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The Enforcement of Arbitration Agreements in Bankruptcy Proceedings

By Michael J. Lichtenstein and Sara A. Michaloski

While federal circuits and bankruptcy courts seem to agree that, in a non-core proceeding, a bankruptcy court does not have discretion to deny enforcement of an arbitration provision, courts are split in their decisions on whether a bankruptcy court can or should deny enforcement of an arbitration provision in a core bankruptcy proceeding. The authors of this article explore the issue.

Many commercial agreements contain arbitration provisions because arbitration is thought to be less costly and less time consuming than litigation. Typically, there is limited discovery and a quicker resolution of any dispute. Moreover, arbitration awards are binding and can be enforced in courts after entry.

The question that bankruptcy courts have grappled with is whether or not arbitration agreements are enforceable in bankruptcy proceedings. There is a tension between the Federal Arbitration Act which favors arbitration agreements and the Bankruptcy Code which is designed to allow bankruptcy courts to resolve parties in interest’s disputes and competing claims.

There is no universal agreement on how to resolve this issue and bankruptcy courts have split in their approaches to the problem.

THE FEDERAL ARBITRATION ACT

The United States Arbitration Act was enacted on February 12, 1925 and is known as the Federal Arbitration Act (“FAA”). The FAA facilitates non-judicial dispute resolution through arbitration. Both state courts and federal courts are bound by the Federal Arbitration Act.

In Southland Corporation v. Keating, the U.S. Supreme Court held that, in
enacting the FAA, Congress “declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.” As a result, the *Southland Corporation* court invalidated a California statute that required the judicial consideration of claims brought under it and held that the FAA applied to contracts under federal and state law. Courts have therefore enforced the FAA in claims brought pursuant to conflicting federal statutes.

Subsequent to the Supreme Court’s discussion of the FAA, federal circuit courts analyzing the relationship of the FAA to the Bankruptcy Code have conceded that they “can no longer subscribe to a hierarchy of congressional concerns that places the bankruptcy law in a position of superiority over the Act.”

Indeed, the U.S. Court of Appeals for the Third Circuit in *Hays & Company* acknowledged the Supreme Court’s “message” for bankruptcy courts is to “enforce such [an arbitration] clause unless that effect would seriously jeopardize the objectives of the Code.”

While the Supreme Court has directed that the FAA “mandates enforcement of agreements to arbitrate statutory claims,” the Supreme Court in *McMahan* held the FAA’s mandate “may be overridden by a contrary congressional command.” The test articulated by the Supreme Court in *McMahan* is: a party opposing enforcement of an arbitration provision must establish a contrary congressional command, or Congress’s intent to create an exception to the FAA’s mandate.

Such intent may be established in one of three ways:

1. the statute’s text;
2. the statute’s legislative history; or

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3 *Id.*
4 *Id.* at 16.
5 See *Rodríguez de Quijas v. Shearson/Am. Exp., Inc.*, 490 U.S. 477, 486 (1989) (enforcing pre-dispute agreement to arbitrate claims under the Securities Act of 1933 and ruling arbitration would not produce substantial inequitable results or undermine substantive rights under the Securities Act); *Shearson/American Express v. McMahon*, 482 U.S. 220, 242 (1987) (enforcing arbitration agreement between broker and customer in customer’s RICO action against broker).
7 *Id.*
8 482 U.S. at 226 (emphasis added).
9 *Id.* at 227 (internal citations omitted).
(3) the existence of an “inherent conflict between arbitration and the statute’s underlying purposes.”

Neither the Bankruptcy Code nor the Bankruptcy Code’s legislative history contain an exception to the FAA. As a result, bankruptcy courts grappling with whether to enforce an arbitration clause in bankruptcy have focused on the third prong of the McMahan test: whether there is an inherent conflict between the Bankruptcy Code and enforcement of arbitration pursuant to the FAA.

The FAA deals with compulsory and binding arbitration based upon a contract provision. The arbitrator or arbitration panel enters an arbitration award rather than a judicial judgment. However, the arbitration award can be confirmed and reduced to a judgment by a court.

