, at which point the burden shifts to the debtor-defendant to prove he or she is entitled to the stay.[4] Because the United States Bankruptcy Code does not define "cause," courts analyze each request for relief on a case to case basis and apply varying balancing tests to determine whether cause exists to warrant relief.[5]

Most courts—including those in the First Circuit—have adopted the twelve-factor balancing test set out by the court in In re Curtis,[6] applying only those factors that are relevant to each specific case.[7] Indeed, each factor will not be pertinent in every case and courts are not required to weigh each factor equally.[8] The most important Curtis factor in determining whether to modify the automatic stay to permit litigation against the debtor in another forum, is the twelfth—the impact of the stay on the parties and the "balance of hurt."[9] Other Curtis factors that are commonly weighed include those that concern the interests of other creditors and the interests of judicial economy.[10]

III. Curtis Factors

A. "Balance of Hurt"—Harm to the Moving Party

Courts routinely grant relief to permit personal injury plaintiffs to continue their state court action where insurance coverage is available so long as their efforts to collect any judgment obtained is limited to the debtor-defendant's available insurance benefits.[11] The apposite provision in the preeminent bankruptcy treatise, *Collier on Bankruptcy*, also stands for the proposition that claims covered by insurance should be permitted to continue because the harm to the plaintiff under those circumstances usually outweighs the harm to the debtor or the debtor's estate.[12]

"Cause" is generally found to exist where the harm that would result to the plaintiff from a continuation of the stay outweighs the harm that might be suffered by the debtor or the debtor's estate if relief from the stay is granted. The harm to the plaintiff often outweighs the harm to the debtor in litigation covered by the debtor's insurance because:

> the prejudice to the debtor, who may suffer modest or even no adverse financial consequences but may only have to expend some time and effort in cooperating with his insurer in the defense of the litigation, is outweighed by the prejudice to the creditor whose ability to prosecute the action and reach the insurance benefits may be undermined by aging evidence, loss of witnesses, and crowded dockets.[13]

The plaintiff in a medical malpractice case is particularly susceptible to harm from the protracted litigation that would result from a denial of relief. Any delay of the state court action could result in the loss of expert witnesses, who may no longer be available at the conclusion of the bankruptcy case. This loss would be fatal to a medical malpractice claim, the success of which ultimately depends on the quality of the parties' experts.

Additionally, plaintiffs in medical malpractice and personal injury cases often have suffered grievous and permanent injuries and are usually without adequate resources to obtain the extensive future care they require. Denying relief from the stay would compound the significant hardship already suffered by the plaintiff by denying him or her of an opportunity to seek compensation to address his or her long-term needs.[14]

Courts also recognize that the plaintiff could be deprived from recovering against solvent co-defendants if the stay is not lifted because the debtor would not be a party for purpose of determining liability.[15] Medical malpractice and personal injury litigation frequently involves multiple defendants and the participation of all of the defendants is required in order to determine the

parties' respective liability and to apportion damages. Moreover, if the pending state court claims include a vicarious liability claim, the debtor-defendant's participation may also be necessary to establish liability on the part of the debtor's employer, depending on the jurisdiction. The plaintiff's ability to resolve his claims against other defendants, therefore, would be impeded if relief from the stay is not granted.[16]

B. "Balance of Hurt"—Harm to the Debtor and the Debtor's Estate

The debtor and the debtor's estate is prejudiced when the debtor "is held personally liable, for purposes of collection, for a civil damage award."[17] However, debtors "suffer little prejudice when they are sued by plaintiffs who seek nothing more than declarations of liability that can serve as a predicate for recovery against insurers" because the debtor's insurer assumes financial responsibility for defending the litigation and pays any judgment or settlement on behalf of its insured.[18] Thus, the harm to the debtor and the debtor's estate is usually minimal or non-existent if the debtor has sufficient insurance to cover the claims and the plaintiff is barred from collecting any award from the debtor's personal assets. Many courts, therefore, find that "[i]nsurance adequate to cover defense costs on unrelated state court proceedings can support a showing of §362 'cause.'"[19]

