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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

In re LYLE SCOVILL, Debtor.	Bankruptcy Case No. 88C-04816 Chapter 11
LYLE SCOVILL, Plaintiff, vs. BEAUTY, INC., Defendant.	Civil Proceeding No. 88PC-0929 Dist. Ct. No. 89 Misc. 053 W (Judge Winder) REPORT AND RECOMMENDATION FOR ABSTENTION UNDER 28 U.S.C. § 1334(c) AND BANKRUPTCY RULE 5011(b)

This matter is presently before the court on a Motion for Abstention filed by the defendant, Beauty, Inc., in the above-captioned adversary proceeding. Plaintiff, Lyle Scovill, who is the debtor in the above-captioned case, contends, inter alia, that this proceeding is a core proceeding and that abstention is inappropriate.

A hearing was held on February 10, 1989. John B. Maycock appeared on behalf of the plaintiff, Lyle Scovill. Jeffrey L. Silvestrini and Julie A. Bryan, of Cohne, Rappaport & Segal, appeared on behalf of the defendant, Beauty, Inc. At the conclusion of the hearing, the court ruled that this proceeding is a noncore proceeding. Also, the court advised the parties that the court would make its report and recommendation regarding abstention in accordance with Bankruptcy Rule 5011(b).[1]

The court has reviewed and carefully considered the arguments of counsel and the authorities presented. Now being fully advised, the court respectfully submits the following report and recommendation to the United States District Court for the District of Utah.

REPORT

I. Background

The court believes that a brief recitation of the background and posture of this proceeding and its relation to two state court actions is necessary to examine the circumstances giving rise to Beauty, Inc.'s Motion for Abstention and to determine whether or not abstention from hearing this proceeding is appropriate.

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[1]*Bankruptcy Rule 5011(b) provides in part: "Unless a district judge orders otherwise, a motion for abstention pursuant to 28 USC § 1334(c) shall be heard by the bankruptcy judge, who shall file a report and recommendation for disposition of the motion." Rule 5011 was added to the Bankruptcy Rules by the 1987 amendments, promulgated by the United States Supreme Court and made effective August 1, 1987.*

1. Defendant, Beauty, Inc., is a closely held Utah corporation, incorporated on or about August 13, 1973. At the time of incorporation, the principal shareholders of Beauty, Inc. were Michael M. Andreasen, Nolan Dean Andreasen, and John R. Andreasen (the "Andreasens").

2. On or about March 2, 1981, ownership of Beauty, Inc. was apparently transferred to Carl J. Eaton, II, Aurora Lee Eaton, John P. Eaton, Sr., and Leona Eaton (the "Eatons") through a stock sale and redemption agreement (the "1981 Agreement"). The 1981 Agreement provided, in part, for payment of the purchase price to the Andreasens through the issuance of two promissory notes by the Eatons and Beauty, Inc., respectively.

3. On or about December 13, 1984, the plaintiff, Lyle Scovill, and his wife (the "Scovills") entered into an agreement (the "1984 Agreement") with the Andreasens, the Eatons, and Beauty, Inc., whereby the Scovills allegedly obtained ownership and control of Beauty, Inc.

4. It appears that in conjunction with the execution of the 1984 Agreement, the Eatons and Beauty, Inc. issued new promissory notes (the "Eaton Note" and the "Beauty, Inc. Note," respectively) representing the then outstanding balance of the Eatons' and Beauty, Inc.'s obligation to the Andreasens under the 1981 Agreement.

5. On December 28, 1984, it appears that Beauty, Inc. assumed the Eaton Note.

6. Pursuant to the 1984 Agreement, the Scovills apparently guaranteed payment of the Eaton Note and the Beauty, Inc. Note (the "Scovill Guarantees"). Also, the Andreasens assert a security interest in the Beauty, Inc. stock acquired by the Scovills.

7. On or about September 21, 1987, the Andreasens filed suit against the Scovills in the Third Judicial District Court of Salt Lake County, State of Utah, Civil No. C87-06275 (the "Andreasen Suit"), seeking payment under the Scovill Guarantees and seeking damages as a result of the Scovills' alleged breach of a debt limitation provision in the 1984 Agreement. The Andreasens amended their complaint, adding causes of action to foreclose on their asserted security interest in the Scovills' stock in Beauty, Inc.

