No. 24672 - Fire — Jordache Enterprises, Inc., a foreign corporation, et al. v. National Union Insurance Company of Pittsburgh, P.A.

Davis, Chief Justice, concurring in part, and dissenting in part:

This case was appealed by Jordache Enterprises, Inc. and its owners, Joseph Nakash, Ralph Nakash and Avi Nakash (hereinafter referred to as "Jordache"). Jordache filed an action against the appellee, National Union Fire Insurance Company (hereinafter referred to as "National"), as a result of National's refusal to provide coverage for Jordache in other litigation. The action included a claim for bad faith. The circuit court subsequently granted summary judgment to National. The majority opinion held that because of a previous ruling by a New York trial court on the issue of indemnification, the circuit court correctly granted summary judgment against all the Nakashes, except with respect to their statutory bad faith claim. I concur with the majority opinion insofar as it finds that the New York decision barred the claims of Jordache Enterprises, Inc., Ralph Nakash and Avi Nakash. However, I dissent with respect to two holdings made by the majority opinion. First, the majority opinion incorrectly found that the New York decision precluded all of Joseph Nakash's claims against National other than his statutory bad faith claim. I believe the New York decision did not preclude any of Joseph Nakash's claims due to the operation of the automatic bankruptcy stay. Second, I dissent from the majority's decision finding that summary judgment was improper on the statutory bad faith claim of Jordache Enterprises, Inc., Ralph Nakash and Avi Nakash as

the bad faith claims asserted by these plaintiffs require the existence of insurance coverage. However, the majority determined there was no such coverage.

A.

Joseph Nakash's Claims

During the New York litigation, Joseph Nakash filed for Chapter 11 bankruptcy. Consequently, an automatic bankruptcy stay prevented National from obtaining an adverse ruling against him, effectively precluding him from mounting a defense in that case. The majority opinion states that the New York trial court issued an order specifically stating that its decision "could not bind Joseph [Nakash], since the action had been stayed as to him." In spite of this evidence, the majority opinion held that Joseph Nakash is bound by the New York decision. The majority opinion justifies its innocuous ruling by finding "that Joseph could have moved for the New York court to expand the automatic stay to the defendants in that action or to enjoin further litigation." This reasoning is illogical and in direct violation of the purpose of the automatic stay. There exists no federal bankruptcy law nor rule which requires a debtor to "expand" an automatic stay to obtain the benefits guaranteed by the bankruptcy stay. Thus, the majority decision nullifies the automatic bankruptcy stay.

In view of the majority opinion's lack of understanding of bankruptcy law, I

must begin with the basics. As a general matter "a bankruptcy filing automatically stays 'any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate,' and 'any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case[.]'" *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 21, 116 S. Ct. 286, 290, 133 L.Ed.2d 258 (1995).[1] The automatic stay is triggered by the act of filing a bankruptcy petition, not by

[1]The automatic stay provision of 11 U.S.C. § 362(a) provides:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of
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> (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, or to recover a claim against the debtor that arose before the commencement of the case under this title;
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> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
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> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
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> (4) any act to create, perfect, or enforce any lien against property of the estate;
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> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
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> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
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> (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
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> (8) the commencement or continuation of a proceeding before the

the entry of an order for relief by the court. *Matter of Eugene L. Pieper, P.C.*, 202 B.R. 294 (D.Neb. 1996). The stay is effective upon the filing of the petition even though the parties have no notice of its existence. *In re Scott*, 24 B.R. 738 (M.D.Ala. 1982). The automatic stay is broad in scope and applies to almost every formal and informal action against the debtor or property of the debtor, except as set forth under 11 U.S.C. § 362(b). 2 Lawrence P. King, et al., Collier on Bankruptcy ¶ 362.04, at 362-34 (15th ed. 1996). In general, acts taken in violation of the automatic stay are void and without legal effect. *Kalb v. Feuerstein*, 308 U.S. 433, 60 S. Ct. 343, 84 L. Ed. 370 (1940).[2]

Moreover, under 11 U.S.C. 362(d), express authority is given to a party to request the bankruptcy court to lift the automatic stay. See *In re Wilson*, 116 F.3d 87 3d Cir. 1997); *In re Countryside Manor, Inc*., 188 B.R. 489 (1995). Courts have held that when a party who has not sought such relief from a bankruptcy stay attempts to commence or continue a lawsuit against a debtor, action taken is void. *Paine v. Sealy*, 956 S.W.2d 803 (Tex. App. 1997). Additionally, pursuant to 11 U.S.C. § 362(d), express authority is given to the bankruptcy court to annul the automatic stay and thereby retroactively validate actions taken that would otherwise be void. *See In re Soares*, 107

United States Tax Court concerning the debtor.

[2]*See also In re Krystal Cadillac Oldsmobile GMC Truck, Inc*., 142 F. 3d 631 (3d Cir. 1998); *In re TNT Farms*, 226 B.R. 436 (D.Idaho 1998); *In re Fitch*, 217 B.R. 286 (S.D.Cal. 1998); *In re Smith*, 224 B.R. 44 (E.D.Mich. 1998); *In re Samaniego*, 224 B.R. 154 (E.D.Wash. 1998);*In re Scott*, 24 B.R. 738 (M.D.Ala. 1982); *Lorenz v. Beltio, Ltd*., 963 P. 2d 488 (Nev. 1998).

F. 3d 969 (1st Cir. 1997); *Easley v. Pettibone Michigan Corp*., 990 F. 2d 905 (6th Cir. 1993); *In re Albany Partners*, 749 F. 2d 670 (11th Cir. 1984). Absent such an annulment by the bankruptcy court, however, the mere termination of the stay does not validate actions taken in violation of it. *In re Eden Associates*, 13 B.R. 578 (S.D.N.Y. 1981). An order terminating the automatic stay permits a party to re-initiate its lawsuit, or start another one, after the termination order is entered, but does not affect the status of actions taken between the filing of the bankruptcy petition and the entry of the termination order; such actions are void ab initio. *Eastern Refractories Co. Inc. v. Forty Eight Insulations Inc*., 157 F. 3d 169 (2d Cir. 1998). The law is clear that only the bankruptcy court has jurisdiction to determine whether a matter is to be exempted from the stay order, a state court does not have jurisdiction to make such a determination. *Hester v. Brewster*, 705 So. 2d 793 (La. Ct. App. 5 Cir. 1997).

The "basic" principles of bankruptcy law reviewed above illustrate that the majority opinion violates the Congressional intent and prior judicial interpretation of bankruptcy law. The law of bankruptcy is designed to give debtors a "fresh" start. It is not designed to be a trap for a debtor. However, a trap is exactly what was created by the majority's decision. The majority decision defies all tenets of fairness by holding "that Joseph could have moved for the New York court to expand the automatic stay to all the defendants in that action or to enjoin further litigation." The majority opinion erroneously assumes the bankruptcy court would automatically enjoin the New York

court proceeding against Joseph Nakash's brothers. *See In re Barney's Inc*., 200 B.R. 527 (S.D.N.Y. 1996) (declining to use equitable powers to enjoin state court proceeding against Chapter 11 debtors' nondebtor principals to enforce principals' guarantees where adjudication of the state proceeding would not impose financial hardships on estates or divert principals from their duties); *In re Spiers Graff Spiers*, 190 B.R. 1001 (N.D.Ill. 1996) (concluding that Chapter 11 debtor-partnership did not establish entitlement to injunction preventing creditor from proceeding in state court action to impose personal liability against debtor's general partners); *In re REPH Acquisition Co*., 134 B.R. 194 (N.D.Tex. 1991) (recognizing that bankruptcy court could not properly use its equitable authority to permanently enjoin lessor from pursuing state court eviction action against nondebtor co-lessee). Assuming, for the sake of argument, that the bankruptcy court would stay the state court proceeding, I have found no bankruptcy law which obligates a debtor to seek a stay against a proceeding involving third-parties. The reason no such law exists is simple. The automatic stay, which the majority opinion has repealed, protects the debtor from extraneous litigation.

Additionally, the majority opinion selectively omits discussion of the legal right and obligation of National to have motioned the bankruptcy court to lift the automatic stay. Herein lies the real problem. Had National wanted to bind Joseph Nakash through the state court proceeding, bankruptcy law provided an express vehicle, under 11 U.S.C. § 362(d), to request the bankruptcy court to lift the stay. *See*

Constitution Bank v. Tubbs, 68 F.3d 685 (3d Cir. 1995); *Matter of M4 Enterprises, Inc*., 183 B.R. 981 (N.D.Ga. 1995); *In re Molitor*, 183 B.R. 547 (E.D.Ark. 1995). Under the majority opinion, the burden now shifts to debtors to plead with bankruptcy courts to enjoin extraneous litigation. For the reasons that follow, I believe such a requirement is illegal under present federal bankruptcy law.

1. Application of the Automatic Stay to Third-Party Litigants

The automatic bankruptcy stay does not extend to separate legal entities such as corporate affiliates, partners in debtor partnerships, or to codefendants in pending litigation. 2 Lawrence P. King, et al., Collier on Bankruptcy ¶ 362.04, at 362-34 & n.1b (15th ed. 1996). The leading case cited by this treatise in favor of not extending the automatic stay to co-defendants is *Wedgeworth v. Fibreboard Corp*., 706 F.2d 541 (5th Cir.1983). The court in *Wedgeworth* articulated that the purpose of the automatic stay is to protect the debtor. It was correctly reasoned by the court in *Wedgeworth* that the Congressional purpose behind the automatic stay is not "advanced by application of the stay rule to codefendants." *Id*., 706 F.2d at 545. This principle, that a codefendant is not entitled to the protection of the automatic stay after another defendant files a petition for bankruptcy, is also followed by the Eighth Circuit. *See Croyden Associates v. Alleco, Inc*., 969 F.2d 675 (8th Cir. 1992), cert. denied, 507 U.S. 908, 113 S.Ct. 1251, 122 L.Ed.2d 650 (1993). For example, in *Croyden* an alleged member of a plaintiff class in a class action lawsuit, sued a public debenture issuer and its successor in interest over

liability stemming from a default on the debentures and the fairness of a proposed settlement, after the defendants agreed to a settlement with a committee of other members of the plaintiff class. During the appeal before the Eighth Circuit, one of the defendants filed a petition in bankruptcy. The Eighth Circuit held that the automatic stay applied only to the claims against the debtor and "that the stay is not available to nonbankrupt codefendants, 'even if they are in a similar legal or factual nexus with the debtor.'" *Id*., 969 F. 2d at 677, (quoting *Maritime Elec. Co. v. United Jersey Bank*, 959 F. 2d 1194, 1205 (3d Cir. 1991), and citing *Fortier v. Dona Anna Plaza Partners*, 747 F. 2d 1324, 1330 (10th Cir. 1984)).

The position taken by *Wedgeworth* and *Croyden*, that codefendants are not protected by the automatic stay, is also supported by analogy to Chapters 12 and 13 of the Bankruptcy Code, which provides in general that a party may not take action against codebtors of a debtor filing for bankruptcy. *See* 11 U.S.C. §§ 1201 & 1301. Since codefendants of a debtor filing bankruptcy under Chapters 12 and 13 are also subject to the automatic stay imposed by 11 U.S.C. § 362(a), the logical conclusion is that Section 362(a) does not include a codefendant stay. If Section 362(a) impliedly protected codebtors, the inclusion of a codebtor stay at Sections 1201 and 1301 would be superfluous. *See Rake v. Wade*, 508 U.S. 464, 471-73, 113 S. Ct. 2187, 2192, 124 L. Ed.2d 424 (1993) ("We generally avoid construing one provision in a statute so as to suspend or supersede another provision"). In the case at hand, Joseph Nakash's

codefendants were not "privy" to the automatic stay. Had the codefendants wanted the protection of the stay, they had to motion the bankruptcy court. *See Stephen Inv. Sec., Inc. v. Securities & Exch. Comm'n*., 27 F.3d 339, 342 n.5 (8th Cir. 1994); *In re North Star Contracting Corp*., 125 B.R. 368, 370-71 (S.D.N.Y. 1991) . However, under the cryptic logic of the majority opinion, Joseph Nakash has been made "privy" to the state court proceeding when, under bankruptcy law, the codefendants were not "privy" to his automatic stay.

2. Res judicata and Collateral Estoppel Cannot be Used to Circumvent the Automatic Stay

I come now to the essence of my dispute with the majority opinion. The majority opinion erroneously relied upon the doctrines of res judicata and collateral estoppel to retroactively lift the automatic stay, and thereby bind Joseph Nakash to the New York court decision. Res judicata and collateral estoppel are not novel issues in matters pertaining to bankruptcy proceedings. Unlike the majority opinion, however, other courts have recognized, in similar cases, that res judicata and collateral estoppel have no application to a bankruptcy debtor. In the case of *In re Replogle*, 929 F. 2d 836 (1st Cir. 1991), the debtor filed bankruptcy in Massachusetts in March of 1988. Thereafter, in September and November of 1988, property of the debtor was foreclosed upon in New York. The First Circuit had little trouble in dispensing with the matter by concluding that "[a]lthough Replogle was a party to the foreclosure, and the bankruptcy

judge had notice, the automatic stay issued in the Chapter 13 proceedings, 11 U.S.C. § 362, meant that the New York decision was not res judicata as to Replogle." *Id.*, 929 F. 2d at 837 n.1. *See also Community Investors IX, Ltd. v. Phillips Plastering Co*., 593 S.W.2d 418 (Tex. App. 1980) (finding judgment of state court foreclosing lien during pendency of automatic stay was void).

