IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: MEDICAL TECHNOLOGY ASSOCIATES II, INC., Debtor.	Chapter 11 Case No. 22-10534 (CTG)
MEDICAL TECHNOLOGY ASSOCIATES II, INC., Plaintiff, v. CARL W. RAUSCH AND WORLD TECHNOLOGY EAST II, LIMITED, Defendants.	Adv. Pro. No. 22-50389 (CTG) **Related Docket Nos. 16, 22 & 24**

MEMORANDUM OPINION

Debtor Medical Technology Associates II, Inc.[1] is a biotech startup. It plans to develop and commercialize a hemoglobin-based oxygen carrier, a substance that is sometimes described as a "blood substitute" and that the first-day declaration asserts may be used in circumstances "related to the use of blood, including trauma and organ preservations."[2] As the first-day declaration explains, the debtor's business remains in the research and development stage.[3] It does not yet have a commercial product

[1] Debtor Medical Technology Associates II, Inc. is referred to herein as "MedTech."

[2] *In re Medical Technology Associates II*, No. 22-10534 (CTG) (Bankr. D. Del. Jun. 14, 2022), D.I. 3 at 2-3.

[3] *Id.* at 5.

and thus generates no revenue.[4] The debtor hopes, through this bankruptcy case, to "cancel existing equity and facilitate a new equity infusion to provide the Debtor with sufficient operating capital to continue its research and development and bring its technology to market eventually."[5]

A key obstacle to the debtor's plan, however, is a dispute with Carl W. Rausch over ownership of the intellectual property rights related to the hemoglobin-based oxygen carriers.[6] Rausch was the debtor's founder and former president and chief executive officer. He left the company in 2019 after a falling out with the board. He contends that he and World Technology,[7] a Hong Kong based company that he owns, hold title to the Hemoglobin IP. Indeed, the ownership of the Hemoglobin IP is one of several issues posed by litigation that is now pending in the U.S. District Court for the Eastern District of Pennsylvania.[8] That litigation has thus far been focused on the argument by Rausch and World Technology that the disputes between the parties are subject to mandatory arbitration. The district court conducted an evidentiary hearing on that issue and directed the parties to submit post-trial briefs. That briefing was nearly complete when – ten days before debtor's reply brief was due –

[4] *Id.*

[5] *Id.* at 5.

[6] The various intellectual property rights at issue are referred to as the "Hemoglobin IP."

[7] Defendant World Technology East II Limited is referred to as "World Technology."

[8] *Medical Technology Associates II v. Rausch*, E.D. Pa. No. 2:21-cv-01095-MMB. This lawsuit is referred to as the "district court litigation." The U.S. District Court for the Eastern District of Pennsylvania is referred to as the "district court."

the debtor filed this bankruptcy case, which operated to stay at least some of the claims in that lawsuit.[9]

In the meantime, the debtor initiated this adversary proceeding, which seeks a declaration that it owns the Hemoglobin IP. That claim is wholly duplicative of a claim that the debtor asserted in the district court litigation – though the district court litigation also includes other claims that are not asserted in this adversary proceeding. Rausch and World Technology counterclaimed for a declaration that they own the Hemoglobin IP. Emphasizing that it needs to have the question of ownership of the Hemoglobin IP resolved before it can emerge from bankruptcy, the debtor immediately sought summary judgment on that issue. It also moved to dismiss the counterclaim.

Rausch and World Technology have responded with a litany of arguments. They contend that claim of ownership of the Hemoglobin IP is subject to mandatory arbitration here for the same reasons asserted in the district court litigation. They argue that this Court should grant relief from the stay to permit the district court to decide that issue. In the alternative, they ask this Court to dismiss the adversary in favor of the alleged agreement to arbitrate. They also argue that summary judgment is inappropriate at this stage of the case because they have not had the opportunity to take sufficient discovery. And they argue that the Court should dismiss the case

[9] *See* 11 U.S.C. § 362(a)(1).

in favor of the district court litigation under the "first-filed doctrine," a judge-made doctrine designed to avoid duplicative litigation.[10]

The Court appreciates the debtor's sense of urgency in bringing the issue of ownership of the Hemoglobin IP to prompt resolution. It does appear that obtaining a resolution of that dispute is a condition precedent to the debtor's ability to reorganize in bankruptcy. That said, the debtor initiated this litigation in the district court, which was nearing resolution of the arbitrability question at the time of the bankruptcy filing. And no one contends that this Court can reach the merits of the debtor's claim without considering and resolving the precise question of arbitrability that was nearly fully briefed in the district court litigation at the time of the bankruptcy filing. In view of the time and energy the district court has devoted to that issue, principles of judicial economy and respect for the district court's jurisdiction counsel in favor of granting relief from the stay and permitting that court to resolve the question of arbitrability.