8. The Scovills filed an Answer, Counterclaim, and Third-Party Claim against the Andreasens, the Eatons, and Beauty, Inc., asserting various defenses which allege violations of state corporate and securities law and breach of contract and asserting causes of action based on state securities fraud and common law fraud in connection with the 1984 Agreement. One of the Scovills' causes of action alleges that as a result of fraud on the part of the Andreasens, Beauty, Inc., and the Eatons, the Scovills guaranteed various obligations to Sandy State Bank and pledged collateral on those obligations.

9. On or about December 14, 1987, Sandy State Bank filed a complaint against Beauty, Inc. and Lyle Scovill in the Third Judicial District Court of Salt Lake County, State of Utah, Civil No. C87-08094 (the "Sandy State Bank Suit"), seeking to recover monies due and owing on promissory notes allegedly executed by Lyle Scovill individually and on behalf of Beauty, Inc., and to foreclose on collateral apparently pledged by Lyle Scovill on the obligations.

10. In the Sandy State Bank Suit, Lyle Scovill filed an Answer, Crossclaim, and Third-Party Claim against Beauty, Inc., alleging that Beauty, Inc. was principally liable on the notes and asserting that Beauty, Inc.'s failure to pay the notes was in bad faith, justifying both compensatory and punitive damages against Beauty, Inc.

11. Beauty, Inc. filed an Answer and Crossclaim against Lyle Scovill, alleging causes of action of, inter alia, breach of fiduciary duty, malfeasance, mismanagement, conversion, and misappropriation of corporate funds. Lyle Scovill filed an Answer to Beauty, Inc.'s Crossclaim and counterclaimed against Beauty, Inc. and the Andreasens. Lyle Scovill's counterclaims include claims of, inter alia, state securities fraud and common law fraud in connection with the 1984 Agreement and fraud resulting in Lyle Scovill's guaranteeing various obligations to Sandy State Bank. Also included in the counterclaims are eight causes of action against Beauty, Inc. for recovery upon certain demand notes. These eight causes of action are essentially identical to the causes of action asserted by Lyle Scovill in this adversary proceeding.

12. On or about May 13, 1988, the Scovills filed a Motion to Consolidate the Andreasen Suit and the Sandy State Bank Suit.

13. In the Sandy State Bank Suit, the state court has heard and granted Sandy State Bank's Motion for Summary Judgment against Beauty, Inc. and Lyle Scovill.

14. On August 18, 1988, Lyle Scovill filed a voluntary petition under Chapter 11 of the Bankruptcy Code.

15. On December 2, 1988, Lyle Scovill, as debtor in possession, filed the complaint in this proceeding against Beauty, Inc. The complaint is styled "Turnover of Property to the Estate" and is assertedly brought under 11 U.S.C. § 542(b). The complaint seeks payment of certain demand notes allegedly payable to the Scovills. The notes are apparently executed by Lyle Scovill as president and allegedly on behalf of Beauty, Inc. As mentioned, the causes of action in this proceeding are essentially identical to Lyle Scovill's counterclaims against Beauty, Inc. in the Sandy State Bank Suit.

16. On January 6, 1989, Beauty, Inc. filed an Answer and Counterclaim in this proceeding. Beauty, Inc.'s affirmative defenses and counterclaims are essentially identical to those raised and asserted by Beauty, Inc. against the Scovills in both the Andreasen Suit and the Sandy State Bank Suit. Also, Beauty, Inc. has alleged as an

affirmative defense that mandatory abstention precludes this proceeding from going forward in this court.

17. On January 20, 1989, Beauty, Inc. filed its Motion for Abstention, which is the subject of this report and recommendation. (The court notes that the Andreasens have filed a Motion to Intervene in this proceeding and have joined in Beauty, Inc.'s Motion for Abstention.)

II. Discussion

A. Mandatory Abstention

Mandatory abstention of civil proceedings in bankruptcy cases is governed by 28 U.S.C. § 1334(c)(2), which provides in part:

> (2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction. Any decision to abstain made under this subsection is not reviewable by appeal or otherwise.

Determinative of whether or not abstention is mandatory is the appropriate characterization of this proceeding. If this is a proceeding based on state law claims or causes of action and is "related to" the above-captioned bankruptcy case of the

debtor Lyle Scovill, but not "arising under" title 11 or "arising in" the case, the court believes that abstention is mandatory.