Once an award is entered by an arbitrator or arbitration panel, it must be “confirmed” in a court of law; and once confirmed, the award is reduced to an enforceable judgment, which may be enforced by the winning party in court, like any other judgment. Under the FAA, awards must be confirmed within one year; while any objection to an award must be challenged by the losing party within three months. An arbitration agreement may be entered “prospectively” (i.e., in advance of any actual dispute), or may be entered into by the disputing parties once a dispute has arisen.

CORE PROCEEDINGS IN BANKRUPTCY

In bankruptcy, there is a distinction between a core proceeding and a non-core proceeding. A core proceeding involves a claim that invokes substantive rights created by federal bankruptcy law under Chapter 11 or is a claim that could only arise in the context of a bankruptcy case. A non-core proceeding

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10 Id. at 227 (internal citations omitted).
12 9 U.S.C. § 2 (mandating that written agreements to arbitrate “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract”).
13 Id. § 9.
14 Id.
15 Id.
16 28 U.S.C. § 157(2)(a) (“Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district”); § 157(2)(A)-(P) (listing examples of core proceedings); MBNA America Bank, N.A. v. Hill, 436 F.3d 104, 108–09 (2d Cir. 2006)
is a proceeding other than a core proceeding that is otherwise related to a case under title 11.”

As it relates to core proceedings in bankruptcy, the U.S. Code provides that:

(a) Each district court may provide that any or 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 shall be referred to the bankruptcy judges for the district.

(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

(2) Core proceedings include, but are not limited to—

(A) matters concerning the administration of the estate;
(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
(C) counterclaims by the estate against persons filing claims against the estate;
(D) orders in respect to obtaining credit;
(E) orders to turn over property of the estate;
(F) proceedings to determine, avoid, or recover preferences;
(G) motions to terminate, annul, or modify the automatic stay;
(H) proceedings to determine, avoid, or recover fraudulent conveyances;
(I) determinations as to the dischargeability of particular debts;
(J) objections to discharges;
(K) determinations of the validity, extent, or priority of liens;
(L) confirmations of plans;

(“Claims that clearly invoke substantive rights created by federal bankruptcy law necessarily arise under Title 11 and are deemed core proceedings.”).

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.\textsuperscript{18}

The bankruptcy judge determines whether or not a proceeding is a core proceeding.

The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.\textsuperscript{19}

Some courts have rejected the core/non-core distinction as a basis for deciding whether a court has discretion to enforce an arbitration clause.\textsuperscript{20} As a result, all bankruptcy courts faced with an arbitration clause must consider and determine that the \textit{McMahon} test has been satisfied before the bankruptcy court may exercise discretion to refuse to stay proceedings and/or to reject a party's motion to compel arbitration of a statutory claim.

\section*{Is There an Inherent Conflict Between the Bankruptcy Code and the FAA?}

Historically, courts have questioned the applicability of arbitration clauses in


\textsuperscript{19} 28 U.S.C. § 157(b)(3).

\textsuperscript{20} \textit{In re Mintze,} 434 F.3d 222, 229 (3d Cir. 2006) (holding bankruptcy court cannot deny enforcement of an arbitration clause, even in a core proceeding, "\textit{unless} the party opposing arbitration can establish congressional intent, under the \textit{McMahon} standard" that enforcement of the arbitration clause conflicts with an underlying purpose of the Bankruptcy Code) (emphasis in original); \textit{In re James P. Barkman, Inc.}, 170 B.R. 321, 323 n.1 (Bank.E.D. Mich. 1994) ("For purposes of determining whether Congress intended to carve out an exception to § 3 of the Arbitration Act, the core/non-core distinction would seem to be of only indirect significance.").
bankruptcy proceedings.\textsuperscript{21} However, there has been a recent trend towards enforcement of pre-dispute agreements to arbitrate.\textsuperscript{22} Bankruptcy courts will also generally enforce the FAA over conflicting state law provisions.