C. Interests of Other Creditors

In determining whether to modify an automatic stay to permit litigation against the debtor in a non-bankruptcy forum, courts also consider the impact that lifting the stay would have on the debtor's other creditors. The purpose of the automatic stay is "to preserve what remains of the debtor's insolvent estate and to provide a systematic equitable liquidation procedure for all creditors, thereby preventing a 'chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts.'"[20] The automatic stay, however, was "never intended to preclude a determination of tort liability and the attendant damages. It was merely intended to prevent a prejudicial dissipation of a debtor's assets."[21]

Where the underlying claim is covered by the debtor's insurance, only the creditors with claims covered by the policy are entitled to the policy proceeds, therefore, "there is no depletion of assets that would otherwise be available to satisfy general, unsecured claims, and there is therefore no reason to delay the creditor seeking to recover under the policy."[22] In cases where the plaintiff is the only claimant under the debtor's insurance policy, which is often the case in personal injury litigation, the continuation of the litigation will not decrease the assets available to fund a distribution to other creditors because the plaintiff would be the only creditor entitled to the policy proceeds. To the extent that the plaintiff is able to recover from the insurance carrier for his or

her damages, his or her claim against the debtor's estate will be eliminated or reduced, thereby creating a benefit for the other creditors.[23]

The sole beneficiary of the automatic stay, therefore, is the insurance carrier. The Bankruptcy Code, however, was not "intended to bestow such a benefit upon insurance companies."[24] Rather, the automatic stay was designed to give the debtor a "'fresh start,' not to provide a method by which an insurer can escape its obligations based simply on the misfortunes of the insured."[25]

D. Judicial Economy

When weighing the interests of judicial economy, courts have shown a willingness to modify the stay to allow litigation to proceed when the stayed, non-bankruptcy litigation has progressed to an advanced stage because "the further along the litigation, the more unfair it is to force the plaintiff suing the debtor-defendant 'to duplicate all of its efforts in the bankruptcy court.'"[26] Requiring the plaintiff to recommence his or her state court claims in the bankruptcy court would be unnecessarily repetitive, expensive, time-consuming, and a waste of judicial time and effort.[27] Indeed, the "risk of unnecessary, duplicative litigation is great" and would impose a significant burden on both the plaintiff and the courts.[28]

In enacting §362(d)(1), Congress recognized that "it will often be more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankruptcy estate would result, in order to leave the parties to their chosen forum and to relieve the bankruptcy court from duties that may be handled elsewhere."[29] Accordingly, courts have found that allowing the state court—which has considerable experience hearing medical negligence and other personal injury actions—to adjudicate the plaintiff's claims in a single proceeding will result in the fairest and most efficient administration of justice.[30] Thus, courts routinely lift the stay where the state court action does not require the expertise of the bankruptcy court.[31] In doing so, the bankruptcy court spares itself the time and resources required to adjudicate the claims while simultaneously providing the plaintiff the most speedy and efficient avenue to liquidate his or her claims.[32]

IV. Conclusion

Although they vary in their approaches, courts regularly lift the automatic stay to permit an action to continue against the debtor in a non-bankruptcy forum where the debtor has sufficient insurance coverage. Courts often find that the harm to the plaintiff considerably outweighs the harm to the debtor and the debtor's estate where the insurance carrier bears the cost of defending the litigation and paying for any judgment obtained. Moreover, "[a]ny concerns regarding the potential liability of the estate may be obviated, by an order which prohibits any action to collect from the estate."[33] The automatic

stay is not intended to provide a windfall to insurance companies. Insurers cannot escape liability simply because the defendant filed for bankruptcy and it is up to plaintiff's attorneys to continue holding defendants and their insurance carriers accountable.

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[2] The filing of a voluntary bankruptcy case operates as an automatic stay of "the commencement or continuation, including issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title." 11 U.S.C. § 362(a)(1).

[3] 11 U.S.C. § 362(d)(1).

[4] *See In re Curtis,* 40 B.R. 795, 803 (Bankr. C.D. Utah 1984) (describing shifting burden).