Plaintiff contends that because Beauty, Inc. owes debts that are property of the debtor's estate and are payable on demand, this is a proceeding under 11 U.S.C. § 542(b) which involves an order to turn over property of the estate and arises under title 11 or in the debtor's bankruptcy case. Section 542(b) provides in part:

> [A]n entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

Although section 542 deals generally with turnover of property of the estate, and 28 U.S.C. § 157(b)(2)(E) provides that core proceedings include "orders to turn over property of the estate," this proceeding is nothing more than an action to collect on debts evidenced by promissory notes which are allegedly due and owing to the debtor. A traditional common law lawsuit brought under the guise of a turnover proceeding is not a core proceeding.

The Tenth Circuit has described noncore or related proceedings as "those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a district court or state court." National Acceptance Co. v. Price (In re Colorado Energy Supply, Inc.), 728 F.2d 1283, 1286 (10th Cir. 1984) (quoting definition of "related proceedings" in Interim Operating Rules); accord In re Terracor, 86 B.R. 671, 676

(D. Utah 1988). The present proceeding is based on traditional state law claims, is not a matter unique to the debtor's bankruptcy case, and could have been brought in state court had the debtor not filed bankruptcy. Indeed, two related actions were pending in state court when the debtor filed bankruptcy; and the claims asserted by the debtor in this proceeding are essentially identical to claims asserted by him in the state actions.

Although the debtor has styled this proceeding as one seeking to turn over property of the estate under section 542(b), "[t]he categorization of 'orders to turn over property of the estate' as core proceedings [under 28 U.S.C. § 157(b)(E)] has misled some courts into expanding bankruptcy court jurisdiction beyond that permissible under [Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982)]." 1 Collier on Bankruptcy, ¶ 3.01[2][b][iii] at 3-41 (15th ed. 1988) [hereinafter Collier's].

> The problem with these cases is that, under their rationale, every action brought by a trustee or debtor in possession to recover money or property could conceivably be characterized as a turnover proceeding, effectively eradicating Marathon. . . . [A] cause of action owned by the debtor at the time the title 11 case [is] filed . . . , by definition, is a "related matter" not within the meaning of core proceedings.

Id.

"[D]etermination of whether a proceeding is core can best be made in terms of the principles underlying the [Marathon] decision." Maislin Industries, U.S., Inc. v. C J Van Houten E Zoon Inc. (In re Maislin Industries, U.S., Inc.), 50 B.R. 943, 948-49

(Bankr. E.D. Mich. 1985). The Supreme Court observed in Marathon: "[T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights . . . . The former may well be a 'public right,' but the latter obviously is not." Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 71 (1982); accord American Community Services, Inc. (In re American Community Services Inc.), 86 B.R. 681, 684 (D. Utah 1988); Maislin Industries, 50 B.R. at 949. "[A] matter of public rights must at a minimum arise 'between the government and others,' " Marathon, 458 U.S. at 69, but a matter of private rights deals with "the liability of one individual to another under the law as defined." Marathon, 458 U.S. at 69-70, 71-72.

In Craig v. Air Brake Controls, Inc. (In re Crabtree), 55 B.R. 130, 132 (Bankr. E.D. Tenn. 1985), a bankruptcy court determined that a suit to enforce a promissory note is a matter of private rights not involving congressionally created statutory rights, is immaterially distinguishable from Marathon, and is thus not constitutionally a core proceeding. Likewise, the present action involves "a right created by state law, a right independent of and antecedent to the reorganization petition that conferred jurisdiction upon [this court]," Marathon, 458 U.S. at 84, and precisely the type of state-created right, adjudication of which the Supreme Court in Marathon held to be beyond Congress' power to assign to the bankruptcy courts. This type of action is not within the scope of a core turnover proceeding contemplated by 28 U.S.C. § 157(b)(2)(E).

And neither section 542(b) nor 28 U.S.C. § 157(b)(2)(E) can be interpreted or construed so broadly as to extend beyond the outer boundaries of Marathon.[2] Cf. American Community Services, 86 B.R. at 686 ("Marathon decision defines the outer boundary of the referred jurisdiction of the bankruptcy courts"). Indeed, the court believes that when these statutory provisions are properly construed in view of the constitutional restraints set forth in Marathon, it becomes clear that this garden-variety notes receivable action, which is based entirely on state law, is not a core bankruptcy function or matter and cannot be classified as a core proceeding.

In American Community Services, 86 B.R. at 684 n.5, the United States District Court for the District of Utah noted that noncore or related proceedings include "causes of action owned by the debtor which become property of the estate pursuant to 11 U.S.C. § 541." It is clear that the debtor Lyle Scovill, having asserted essentially identical causes of action in state court prior to filing bankruptcy, owned the causes of action asserted in this proceeding on the petition date. The district court also mentioned: "[A] suit on a prepetition contract or account receivable is not a matter at the core of the bankruptcy power." Id. (citing Rushton v. Traub (In re Nell), 71 B.R.

