FILED
U.S. Bankruptcy Appellate Panel
of the Tenth Circuit
June 22, 2004
Barbara A. Schermerhorn
Clerk

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

IN RE PII, INC., a Nevada/Kansas corporation, also known as Purification Industries International, Debtor.	BAP No. KS-03-068 BAP No. KS-03-072
CHRISTOPHER J. REDMOND, Trustee, Plaintiff – Appellant – Cross-Appellee, v. DIVERSIFIED TECHNOLOGIES, INC., Defendant – Appellee – Cross-Appellant.	Bankr. No. 97-20560-7 Adv. No. 99-6014 Chapter 7 ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the District of Kansas

Before CLARK, CORNISH, and McNIFF, Bankruptcy Judges.

McNIFF, Bankruptcy Judge.

Christopher J. Redmond, the Chapter 7 Trustee (Trustee) for the bankruptcy estate of PII, Inc., appeals two orders of the United States Bankruptcy Court for the District of Kansas, the Judgment and Memorandum Opinion and Order (Opinion and Order) entered June 23, 2003, and the Order Denying Trustee's

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP L.R. 8018-6(a).

Motion to Modify Judgment (Order Denying Motion) entered on August 25, 2003. The Trustee argues the bankruptcy court erred when it abstained from deciding a wrongful garnishment issue based on jurisdictional grounds; when it refused to decide the Trustee's 11 U.S.C. § 547 claim against the Appellee, Diversified Technologies, Inc. (Diversified); and when it prematurely concluded the litigation. Diversified cross appeals, claiming the bankruptcy court should have made a final decision on the § 547 claim in Diversified's favor. We affirm the bankruptcy court's decision to allow a state court to determine the wrongful garnishment issues and reverse and remand the bankruptcy court's seemingly inconsistent ruling to conclude its adversary proceeding prior to completion of that state court litigation.

Jurisdiction and Standard of Review

The Bankruptcy Appellate Panel has jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy courts within this circuit. 28 U.S.C. § 158(a)(1), (b)(1), & (c)(1). The parties have not chosen to have this appeal heard by the United States District Court for the District of Kansas; therefore, they are deemed to have consented to jurisdiction of the Bankruptcy Appellate Panel. 28 U.S.C. § 158(c)(1)(A) & (B); Fed R. Bankr. P. 8001(e). Because we construe the bankruptcy court's order deferring to a state court forum as one of abstention under 28 U.S.C. § 1334(c)(1) or (c)(2), the order is an appealable order under the "collateral order" doctrine. *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 712 (1996); *Personette v. Kennedy (In re Midgard Corp.)*, 204 B.R. 764, 768-69 (10th Cir. BAP 1997) (bankruptcy appellate panel not precluded from reviewing a decision to abstain entered pursuant to § 1334(c)).

Standard of Review

Orders of permissive abstention are matters within the sound discretion of the bankruptcy court and are reviewed under the abuse of discretion standard. *Luan Inv. S.E. v. Franklin 145 Corp. (In re Petrie Retail, Inc.)*, 304 F.3d 223, 232

(2nd Cir. 2002); *The Ridge at Hiwan, Ltd. v. Thompson (In re Thompson)*, 231 B.R. 802, 806 (D. Colo. 1999). Under the abuse of discretion standard, the appellate court will not disturb the trial court's decision unless it has a definite and firm conviction that the lower court made a clear error of judgment or exceeded the bounds of permissible choice. *Moothart v. Bell*, 21 F.3d 1499, 1504 (10th Cir. 1994); *Coletti v. Cudd Pressure Control*, 165 F.3d 767, 777 (10th Cir. 1999) (abuse of discretion is "an arbitrary, capricious, whimsical, or manifestly unreasonable [judgment]") (internal quotation omitted).

Factual Background

Prebankruptcy: In 1995, Diversified obtained an Alabama judgment against Purification Industries, Inc. (Purification) and caused a garnishment order (First Garnishment) to issue against Purification from a Kansas court, directed to the First National Bank of Kansas (Bank). However, in the garnishment pleadings, Diversified listed the taxpayer identification number of PII, Inc. In response to the First Garnishment, the Bank suspended $15,388.42 in PII, Inc.'s account. PII, Inc. closed the account and intervened in the garnishment case.

Diversified then filed a second lawsuit against Purification and also PII, Inc. in the District Court of Johnson County, Kansas (Kansas Court), alleging fraudulent conveyances, among other things. On February 19, 1997, Diversified obtained a prejudgment attachment and a second garnishment order (Second Garnishment), also directed to the Bank. In its answer to the Second Garnishment, the Bank stated that it had already suspended all the funds in the PII, Inc. account in response to the First Garnishment, and that PII, Inc. had closed the account. The Kansas Court consolidated the two garnishment actions (Kansas Garnishment Lawsuit).

Bankruptcy Proceedings: On March 10, 1997, within 90 days of the Second Garnishment, PII, Inc. filed its voluntary Chapter 7 petition for relief. On February 19, 1999, just prior to the expiration of the filing deadline imposed by

§ 546(a)(1)(A), the Trustee filed an adversary complaint against Diversified and the Bank. The Trustee pleaded claims for turnover of the funds frozen in response to the First Garnishment; damages resulting from an alleged wrongful garnishment (First Garnishment); and a claim under § 547 to avoid the Second Garnishment as a preferential transfer. By agreement of the parties, the Bank turned the suspended funds from the First Garnishment over to the Trustee, and the bankruptcy court dismissed the Bank from the adversary proceeding.

The adversary proceeding went to trial on the preferential transfer issue only. However, in its June 23, 2003 Opinion and Order, the bankruptcy court found it had no jurisdiction over the wrongful garnishment and damage issues pending in the Kansas Court under the doctrine of *custodia legis*, stated the avoidance claim had no merit, and ultimately ruled that a decision from the Kansas Garnishment Lawsuit was necessary before the avoidance claim could be decided. The court granted relief from the automatic stay to permit the Kansas Garnishment Lawsuit to proceed and denied the Trustee's preference claim without prejudice. The court did not enter a judgment on the merits of the § 547 avoidance claim.

The Trustee filed a Motion to Modify the Memorandum Opinion and Order (Motion to Modify) under Fed. R. Bankr. P. 9023, requesting a stay of the adversary proceeding pending a result from the Kansas Court. The Trustee argued that if the adversary proceeding were dismissed or closed prior to a decision from the Kansas Court, any future preferential transfer claim was time-barred under § 546(a)(1)(A).

The bankruptcy court held a hearing and conceded some inconsistency in its orders. The court opined that the preference action had no merit regardless because either the property was property of PII, Inc., or there was nothing to transfer in response to the Second Garnishment. The bankruptcy court denied the Trustee's motion. Both parties filed timely notices of appeal.

Discussion

The Trustee contends the bankruptcy court should have decided the garnishment issues because it had "related to" jurisdiction over those claims under 28 U.S.C. § 1334(b) as interpreted by the Tenth Circuit Court of Appeals in the case of *Gardner v. United States (In re Gardner)*, 913 F.2d 1515, 1518 (10th Cir. 1990). The majority of this panel disagrees because the bankruptcy court did not abuse its discretion in deferring to the Kansas Court for a resolution of the garnishment issues, whether or not the court had "related to" jurisdiction as the Trustee contends.

Permissive abstention arises under 28 U.S.C. § 1334(c)(1), which provides: "[n]othing in this section prevents a district court in the interest of justice . . . from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11." The Ninth Circuit Court of Appeals summarized the factors to be considered when deciding whether to abstain under § 1334(c)(1) in *Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.)*, 912 F.2d 1162, 1167 (9th Cir. 1990) (citing *Republic Reader's Serv., Inc. v. Magazine Serv. Bureau, Inc. (In re Republic Reader's Serv., Inc.)*, 81 B.R. 422 (Bankr. S.D. Tex. 1987)). The factors relevant here are the presence of a related proceeding commenced in a non-bankruptcy court; the substance of the "core" proceeding pending in the bankruptcy court; the extent to which state law issues predominate; the difficulty or unsettled nature of the applicable state law; the jurisdictional basis for the bankruptcy action; and the feasibility of severing the state law claims from the core bankruptcy matters. *In re Republic Reader's Serv., Inc.,* 81 B.R. at 429.

In this case, the Kansas Garnishment Lawsuit was pending prior to the bankruptcy filing, the garnishment issues are issues of state law within the expertise of the Kansas Court, and resolution of those state law claims may resolve the preferential transfer claim without further proceedings. Because we

find no error in the bankruptcy court's decision to defer to the Kansas Court for resolution of the garnishment proceedings, that portion of the bankruptcy court's ruling will be affirmed.

The Trustee also contends the bankruptcy court should have stayed the adversary proceeding, rather than denying his preferential transfer claim without prejudice. Diversified argues the merits of its position on the preferential transfer claim, concluding the bankruptcy court should be affirmed in its decision to deny the claim. The majority of this Court agrees with the Trustee.

The bankruptcy court stated in the Opinion and Order and at the subsequent hearing that no preferential transfer occurred. At the same time, the court deferred a ruling on the preference claim but refused to stay the adversary proceeding. The ruling, which effectively precludes a decision on the merits of the preferential transfer claim, was an abuse of discretion because the avoidance claim is now time-barred under § 546(a)(1)(A). Therefore, the Order will be reversed to the extent it denies the Trustee's request for a stay of the adversary proceeding.

Conclusion

ACCORDINGLY, the bankruptcy court's decision is AFFIRMED IN PART, REVERSED IN PART, AND REMANDED for entry of an order consistent with this Order and Judgment.

CLARK, Bankruptcy Judge, Concurring in Part and Dissenting in Part.

I concur that the bankruptcy court should be affirmed, but on grounds different than those articulated by the majority. I respectfully dissent from that portion of the majority's Order and Judgment that reverses in part and remands.

The Trustee's complaint against Diversified asserted a cause of action for wrongful garnishment, and a cause of action to avoid the 1997 garnishment pursuant to 11 U.S.C. § 547(b). The bankruptcy court informed the parties at a pretrial conference that it questioned its jurisdiction over the wrongful garnishment cause of action. Indeed, an action was pending in the state court on that very same cause of action, and it had not been removed to the bankruptcy court. The bankruptcy court decided, however, to allow the Trustee's complaint to proceed to trial because the "parties wished to" do so and "agreed" to limit the trial to the § 547(b) action.[1] After a trial expressly limited to the § 547(b) cause of action, the bankruptcy court entered its Memorandum Opinion, in which it states: "The question presented is whether the second garnishment is a transfer under § 547. The answer is no."[2] I agree with this characterization of the issue, and with the bankruptcy court's conclusion and, therefore, I would affirm the bankruptcy court.[3]

The Trustee contends that the bankruptcy court erred because it did not

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[1] Redmond v. Diversified Technologies, Inc. (In re PII, Inc.), 294 B.R. 380, 386 (Bankr. D. Kan. 2003).

[2] Id. at 381.

[3] The Trustee has not provided this Court with an adequate record for review because he did not include the trial record. Typically, when there is not an adequate record, the bankruptcy court's judgment is summarily affirmed. *See, e.g.,* Travelers Indemnity Co. v. Accurate Autobody, Inc., 340 F.3d 1118 (10th Cir. 2003); Gonzales v. United States (In re Silver), 303 B.R. 849 (10th Cir. BAP 2004). This seems particularly important in this case where, because of the lack of record, this Court has no way of knowing whether the Trustee met his burden of proving each element of § 547(b). *See* 11 U.S.C. § 547(g). But, assuming that he proved every element, other than the existence of a "transfer of property of the debtor" under § 547(b), I would affirm because, as discussed above, the bankruptcy court correctly held that § 547(b) does not apply.

decide the propriety of the garnishments in the context of the § 547(b) action.[4] This argument seems incongruous in light of the fact that he expressly agreed not to try the wrongful garnishment cause of action due to the bankruptcy court's jurisdictional concerns. Regardless, I agree with the bankruptcy court's ultimate (although, admittedly, somewhat confused) conclusion that the propriety of the garnishments has no bearing on the existence of a preference. In particular, the bankruptcy court states:

> Although the trustee seems to think so, these issues [i.e., the propriety of the garnishments] are not questions determinable in a bankruptcy preference action. They are questions for the state court to decide in resolving the wrongful garnishment case, over which it clearly has jurisdiction, while this court does not. . . .
>
> The trustee's adversary complaint in this case seeks damages for wrongful garnishment and necessarily asks for a determination of the ownership of the $15,338.42 suspended from the debtor's bank account by the 1996 garnishment. The state court will decide to whom the bank account belonged when the 1996 garnishment was served on the Bank and whether the garnishment lien attached. If the state court decides the garnishment was wrongful, presumably, it will say that the account belonged to PII, Inc., no garnishment lien attached, and the suspended funds belong to PII, Inc. If so, those funds will come into the bankruptcy estate as property of the debtor, mooting the trustee's preference action.
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> If the state court decides the garnishment was not wrongful, it will presumably find merit in Diversified's fraud and collusion argument and rule that the account was properly garnished because it was the property of Purification . . . [and, thus, not property of the debtor to which a preference action applies].[5]

Accordingly, as stated by the bankruptcy court, the propriety of the garnishments

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[4] As recognized by the majority, the Trustee claims that the bankruptcy court erred in "abstaining" from deciding the garnishment issues. Respectfully, I do not believe that this case is at all governed by abstention. Section 1334(c)(1) of title 28 states that bankruptcy courts may abstain from a "proceeding." The bankruptcy court in no way abstained from considering the adversary proceeding before it. The parties agreed to limit the proceeding to a trial on the § 547(b) cause of action, and the bankruptcy court tried that action and entered a decision. It may have confused matters when it dismissed the § 547(b) action "without prejudice"; but, effectively, it rejected the Trustee's § 547(b) cause of action.

[5] PII, Inc., 294 B.R. at 388; *see* Transcript at 5-6, *in* Appellant's Appendix at Tab 10.

has no bearing on the existence of a § 547(b) cause of action. If the garnishments were improper, the property sought to be recovered by this action is property of the estate–no avoidance action is necessary to make it so. If the garnishments were proper, the funds were not property of the debtor to begin with and, therefore, § 547(b) does not apply. In short, the Trustee should seek the relief he desires against Diversified in the pending state court action.

Because the bankruptcy court did not err in rejecting a § 547(b) cause of action, I conclude that it did not err in dismissing the Trustee's complaint or in refusing to stay the adversary proceeding. Although the Trustee correctly states that dismissal of his complaint bars any future avoidance complaint, for the reasons stated above, there are no grounds for such a cause of action that would merit a future action. Thus, I dissent from the portion of the majority's Order and Judgment that reverses the bankruptcy court in part and remands. The only error that the bankruptcy court made was in dismissing the Trustee's complaint "without prejudice" to await a decision by the state court on the propriety of the garnishments. There was no reason to do this because, as the bankruptcy court found, the § 547(b) action had been tried and was without merit. Indeed, it stated as much when it denied the Trustee's motion to amend its order.[6] This error, however, is harmless, because the bankruptcy court's ultimate conclusion–that the Trustee's § 547(b) action was without merit–was correct. I would simply affirm.

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[6] *See* Transcript at 5-6, *in* Appellant's Appendix at Tab 10.