[5] *See e.g., In Re Tribune Company*, et al., 418 B.R. 116 (Bankr. D. Del. 2009); *In re Andersen 2000, Inc.,* 2006 Bankr. LEXIS 1113 (Bankr. N.D. Ga. 2006); *In re Rexene Products Co.*, 141 B.R. 574 (Bankr. D. Del. 1992); *In re Fernstrom Storage & Van Co.*, 938 F.2d 731 (7th Cir. 1991); *In re Bock Laundry Machine Co.*, 37 B.R. 564 (Bankr. N.D. Ohio 1984). These courts apply a three-pronged balancing test that weighs: (1) whether any great prejudice to either the bankrupt estate or the debtor will result from continuation of the civil suit; (2) whether the hardship to the non-bankrupt party by maintenance of the stay considerably outweighs the hardship to the debtor; and (3) whether the creditor has a probability of prevailing on the merits. Other courts only require the movant to establish the first two elements of this three-part test. *See e.g., In re UNR Indus.,* 54 B.R. 266 (Bankr. N.D. Ill. 1985); *In re Turner*, 55 B.R. 498 (Bankr. N.D. Ohio 1985); *In re Steffens Farm Supply, Inc.*, 35 B.R. 73 (Bankr. N.D. Iowa 1983); *In re McGraw*, 18 B.R. 140 (Bankr. W.D. Wisc. 1982); *In re Honosky*, 6 B.R. 667 (Bankr. S.D. W. Va. 1980). Yet another line of cases considers the interests of judicial economy as the third prong instead of weighing the probability of success on the merits. *See e.g. In re Holtkamp*, 669 F.2d 505 (7th Cir. 1982).

[6] 40 B.R. 795 (Bankr. C.D. Utah 1984) (identifying 12 factors which may be considered in determining whether modification of stay is appropriate). The Curtis Factors are:

(1) Whether the relief will result in a partial or complete resolution of the issues;
(2) The lack of any connection or interference with the bankruptcy case;
(3) Whether the foreign proceeding involves the debtor as a fiduciary;
(4) Whether a specialized tribunal has been established to hear the particular cause of action and that tribunal has expertise to hear such cases;
(5) Whether the debtor's insurance carrier has assumed full financial responsibility for defending the litigation;
(6) Whether the action essentially involves third parties, and the debtor functions only as a bailee or conduit for the good or proceeds in question;
(7) Whether litigation in another forum would prejudice the interests of other creditors, the creditors' committee and other interested parties;
(8) Whether the judgment claim arising from the foreign action is subject to equitable subordination;
(9) Whether the movant's success in the foreign proceeding would result in a judicial lien avoidable by the debtor under section 522(f);

(10) The interest of judicial economy and the expeditious and economical determination of litigation for the parties;
(11) Whether the foreign proceedings have progressed to the point where the parties are prepared for trial; and
(12) The impact of the stay on the parties and the "balance of hurt."

[7] *See e.g.*, *In re Bridge*, 600 B.R. 98 (Bankr. D. N.M. 2019) (identifying and applying relevant *Curtis* factors); *In re John Q. Hammons Fall 2006, LLC*, 600 B.R. 84 (Bankr. D. Kan. 2018) (noting Curtis factors have been widely adopted by courts and applying various factors in granting relief from stay); *In re Advanced Med. SPA Inc.*, 2016 Bankr. LEXIS 4084 (B.A.P. 9th Cir. 2016) (weighing hardship to parties and debtor's estate among other factors); *In re Busch*, 294 B.R. 137 (B.A.P. 10th Cir. 2003) (considering seven *Curtis* factors, "balance of the hurt" factor); *In re N.Y. Med. Group, P.C.*, 265 B.R. 408 (Bankr. S.D.N.Y. 2001) (weighing Curtis factors relating to hardship of the parties and judicial economy); *In re Unanue-Casal*, 159 B.R. 90 (D.P.R. 1993) *aff'd* 23 F. 3d 395 (1st Cir. 1994) (considering *Curtis* factors concerning judicial economy and hardship to the parties); *Peerless Ins. Co. v. Rivera*, 208 B.R. 313 (D. R.I. 1997) (weighing four Curtis factors: harm to party seeking relief, harm to the debtor, interests of creditors, and the effect on fair and efficient administration of justice); *Sonnax Industries, Inc. v. Tri Component Products Corp. (In re Sonnax Industries, Inc.),* 907 F.2d 1290 (2d Cir. 1990) (applying four "relevant" *Curtis* factors).

