UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

In re:

Scott W. Charmoli and Lynne M. Charmoli,	Case No. 22-24358-gmh Chapter 11
Debtors.	

Scott W. Charmoli,	
Plaintiff,	
v.	Adv. Proc. No. 22-02130-gmh
Aspen American Insurance Company,	
Defendant.	

REPORT AND RECOMMENDATION ON
DEFENDANT'S MOTION TO WITHDRAW REFERENCE

After a jury found him guilty of health care fraud and related crimes, in *United States v. Charmoli*, Case No. 20-CR-242 (E.D. Wis. verdict returned Mar. 10, 2022), Scott Charmoli and his wife filed a joint case under chapter 11, subchapter V, of the Bankruptcy Code to liquidate their non-exempt assets and confirm a plan of reorganization, the main aim of which is to pay claims of his former dental patients after any disputes over the validity and amount of those claims are settled, adjudicated, or otherwise resolved. Charmoli commenced this adversary proceeding against Aspen

American Insurance Company to obtain a declaration that professional-liability policies that Aspen issued remain effective because Aspen failed to properly rescind those policies under Wisconsin law, specifically Wisconsin Statutes section 631.11(4)(b).

Aspen asks the district court to withdraw its reference of this proceeding to the bankruptcy court so that the district court may oversee it from soup to nuts. Aspen's request does not stay the proceeding in the bankruptcy court, however. Fed. R. Bankr. P. 5011(c). And for the reasons explained below, the bankruptcy court recommends that the district court either deny Aspen's motion as premature or withdraw the reference only for the purpose of conducting a trial, otherwise leaving the reference in place so that the bankruptcy court may oversee all pretrial matters, including any motions for summary judgment. See Order Re. Mot. to Withdraw Reference, *Catholic Bishop of N. Alaska v. Cont'l Ins. Co. (In re Catholic Bishop of N. Alaska)*, No. 08-cv-0038 (D. Alaska Oct. 21, 2008), Aspen's Mem. in Supp. of Mot. to Withdraw Reference Ex. E, ECF No. 16, at 72–73.[1] The bankruptcy court is well situated to preside over this proceeding through the pretrial stage, and the interests of judicial economy and fidelity to Congress's division of judicial labor favor leaving the reference in place until the matter is ready for trial, presuming the parties are unable to resolve it before then.

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1. Aspen, in its brief in support of its motion to withdraw the reference, cites the district court's order in *Catholic Bishop* and describes it, in a parenthetical, as "granting a motion to withdraw the reference" of a "declaratory judgment insurance coverage action substantially similar to the current Adversary Proceeding" after finding the action "to be non-core". ECF No. 16, at 19. But the district court in that case only withdrew the reference "for the purpose of conducting trial", further ordering:

> This proceeding will be retained in the Bankruptcy Court for the handling of all pre-trial matters, including motions for summary judgment. If summary judgment motions are filed, the Bankruptcy Court will issue proposed findings of fact and conclusions of law thereon to the District Court, pursuant to 28 U.S.C. § 157(c)(1).
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> Upon conclusion of all pre-trial matters, the Bankruptcy Court will certify to the District Court that this matter is ready for trial.

Order Re. Mot. to Withdraw Reference at 2, *Catholic Bishop*, No. 08-cv-0038, ECF No. 16, at 73.

Bankruptcy Court Jurisdiction by Reference and the Request for its Withdrawal

The district court has "original . . . jurisdiction of all civil proceedings . . . related to cases under title 11", i.e., the Bankruptcy Code, including this one. 28 U.S.C. §1334(b). But the district court refers all such proceedings to the bankruptcy court. Order of Reference (E.D. Wis. July 16, 1984) ("[A]ll proceedings . . . related to a case under title 11 shall be referred to the bankruptcy judges of this District."), https: //www.wied.uscourts .gov/general-orders/order-reference; see 28 U.S.C. §157(a) ("Each district court may provide that . . . any or all proceedings . . . related to a case under title 11 shall be referred to the bankruptcy judges for the district."); *id.* §151 ("In each judicial district, the bankruptcy judges . . . constitute . . . the bankruptcy court for that district.").

Aspen moves to withdraw the reference of this proceeding. ECF No. 15.[2] The motion must "be heard by a district judge." Fed. R. Bankr. P. 5011(a). The bankruptcy court makes this report and recommendation to assist the district court. See *In re Vicars Ins. Agency, Inc.*, 96 F.3d 949, 954 (7th Cir. 1996) ("Some bankruptcy courts, even though they are without jurisdiction to hear a motion for withdrawal, *see* 28 U.S.C. § 157(d), make recommendations to the district court as to whether this should be done.").

