

UNITED STATES BANKRUPTCY COURT

Eastern District of California

Honorable Ronald H. Sargis
Chief Bankruptcy Judge
Sacramento, California

June 7, 2016 at 1:30 p.m.

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| 1. | <u>16-20734</u> -E-13 EUGENE SPENCER | MOTION FOR ABSTENTION AND/OR |
| | <u>16-2059</u> MAS-1 | MOTION FOR REMAND |
| | SPENCER V. SPENCER, III | 5-6-16 [<u>8</u>] |

Tentative Ruling: The Motion for Abstention and Remand to State Court has been set for hearing on the notice required by Local Bankruptcy Rule 9014-1(f)(1). The failure of the respondent and other parties in interest to file written opposition at least 14 days prior to the hearing as required by Local Bankruptcy Rule 9014-1(f)(1)(ii) is considered to be the equivalent of a statement of nonopposition. *Cf. Ghazali v. Moran*, 46 F.3d 52, 53 (9th Cir. 1995).

Oral argument may be presented by the parties at the scheduled hearing, where the parties shall address the issues identified in this tentative ruling and such other issues as are necessary and appropriate to the court's resolution of the matter.

Below is the court's tentative ruling.

Local Rule 9014-1(f)(1) Motion - Hearing Required.

Correct Notice Provided. The Proof of Service states that the Motion and supporting pleadings were served on Debtor-Defendant on May 6, 2016. By the court's calculation, 30 days' notice was provided. 28 days' notice is required.

The Motion for Abstention and Remand to State Court has been set for hearing on the notice required by Local Bankruptcy Rule 9014-1(f)(1). The failure of the respondent and other parties in interest to file written opposition at least 14 days prior to the hearing as required by Local Bankruptcy Rule 9014-1(f)(1)(ii) is considered to be the equivalent of a statement of nonopposition. *Cf. Ghazali v. Moran*, 46 F.3d 52, 53 (9th Cir. 1995). The defaults of the non-responding parties and other parties in interest are entered.

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| <p>The hearing on the Motion for Abstention and Remand to State Court is continued to 1:30 p.m. on xxxxxxxxxxxx, 2016.</p> |
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Disarie Ranessa Spencer ("Plaintiff") filed the instant Motion for Abstention and Remand to State Court on May 6, 2016. Dckt. 8. The Plaintiff is seeking to have the court abstain from determining the issues in the instant Adversary Proceeding and remand to be tried by the family law division of the Sacramento Superior Court.

Plaintiff asserts that the complaint asserts breach of fiduciary duty based on Eugene Joseph Spencer, III's ("Defendant-Debtor") violations of the California Family Code. The Debtor-Defendant's counterclaim states a claim pursuant to California Family Code and, but for the bankruptcy, there would not be federal court jurisdiction.

In support, the Plaintiff asserts the following:

1. State law issues predominate, all of the issues arising under California Family Code.
2. The bankruptcy court is particularly unfit to deal with matters arising under the Family Code and the specialized California family courts are preferable to bankruptcy court adjudication of unequivocally California family law issues.
3. There was a proceeding about to go to trial in the family court in Sacramento until the instant bankruptcy was filed which stopped the case going to trial.

The Plaintiff asserts that any findings of fact and conclusions of law found in the family court will be considered in the non-dischargeability action with preclusive effect once a final judgment has been entered.

COMPLAINT

The Plaintiff initiated the instant Adversary Proceeding on March 25, 2016. Dckt. 1. The Plaintiff asserts the following:

1. "Pursuant to the California Family Code, at all relevant times, Debtor was a fiduciary of Plaintiff, especially regarding community property. The willful concealment and hiding of community property assets constitutes defalcation of fiduciary duty within the meaning of 11 U.S.C. § 523(a)(4)."
2. "The willful hiding of community property assets and willful failure to disclose them and the complete exhaustion of those community property assets by the Debtor were willful, wanton, and fraudulent and in gross derogation of Debtor's fiduciary duty to Plaintiff."
3. "As a proximate result of the aforementioned defalcation of fiduciary duty, Plaintiff is entitled to judgment in the amount of \$131,524.75 exclusive of interest together with an order/judgment determining that such amount is non-dischargeable within the meaning of 11 U.S.C. § 524(a)(4)."
4. "Plaintiff has incurred and will continue to incur attorneys' fees pursuant to the defalcation of fiduciary duty claim which should be determined to be non-dischargeable within the meaning of 11 U.S.C. § 523(a)(15)."