[8] *See In re Advanced Med. SPA Inc.*, 2016 Bankr. LEXIS 4084 (B.A.P. 9th Cir. 2016)*; In re Plumberex Specialty Prods. Inc.*, 311 B.R. 551 (Bankr. C.D. Cal. 2004).

[9] *In re Curtis,* 40 B.R. 795, 806 (Bankr. C.D. Utah 1984); *see also In re Advanced Med. SPA Inc.*, 2016 Bankr. LEXIS 4084 at *10-11 (B.A.P. 9th Cir. 2016) (noting "the balancing of potential harm to the creditor on the one hand and to the debtor and the bankruptcy estate on the other hand frequently is dispositive"); *Peerless Ins. Co. v. Rivera*, 208 B.R. 313 (D. R.I. 1997) (stating "cause' is said to exist when the harm that would result from a continuation of the stay would outweigh any harm that might be suffered by the debtor or the debtor's estate if the state is lifted").

[10] *See supra* note 7 (identifying courts that apply pertinent *Curtis* factors in determining whether cause exists).

[11] *See In re Fowler*, 259 B.R. 856, 859 (Bankr. E.D. Tex. 2001) (pointing out that courts regularly lift stays to allow tort suits to go forward).

[12] *See* Collier on Bankruptcy § 362.07(3) at 362-49 (stating "[w]here the claim is one covered by insurance or indemnity, continuation of the action should be permitted since hardship to the debtor is likely to be outweighed by hardship to the plaintiff").

[13] *In re Glunk*, 342 B.R. 717, 740 (Bankr. E.D. Pa. 2006) (explaining rationale for granting relief when underlying claim is covered by insurance); *In re Bock Laundry Machine Co.*, 37 B.R. 564, 567 (Bankr. N.D. Ohio 1984) (noting hardships that would result to plaintiff if precluded from continuing state court claims).

[14] *See In re Krank*, 84 B.R. 372, 375 (Bankr. E.D. Pa. 1988) (recognizing that state court may provide the plaintiff his or her only opportunity for redress given the limited assets available to creditors in a bankruptcy case); *In re Bock Laundry Machine Co.*, 37 B.R. 564, 567 (Bankr. N.D. Ohio 1984) (acknowledging that plaintiffs would be denied an opportunity to be heard if forced to forego prosecution of their claims until stay is no longer in effect); *In re Honosky*, 6 B.R. 667, 669 (Bankr. S.D. W. Va. 1980) (noting "were this court not to lift the stay to permit the Plaintiff to proceed against the Debtor, she would be effectively precluded from any recovery for her alleged injuries. The choice is between lifting the stay to permit the action to proceed or to simply allow the unliquidated claim to be discharged. The court is not convinced that the Bankruptcy code was intended to bestow such a benefit upon insurance companies.")

[15] *See In re McGraw*, 18 B.R. 140 (Bankr. W.D. Wisc. 1982) (appreciating that plaintiff may be precluded from recovering against other defendants).

[16] *See In re Podmostka*, 527 B.R. 51, 54 (Bankr. D. Mass. 2015) (holding that relief from stay is appropriate where "it is necessary to join the debtor in order to establish liability against a third party); *In re McGraw*, 18 B.R. 140, 142 (noting that plaintiff would have no remedy if stay is not modified).