For instance in \textit{In re Northwestern Corporation v. National Union Fire Insurance Company of Pittsburgh, PA.},\textsuperscript{23} the bankruptcy court held the Montana Arbitration Statute, which “served to prevent arbitration of disputes relating to insurance policies or annuity contracts” was preempted by the FAA and could not prevent the Chapter 11 debtor-corporation from compelling the insurer to submit a non-core dispute to arbitration.\textsuperscript{24} The court ruled that the FAA displaced the “special notice” requirement of the Montana arbitration statute, because courts may not “invalidate arbitration agreements under state laws applicable only to arbitration provisions.”\textsuperscript{25} Congress enacted the FAA to preclude states from “singling out arbitration provisions for suspect status.”\textsuperscript{26}

Ultimately, the court held that bankruptcy courts “\textit{do not have discretion to decline to stay non-core proceedings in favor of arbitration.”}\textsuperscript{27}

Several federal circuit courts have also concluded that a bankruptcy court \textit{must} compel arbitration of a non-core proceeding.\textsuperscript{28}

\begin{itemize}
\item \textsuperscript{21} \textit{In re Tre Scalini, Inc.}, 178 B.R. 237, 239 (Bankr. C.D. Cal. 1995); \textit{Zimmerman v. Continental Airlines}, 712 F.2d 55, 59 (3d Cir. 1983) (ruling because arbitration “cannot be said to occupy a position of similar importance . . . [as] the importance of bankruptcy proceedings in general” the Bankruptcy Reform Act “impliedly” modifies the Arbitration Act and leave the power to stay proceedings within “the sound discretion of the bankruptcy court”). The Third Circuit reversed \textit{Zimmerman} in \textit{Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.}, 885 F.2d 1149 (3d Cir. 1989).
\item \textsuperscript{22} See e.g., \textit{In re No Place Like Home, Inc.}, No. 15-31133-K (Bankr. W.D. Tenn. Oct. 27, 2016) (granting claimants’ motion for relief from stay in home health care provider’s Chapter 11 to permit arbitration of claimants’ FLSA overtime claims, noting that “allowing arbitration would give the appropriate arbitration forum a chance to determine complex claims arising under non-bankruptcy law and efficiently accomplish via indirect the judicial goal set forth in [Federal Rule of Bankruptcy Procedure] 1001”).
\item \textsuperscript{23} 321 B.R. 120, 128 (Bankr. D. Del. 2005).
\item \textsuperscript{24} \textit{Id.}; see also \textit{AT&T Mobility LLC v. Concepcion}, 563 U.S. 333, 341 (2011) (holding that FAA will supersede conflicting state law that prohibits arbitration of particular type of claim, and further holding that FAA preempts California’s judicial rule finding certain class arbitration waiver unconscionable).
\item \textsuperscript{25} 321 B.R. at 124.
\item \textsuperscript{26} \textit{Id.}
\item \textsuperscript{27} \textit{Id.} at 123.
\item \textsuperscript{28} See \textit{In re Gandy}, 299 F.3d 489, 495 (5th Cir. 2002) (ruling a bankruptcy court may decline to stay proceeding for arbitration “whose underlying nature derives exclusively from the
Moreover, bankruptcy courts have acknowledged that “consistent with the
Bankruptcy Code’s mandate to enforce a valid pre-petition, non-executory
contract, the presence of a strong federal policy favoring arbitration, and the
absence of a serious conflict with the objectives of the Bankruptcy Code” an
arbitration provision should be enforced.29

COURTS THAT HAVE ENFORCED ARBITRATION PROVISIONS

Several circuit courts have been guided by the FAA and have enforced
mandatory arbitration provisions.

Second Circuit

In MBNA America Bank, N.A. v. Hill,30 the U.S. Court of Appeals for the
Second Circuit held that the bankruptcy court abused its discretion in denying
a creditor’s motion to stay or dismiss an adversary proceeding in favor of
arbitration.31

In Hill, a Chapter 7 debtor filed an adversary proceeding against a creditor
for willful violation of the automatic stay and a purported class action for unjust
enrichment as the creditor withdrew money from the debtor’s bank account
after she filed for relief under Chapter 7.32 The creditor sought to stay or
dismiss the proceeding to enforce an arbitration clause contained in the debtor’s
credit account agreement.33 The debtor’s § 362(h) claim was a core proceed-