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[2]*In addition to 28 U.S.C. § 157(b)(2)(E), the court believes that neither 28 U.S.C. § 157(b)(2)(A) (core proceedings include matters concerning the administration of the estate) nor 28 U.S.C. § 157(b)(2)(O) (core proceedings include other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship) can be employed as jurisdictional bases for this action. Such a broad interpretation is prohibited by Marathon. If these jurisdictional provisions are not read narrowly as required by Marathon, it is difficult to imagine what sort of proceedings would not be core.*

305, 308 (D. Utah 1987)); accord George Woloch Co. v. Longview Capital Plastic Pipe, Inc. (In re George Woloch Co.), 49 B.R. 68 (E.D. Pa. 1985) (adversary proceeding to collect an account receivable is a "related" rather than a "core" proceeding). In Nell the district court had observed: "Several bankruptcy courts have also correctly held that a suit by a debtor to collect prepetition accounts receivable is a non-core proceeding. Other bankruptcy courts have erroneously held that actions by debtors to collect prepetition accounts receivable are core proceedings." Nell, 71 B.R. at 308 n.3 (citations omitted).

In Atlas Automation, Inc. v. Jensen, Inc. (In re Atlas Automation, Inc.), 42 B.R. 246 (Bankr. E.D. Mich. 1984), an action commenced by a debtor for a money judgment on an account receivable, the bankruptcy court determined that the action was not a core proceeding, stating:

> Although money due to a Chapter 11 debtor can certainly be described as "property of the estate" for which the plaintiff is requesting a "turn over" order, and although this is a "proceeding affecting the liquidation of the assets of the estate" in that it is indeed an action to liquidate what at least the debtor perceives to be an asset, to wit: an account receivable, the Court cannot ignore the legislative intent behind the recent [enactment] of the Bankruptcy Amendments and Federal Judgeship Act of 1984, P.L. 98-353. . . . [I]t is doubtful that Congress intended this type of case to be tried by a bankruptcy court. Thus, although the perimeters of the definition of "turn over property of the estate" and "proceeding affecting the liquidation of the assets of the estate" are yet to be explored, they do not include actions of this type.

Id. at 247. This action is similar in analysis to an action to collect matured prepetition accounts receivable. Such actions are comparable to and encompassed within the rationale of the Marathon-type cause of action, Collier's at 3-47, which this court believes Congress intended to be noncore.

As the foregoing details, this court believes that this proceeding is based on state law claims and causes of action and is "related to" but not "arising under" title 11 or "arising in" the debtor Lyle Scovill's bankruptcy case. In short, this is a noncore proceeding. Further, this court believes that the other requisites of section 1334(c)(2) are clearly satisfied. The defendant, Beauty, Inc., has timely moved for abstention of this proceeding. This proceeding could not have been commenced in federal court absent jurisdiction under section 1334 inasmuch as there is no federal question or diversity jurisdiction. Related actions have been commenced in state court, and this court believes that those actions can be timely adjudicated.

Accordingly, this court believes that abstention is mandatory under 28 U.S.C. § 1334(c)(2).

B. Discretionary Abstention

Even assuming that abstention from hearing this proceeding is not mandatory, the court believes that discretionary abstention is appropriate. 28 U.S.C. § 1334(c)(1) provides for discretionary abstention in appropriate circumstances: "Nothing in [section 1334] prevents a district court in the interest of justice, or in the interest of comity with

State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11." The critical issue of section 1334(c)(1), then, is whether or not abstention of this proceeding would serve the interest of justice or the interest of comity with state courts or respect for state law.

The United States District Court for the District of Utah, adopting a detailed report and recommendation of this court submitted by the Honorable Judith A. Boulden, discussed discretionary abstention in In re Terracor, 86 B.R. 671 (D. Utah 1988). In that case, the court, quoting Citibank, N.A. v. White Motor Corp. (In re White Motor Credit), 761 F.2d 270, 274 (6th Cir. 1985) (citing United Mine Workers v. Gibbs, 383 U.S. 715, 726 (1966)), stated: "The court recognizes 'that federal courts should be hesitant to exercise jurisdiction when "state issues substantially predominate, whether in terms of proof, [of the] scope of [the] issues raised, or of the comprehensiveness of the remedy sought." ' " Terracor, 86 B.R. at 679.