[17] *In re Fowler*, 259 B.R. 856, 859 (Bankr. E.D. Tex. 2001); *In re McGraw*, 18 B.R. 140 (Bankr. W.D. Wisc. 1982).
[18] *In re Andersen 2000, Inc.,* 2006 Bankr. LEXIS 1113 (Bankr. N.D. Ga. 2006); *In re Fernstrom Storage & Van Co.*, 938 F.2d 731, 736 (7th Cir. 1991).
[19] *In re Krank*, 84 B.R. 372, 375 (Bankr. E.D. Pa. 1988).
[20] *In re Holtkamp*, 669 F.2d 505, 508 (7th Cir. 1982); *see also In re Rexene Products Co.*, 141 B.R. 574 (Bankr. D. Del. 1992) (stating purpose of stay is three-fold: "to prevent certain creditors from gaining a preference for their claims against the debtor; to forestall the depletion of the debtor's assets due to legal costs in defending proceedings against it; and, in general, to avoid interference with the orderly liquidation or rehabilitation of the debtor").
[21] *In re Bock Laundry Machine Co.*, 37 B.R. 564, 567 (Bankr. N.D. Ohio 1984).
[22] Collier on Bankruptcy § 362.07(3)(a) at 362-85.
[23] *See Peerless Ins. Co. v. Rivera*, 208 B.R. 313, 317 (D. R.I. 1997) (explaining that the "satisfaction of [the plaintiff's personal injury claims] would benefit the estate and other creditors by either allowing [the debtor] to emerge from bankruptcy; or by significantly reducing the obligations to be satisfied from the estate's assets.)
[24] *In re Honosky*, 6 B.R. 667, 669 (Bankr. S.D. W. Va. 1980) (noting that denying relief would preclude plaintiff from any recovery, which is not the purpose of the stay).
[25] *Weakly-Hoyt v. Foster*, 230 Cal. App. 4th 928, 932 (Cal. Dist. Ct. App. 2014); *In re Turner*, 55 B.R. 498 (Bankr. N.D. Ohio 1985) (holding that allowing modification of the stay would prevent a windfall to the insurance company).
[26] *In re Murray Indus.*, 121 Bankr. 635, 637 (Bankr. M.D. Fla. 1990); *see also In re Kaufman*, 98 Bankr. 214, 215 (Bankr. E.D. Pa. 1989); *cf. In re Sonnax Indus.*, 907 F.2d 1280, 1287 (2d Cir. 1990) (declining to lift stay in part because "the litigation in state court has not progressed even to the discovery stage."); *In re Collins*, 118 Bankr. 35 (Bankr. D.Md. 1990) (declining to lift stay where parties in state court proceeding had not yet begun discovery); *In re Holtkamp*, 669 F.2d 505, 508 (7th Cir. 1982) (finding "interests of judicial economy militated in favor of permitting the suit to go forward, for the trial date had been set and witnesses…had been subpoenaed").
[27] *See In re Murray Indus.*, 121 Bankr. 635, 637 (Bankr. M.D. Fla. 1990); *In re Philadelphia Athletic Club, Inc.*, 9 B.R. 280 (Bankr. E.D. Pa. 1981) (stating that duplicative litigation is a waste of judicial time and effort).
[28] *In re Rexene Products Co.*, 141 B.R. 574 (Bankr. D. Del. 1992) (emphasizing the burden that would be imposed on court and moving party by duplicative litigation).
[29] S. Rep. No. 989, 95th Cong., 2s Sess. 52.
[30] *See In re Glunk*, 342 B.R. 717, 740 (Bankr. E.D. Pa. 2006) (pointing out that state court had more experience in handling medical malpractice claims).
[31] *See In re UNR Indus.*, 54 B.R. 266, 267 (Bankr. N.D. Ill. 1985) (noting that pending claim did not require specialized expertise of bankruptcy court); *In re Holtkamp*, 669 F.2d 505, 508 (7th Cir. 1982) (finding that lifting the stay was appropriate because the "determination of the issues in personal injury actions did not require the expertise of the bankruptcy court").
[32] *See In re Glunk*, 342 B.R. 717, 740 (Bankr. E.D. Pa. 2006) (deferring to state court to handle the litigaton to save the court's time and effort); *In re UNR Indus.*, 54 B.R. 266 (Bankr. N.D. Ill. 1985) (finding that the liquidation of the plaintiff's claim would be more speedily determined in the state forum); *In re Philadelphia Athletic Club, Inc.*, 9 B.R. 280 (Bankr. E.D. Pa. 1981) (explaining that "[t]he policy of the Code to have issues relating to bankruptcy decided in a court with expertise in that area will not be eroded by our decision [to lift the stay] in this case because there is no issue involved in the state suit which requires the legal competence of the bankruptcy court").
[33] *In re Fernstrom Storage & Van Co.*, 100 B.R. 1017, 1024 (Bankr. N.D. Ill. 1989).