29 In Re Farmland Industries, Inc. 309 B.R. 14, 19 (Bankr. W.D. Mo. 2004); see also In re Taylor,
260 B.R. 548, 564 (Bankr. M.D. Fla. 2000) (enforcing arbitration of claims brought by
Chapter 13 debtors alleging mortgagee’s alleged mishandling of debtors’ payments during prior
bankruptcy proceeding, as per arbitration clause contained in note).
30 436 F.3d 104, 105 (2d Cir. 2006).
31 Id.
32 Id.
33 Id. at 106.
The Hill court analyzed the creditor’s motion to compel arbitration under the McMahon framework. Acknowledging that bankruptcy courts “are more likely to have discretion to refuse to compel arbitration of core bankruptcy matters” the Second Circuit ruled that, even as to core proceedings, the court cannot override an arbitration agreement unless it finds “the proceedings are based on provisions of the Bankruptcy Code that ‘inherently conflict’ with the [FAA] or that arbitration of the claim would “necessarily jeopardize” the objectives of the Bankruptcy Code.”

The Second Circuit identified some objectives of the Bankruptcy Code: the “goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.”

The Second Circuit held that arbitration of the debtor’s claim would not seriously jeopardize the objectives of the Bankruptcy Code because:

1. the debtor’s estate had been fully administered and her debts discharged;
2. the debtor’s claims lacked a direct connection to her own bankruptcy case; and
3. the bankruptcy court is not uniquely able to interpret and decide the debtor’s claims.

In addition, the Hill court distinguished the instant case from situations where “resolution of the arbitrable claims [would] directly implicate[] matters central to the purposes and policies of the Bankruptcy Code, ” for instance by interfering with or affecting distribution of the estate.

**Third Circuit**

The Third Circuit has rejected the core/non-core distinction as a determining factor for whether a court can decline to enforce an arbitration clause. In *Mintze v. American General Financial Services, Inc.* (“In re Mintze”) the Third Circuit held a bankruptcy court lacks authority and discretion to deny

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34 Id. at 108.
35 Id. at 109.
36 Id.
37 Id. at 109.
38 Id. at 110.
39 434 F.3d 222, 231 (3d Cir. 2006).
enforcement of an arbitration provision—in a core or non-core proceeding—unless the party opposing arbitration can establish congressional intent to the contrary.\textsuperscript{40}

In \textit{In re Mintze}, a borrower and lender entered into a loan agreement with a binding arbitration provision.\textsuperscript{41} The borrower filed for relief under Chapter 13 of the Bankruptcy Code and asserted a complaint against the lender based on the Truth in Lending Act and several other federal and state consumer protection laws.\textsuperscript{42}

The bankruptcy court determined that:

1. the debtor’s proceeding was a core proceeding;
2. as a result, the bankruptcy court had discretion to deny enforcement of the arbitration clause; and
3. ultimately, the matter was best resolved in the bankruptcy court system because the claim would affect the debtor’s plan and distribution.\textsuperscript{43}

On appeal, the Third Circuit found the bankruptcy court erred at the outset when it automatically assumed it had discretion to deny the lender’s motion to compel based on the sole fact that the proceeding was core.\textsuperscript{44}

Instead, the Third Circuit reiterated the \textit{McMahon} framework and held the bankruptcy court lacks authority and discretion to deny enforcement of an arbitration clause unless the party opposing arbitration establishes congressional intent to override the FAA’s mandate.\textsuperscript{45} More importantly, the \textit{McMahon} standard requires congressional intent to override arbitration as related to the specific statutory rights at issue.\textsuperscript{46}

Here, the debtor brought claims based on the Truth in Lending Act and other federal and state consumer protection laws. Because the debtor failed to raise statutory claims created by the Bankruptcy Code, the court stated it cannot find “an inherent conflict between arbitration” of the debtor’s claims and

\textsuperscript{40} \textit{Id.}
\textsuperscript{41} \textit{Id.} at 226.
\textsuperscript{42} \textit{Id.}
\textsuperscript{43} \textit{Id.} at 227.
\textsuperscript{44} \textit{Id.} at 222.
\textsuperscript{45} \textit{Id.} at 232.
\textsuperscript{46} \textit{Id.} at 231.
the underlying purposes of the Bankruptcy Code.\footnote{Id.}

**Eleventh Circuit**

*The Whiting-Turner Contracting Company v. Electric Machinery Enterprises, Inc. ("In re Electric Machinery Enterprises")*\footnote{479 F.3d 791, 793–94 (11th Cir. 2007).} involved a Chapter 11 subcontractor’s proceeding to compel a general contractor to turnover monies allegedly due and owing to the subcontractor.\footnote{Id.} The U.S. Court of Appeals for the Eleventh Circuit found the dispute between the parties and a determination as to how much money the general contractor owed the subcontractor was not a core proceeding as it does not involve “a right created by federal bankruptcy law” and it is not a “proceeding that would arise only in bankruptcy.”\footnote{Id. at 798.}

The Eleventh Circuit, therefore, found the bankruptcy court and district court erred in their conclusion that the adversary proceeding was core.\footnote{Id. at 798.} The court further stated “the subcontractor] could have brought its claim against the [general contractor] irrespective of whether [the subcontractor] filed for bankruptcy. [. . . The claim] does not involve the traditional purpose of the bankruptcy court-modifying the rights of creditors who make claims against the bankruptcy debtors’ estate.”\footnote{Id.}

Therefore, the Eleventh Circuit stated that, because the claim is only related to the bankruptcy, it is non-core and it is subject to arbitration.\footnote{Id. at 799.}

More importantly, the Eleventh Circuit found the bankruptcy court and district court—even if the proceeding was a core proceeding—did not assess “whether enforcing the parties' arbitration agreement would inherently conflict with the underlying purposes of the Bankruptcy Code.”\footnote{Id. at 798–99.}

The Eleventh Circuit revered and remanded the case to the district court, with instructions to compel the parties to arbitration with the terms of their arbitration agreement.\footnote{Id. at 799.}
COURTS THAT HAVE REFUSED TO ENFORCE ARBITRATION PROVISIONS

Fourth Circuit

In contrast, other courts have refused to enforce arbitration provisions. For example, in In re White Mountain Mining Company, LLC (“In re White Mountain”) the U.S. Court of Appeals for the Fourth Circuit affirmed the bankruptcy court and district court’s denial of a motion to compel arbitration because the arbitration proceedings would have seriously interfered with the debtor’s efforts to reorganize. In In re White Mountain, a coal mining company owner sold half of his business to a foreign investment trust, and the parties signed sale documents that contained an arbitration clause. After the sale, the owner advanced over $10.6 million of his own money to the coal mining company to meet business expenses. Ultimately, however, the owner filed an involuntary Chapter 11 bankruptcy petition against the company, and initiated an adversary proceeding for the bankruptcy court to find the $10.6 million he gave to the company was a loan instead of a contribution to capital. Pursuant to the sale documents, a third party that had acquired an interest in the company sought to compel arbitration.

The bankruptcy court held that Phillips’ complaint was a core proceeding under 28 U.S.C. § 157(b)(2)(B) as the complaint sought a determination that the debtor owed Phillips money. Additionally, as the issues were critical to the debtor’s ability to formulate a plan of reorganization, the bankruptcy court held that the core proceeding trumped the arbitration.

In affirming the lower courts, the Fourth Circuit ruled that “[a]rbitration is inconsistent with centralized decision-making because permitting an arbitrator to decide a core issue would make debtor-creditor rights contingent upon an

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56 403 F.3d 164, 170 (4th Cir. 2005).
57 Id.
58 Id. at 166.
59 Id. at 166–67.
60 Id. at 167.
61 Id.
62 403 F.3d at 167.
63 Id.
arbitrator’s ruling rather than the ruling of the bankruptcy judge assigned to hear the case.”

The Fourth Circuit held that the arbitration “was inconsistent with the purpose of the bankruptcy laws to centralize disputes about a chapter 11 debtor’s legal obligations so that organization can proceeding efficiently . . . [and in this case would have] substantially interfered with the debtor’s efforts to reorganize.”

In Moses v. CashCall, Inc., the debtor entered into a consumer loan agreement for $1,000 and promised to repay the lender $1,500 with an annual percentage rate of 233.10 percent which “far exceeded the 16% maximum rate allowed by North Carolina law.”