The Court also believes that, wherever the case may ultimately proceed, Rausch and World Technology are entitled to additional discovery before it would be appropriate for the Court to consider the debtor's motion for summary judgment. In view of the debtor's legitimate interest in prompt resolution, the Court will direct the parties, beginning immediately, to conduct such discovery as is appropriate to permit Rausch and World Technology to respond to the summary judgment motion.

[10] This Memorandum Opinion sets out the Court's findings of fact and conclusions of law under Fed. R. Civ. P. 52, as made applicable to this contested matter under Fed. R. Bankr. P. 9014(c).

The Court will otherwise hold the other motions in abeyance pending the district court's resolution of the arbitrability question. And aside from lifting the stay so that the district court may resolve the question of arbitrability, the automatic stay shall remain in place. Once the question of arbitrability is decided, the Court intends to act promptly to ensure that the case moves forward as expeditiously as possible in whatever forum is appropriate.

Factual and Procedural Background

MedTech was established in 2015 as a Delaware company.[11] From 2015 to 2017, Rausch was its sole director.[12] By 2019, after various rounds of financing, MedTech had a total of four board members.[13] Rausch, in addition to his role as a board member, also served as the president and chief executive officer until December 2019, when he resigned amidst disagreements with the other members of the company's board.[14]

1. Rausch's alleged interference with MedTech's patent applications

MedTech alleges that by 2019, as a result of the board questioning Rausch's leadership, Rausch sought to position himself as owner of MedTech's intellectual property.[15] Specifically, MedTech claims that Rausch purported to reassign MedTech's patent applications and fabricated a "development and license agreement"

[11] D.I. 19-1 at 22.

[12] D.I. 18-3 at 5-7.

[13] *Id.* at 15.

[14] *Id.* at 16.

[15] D.I. 1 ¶¶ 26-33.

that licenses to MedTech the right to use the Hemoglobin IP in which World Technology asserts an ownership interest.[16]

Rausch disputes the debtor's claims. In his opposition to MedTech's motion for summary judgment and in his response to MedTech's complaint, Rausch claims that it was always his intention to retain ownership of the Hemoglobin IP, as memorialized in the development and license agreement. According to Rausch, since World Technology was a Hong Kong entity, he founded MedTech "to gain approval for use of [hemoglobin] technology in the United States."[17] He contends, however, that the intent was always that Rausch "would maintain ownership of any technology patents" obtained by MedTech "until specific product registration, but he would appropriately license or collaborate with those prosecuted and issue patents as necessary to other entities."[18] Thus, while Rausch recognizes that he did attempt to reassign certain patent applications to World Technology, he asserts that his actions were authorized under the development and license agreement, which he says that he signed in September 2017 in his then-capacity as sole shareholder of both World Technology and MedTech.[19] Rausch also argues that the authenticity of the development and license agreement is not a matter that ought to be decided by this Court on a summary judgment record, since the district court determined an

[16] *Id.* ¶¶ 26-38.

[17] D.I. 21 ¶ 9 of Counterclaim.

[18] *Id.* ¶ 12.