Similarly, in the case of *In re Haines*, 210 B.R. 586 (S.D.Cal. 1997), the automatic stay was lifted for specific matters to be litigated between the debtor and his spouse in a divorce proceeding. One issue that the domestic court was not authorized to litigate was the debtor's ability to pay the amount determined to be owed to his spouse by that court. During the bankruptcy proceeding, the debtor's spouse contended that the debtor was collaterally estopped from contesting his ability to pay divorce related debt because the domestic court had determined the issue. The bankruptcy court rejected the collateral estoppel argument and held that "[t]he determination by the family court of [the debtor's] ability to pay the amounts it awarded [the spouse] was not within the limited scope of the stay relief . . . . Actions taken in violation of the automatic stay are void." *Id*., 210 B.R. at 591 (citing *In re Schwartz*, 954 F.2d 569 (9th Cir. 1992)).

The decisions in *Replogle* and *Haines* support my position that neither res judicata nor collateral estoppel may be invoked against a bankruptcy debtor, unless the

automatic stay has been lifted specifically to allow extraneous litigation against the debtor for the specific matters with regard to which res judicata or collateral estoppel are raised.[3] In this case, no evidence was adduced showing that the bankruptcy court lifted the automatic stay so that National could litigate against Joseph Nakash. The majority opinion, however, has ruled that the stay did not have to be lifted because National could argue "privity" among codefendants. This is simply wrong according to *Replogle* and *Haines*. Where a debtor is the sole defendant in an extraneous action, the automatic stay cannot be circumvented by the doctrines of res judicata and collateral estoppel. It stands to reason, then, that where codebtors are codefendants against whom an extraneous judgment has been rendered, the automatic stay must similarly prevail over the preclusive doctrines of res judicata and collateral estoppel with regard to a codebtor who has filed for bankruptcy. There can be no privity in a judgment that is void against a debtor. To hold otherwise renders the automatic bankruptcy stay meaningless in all matters involving codefendants. In essence, the majority decision has modified bankruptcy law and rendered the automatic stay meaningless. However, modifying bankruptcy law requires Congressional action, not state court usurpation of power. To permit state courts to do what the majority opinion has done "seriously undercut[s] the orderly process of the law." *Celotex Corporation v. Edwards*, 514 U.S. 300, 313, 115 S. Ct. 1493, 1501,

[3]As I discussed in the text, under 11 U.S.C. § 362(d) authority is given to the bankruptcy court to terminate, annul, modify or condition the automatic stay. *See, e.g., In re Soares*, 107 F. 3d 969 (1st Cir. 1997); *Easley v. Pettibone Michigan Corp*., 990 F. 2d 905 (6th Cir. 1993); *In re Albany Partners*, 749 F. 2d 670 (11th Cir. 1984).

131 L. Ed.2d 403 (1995).

B.
Statutory Bad Faith Claim Of Jordache Enterprises, Inc., Ralph Nakash And Avi Nakash

The majority opinion erroneously remands the statutory bad faith claim of Jordache Enterprises, Inc., Ralph Nakash and Avi Nakash, ruling that the statutory bad faith claim is alive and justiciable because it is "not a claim that rests on substantially prevailing on the underlying contract action." Had the majority carefully reviewed the specific provisions of West Virginia law upon which these plaintiffs rely in asserting their bad faith claim, I believe the majority would have affirmed summary judgment on that claim.

According to the majority, Jordache Enterprises, Inc., Ralph Nakash and Avi Nakash claim that National committed bad faith pursuant to W.Va. Code §§ 33-11-4(9)(b), (c), (d), (e) and (f), which read:

> (b) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
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> (c) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
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> (d) Refusing to pay claims without conducting a reasonable investigation based upon all available information;
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> (e) Failing to affirm or deny coverage of claims within a reasonable

time after proof of loss statements have been completed;

(f) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear.

A fair reading of (b), (c), (d) and (f) requires any reasonable person to conclude that "coverage" must exist for them to be viable. However, the majority opinion determined that coverage did not exist. Therefore, provisions (b), (c), (d) and (f) are not justiciable. Summary judgment was appropriate as to those provisions.

As to provision (e), two types of claims exist: (1) failing to affirm coverage timely and (2) failing to deny coverage timely. Nothing in the majority opinion, nor the record, reveal a material issue of dispute as to whether National failed to deny coverage within a reasonable time. It is clear from the record and the majority opinion that Jordache Enterprises, Inc., Ralph Nakash and Avi Nakash were asserting that part of provision (e) which addresses failing to "affirm" coverage within a reasonable time. On this issue, the majority opinion concluded that coverage did not exist. Thus, summary judgment should have been affirmed.