Additionally, the Terracor court referred to a list of factors to be considered in deciding whether or not to abstain under section 1334(c)(1):

> "(1) [T]he effect or lack thereof on the efficient administration of the estate if a [C]ourt recommends abstention, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable state law, (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court, (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case,

> (7) the substance rather than [the] form of [an] asserted "core" proceeding, (8) the feasibility of severing state law claims [from core] bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden of [the court's] docket, (10) the likelihood that the commencement of the proceeding in [the] bankruptcy court involves forum shopping by one of the parties, [(11) the existence of a right to a jury trial,] and (12) the presence in the [proceeding] of nondebtor parties."

Id. (quoting Republic Reader's Service, Inc. v. Magazine Service Bureau, Inc. (In re Republic Reader's Service, Inc.), 81 B.R. 422, 429 (Bankr. S.D. Tex. 1987)). "The list generally provides an example of factors that are unique to the area of bankruptcy that are relevant to [discretionary] abstention." Id.

The court will briefly consider in turn each of the above factors: (1) The court does not believe that abstention will in any way negatively affect the efficient administration of the estate. (2) As the court's discussion on mandatory abstention indicates, state law issues obviously predominate over bankruptcy issues. (3) The court believes that numerous state law issues have been raised in this proceeding and in the related state actions that will require more than a straightforward application of settled principles of state law. (4) A review of the complaint in this proceeding and the claims asserted in the two actions pending in state court when the debtor filed bankruptcy convinces the court that the state court actions are intimately related to this proceeding. (5) There is no jurisdictional basis for this proceeding other than 28 U.S.C. § 1334. (6) The court believes that this proceeding is "related to" the debtor's

bankruptcy case as generally would be actions brought by a debtor to collect a prepetition debt. (7) As detailed above, although the plaintiff has styled this proceeding as one to turn over property, this court is convinced that in substance this is a noncore proceeding.[3] (8) Abstaining from hearing this matter does not result in an infeasible severing of state law claims from core bankruptcy matters. (9) Although the court has not considered the burden of its docket in determining to recommend abstention, the court believes that given its determination that this is a noncore proceeding, the ultimate resolution of this dispute should come more quickly in the state context rather than in the federal forum. Pursuant to 28 U.S.C. § 157(c)(1), this court may only submit proposed findings of fact and conclusions of law to the district court; and the district court must review de novo those matters to which any party objects. The state court, on the other hand, can make a final determination; and the court notes that the state court actions have been proceeding for more than a year. (10) There may be a likelihood that the commencement of this proceeding in the bankruptcy court involves forum shopping by the debtor. The debtor initiated this proceeding, asserting claims against Beauty, Inc. that the debtor had previously asserted in state court. Yet, the debtor has attempted to preclude Beauty, Inc. from asserting essentially identical counterclaims that Beauty, Inc. also asserted in the state actions. The court disagrees

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[3]*The court notes that for purposes of discretionary abstention under 28 U.S.C. § 1334(c)(1), the status of a proceeding as "core" is not fatal.*

with the debtor's contention that this is a simple turnover action and that Beauty, Inc.'s counterclaims should be stricken. (11) Although the parties did not address this factor, the court notes that issues raised in this proceeding are generally triable by jury if that right is not waived. (12) Not only will this proceeding necessarily involve the debtor and Beauty, Inc., it appears that the Andreasens, the Eatons, and Mrs. Scovill may be brought in as nondebtor parties.

Based on a consideration of the foregoing factors, this court is convinced that in the interest of justice and comity with state courts and respect for state law, the causes of action asserted by the plaintiff in this proceeding ought to be decided in the pending state court actions. Additionally, Beauty, Inc. has asserted numerous affirmative defenses and counterclaims which and can better be decided by the state court applying and developing state law. Also, the Andreasens have filed a motion to intervene in this proceeding. The state court can also properly address and decide the Andreasens' claims. Indeed, those claims are already before the state court.

Accordingly, this court believes that discretionary abstention is appropriate pursuant to 28 U.S.C. § 1334(c)(1).

RECOMMENDATION

Based on the foregoing report, this court respectfully recommends to the United States District Court for the District of Utah that the court abstain from hearing this proceeding pursuant to 28 U.S.C. § 1334(c).

RESPECTFULLY SUBMITTED this 14 day of March, 1989.

BY THE COURT:

GLEN E. CLARK, CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT