

Remand
Permissive Abstention
28 USC § 1334(c)
28 USC § 1452(b)

Machine Zone v. Peak Web, Adversary No. 16-3083
Peak Web LLC, Case No. 16-32311-pcm11

08/24/2016 PCM

Unpublished


After creditor Machine Zone removed this consolidated action from California state court, debtor moved for permissive abstention or equitable remand.

The court noted that abstention does not apply where a case has been removed from state court to federal court.

The court then considered the factors relevant to remand and determined that equitable remand to state court was warranted. Among other things, factors favoring remand included that all of the claims are state law claims, completion of the litigation is not a prerequisite to debtor's ability to reorganize, debtor wants to litigate in state court, this court could not conduct the jury trial both parties have demanded because the parties do not consent, and the state court is poised to try the case promptly.

Below is an Opinion of the Court.

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PETER C. MCKITTRICK
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)
PEAK WEB LLC,) Bankruptcy Case No.
Debtor.) 16-32311-pcm11
_____)
MACHINE ZONE, INC.,) Adversary No. 16-3083
Plaintiff,) MEMORANDUM OPINION
v.)
PEAK WEB LLC,)
Defendant.)
_____)
PEAK WEB LLC,)
Plaintiff,)
v.)
MACHINE ZONE, INC. and)
EPIC WAR LLC,)
Defendants.)
_____)

1 Debtor Peak Web LLC moves for remand of this consolidated action
2 that was removed from California state court to this court by defendants
3 Machine Zone Inc. and Epic War LLC. For the reasons that follow, the
4 motion will be granted.

5 PROCEDURE

6 Debtor supported its motion for remand with declarations. At an
7 August 4, 2016, hearing on a motion in the main case, Case No. 16-32311,
8 the court discussed with counsel the parties' intention with regard to
9 presenting evidence on this motion for remand. Counsel for Machine Zone
10 indicated that he would either simply file a responsive brief or a brief
11 and declaration. Transcript of August 4, 2016, hearing at 11:16-17,
12 Docket # 219. Debtor's counsel indicated that he would talk to
13 litigation counsel about presentation of evidence. Id. at 11:4-6. The
14 court left it to the parties to decide whether they wanted to present
15 evidence by declarations, and set a deadline for submission of any
16 further declarations. Id. at 12:6-11.

17 After the August 4 hearing, Machine Zone filed an objection to the
18 motion, which it supported with a declaration. Debtor filed a reply and
19 two additional declarations. Machine Zone did not file any objections to
20 the declarations submitted by debtor.

21 The court held a hearing on the motion on August 17, 2016. After
22 counsel for Machine Zone had argued its position for more than an hour
23 and had responded to the argument by debtor's counsel, Machine Zone's
24 counsel for the first time objected to the court's consideration of the
25 declarations filed by debtor, arguing that they were inadmissible hearsay
26 if the declarant was not in court and subject to cross-examination.

1 The court continued the hearing to give Machine Zone an opportunity
2 to cross-examine declarants who were not available for cross-examination
3 at the August 17 hearing, and required Machine Zone to advise debtor and
4 the court by close of business on August 18 which declarants it sought to
5 cross-examine. On August 18, Machine Zone informed the court and debtor
6 that it did not need to cross-examine any of the declarants. Thus, the
7 continued hearing was cancelled. Pursuant to an agreement reached at the
8 hearing, debtor submitted one additional declaration after the hearing
9 that attaches a document Machine Zone wanted in the record. The court
10 has considered the declarations in support of and in opposition to the
11 motion, with the exception of the declaration of Ava Schoen, which debtor
12 withdrew as unnecessary.

13 Counsel for the creditors' committee informed the court at the
14 hearing that it supported trial of the case in whatever forum debtor
15 prefers.

16 FACTS

17 Debtor and Machine Zone were parties to an agreement under which
18 debtor provided network hosting services for a mobile gaming application
19 developed by Machine Zone. In November 2015, Machine Zone filed a
20 complaint against debtor in the Superior Court of California, Santa Clara
21 County. The complaint alleges causes of action for (1) breach of
22 contract; (2) declaratory relief regarding the right to terminate a
23 services agreement; (3) breach of the covenant of good faith and fair
24 dealing; (4) fraudulent inducement and rescission under California state
25 law; (5) negligent misrepresentation; and (6) promissory estoppel.
26 Shortly thereafter, debtor filed a complaint against Machine Zone and its

1 subsidiary Epic War in the same state court, alleging claims for (1)
2 misappropriation of trade secrets; (2) breach of contract; (3) breach of
3 the covenant of good faith and fair dealing; (4) negligent
4 misrepresentation; (5) fraudulent inducement; (6) unfair competition; (7)
5 promissory estoppel; (8) conversion; and (9) declaratory relief regarding
6 the parties' rights, obligations, and duties under their agreements.
7 Both parties demanded a jury trial.

8 The state court consolidated the two actions for all purposes and
9 assigned the case to the complex civil litigation department. This
10 resulted in the assignment of a single judge for all purposes of the
11 case, including discovery and trial, and meant that the trial date would
12 not be postponed due to the priority of criminal trials. An early
13 mediation attempt failed. The state court allowed discovery to proceed,
14 and set a trial date for early March 2017, over Machine Zone's objection.

15 After debtor filed its chapter 11 case, Machine Zone removed the
16 consolidated action to this court. The court understands that, as a
17 result of Machine Zone's removal of the case to federal court, the state
18 court has vacated the March 2017 trial date.

19 Debtor seeks remand of the consolidated action to the Santa Clara
20 County California state court.

21 DISCUSSION

22 Debtor's motion seeks permissive abstention under 28 U.S.C.
23 § 1334(c),¹ or in the alternative equitable remand under 28 U.S.C.

24
25 ¹ Because of this court's earlier ruling that the automatic stay
26 did not apply to Machine Zone's removal of the action from state court,
(continued...)

1 § 1452(b).

2 As the court explained in Security Farms v. Internat'l Brotherhood
3 of Teamsters, 124 F.3d 999, 1009 (9th Cir. 1997), abstention is not
4 applicable where the case has been removed from state to federal court.
5 "Abstention can exist only where there is a parallel proceeding in state
6 court." Id. There is no state court action pending that this court
7 could abstain from hearing. Accord In re Lazar, 237 F.3d 967, 981 (9th
8 Cir. 2001).

9 Equitable remand is governed by 28 U.S.C. § 1452(b), which allows
10 the court to remand "on any equitable ground." This statute provides "an
11 unusually broad grant of authority" to remand on equitable grounds. In
12 re McCarthy, 230 B.R. 414, 417 (9th Cir. BAP 1999). Although courts have
13 stated the test for equitable remand in various ways, the court should
14 generally consider the factors set out in In re Cedar Funding, Inc., 419
15 B.R. 807, 820 (9th Cir. BAP 2009), as well as "judicial economy and 'the
16 effect of bifurcating the claims and parties' and 'the possibilities of
17 inconsistent results.'" Cox v. Holcomb Family Ltd. P'ship, 2015 WL
18 128001 at *1 (Bankr. D. Or. 2015) (quoting In re Sequoia Village, LLC,
19 2012 WL 478926 at *1 (Bankr. D. Or. 2012)). The Cedar Funding factors
20 are:

21 (1) the effect or lack thereof on the efficient administration of
22 the estate if the Court recommends [remand or] abstention; (2) the
23 extent to which state law issues predominate over bankruptcy issues;
24 (3) difficult or unsettled nature of applicable law; (4) presence of
related proceeding commenced in state court or other nonbankruptcy
proceeding; (5) jurisdictional basis, if any, other than § 1334; (6)
degree of relatedness or remoteness of proceeding to main bankruptcy

25 _____
26 ¹(...continued)
debtor no longer asserts that abstention is mandatory.

1 case; (7) the substance rather than the form of an asserted core
2 proceeding; (8) the feasibility of severing state law claims from
3 core bankruptcy matters to allow judgments to be entered in state
4 court with enforcement left to the bankruptcy court; (9) the burden
5 on the bankruptcy court's docket; (10) the likelihood that the
6 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; (12) the presence in the proceeding of nondebtor
parties; (13) comity; and (14) the possibility of prejudice to other
parties in the action.

7 Cedar Funding, 419 B.R. at 820 n.18 (citing In re Enron Corp., 296 B.R.
8 505, 508 n.2 (C.D. Cal. 2003)).

9 (1) The effect or lack thereof on the efficient administration of the
10 estate

11 Machine Zone argues that keeping the litigation in this court would
12 be more efficient for administration of the estate; debtor argues that
13 the bankruptcy case can proceed on two tracks -- reorganization and
14 litigation -- without impacting efficient administration of the estate
15 and that, before removal, the state court was poised to resolve the
16 litigation promptly.

17 I agree with debtor that this case can proceed on parallel tracks,
18 with reorganization proceeding in this court and the Machine Zone
19 litigation proceeding in state court. Debtor represented that, although
20 the claims by and against Machine Zone are important to debtor and its
21 reorganization, reorganization is not dependent on resolution of the
22 claims. The possibilities of a large liability to Machine Zone or a
23 large recovery from Machine Zone will affect the amount that will be
24 available to distribute to creditors, but debtor represents, and there is
25 no evidence to the contrary, that it can confirm a plan without first
26 completing the litigation. Thus, the estate can be efficiently

1 administered without first resolving the Machine Zone litigation.

2 This is not a case where there are bankruptcy issues that need to be
3 resolved before the state law claims can be determined.

4 Machine Zone argues that it would be more efficient to
5 administration of the estate for this court to be able to control both
6 the reorganization effort and the litigation. Oftentimes, when
7 litigation is critical to the reorganization effort and litigation on two
8 fronts will disrupt the reorganization process, bankruptcy court control
9 of related litigation is important. That is not the case here, where the
10 reorganization effort is not, according to debtor, dependent on
11 resolution of the litigation and debtor wants to proceed in the forum
12 both parties initially chose.

13 Before this consolidated litigation was removed to federal court,
14 the state court had assigned the case to the complex civil litigation
15 department, assigned a judge who would handle the case from start to
16 finish, and set an early trial date, which would not be rescheduled based
17 on priority criminal cases. This demonstrates that, had the consolidated
18 cases not been removed, relief from stay could have been obtained
19 promptly and the litigation could have proceeded to a timely resolution.
20 It is likely that, upon remand, the state court will renew its management
21 of the case and set the trial promptly. Therefore, it is likely that the
22 state court can provide prompt, efficient resolution of the litigation.
23 To the extent the litigation is necessary to the reorganization, prompt
24 resolution in state court will further rather than hinder that effort.

25 This court can efficiently move forward toward a confirmation
26 hearing without having the litigation resolved. If issues arise

1 regarding voting rights, estimation of claims, and the like relating to
2 confirmation, there are summary procedures available to resolve those
3 issues without waiting for liquidation of the claims.

4 I conclude that remanding to state court will not have an adverse
5 effect on the efficient administration of the estate. This factor weighs
6 heavily in favor of remand.

7 (2) Extent to which state law issues predominate

8 State law issues not only predominate in this litigation; all claims
9 are based on state law, not federal law. There are no bankruptcy issues
10 that need to be determined before the case can be tried. This weighs in
11 favor of remand to state court.

12 (3) Difficult or unsettled nature of applicable law

13 Debtor argues that, although this court is capable of resolving
14 issues of state law, this case concerns complex legal issues relating to
15 trade secrets or confidential information under California law, which
16 state courts are in a better position to determine. I do not think that
17 the legal issues raised in this litigation are particularly complex or
18 novel.

19 However, the case has the potential to become factually complex,
20 involving disputes about technical trade secrets and confidential
21 information. The complex civil litigation court in Santa Clara County is
22 likely better suited to resolve such complex technical commercial issues
23 than is this court. This factor weighs in favor of remand.

24 (4) Presence of related proceeding commenced in state court

25 There is no related proceeding pending in state court. If this
26 court were to retain the litigation, all claims could be resolved in

1 federal court. This factor weighs against remand.

2 (5) Jurisdictional basis, if any, other than 28 U.S.C. § 1334

3 Debtor argues that there is no basis for federal jurisdiction other
4 than § 1334. Machine Zone argues that there is diversity jurisdiction.

5 There is a factual dispute over whether debtor is a citizen of
6 California for purposes of diversity jurisdiction. If it is, then there
7 is not diversity jurisdiction under 28 U.S.C. § 1332, because Machine
8 Zone is also a citizen of California.

9 I conclude that whether or not there is a basis for diversity
10 jurisdiction is not an important factor in deciding whether to remand in
11 this case. There is no question that this court could retain the
12 litigation in bankruptcy court as related to the bankruptcy case,
13 pursuant to 28 U.S.C. § 1334. There are no federal law claims. This
14 factor is, in my view, neutral.

15 (6) Degree of relatedness or remoteness of proceeding to main bankruptcy
16 case

17 This litigation is not remote to the bankruptcy case; debtor has
18 acknowledged that the outcome of the litigation will affect the amount
19 debtor can pay to creditors. The claims by Machine Zone against debtor
20 are the largest claims against the estate; the claims by debtor against
21 Machine Zone are the largest potential asset of the estate.

22 However, these important claims need not be resolved before the
23 confirmation hearing, and there is no indication that confirmation is
24 dependent on successful prosecution of the litigation. This factor
25 weighs in favor of remand.

26 (7) and (8) The substance rather than form of an asserted core

1 proceeding and the feasibility of severing state law claims from core
2 bankruptcy matters to allow judgments to be entered in state court with
3 enforcement left to the bankruptcy court

4 The parties agree that these claims are not core proceedings,
5 therefore these factors are neutral. See Cox, 2015 WL 128001 at *2
6 (these factors apply only to core proceedings).

7 (9) The burden on the bankruptcy court's docket

8 This litigation would create a burden on the bankruptcy court's
9 docket if it were retained here. Because Machine Zone does not consent
10 to entry of final judgment by the bankruptcy judge, this court would need
11 to conduct all pre-trial matters and then transfer the case to the
12 district court, thereby also burdening that court. The district court
13 would have no prior knowledge of the parties or the case, requiring it to
14 become familiar with the parties and the issues before trial.

15 Further, it is very possible that there will be significant pre-
16 trial matters that will take a significant amount of the trial judge's
17 time, whether matters of discovery disputes, motion practice, or the
18 like. Although this court is certainly capable of resolving such
19 disputes, the bankruptcy court's role is ordinarily focused on issues
20 arising under bankruptcy law and managing the reorganization process, not
21 conducting complex litigation.

22 The trade secrets claims will likely require evidence of details of
23 technology that are outside the types of issues usually handled on this
24 court's calendar.

25 On the other hand, the state court is fully equipped to and capable
26 of adjudicating the claims and has the complex civil litigation
department available to promptly and efficiently try the case. This

1 factor weighs in favor of remand.

2 (10) Forum shopping

3 This case does not involve any suggestion that debtor filed its
4 bankruptcy case in Oregon in order to move California state litigation to
5 this district and court. In fact, debtor wants the litigation to remain
6 in state court.

7 Debtor argues that Machine Zone is forum shopping, in the sense of
8 attempting to avoid remand, so that an important witness in the case,
9 Cisco, will be outside the court's subpoena power. Debtor represents
10 that Cisco is located in northern California and thus is subject to the
11 jurisdiction of the California state court. Obtaining the testimony from
12 Cisco in this court would add complexity and expenses.

13 Machine Zone argues that debtor can simply obtain an out-of-district
14 subpoena and, if Cisco cannot be compelled to appear in this court (or
15 district) to testify, its testimony can be presented by video deposition.

16 I agree with debtor that a video deposition is not the equivalent of
17 live testimony. Debtor asserts that Cisco is a very important witness in
18 the case. Although it is not clear to me that the reason Machine Zone
19 removed this litigation from California state court was to preclude live
20 testimony from Cisco, the prospect of forcing debtor to rely on video
21 deposition testimony is troubling.

22 Nonetheless, I do not see the removal as forum shopping, other than
23 the usual dispute in a removed case over which court is the appropriate
24 forum for trial. This factor is neutral.

25 (11) Right to a jury trial

26 Both parties demanded a jury trial in their complaints and neither

1 denies that there is a right to a jury trial on the claims. Machine Zone
2 does not consent to entry of final judgment by the bankruptcy court.
3 This court cannot conduct a jury trial without consent of the parties and
4 the approval of the district court. See Local Dist. Ct. Rule 2110-8(a).
5 Trial would therefore require the involvement of both this court, in
6 presiding over pre-trial matters, and the district court, which would
7 preside over the jury trial.

8 In contrast, the complex civil litigation department of the state
9 court in Santa Clara County can handle all pre-trial matters as well as a
10 trial by jury, and enter final judgment. The right to a jury trial does
11 not require remand, but it does weigh in favor of remand.

12 (12) Presence in the proceeding of nondebtor parties

13 There are no parties in this action other than debtor and Machine
14 Zone and its subsidiary. There are no nondebtor parties over which this
15 court lacks jurisdiction. Thus, the litigation could be completed in its
16 entirety in this court, with the involvement of the district court. This
17 factor weighs against remand.

18 (13) Comity

19 Comity implicates respect for the states and their laws and courts.

20 The claims in this litigation are all California state law claims,
21 which the California state courts are well-suited to decide.

22 On the other hand, it does not appear that the state court had
23 invested a substantial amount of time and effort in the case. The
24 complaints were filed in November and December 2015. The cases were
25 consolidated and assigned to the complex civil litigation department.
26 Thereafter there were some skirmishes, including the filing of a motion

1 for a temporary restraining order, and the trial court held a case
2 management conference. Discovery had commenced and was proceeding. The
3 case was more than seven months old by the time Machine Zone removed the
4 action to this court, but the parties had not yet filed any responsive
5 pleadings or engaged in any motion practice.

6 Nonetheless, I conclude that, as a matter of comity, the state
7 court's familiarity with the case as well as the fact that there are no
8 federal claims weighs in favor of remand.

9 (14) Possibility of prejudice to other parties in the action

10 Machine Zone does not argue that it will be prejudiced by a remand
11 to state court. In fact, the contract that is the subject of this
12 dispute provides that California state law applies to any disputes and
13 that the parties submit to jurisdiction in the courts of Santa Clara
14 County to resolve disputes regarding the confidentiality provision.²
15 There are no other parties to this action that would be prejudiced by
16 remand. This factor weighs in favor of remand.

17 As for the additional factors from Sequoia Village, judicial economy
18 will be enhanced by allowing this case to proceed in Santa Clara County
19 state court. Litigation of the case in state court is likely to be more
20 efficient than litigating in federal court. On remand, I anticipate that
21 the case will again be assigned to a dedicated judge in the complex civil
22 litigation department, which will manage the litigation and move it

23
24 ² Machine Zone says that jurisdiction in Santa Clara County court
25 is not exclusive, and that it applies only to equitable claims. Whether
26 it is exclusive or applies only to equitable claims, the parties each
filed their complaints in Santa Clara County, which is consistent with
the contract provision.

1 toward an early trial. That court is likely better suited to resolve
2 technical state law claims. Although the parties have at this point lost
3 the March 2017 trial date because of Machine Zone's removal to this
4 court, it is likely that the state court will again set a prompt trial
5 date.

6 Retaining the case in this court will be less efficient, requiring
7 this court's involvement in pre-trial matters and the district court in a
8 jury trial and entry of final judgment. The district court judge would
9 be new to the case and its history, requiring education at the end of the
10 case. This is inefficient.

11 Machine Zone argues that this court already has a substantial
12 background concerning this litigation, including information about debtor
13 and its business, its financing, its principal, and other parties to the
14 case. This court's familiarity with debtor's business and circumstances
15 relates more to bankruptcy issues than to the issues presented in the
16 litigation over breach of contract and trade secrets. If on remand the
17 case is assigned to the same state court judge who handled it before
18 removal, that judge will already have knowledge of the case from his pre-
19 removal management. If it is assigned to a new judge, that judge can be
20 brought up to speed quickly early in the litigation process.

21 Machine Zone argues that retention of this litigation in bankruptcy
22 court would avoid piecemeal litigation and avoid the involvement of two
23 courts in the liquidation of the claims. There is no issue of piecemeal
24 litigation; all of the claims in the consolidated actions are based on
25 state law and can be determined in state court. This is not a situation
26 where some claims will need to remain in bankruptcy court and others will

1 be returned to state court; the consolidated case will stay together
2 whether in federal or state court.

3 Machine Zone's concern that remand will result in the involvement of
4 two different judges for the litigation does not support retaining the
5 case here. There will be two judges involved regardless of where the
6 case is tried -- either the bankruptcy judge (for bankruptcy issues) and
7 the Santa Clara County judge, or the bankruptcy judge (for pre-trial
8 matters) and the district judge. Judicial efficiency will be furthered
9 by having a single judge handle the entire state court litigation.

10 The other Sequoia Village factors, relating to bifurcating claims
11 and the possibility of inconsistent results, are not implicated in this
12 case.

13 CONCLUSION

14 Having taken all of the Cedar Funding factors into account, as well
15 as considering judicial efficiency, I conclude that the consolidated case
16 should be remanded to state court. This is not a close call. Many
17 factors support my conclusion, but most important are that (1) all of the
18 claims are state law claims that can be ably and efficiently adjudicated
19 in state court; (2) debtor represents that completion of this litigation
20 is not a prerequisite to its ability to propose and seek confirmation of
21 a plan of reorganization, so the reorganization can proceed on a parallel
22 track with the litigation; (3) debtor, who sought the protection of the
23 bankruptcy court, wants to proceed in state court to litigate the claims,
24 a choice supported by the unsecured creditors' committee; (4) this court
25 could not conduct a jury trial or enter final judgment in this case
26 without party consent and approval of the district court, so the case

1 would need to be sent to district court for trial; and (5) the state
2 court in Santa Clara County is poised to try this case promptly. The
3 factors weighing against remand or that are neutral are few and are not,
4 in my view, significant enough to outweigh the factors that weigh heavily
5 in favor of remand.

6 ###

7 cc: Timothy J. Conway
8 Douglas R. Pahl
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