COUNTERCLAIM

On April 25, 2016, the Defendant-Debtor filed an Answer and Counterclaim. Dckt. 7. In relevant part, the Counterclaim asserts the following:

1. "As part of the divorce order, Spencer was entitled to exclusive use and possession of the family owned real property at 8191 Gandy Dancer Way, Sacramento, CA 95823. In exchange for that entitlement, Spencer owed [Defendant-Debtor] the fiduciary duty to make all payments relating to the mortgage, property taxes, and utilities in such a way that there was no detriment to [Defendant-Debtor's] credit. Spencer failed to make such payments, resulting in defaults being recorded on the mortgage and the home going into foreclosure proceedings numerous times, causing [Defendant-Debtor] damages."
2. "The willful hiding of community assets by Spencer and her failure to make payments associated with the real property were wanton, fraudulent, and in derogation of Spencer's fiduciary duties to [Defendant-Debtor]."
3. "As a proximate result of Spencer's breach of fiduciary duty, [Defendant-Debtor] is entitled to a judgment in the amount of \$120,000.00, exclusive of interest."
4. "[Defendant-Debtor], will need legal representation by counsel for trial in this matter and anticipates incurring legal expenses in excess of \$20,000.00."

Defendant-Debtor has filed his Answer in *pro se*. Dckt. 7.

APPLICABLE LAW

Federal court jurisdiction in bankruptcy cases is established pursuant to 28 U.S.C. § 1334(a), which provides that the United States District Court shall have original and exclusive jurisdiction over all cases under title 11 (the Bankruptcy Code). Congress further provided that the United States District Courts shall have original, but not exclusive, jurisdiction over all civil proceedings arising under title 11 or arising in or related to a case under title 11. 28 U.S.C. § 1334(b). This is a very broad grant of jurisdiction, often needed to address the various matters relating to a bankruptcy case in an expeditious manner to allow for the proper administration of the bankruptcy estate.

Congress then created the bankruptcy courts, which are part of the United States District Courts, 28 U.S.C. § 151, as a specialized court to allow for the sufficient prosecution of bankruptcy and bankruptcy related cases. Each United States District Court is empowered to transfer any and all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 to a bankruptcy judge in that district. The United States District Court for the Eastern District of California has so referred all such matters to the bankruptcy judges. E.D. Cal. Gen. Orders 182, 223.

Bankruptcy judges are empowered to determine all cases under title 11 and enter final judgments and orders in all core proceedings arising under

title 11 or arising in a case under title 11. 28 U.S.C. § 157(b)(1). Core proceedings are generally defined in 28 U.S.C. § 157(b)(2), and by their nature are matters for which Congress has created rights and remedies under the Bankruptcy Code. Bankruptcy jurisdiction extends to four types of title 11 matters: cases "under title 11," cases "arising under title 11," proceedings "arising in a case under title 11," and cases "related to a case under title 11." See *Stoe v. Flaherty*, 436 F.3d 209, 216 (3rd Cir. 2006). A proceeding "arising under title 11" is one that "'invokes a substantive right provided by title 11.'" *Gruntz v. County of Los Angeles (In re Gruntz)*, 202 F.3d 1074, 1081 (9th Cir. 2000) (quoting *Wood v. Wood (In re Wood)*, 825 F.2d 90, 97 (5th Cir. 1987)). A proceeding "arising in a case under title 11" is one that "'by its nature, could arise only in the context of a bankruptcy case.'" *Id.* A proceeding is "related to a case under title 11" if its outcome could conceivably affect the administration of the estate." *Lorence v. Does 1 through 50 (In re Diversified Contract Servs., Inc.)*, 167 B.R. 591, 595 (Bankr. N.D. Cal. 1994) (citing *Fietz v. Great Western Savings (In re Fietz)*, 852 F.2d 455, 457 (9th Cir. 1988)).

Matters other than a case under title 11, or arising under title 11 or in a case under title 11 are referred to as "related to matters." These matters arise under nonbankruptcy law and are only before the bankruptcy judge (rather than general trial courts such as the United States District Court and California Superior Court) because a bankruptcy case has been filed. A bankruptcy judge hearing and deciding a related-to matter raises Constitutional issues as to the exercise of the federal judicial power which resided in the judiciary under Article III of the United States Constitution. See *Stern v. Marshall*, 564 U.S. ___, 131 S. Ct. 2594 (2011), for a discussion of the exercise of federal court powers and the scope of an Article I judge's ability (such as a bankruptcy judge) to enter final judgments and orders on related to matters.