[19] D.I. 26-8 at 12.

evidentiary hearing was required before that court could make such a determination – and indeed has already held such a hearing.[20]

2. The district court litigation and subsequent bankruptcy proceedings

On March 5, 2021, MedTech filed a complaint against Rausch and World Technology in the district court.[21] That complaint sought declaratory judgments that (1) MedTech is the sole owner of all intellectual property developed by Rausch during his tenure at MedTech, (2) the development and license agreement is a legal nullity on the grounds that it was fabricated, and (3) MedTech does not owe any payment to World Technology under with the development and license agreement.[22] On August 16, 2021, Rausch and World Technology moved to compel arbitration and to stay the litigation, arguing that the debtor's claims and defendants' counterclaims are subject to mandatory arbitration under the development and license agreement.[23] Then, on August 27, 2021, defendants filed a counterclaim against the debtor for breach of contract and unjust enrichment, alleging that the debtor had failed to make payments to World Technology pursuant to the development and license agreement and master service agreement. The defendants also asserted a counterclaim against the debtor

[20] D.I. 26 at 19 n.4.

[21] *Medical Technology Associates II v. Rausch*, No. 2:21-cv-01095 (E.D. Pa. Mar. 5, 2021), D.I. 1.

[22] *Id.* ¶¶ 69, 74, 79.

[23] *Medical Technology Associates II v. Rausch*, No. 2:21-cv-01095 (E.D. Pa. Aug. 16, 2021), D.I. 34 at 1.

seeking declaratory judgment that the development and license agreement is a valid agreement.

The debtor opposed the motion to compel arbitration, arguing that the development and license agreement was fabricated by Rausch and that, even if the development and license agreement were a valid agreement, the debtor's IP ownership and fiduciary duty claims are outside the scope of arbitration. The district court authorized discovery and heard oral arguments on the question of whether the development and license agreement is valid, and which claims, if any, are subject to its arbitration provision. The district court set June 24, 2022 as the due date for debtor's final reply brief, but MedTech filed for bankruptcy on June 14, 2022. On July 12, 2022, the debtor filed this adversary proceeding, seeking only declaratory relief that MedTech is the sole owner of all the disputed intellectual property.

Jurisdiction

The Court has subject-matter jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(b). As a case within the district court's bankruptcy jurisdiction, it has been referred to this Court under 28 U.S.C. § 157(a) and the district court's standing order of reference.[24] The defendants' motion for relief from stay is a core proceeding under § 157(b)(2)(G) which may be heard and decided in this Court.[25]

[24] Amended Standing Order of Reference from the United States District Court for the District of Delaware, dated Feb. 29, 2012.

[25] Motions to "terminate, annul, or modify the automatic stay" are considered core matters.

The complaint alleges that the debtor's claim to ownership of the Hemoglobin IP is also a core proceeding. A case can be made for that proposition, as the issue can be characterized as one "arising under" § 541. And there are cases holding that disputes over the metes and bounds of the bankruptcy estate are core matters.[26] But that issue need not be decided at this stage of the litigation, since the Court's determination to lift the stay to have the district court resolve the pending question of arbitrability means that the question whether this Court could enter final judgment in this adversary proceeding is not yet ripe for decision.

Analysis

I. To the extent the automatic stay is implicated, the Court will grant relief from stay so that the district court may resolve defendants' motion to compel arbitration.

Section 362 of the Bankruptcy Code provides that the filing of a chapter 11 bankruptcy petition effectuates a stay of:

> (1) The commencement or continuation, including the 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. . .[27]

[26] *In re Continental Airlines*, 138 B.R. 442, 445 (D. Del. 1992) ("[T]he determination of the property of the estate is one of the core proceedings arising under title 11. . . [and] is inherently an issue to be determined by the bankruptcy court") (citations omitted). *See In re AGR Premier Consulting, Inc.*, 550 Fed. App'x. 115, 122 (3d Cir. 2014) ("[A] determination of what is property of the estate and concurrently, of what is available for distribution to creditors of that estate, is precisely the type of proceeding over which the bankruptcy court has exclusive jurisdiction"); *In re SCO Group, Inc.*, 395 B.R. 852, 858 (Bankr. D. Del. 2007) ("[I]t is the very essence of a bankruptcy court's jurisdiction to decide what is property of the estate").

[27] 11 U.SC. § 362(a)(1).