The district court may withdraw the reference "for cause shown." §157(d). As the district court has observed, however, "permissive withdrawal is the exception, rather than the rule". *Kemp v. Nelson*, No. 16-CV-1546, 2016 WL 7177508, at *1 (E.D. Wis. Dec. 9, 2016) (Stadtmueller, J.) (quoting *Grochocinski v. LaSalle Bank Nat'l Ass'n* (*In re K & R Express Sys., Inc.*), 382 B.R. 443, 446 (N.D. Ill. 2007)). After all, "bankruptcy jurisdiction is 'designed to provide a single forum for dealing with all claims to the bankrupt's assets.'" *K & R Express Sys.*, 382 B.R. at 446 (quoting *Elscint, Inc. v. First Wis. Fin. Corp. (In re Xonics, Inc.)*, 813 F.2d 127, 131 (7th Cir. 1987)), quoted in *Kemp*, 2016 WL 7177508,

2. Unless otherwise specified, all citations to the record are to *Charmoli v. Aspen Am. Ins. Co. (In re Charmoli)*, Adv. Proc. No. 22-02130 (Bankr. E.D. Wis. filed Dec. 14, 2022).

at *1. And withdrawing the reference risks undermining that design. Aspen, as the moving party, "bears the burden of establishing that withdrawal is appropriate." *Vlastelica v. Novoselsky*, No. 15-CV-0910, 2015 WL 6393968, at *1 (E.D. Wis. Oct. 21, 2015) (Adelman, J.); see also *Kemp*, 2016 WL 7177508, at *1.

"Sufficient cause for permissive withdrawal exists where 'withdrawal . . . is essential to preserve a higher interest than that recognized by Congress and is narrowly tailored to serve that interest.'" *Kemp*, 2016 WL 7177508, at *1 (quoting *Vista Metals Corp. v. Metal Brokers Int'l, Inc.*, 161 B.R. 454, 456 (E.D. Wis. 1993)). The district court has considered six factors when deciding whether a party has shown cause to withdraw the reference: "(i) whether the proceeding is core or non-core, (ii) considerations of judicial economy and convenience, (iii) promoting uniformity and efficiency of bankruptcy administration, (iv) forum shopping and confusion, (v) conservation of debtor and creditor resources, and (vi) whether the parties requested a jury trial." *Kemp*, 2016 WL 7177508, at *1 (quoting *Vlastelica*, 2015 WL 6393968, at *1).

The bankruptcy court makes this report and recommendation without deciding whether (1) this is a core proceeding or (2) Aspen is entitled to a jury trial. For purposes of this report and recommendation, the bankruptcy court presumes that this is not a core proceeding, so any final judgment must be entered by the district court, absent the parties' consent to the entry of judgment by the bankruptcy court. See §157(c); *Stern v. Marshall*, 564 U.S. 462, 481 (2011). The bankruptcy court further presumes, with respect to whether Aspen's rescission of the relevant policies was timely under Wisconsin law, that Aspen is entitled to a jury trial, which, if necessary, must be conducted by a district judge, absent the parties' consent to have the trial conducted by the bankruptcy judge. See §157(e); Fed. R. Bankr. P. 9015(b).[3] While these considerations might justify

3. Aspen asserts that it is entitled to a jury trial, but it does not explain why. Aspen cites a Third Circuit case, governed by Pennsylvania law, holding in relevant part that the plaintiff was entitled

withdrawing the reference when this proceeding is ready for trial, other relevant factors weigh against withdrawing the reference before then.

The Parties' Dispute

In his amended complaint, Charmoli seeks declaratory relief, alleging as follows: He first purchased professional-liability insurance from Aspen in March 2018, when he was a practicing dentist. ECF No. 29, at 1, ¶1. Aspen was a defendant to multiple state-court civil actions filed against him by dozens of his former patients in February, October, and December 2021, alleging that he injured them by performing unnecessary dental work for which he fraudulently billed dental insurers. *Id.* at 3–6, ¶¶14–28. Aspen claimed this conduct as grounds for rescinding the relevant policies, but it did not give him notice of its intent to rescind those policies until August 2022, months after a jury found him guilty of health care fraud and related false statements. *Id.* at 5–6, ¶¶27–28 & 30. By then, it was too late, however, because Wisconsin law requires notice of intent to rescind an insurance policy within 60 days after the insurer learns of facts sufficient to justify rescission. *Id.* at 6–7, ¶¶28 & 35–38.

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to a jury trial on its claims for declaratory relief (that its insurers had to indemnify it in various "asbestos-related suits") because if federal law did not provide a "declaratory judgment remedy", then the claims would have been for legal relief—namely "damages consisting, *inter alia*, of reimbursement of litigation costs and amounts paid to victims"—not equitable relief (e.g., specific performance). *AstenJohnson, Inc. v. Columbia Cas. Co.*, 562 F.3d 213, 217–18 & 223–26 (3d Cir. 2009), cited in ECF No. 16, at 25–26. Here, Charmoli seeks a declaration that the relevant policies are enforceable against Aspen, despite its purported rescission of those policies, because it failed to give timely notice under Wisconsin Statutes section 631.11(4)(b) of its intent to rescind them. Whether a party is entitled to a jury trial on such a claim—because, absent a declaratory remedy, it would be for legal, not equitable, relief—is unclear. Compare *Little v. Roundy's, Inc.*, 449 N.W.2d 78, 81–82 (Wis. Ct. App. 1989) ("An action to rescind a contract is equitable in nature. . . . Equitable claims are properly determined by the trial court."), and *Seidling v. Stepan*, 776 N.W.2d 287 (Wis. Ct. App. 2009) ("Foreclosure and rescission claims are equitable actions tried to the court."), with *Gifford v. Thur*, 276 N.W. 348, 352 (Wis. 1937) (quoting *Mueller v. Michels*, 199 N.W. 380, 382 (Wis. 1924)) ("In a legal rescission the defrauded party rescinds, and he does so by either restoring or by offering to restore the consideration received by him, and it follows as a matter of course, if the fraud be established, that he may recover the consideration paid, whether it be money or property. On the other hand, the party himself does not rescind in a suit for equitable rescission. In such a case the appeal to the court is an application for the court to rescind, and the rescission does not take place until it is adjudged by the court.").

Aspen has moved to dismiss Charmoli's claim for declaratory relief, contending that the preclusive effect of his criminal conviction justified recission. ECF Nos. 22 & 23. Aspen contends that "although [it] was aware of the allegations against [Charmoli] in the Civil Actions, it was required to wait until it could 'determine conclusively' the facts, which it could not have done until, at the earliest, July 2022", when the district court entered a final judgment in the criminal case. ECF No. 32, at 6.[4]

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4. Aspen placed quotation marks around "determine conclusively" and cited *Broege v. Lincoln National Life Insurance Co.*, No. 11-cv-566, 2012 WL 13069918 (W.D. Wis. Apr. 9, 2012), suggesting that the language is a quote from that decision, but if that is what Aspen intended, it misquoted: *Broege* says, "determin*ing* conclusively". *Id.* at *4 (emphasis added). Moreover, the cited (or quoted) language is from the court's description of *the insurer's argument* in that case, not the court's construction of Wisconsin Statute section 631.11(4)(b). The language occurs in the following passage describing insurer Lincoln's contention that inconsistent information left it uncertain about whether there was a basis for recission of a life-insurance policy and its need to secure the insured's medical records:

> Lincoln contends . . . that it had 120 days—not 60—from November 16, 2010 within which to rescind the policy, because on that date it received *two* statements from Barbara Broege—one indicating that her husband *had* been a smoker and the other indicating that he had *not*—which created **an inconsistency that precluded Lincoln from determining conclusively whether a basis for rescission existed**. In order to resolve this inconsistency, Lincoln says it had to review Broege's medical records, which put the statute's 120-day deadline into play.
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> Lincoln is correct. As the statute makes clear, once Lincoln determined that it needed additional medical information, Lincoln had 120 days in which to complete its investigation and notify plaintiffs.

Id. at *4–5 (last emphasis added) (footnote omitted). Rather than concluding that section 631.11(4)(b)'s 60-day notice period does not start until the insurer makes a conclusive determination that it has grounds to rescind, the court reasoned that the time for the insurer to give notice of its intent to rescind started when the insurer learned that it *may* have grounds for recission, even though other information available to the insurer left it unable, at that time, to determine with certainty whether it *did*:

> [U]nder the statute, the clock begins to run when the insurer acquires "knowledge of sufficient facts to constitute grounds for rescission of the policy." When these grounds for **possible rescission** necessitate medical record review, the time on the clock is increased to 120 days total, but the clock is not rewound. In other words, the clock only starts once; whether it runs out in 60 days or 120 days depends on whether the insurer sees the need to gather additional medical information.

Id. at *5 (emphasis added) (quoting Wis. Stat. §631.11(4)(b)). This suggests a construction of the statute

Judicial Economy Does Not Favor Withdrawing the Reference

While the parties have not yet fully briefed Aspen's motion to dismiss, their presentations at the Rule 16 conference, held on March 6, 2023, suggest that dismissal turns on whether Wisconsin Statutes section 631.11(4)(b)'s "knowledge of sufficient facts", at least as applied here, codifies an epistemological theory under which an insurer cannot know a fact until a judgment is entered that proves it. If the statute's knowledge requirement instead calls for a factual inquiry (that is, as its text seems to indicate, the essential issue is, when did the insurer "acquire[] knowledge of sufficient facts to constitute grounds for rescission"?), then Charmoli's allegations in the amended complaint—that Aspen learned facts sufficient to warrant its rescission of the relevant policies when it was a party to several state-court proceedings against Charmoli, far more than 60 days before it gave him notice of its intent to rescind—seem more than adequate to defeat its motion to dismiss. §631.11(4)(b).

If the bankruptcy court so concludes and denies Aspen's motion to dismiss, the parties' Rule 26(f) report indicates that they will need several months to complete discovery before they are ready to proceed to trial. ECF No. 31, at 4. Judicial economy favors allowing the bankruptcy court to preside over discovery and any other pretrial matters. Unlike the bankruptcy court, whose jurisdiction is limited to bankruptcy-related matters, the district court must manage cases arising under all titles of the United States Code, including title 18. In recent years, bankruptcy filings have waned substantially, resulting in the bankruptcy court's four judges enjoying a rare period of excess capacity.[5] So, while there may be a time when efficient judicial administration

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under which an insurer who learns facts that, if true, *would be* sufficient to justify rescission must, within 60 (or 120) days, investigate, decide whether it intends to rescind, and if it does, give the insured notice.

5. From October 2019 through March 2020, an average of 875 new cases were filed in the bankruptcy court each month. See *Bankruptcy Statistics: Calendar Year Comparison 2018, 2019, 2020*, Bankr. E.D. Wis. (Mar. 9, 2023), https://www.wieb.uscourts.gov/bankruptcy- statistics/?calendaryear=2020. In the six months that followed, from April 2020 through September 2020, an average of only 677 new cases

would justify the district court deciding to preside over discovery and other pretrial litigation in bankruptcy adversary proceedings, that time has not yet arrived.

Denying the Motion Promotes Efficient Bankruptcy Administration

In all events, until this proceeding is ready for final adjudication, the benefits of bankruptcy-court oversight outweigh any arguable efficiency to be gained from withdrawing the reference. As noted earlier, the underlying bankruptcy case—to which this adversary proceeding relates—is one under subchapter V of chapter 11, Congress's recent addition to the Bankruptcy Code for small-business reorganizations. Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079. As in most other chapter 11 cases, the Charmolis are "debtors in possession" of their bankruptcy estate, created by operation of §541 of the Bankruptcy Code, consisting of essentially all their non-exempt property. 11 U.S.C. §1182(2). As such, with certain exceptions, they "have all the rights . . . and powers" and must "perform all functions and duties . . . of a trustee serving in a case under [chapter 11]", and they are charged with maximizing the estate's value. *Id.* §1184. They must, among other things, propose a plan of reorganization that—absent consent of all classes of creditors—"is fair and equitable," meaning it must distribute estate property to creditors before the debtors are entitled to retain non-exempt assets. *Id.* §1191(b) & (c); see also *id.* §§1189–90.

The debtors have filed a proposed plan of reorganization that provides for the payment of claims, including those held by Scott Charmoli's former patients, through the liquidation of non-exempt real property, which according to the debtors' schedules have significant value; insurance coverage from Aspen; and the recovery of claims by Charmoli and his LLC against the purchaser of his practice, the subject of another

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were filed in the bankruptcy court each month. See *id.* Recent case filings have dropped even lower, to only about half of what they were in the months before April 2020. See *Bankruptcy Statistics: Calendar Year Comparison 2021, 2022, 2023*, Bankr. E.D. Wis. (Mar. 9, 2023), https://www.wieb.uscourts.gov/bankruptcy-statistics/?calendaryear=2023 (On average, 453 new cases were filed in the bankruptcy court each month from September 2022 through February 2023.).

adversary proceeding. *In re Charmoli*, Case No. 22-24358, ECF No. 110, at 3–4 & 8. The debtors' filings in the main case indicate their intent to seek as many consensual resolutions of the bankruptcy-related disputes as possible. This is to be expected, of course—typically the best, if not only, way for a reorganizing debtor to achieve a confirmable plan is to resolve most, if not all, disputes with creditors and others amicably. Protracted litigation or "scorched earth" tactics risk having the bankruptcy estate consumed by the costs of administration, principally the compensation owed to the estate's lawyers and other professionals.

The debtors will be aided in their effort to achieve consensus by the subchapter V trustee, William Wallo, appointed by the United States trustee, as is required in subchapter V cases like this one. Mr. Wallo is a well-regarded bankruptcy practitioner with many years' experience in this area of practice. The debtors have also reported that Bankruptcy Judge Susan Kelley (ret.) has agreed to mediate disputes involving claims filed by former patients (who are reportedly represented by only a few lawyers). Other than the debtors, the patients are the principal players in the main case, so a concerted effort to settle their disputes in the claims-allowance process seems likely to lead to an effort by all interested parties to seek a global settlement by which the debtors can confirm a plan of reorganization, maximizing payments to those with legitimate claims against the debtors while minimizing the bankruptcy estate's administrative costs, including the costs of litigating this adversary proceeding.

Bankruptcy-Court Oversight Conserves Debtor and Creditor Resources

Congress stationed bankruptcy judges as bulwarks against excessive litigation fees and costs that can threaten a debtor's efforts to reorganize. The Bankruptcy Code affords payment priority to the fees and expenses of debtors' counsel and requires, absent contrary agreement, that those fees and expenses be paid in full on the effective date of the plan of reorganization, but only to the extent the bankruptcy court approves

them after determining that they were reasonably and necessarily incurred on the estate's behalf. See 11 U.S.C. §§330(a), 503(b)(2), 507(a)(2), 1129(a)(9)(A) & 1191(a).

Bankruptcy-court oversight of litigation involving the debtors is paramount to the court being able to perform its statutory duty to monitor the bankruptcy estate's administrative expenses and decide whether fees incurred by counsel for the estate and other professionals in pursuing and responding to litigation are reasonable, as well as ensuring that litigation ultimately funded by the bankruptcy estate is conducted in a manner that is most likely to maximize the estate's value, or at least not diminish it in a way that disserves interested claimants. In the context of this adversary proceeding, the best way for the bankruptcy court to accomplish this oversight is for it to preside over the litigation until the matter is ready for trial.

There are no obvious offsetting benefits to withdrawing the reference. Aspen filed its motion to withdraw the reference as a matter related to Scott Charmoli's criminal case, over which Judge Adelman presided. Presumably, Aspen hopes that Judge Adelman's familiarity with Charmoli's criminal conviction and the resulting forfeiture award he entered will make him more receptive to Aspen's contention that issue preclusion bars Charmoli from contesting Aspen's basis for rescinding its policies (though all of that may well be irrelevant if Aspen failed to give timely notice of its intent to rescind). Depending on what issues (if any) must ultimately be determined at trial (or on summary judgment), perhaps Judge Adelman's familiarity with the criminal proceedings will aid him in that effort (if the district court assigns the adversary proceeding to him). But, again, there is no obvious benefit to the parties to having Judge Adelman or one of his colleagues oversee discovery and any nondispositive motion practice, nor is the interest of efficient judicial administration clearly served thereby, especially when the bankruptcy court has excess capacity and the proceedings in the main bankruptcy case are expected to afford avenues that maximize the potential for the parties to resolve this proceeding amicably.

Conclusion

At base, Aspen's pitch for immediate withdrawal of the reference depends on the dubious contention that having the district court preside over this proceeding from beginning to end is more efficient than having the bankruptcy court preside over it until trial. While Aspen can insist that the district court conduct the trial, if a trial proves necessary, that is an unlikely outcome. If the case gets past the pleading stage—and the bankruptcy court expects to rule on Aspen's motion to dismiss within 30 days after the submission of the supplemental briefing that has been ordered—the bankruptcy court is well positioned to oversee discovery and any pretrial motion practice commensurate with its statutory charge to constrain the bankruptcy estate's administrative costs. While Aspen favors separating this matter from the many others that bear on the debtors' ability to confirm a plan of reorganization, the better course is to allow the bankruptcy court to oversee this proceeding until it is trial ready, especially since, if the case moves past the pleading stage, one expects that this matter might be resolved in a global settlement of the debtors' disputes, reached in an effort to achieve a confirmable plan of reorganization.

For these reasons, the bankruptcy court recommends that the district court deny Aspen's motion to withdraw the reference without prejudice to Aspen seeking that relief when the matter is ready for trial or, in the alternative, withdraw the reference for the limited purpose of conducting any future trial, leaving the reference in place as to all other pretrial matters, including summary judgment.

March 9, 2023

G. Michael Halfenger
Chief United States Bankruptcy Judge