UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

CRAIG T. GOLDBLATT
JUDGE

824 N. MARKET STREET
WILMINGTON, DELAWARE
(302) 252-3832

May 13, 2024

VIA CM/ECF

Re: *In re Recovery Brands, LLC*, No. 20-11631

Dear Counsel:

Kerri E. Cornella asserts that she was injured in February 2020 when she hit her head on the ground in the parking lot of one of the debtors' facilities. The debtors filed this bankruptcy case in June 2020, meaning that Cornella held a prepetition claim. What happened to Cornella's claim during the bankruptcy case is rather unusual. She received notice of the bankruptcy and timely filed a proof of claim.[1]

The surprising part, however, is that she then nevertheless actively pursued her claim in a mediation, which was in open and notorious violation of the Bankruptcy Code's automatic stay, 11 U.S.C. § 362(a). At least equally surprisingly, the debtors, through defense counsel that had been appointed by its insurer, actively participated in the mediation without ever suggesting that the

[1] Cornella acknowledges these facts in her motion for relief from the stay. D.I. 212 at 4.

plaintiff had violated the automatic stay. That mediation ended in a settlement agreement. Indeed, it appears that the underlying lawsuit was dismissed by the state court based on the representations of counsel that the mediation resulted in a settlement under which Cornella was to receive $325,000.[2] It was not until Cornella demanded to be paid on the settlement that the debtors pointed out that Cornella is asserting a prepetition claim and that she had never sought, much less obtained, relief from the automatic stay to permit the mediation to proceed.

Cornella has now belatedly sought relief from the discharge injunction (the automatic stay having terminated when the debtors' plan was confirmed and the now-reorganized debtors emerged from bankruptcy). Cornella thus seeks relief from the discharge injunction solely for the purpose of seeking to compel the insurer, not the reorganized debtors, to pay the agreed settlement.

The reorganized debtors argue in the first instance that the motion should be denied on account of Cornella's obvious flouting of the automatic stay. Cornella responds by arguing that the debtors had effectively acquiesced in permitting the mediation to proceed notwithstanding the bankruptcy and should not now be heard to argue that the mediation in which they actively participated was all in violation of the automatic stay.

The Court held a hearing on the stay relief motion on April 16, 2024. At that hearing, a number of documents were introduced into evidence. In addition, on

[2] *See* D.I. 212-7 and D.I. 212-8.

April 19, 2024, the reorganized debtors submitted the declaration of Dale Campbell, the reorganized debtors' vice president of finance and accounting, which Cornella agreed could also be admitted into evidence.[3] As a result, the basic facts set forth above are not materially disputed.

While neither party's conduct is a model of what the Bankruptcy Code contemplates, the Court views both parties' errors – Cornella's violations of the stay and the debtors' acquiescence in the mediation and entry into the settlement agreement – as being essentially offsetting. For what it is worth, at the April 16 hearing, Cornella's counsel explained that the actions he took in violation of the automatic stay were the result of his own unfamiliarity with bankruptcy law.[4] And counsel for the reorganized debtors explained that the debtors' failure to invoke the bankruptcy filing or the automatic stay resulted from the fact that "senior management turned over, including the in-house counsel."[5] As a result, the "[l]eft hand [and] right hand weren't communicating."[6]

Both of these explanations are entirely consistent with common experience in complex chapter 11 cases and thus both have a ring of truth to them. Under the circumstances, this Court's view is that it is unnecessary, and would be both inappropriate and inequitable, to rule for one side or the other on account of the

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[3] *See* D.I. 227-1; D.I. 229.

[4] April 16, 2024 Hr'g Tr. at 15.

[5] *Id.* at 33.

[6] *Id.*

other party's errors. The Court is thus inclined to treat those mistakes as amounting to a net wash and hold them aside for this purpose. The question is therefore what to do from here.

To that end, Cornella says that the relief she is requesting should be noncontroversial, as she seeks only to recover against the insurer, not the reorganized debtors. In its objection, however, the reorganized debtors argued that permitting such relief would impose costs on the reorganized debtors, in view of the self-insured retention under the applicable insurance policy.[7] And it is true that the debtors' confirmed plan of reorganization provides for the assumption of the debtors' insurance policies, which means that the reorganized debtors could therefore be liable to the insurer for any self-insured retention if the insurer were to incur further defense costs and/or if Cornella were to prevail in an action against the insurer.[8]

As Judge Shannon explained in *In re East West Resort Development*, courts will typically grant relief from the discharge injunction to permit a claimant to proceed with litigation that is covered by insurance so long as doing so will not

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[7] D.I. 219 at 12.

[8] Case No. 20-11648, D.I. 695 (order confirming Second Amended plan); Case No. 20-11648, D.I. 647, Art. V.D. (confirmed plan, providing that "[a]ll of the Debtor's insurance policies … are treated as and deemed to be Executory Contracts [and] shall be deemed to [be] assumed"). Because the confirmed plan so provides, this Court need not address the question whether a standard comprehensive general liability policy is properly understood as an executory contract in bankruptcy. *See generally In re Boy Scouts of America and Delaware BSA, LLC*, 642 B.R. 504, 668, n.729 (Bankr. D. Del. 2022) (noting that, in that case, the "Plan provides that the Insurance Policies are not executory contracts and no insurer has argued otherwise").

impose costs on the estate.[9] Because the discharge injunction "does not extinguish the debt" but merely prevents its enforcement against the debtor, it may still "be collected from any other entity that may be liable."[10] That principle makes sense. To the extent there is a claim against the debtor that is otherwise covered by insurance or a third party's guaranty, nothing about the debtor's bankruptcy or the discharge is intended to create a windfall for the insurer or guarantor, relieving it of liability for which it would otherwise be contractually responsible.

That said, where granting relief from the automatic stay or discharge injunction to permit a creditor to pursue a third party will impose costs on a reorganized debtor, litigation trust, or bankruptcy estate, courts typically will not grant such relief. As the court put it in *East West Resort*, "to the extent [the creditor's] lawsuit against [the insurer] would trigger deductible or [self-insured retention] obligations for the Debtors … [pursuit of such a claim] would be a violation of the Plan Injunction."[11]

The reorganized debtors relied on this principle in their opposition to Cornella's motion. They explained that the "primary insurance policy that could potentially provide coverage for the Movant's claims is the Miscellaneous Medical Facilities and Providers Professional and Other Liability Policy" that was "issued

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[9] *In re East West Resort Dev. V, L.P.*, No. 10-10452-BLS, 2014 WL 4537500, at *10 (Bankr. D. Del. Sept. 12, 2014).

[10] *Id.*

[11] *Id.*

by Ironshore Specialty Insurance Company."[12] Under that policy, however, the insurer's "obligation to pay … applies only to the amount of the damages [and defense costs] in excess of the applicable self-insured retention of $250,000."[13] In addition, the policy "provides that the Reorganized Debtors are responsible for the payment of the [self-insured retention]."[14] The opposition did not, however, state how much was left on the $250,000 self-insured retention.

Counsel for the reorganized debtors did, however, address that issue at the argument on the motion, representing that it was counsel's "understanding … that the debtors paid the defense costs on this litigation to the tune of something just north of $200,000."[15] Based on these statements, the Court expected that it would condition relief from the discharge injunction on Cornella's agreeing (a) to indemnify the reorganized debtors for any obligation they might incur to their insurer and (b) to post an appropriate bond, letter of credit, or other security designed to ensure her ability to honor that obligation. This type of conditional relief seemed to better reflect the principle articulated in *East West Resort* than would denying relief entirely because of the possibility that the reorganized debtors might be required to bear some relatively small cost. To the extent the movant would indemnify the reorganized debtors for that cost and post appropriate security

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[12] D.I. 219 at 9.

[13] *Id.*

[14] *Id.*

[15] April 16, 2024 Hearing Tr. at 32.

to ensure that the movant could meet that indemnity obligation, there would not appear to be any reason why the movant should not be permitted to pursue a claim against a non-debtor.[16]

That said, the subsequent declaration submitted by Dale Campbell, the reorganized debtors' vice president of finance and accounting, effectively moots that concern. In that declaration, Campbell states (as the reorganized debtors had in their brief) that the self-insured retention under the applicable insurance policy is $250,000.[17] Campbell goes on, however, to state that "the Reorganized Debtors have paid 100% of the costs of defending the State Court Action, including the fees and expenses of defense counsel, in the amount of at least $250,718.00."[18]

The consequence of that statement is that the $250,000 deductible has now been exhausted, and any further costs or expenses would need to be borne by the insurer rather than the reorganized debtors. As such, permitting Cornella to assert a claim against the insurer would not appear to impose any financial obligation on the reorganized debtors.

The Court will therefore grant the relief Cornella seeks. The order so providing, which should be settled by the parties and submitted under certification, shall provide that the relief is to be limited to permitting Cornella to assert a claim

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[16] *See East West Resort Dev.*, 2014 WL 4537500 at *11 ("where a party will trigger deductible obligations owed by a debtor, the Court requires that the party reimburse the debtor for amounts paid or that the insurance carrier waive the deductible").

[17] D.I. 227-1 at 2.

[18] *Id.*

against the obligor on the Ironshore insurance policy and does not authorize the imposition of financial responsibility for the claim on the reorganized debtors.

Sincerely,

Craig T. Goldblatt
United States Bankruptcy Judge