As such, all judicial actions against a debtor that were or could have been brought before a bankruptcy filing are stayed by operation of the statute. The debtor need not take any affirmative action, beyond the filing of the petition, to bring the stay into effect. The point of the automatic stay is to "provide the debtor a breathing spell from creditors by stopping all collection efforts, all harassment, and all foreclosure actions."[28] The stay also protects creditors by solving a potential collective action problem; no creditor can collect to the detriment of another.[29] While the automatic stay is broad by design, "a bankruptcy court with jurisdiction over a debtor's case has the authority to grant relief from the stay of judicial proceedings against the debtor."[30] Under § 362(d) of the Bankruptcy Code, a bankruptcy court may, upon request of "a party in interest" and after notice and a hearing, provide appropriate relief from the automatic stay including "terminating, annulling, modifying, or conditioning the stay."[31]

"Although the automatic stay is broad, the clear language of 362(a) indicates that it stays only proceedings *against* a debtor. The statute does not address actions brought by the debtor which would inure to the benefit of the bankruptcy estate."[32] The automatic stay therefore would not appear to bar ongoing proceedings in the Eastern District of Pennsylvania on the debtor's claim seeking a determination that

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[28] *Maritime Elec. Co. v. United Jersey Bank*, 959 F.2d 1194, 1204 (3d Cir. 1991).

[29] *Id.*

[30] *Id.*

[31] 11 U.S.C. § 362(d).

[32] *Maritime Elec.*, 959 F.2d at 1204 (citing *Assoc. of St. Croix Condominium Owners v. St. Croix Hotel Corp.*, 682 F.2d 446, 448 (3d Cir. 1982)).

it owns the Hemoglobin IP. Whether a claim is barred by the automatic stay depends on the nature of the claim "at its inception."[33] If the underlying claims were originally brought against the debtor, they are subject to the automatic stay;[34] if they were originally brought by the debtor, the automatic stay does not apply.

"That determination should not change depending on the particular stage of the litigation in which the filing of petition in bankruptcy occurs."[35] Thus, it is settled law that a defendant's appeal from a judgment in favor of a debtor/plaintiff is not stayed by the debtor's bankruptcy case.[36] Further, in a complex judicial proceeding involving multiple claims, each claim must be disaggregated to determine whether the claim is subject to the automatic stay.[37] Finally, affirmative "[d]efenses, as

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[33] *St. Croix.*, 682 F.2d at 449.

[34] 11 U.S.C. § 362(a)(1); *St. Croix.*, 682 F.2d at 448. Note that declaratory judgment claims can sometimes pose complications. A claim by a putative plaintiff seeking a declaration that it is not liable on a potential claim that has been threatened against it by a putative defendant might be viewed, in substance, as addressing a claim against the plaintiff. *See, e.g. In re Johns-Manville Corp.*, 31 B.R. 965 (S.D.N.Y. 1983) (holding that an insurance company's suit seeking declaratory judgment as to the coverage of its policy on its insured, the debtor, must be barred by the automatic stay because the declaratory judgment involved a determination of the debtor's ultimate obligations under the policy); *Borman v. Raymark Indus., Inc.*, 946 F.2d 1031, 1035 (3d. Cir. 1991) (noting that since § 362(a)(1) stays "proceedings against the debtor," it must "require a stay of declaratory judgment action against the debtor regardless of whether such action constitutes a claim against the debtor"). That wrinkle, however, does not appear to be posed by the declaratory judgment action that the debtor initiated here.

[35] *St. Croix.*, 682 F.2d at 449.

[36] *Id.* ("section 362 should be read to stay all appeals in proceedings that were *originally brought* against the debtor, regardless of whether the debtor is the appellant or appellee."); *Crosby v. Monroe County*, 394 F.3d 1328, 1331 n.2 (11th Cir. 2004) (holding that the automatic stay did not apply to the debtor's appeal of an adverse judgment in an action initiated by the debtor); *In re Kozich*, 406 B.R. 949, 953 (Bankr. S.D. Fla. 2009) (the automatic stay does not apply to an appeal by the debtor from an order of dismissal entered in the underlying action initiated by the debtor).

[37] *Maritime Elec.*, 995 F.2d at 1204.

opposed to counter-claims, do not violate the automatic stay because the stay does not seek to prevent defendants sued by a debtor from defending their legal rights and 'the defendant in the bankrupt's suit is not, by opposing that suit, seeking to take possession of it…".[38] Taken together, these points suggest that the automatic stay likely was not implicated by proceedings on the defendants' motion to determine that the debtor's ownership claim was subject to mandatory arbitration. That said, the motion to compel arbitration also implicated other claims, including claims for damages against the debtor, where the automatic stay would appear to bar further proceedings, including those on the question of arbitrability. And the Court further understands that the debtor has argued in the district court that even if *some* claims asserted in the district court may be subject to arbitration (which the debtor disputes), other claims – including the claim over ownership of the Hemoglobin IP – would fall outside the scope of any agreement to arbitrate.

The automatic stay, of course, may be lifted for "cause."[39] The Court is persuaded that there is cause to lift it here so that the district court may resolve the question of arbitrability. To that end, it is significant that the question of ownership of the Hemoglobin IP cannot be decided by *any* court until the question of arbitrability is decided. Importantly, while there is a body of caselaw holding that there are certain circumstances in which an agreement to arbitrate is unenforceable in bankruptcy on the ground that arbitration is incompatible with the Bankruptcy

[38] *ACandS, Inc. v. Travelers Cas. & Sur. Co.*, 435 F.3d 252, 259 (3d Cir. 2006) (quoting *Martin-Trigona v. Champion Fed. Sav. & Loan Ass'n.*, 892 F.2d 575, 577 (7th Cir. 1989)).

[39] 11 U.S.C. § 362(d)(1).

Code,[40] the debtor does not suggest that this principle applies in this case. As a result, even if this Court were otherwise inclined to proceed with the adversary proceeding (notwithstanding the defendants' contentions about the "first-filed" doctrine), it would need to decide the very same question of arbitrability on which the district court has already held an evidentiary hearing.

That is precisely the kind of circumstance in which stay relief is appropriate. In *Rexene Products*,[41] this Court observed that the legislative history of § 362(d) suggested that it will "often be more appropriate to permit proceedings to continue in their place of origin."[42] While courts have pointed to a three-part balancing test focusing on prejudice to the estate, the balance of hardships, and the likelihood of success on the merits,[43] this analysis ultimately boils down to a common-sense judgment about whether it makes good sense to have the case proceed in the court where it was pending as opposed to being heard in the bankruptcy court. In *Rexene,* Judge Balick granted stay relief to allow a class action ERISA and fiduciary duty

[40] *Mintze v. Am. General Fin. Servs., Inc.*, 434 F.3d 222, 229 (3d. Cir. 2006) (holding that where an "inherent conflict" between arbitration and the Bankruptcy Code exists, the court may deny enforcement of the arbitration clause); *see In re Fresh & Easy, LLC*, No. 15-12220, 2016 Bankr. LEXIS 2883 (Bankr. D. Del. June 2, 2016) (applying *Mintze* to determine whether plaintiff had met its burden of proving an inherent conflict existed between the arbitration clause and Bankruptcy Code); Robert M. Lawless, *Core and Not-So-Core Rhetoric About the Intersection of Arbitration and Bankruptcy*, 28 NO. 7 BLL 1 (2008).

[41] *In re Rexene Products Co.*, 141 B.R. 574 (Bankr. D. Del. 1992).

[42] *Id.* at 576 (citing H.R.Rep. No. 595, 95th Cong., 1st Sess., 341 (1977)).

[43] *Id.* at 576; *In re Tribune Co.,* 418 B.R. 116, 126 (Bankr. D. Del. 2009).

lawsuit against the debtor to continue in a district court in Texas where discovery was "nearly complete"[44] and the case was six weeks away from the start of a trial.

The claim for stay relief (at least to permit a resolution of the motion to compel arbitration) is at least as strong here. As noted above, the district court here had conducted an evidentiary hearing, and post-hearing briefing was nearly complete as of the time of the bankruptcy filing. Moreover, counsel represented at oral argument on the motion for stay relief that the district court had stated that it intended to resolve the arbitration question within 30 days of the completion of post-hearing briefing.