Congress has addressed the Constitutional issue of an Article I judge exercising federal-court power for related to matters in 28 U.S.C. § 157(c)(1) and (2). This provides that for related to matters the bankruptcy judge shall either (1) hear the matter and make proposed findings of fact and conclusion of law to the district court judge, who shall review them *de novo*, or (2) if the parties consent, the bankruptcy judge shall issue the final judgment and orders in the related to matter. See *Executive Benefits Insurance Agency v. Arkison*, ___ U.S. ___, 189 L.Ed. 2d 83, 2014 U.S. LEXIS 3993 (2014), affirming the *de novo* review procedure provided in 28 U.S.C. § 157(c)(1).

Congress has provided in 28 U.S.C. § 1334(c)(2) for the mandatory abstention by federal courts from exercising the broad grant of jurisdiction for matters "related to" bankruptcy cases. Five elements must be met for mandatory abstention to apply: "(a) the motion must have been made on a timely basis, (b) the claim must have been based on state law, (c) the claim cannot be either based on bankruptcy law or have arisen in a bankruptcy case, (d) the claim must have not been capable of being filed in a federal court absent bankruptcy jurisdiction, and (e) the claim must be capable of being timely adjudicated in state court." *Bally Total Fitness Corp. v. Contra Costa Retail Center*, 384 B.R. 566, 570 (Bankr. N.D. Cal. 2008).

Recognizing that the scope of federal-court jurisdiction for bankruptcy cases as granted in 28 U.S.C. § 1334 is very broad, encompassing anything and everything which can even be merely related to the bankruptcy case, Congress

also empowered federal judges to abstain from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11 in the interest of justice, or interest of comity or respect for State law. 28 U.S.C. § 1334(c)(1). This is commonly called discretionary abstention.

As discussed by the Eighth Circuit Court of Appeals, where the related to matter sounds in nonbankruptcy law and bears a limited connection to the debtor's bankruptcy case, abstention is particularly compelling. *In re Titan Energy, Inc.*, 837 F.2d 325, 331 (8th Cir. 1988); see also *In re Tucson Estates, Inc.*, 912 F.2d 1162, 1169 (9th Cir. 1990) (citing *Titan Energy* for the proposition that abstention is appropriate when the issues in the related to matter arise under state law and disposition in another court will not hinder the bankruptcy case). Citing to a Texas bankruptcy case, the Ninth Circuit identified a summary of factors which would be considered in determining whether abstention was appropriate:

(1) the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention;

(2) the extent to which state law issues predominate over bankruptcy issues;

(3) the difficulty or unsettled nature of the applicable 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 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 bankruptcy court's] docket;

(10) the likelihood that the commencement of the proceeding in 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. at 1167.

DISCUSSION

The court begins with the nature of the request - the court "abstain" from conducting this Adversary Proceeding. The doctrine of abstention is one in which the federal court elects not to adjudicate the proceeding, but leave it to the non-federal court to issue the final orders and judgment. The Adversary Proceeding is not merely a "related to matter," but is one arising under the Bankruptcy Code itself - 11 U.S.C. § 523(a)(4), breach of fiduciary duty. The allegations in the Complaint include the following:

- A. "5. This is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2)(I) and (J)."
- B. "11. Pursuant to the California Family Code, at all relevant times, Debtor was a fiduciary of Plaintiff, especially regarding community property. The willful concealment and hiding of community property assets constitutes defalcation of fiduciary duty within the meaning of 11 U.S.C. § 523(a)(4). See also *In re Lam* 364 B.R. 379 (Bankr. N.D. Cal. 2007)."
- C. "13. As a proximate result of the aforementioned defalcation of fiduciary duty, Plaintiff is entitled to a judgment in the amount of \$131,524.75 exclusive of interest together with an order/judgment determining that such amount is non-dischargeable within the meaning of 11 U.S.C. § 523(a)(4)."
- D. "14. Plaintiff has incurred and will continue to incur attorneys' fees pursuant to the defalcation of fiduciary duty claim which should be determined to be non-dischargeable within the meaning of 11 U.S.C. § 523(a)(15)."

Complaint, ¶¶ 5, 11, 13, 14.

There are two distinct issues to consider in the dischargeability analysis: first, the establishment of the debt itself; and, second, a determination as to the nature of that debt, an issue within the exclusive jurisdiction of the bankruptcy court and thus governed by Bankruptcy Rule 4007. *Banks v. Gill Distribution Centers, Inc.*, 263 F.3d 862, 867 (9th Cir. 2001). Clearly, the relief requested is that arising under the Bankruptcy Code, and is a federal law question which is for federal judges to determine and enter the final judgment. That is not a "related to" matter.

Additionally, the Complaint which is the subject of this Adversary Proceeding was filed in this federal court and not in the state court and removed to this federal court. Thus, to the extent that it requests the court "remand" this Adversary Proceeding to the state court, such relief cannot be granted. 28 U.S.C. § 1452 is the statutory basis for removal of state court actions "related to" a bankruptcy case. Such a case may be remanded to the state court in which the action was removed from. 28 U.S.C. § 1447(d).

**Abstention from Determining State Law Issues
And Staying This Adversary Proceeding Pending
Final State Court Judgement**

While this is not a "related to" proceeding, Plaintiff is correct that determination of the underlying rights and obligations of Plaintiff and Defendant-Debtor arising under California Family Law. While federal judges

commonly determine state law issues and matters in contested matters and adversary proceedings, due deference is given to state court determining such issues when they may be expeditiously litigated in the state court. This is especially true in connection with family law matters. *Elk Grove Unified School District v. Newdow*, 542 U.S. 1, 12 (2004). "Thus, while rare instances arise in which it is necessary to answer a substantial federal question that transcends or exists apart from the family law issue, see, e.g., *Palmore v. Sidoti*, 466 U.S. 429, 432-434, 80 L. Ed. 2d 421, 104 S. Ct. 1879 (1984), in general it is appropriate for the federal courts to leave delicate issues of domestic relations to the state courts." *Id.* at 13.

It is alleged that the present bankruptcy case was filed by Defendant-Debtor on the eve of the state court determining the respective rights and obligations of these two parties as former spouses under California Family Law. While it is not shocking that a debtor would have filed a bankruptcy case on the eve of a trial, foreclose, a state court receiving taking possession of debtor's business, or the like, the court properly considers the nature of the non-bankruptcy court proceeding and how it meshes or unduly conflicts with the bankruptcy process.

Debtor's bankruptcy case was filed on February 10, 2016. To date, three proofs of claims have been filed. Plaintiff's proof of claim is in the amount of \$45,822.81 and comprises 98.5% of all claims filed in this case. Official Registry of Claims, Case No. 16-20734. The claims bar date for non-governmental claims is June 22, 2016, and for governmental claims is August 8, 2016. 16-20734; Notice of Bankruptcy, Dckt. 19.

In reviewing the Complaint and Counter-complaint, it is clear that while the determinations to be made in the Adversary Proceeding would have direct effect of the dischargeability of the Plaintiff's claim, the underlying issue resonates in California Family Law. The counter-claim filed by Defendant-Debtor. While not specified, it appears that the following state law matters may, and should in the context of this Adversary Proceeding and Defendant-Debtor's bankruptcy case, be allowed to be determined in the state court - so long as they can be promptly and timely determined so as not to unduly impair Defendant-Debtors' ability and right to an effective prosecution of his underlying bankruptcy case.

| State Law Claims Stated In Nondischargeability Complaint 11 U.S.C. § 523 | State Law Claims Stated in Counter-Claim (Property of Estate - 11 U.S.C. § 541(a)) |
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| "8. Subsequent to the completion of the divorce, Plaintiff learned that Debtor had wrongfully concealed substantial community property assets in the form of willfully undisclosed pension monies, refinance proceeds, and other property. The value of these willfully concealed and/or hidden community property assets is over \$100,000.00." | "40. The parties continued to live together in the community-owned residence for at least one (1) year following service of the summons and complaint for dissolution." |

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| <p>"9. A trial was set in the Family Law Action for February 2016 on a claim for breach of fiduciary duty to disclose assets as well as attorneys' fees incurred by Plaintiff."</p> | <p>"41. After Spencer complained that Spencer III did not disclose assets in the divorce proceeding, Spencer III discovered that other assets belonging to the community, that were in the exclusive control of Spencer, were not disclosed or shared by her."</p> |
| <p>"10. Less than 24 hours prior to the time that the trial in the Family Law Action was to begin, Debtor filed his bankruptcy petition herein."</p> | <p>"42. Specifically, Spencer purposefully willfully failed to disclose bank accounts and retirement accounts that belonged to the community, breaching the fiduciary duty Spencer owed to Spencer III within the meaning of California Family Code § 1101."</p> |
| <p>"11. Pursuant to the California Family Code, at all relevant times, Debtor was a fiduciary of Plaintiff, especially regarding community property."</p> | <p>"43. Spencer III estimates the value of the undisclosed assets to be in excess of \$90,000."</p> |
| <p>"12. The willful hiding of community property assets and willful failure to disclose them and the complete exhaustion of those community property assets by the Debtor were willful, wanton, and fraudulent and in gross derogation of Debtor's fiduciary duty to Plaintiff."</p> | <p>"44. At all relevant times, Spencer was a fiduciary of Spencer III regarding the community property."</p> |
| <p>"13. As a proximate result of the aforementioned defalcation of fiduciary duty, Plaintiff is entitled to a judgment in the amount of \$131,524.75 exclusive of interest...."</p> | <p>"45. As part of the divorce order, Spencer was entitled to exclusive use and possession of the family owned real property at 8191 Gandy Dancer Way, Sacramento, CA 95823. In exchange for that entitlement, Spencer owed Spencer III the fiduciary duty to make all payments relating to the mortgage, property taxes, and utilities in such a way that there was no detriment to Spencer III's credit. Spencer failed to make such payments, resulting in defaults being recorded on the mortgage and the home going into foreclosure proceedings numerous times, causing Spencer III damages."</p> |

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| | "46. The willful hiding of community assets by Spencer and her failure to make payments associated with the real property were wanton, fraudulent, and in derogation of Spencer's fiduciary duties to Spencer III." |
| | "47. As a proximate result of Spencer's breach of fiduciary duty, Spencer III is entitled to a judgment in the amount of \$120,000.00, exclusive of interest." |

Complaint, Dckt. 1; Counter-Claim, Dckt. 7.

Thus, it is proper for this court to: (1) "abstain" from determining the state law duties, rights, and obligations as "fiduciaries" and the damages, if any, owed by Defendant-Debtor to Plaintiff (Plaintiff's claim) and owed by Plaintiff to Defendant-Debtor (property of the estate). However, what is to be litigated in State court must be clearly identified and identified to an existing complaint. Further, the automatic stay must be modified to allow the state court judge to conduct the necessary proceedings and enter final orders and judgment.

Once the final state court judgment is entered, and all of the required findings of fact and conclusions of law are made, this federal court will then conduct this Adversary Proceeding, applying the doctrine of collateral estoppel, and determine all issues necessary to make the determination of what claims, if any, are nondischargeable.

The court continues the hearing for further pleadings and proceedings in which the court is provided with information that:

- A. Clearly identifies the state court proceedings in which the state law issues determining the fiduciary duties and obligations arising under California Family Law of the Plaintiff and Defendant-Debtor;
- B. How the state court will timely allow for the presentation of the counterclaims of Defendant-Debtor;
- C. How the state court will timely adjudicate these claims and counterclaims; and
- D. Such other matters as necessary and appropriate to properly provide for the exercise of the state court judicial power for the state law issues.

The court does not modify the stay for the State Court to take any action with respect to property of the bankruptcy estate, enforce any obligations against the Defendant-Debtor or the bankruptcy estate, offset any obligations of the Debtor-Defendant to Plaintiff against property of the bankruptcy estate, or alter, diminish, reduce, or allocate to Plaintiff any property of the bankruptcy estate.

The court continues the hearing to allow the Parties to provide the court with the necessary information and sets the following schedule for filing additional pleadings:

- A. Plaintiff files and serves supplemental pleadings on or before **xxxxxxx, 2016.**
- B. Defendant-Debtor files and serves supplemental pleadings on or before **xxxxxxx, 2016**
- C. Plaintiff files and serves replies, if any, on or before **xxxxxxx, 2016.**

The court shall issue a minute order substantially in the following form holding that:

Findings of Fact and Conclusions of Law are stated in the Civil Minutes for the hearing.

The Motion for Abstention and Remand to State Court having been presented to the court, and upon review of the pleadings, evidence, arguments of counsel, and good cause appearing,

IT IS ORDERED that the hearing on the Motion for Abstention and Remand to State Court is continued to **1:30 p.m. on xxxxxxxx, 2016.**

IT IS FURTHER ORDERED that Plaintiff and Defendant-Debtor shall file and serve supplemental pleadings addressing the state law issues, claims, counterclaims, timely proceedings, and other matters deemed proper and necessary for this court to modify the automatic stay to allow the state court to determine the California Family Law duties, obligations, and rights of the Plaintiff and Defendant-Debtor to the other arising from their marital fiduciary duty obligations and the pending state court action in which Plaintiff has asserted such state law claims. The Parties shall file the supplemental pleadings on the following scheduled:

- A. Plaintiff files and serves supplemental pleadings on or before **xxxxxxx, 2016.**
- B. Defendant-Debtor files and serves supplemental pleadings on or before **xxxxxxx, 2016**
- C. Plaintiff files and serves replies, if any, on or before **xxxxxxx, 2016.**