Under these circumstances, the case for lifting the stay so that the question of arbitrability may be decided by the district court is very strong. In fairness, the debtor points to this Court's decision in *In re SCO Group, Inc.*[45] where Judge Gross lifted the stay to permit several claims to proceed outside of bankruptcy, but denied stay relief so that the bankruptcy court could itself resolve a question of whether a particular asset was property of the estate. "[I]t is the very essence of a bankruptcy court's jurisdiction to decide what is property of the estate."[46] And while that point is fair enough, what is different about this case is the defendant's claim that the debtor agreed to have that very question decided by an arbitrator. It also bears repeating that the debtor makes no argument that any principle of bankruptcy law

[44] *In re Rexene Products Co.*, 141 B.R. at 577.

[45] 395 B.R. 852 (Bankr. D. Del. 2007).

[46] *Id.* at 858.

should override the usual principles that federal courts enforce agreements to arbitrate. Critically, the Court is *not* resolving the question – as between this Court and the district court – of which court should hear a dispute over ownership of estate property. The holding of this opinion is limited to the conclusion that the question of *arbitrability*, on which the district court already held an evidentiary hearing and that it was close to deciding at the time of the bankruptcy filing, should be resolved by the district court.

The Court is not persuaded that relief from stay should be limited to deciding the arbitrability of some claims rather than others. To the contrary, the Court believes that judicial economy counsels in favor of the district court addressing the question of arbitrability with respect to all of the claims pending before it. To be sure, there may well be claims (beyond the claim of ownership of the Hemoglobin IP that is the subject of the pending motion) as to which the parties may contend that permitting arbitration will conflict with the Bankruptcy Code. But because the motion to compel arbitration was presented to the district court with respect to the entire lawsuit before it, this Court believes it appropriate for the district court to resolve that motion in the form in which it was presented. This Court can thereafter address the application of bankruptcy law (including the automatic stay and any argument that arbitration may be inconsistent with principles of bankruptcy law) that may be presented to it relating to the further pursuit of those claims in whatever tribunal is appropriate in view of the district court's decision.

II. Discovery should proceed on the merits of the claim regarding ownership of the Hemoglobin IP.

The Court appreciates the debtor's argument that a resolution of the claim of ownership of the Hemoglobin IP is necessary for it to emerge from bankruptcy. The debtor accordingly urged this Court to proceed promptly to the merits of its motion for summary judgment on that issue. While the Court's determination that the question of arbitrability should first be decided by the district court means that the Court will not now address that issue, in the course of preparing for the argument the Court was persuaded that the defendants were correct that they were entitled to additional discovery before a summary judgment motion would properly be heard on the merits. And because no party contends that discovery on that issue would be "wasted" if that claim were to proceed either in the district court or before an arbitrator, the Court directs that the parties proceed – while the district court is considering the question of arbitrability – with such discovery in this adversary proceeding. To the extent a dispute regarding the scope of such discovery were to ripen before the arbitrability question is decided, the parties should present any such dispute to this Court by letter briefs, consistent with this Court's chambers procedures.

III. The remaining matters raised in the parties' motions will be held in abeyance.

The remaining arguments of the parties, including the motion for summary judgment and the contentions that the "first-filed" doctrine counsels in favor of dismissing the adversary proceeding in favor of the district court proceeding, will be held in abeyance pending the district court's resolution of the question of

arbitrability. The same is true of the question that this Court asked the parties to address – whether principles of permissive abstention counseled in favor of deferring to the previously filed district court lawsuit.[47] The Court will consider these issues, to the extent appropriate, following the district court's resolution of the motion to compel arbitration.

Conclusion

For the foregoing reasons, the Court will direct that the automatic stay be lifted so that the district court may resolve the pending motion to compel arbitration. In the meantime, discovery on the question of ownership of the Hemoglobin IP may proceed in this adversary proceeding. The remaining motions shall be held in abeyance. The parties are directed to settle an order so providing.

Dated: November 2, 2022

CRAIG T. GOLDBLATT
UNITED STATES BANKRUPTCY JUDGE

[47] In view of the uncertainty regarding the application of the judge-made "first-filed" doctrine to cases (like this one) that fall within a federal court's bankruptcy jurisdiction, the Court asked the parties to address the question of permissive abstention on the ground that 28 U.S.C. § 1334(c)(1) might provide a statutory basis for the same principles of judicial economy and procedural regularity that underlie the "first-filed" doctrine.