In bankruptcy, the debtor filed an adversary proceeding against the loan company for the bankruptcy court to:

1. declare the loan illegal and void; and
2. to obtain damages against the company for the illegal debt collection activities.

The lender moved to dismiss the adversary proceeding or to stay the proceeding and compel arbitration pursuant to the loan documents.

The Fourth Circuit upheld the district court’s denial of arbitrating on the debtor’s first claim, ruling that the claim was constitutionally a core proceeding and that sending the claim to arbitration would substantially interfere with the debtor’s plans for reorganization.

As for the second claim, however, the debtor’s suit for damages pursuant to the North Carolina Debt Collection Act, the Fourth Circuit found that claim was statutorily core but not constitutionally core and therefore need not “necessarily be resolved in the claims allowance process.”

As a result, the Fourth Circuit held that the district court “erred in declining

64 Id. at 169.
65 Id. at 170.
66 781 F.3d 63 (4th Cir. 2015).
67 Id at 67.
68 Id.
69 Id.
70 Id. at 69.
71 Id. at 70–71.
to send [the Debtor’s] non-core claim to arbitration.”

Ninth Circuit

The U.S. Court of Appeals for the Ninth Circuit’s seminal decision on whether a bankruptcy court has discretion to refuse to enforce an arbitration provision is Continental Insurance Co. v. Thorpe Insulation Co (“In re Thorpe”).

In re Thorpe involved an arbitration provision in a settlement agreement between an asbestos distributor and one of its insurers. After the asbestos distributor filed for bankruptcy, the insurer filed a proof of claim and moved to compel arbitration. The asbestos distributor’s goal was to confirm a plan of reorganization pursuant to Section 524(g) of the Bankruptcy Code, which provides a mechanism for “consolidating asbestos-related assets and liabilities of a debtor into a single trust for the benefit of present and future asbestos claimants.”

The Ninth Circuit considered the decisions of its sister circuits, noting that while the bankruptcy court does not have discretion to deny enforcement of a valid arbitration clause, generally a bankruptcy court does have discretion to deny enforcement in the context of a core proceeding. However, the Ninth Circuit noted that the “core/non-core distinction is not dispositive” and joined the holdings of its sister circuits when ruling “even in a core proceeding, the McMahon standard must be met—that is, a bankruptcy court has discretion to decline to enforce an otherwise applicable arbitration provision only if arbitration would conflict with the underlying purposes of the Bankruptcy Code.” The Ninth Circuit agreed with the bankruptcy court and district court that the insurer’s claim against the asbestos distributor was a core proceeding in the bankruptcy.

The Ninth Circuit agreed that, the insurer’s breach of contract (of the pre-bankruptcy settlement agreement) raised questions that went to the “heart
of Section 524(g) and the management of an asbestos-related bankruptcy court and that should be resolved by a bankruptcy judge and not an arbitrator.80

Finding the McMahon standard met as arbitration of the insurer’s claim would conflict with the purposes and policies of Section 524(g), the Ninth Circuit held that the bankruptcy court had discretion not to enforce the arbitration provision and did not abuse its discretion in denying the insurer’s motion to compel arbitration.81

In In re Wade,82 the U.S. Bankruptcy Court for the Western District of Tennessee found a law firm’s breach of fiduciary duty claim against a Chapter 7 debtor “inextricably intertwined” with the firm’s dischargeability claim that was within exclusive jurisdiction of bankruptcy court, and that as a result, the bankruptcy court had the discretion to enforce arbitration agreement.83

The In re Wade court declined to enforce the arbitration agreement as “avoiding arbitration here would centralize the adjudication of all claims into one forum and concomitantly accomplish the judicial goal set forth in Federal Rule of Bankruptcy Procedure 1001.”84

Washington, D.C.

In In re Bailey,85 Judge Teel considered a motion to dismiss filed by Chapter 7 debtors on the grounds that the claims had to be submitted to arbitration, but Judge Teel never reached the issue because found that the Chapter 7 debtors lacked standing to prosecute claims that were property of the estate.86

In In re BHI International, Inc.87 Judge Teel again considered arbitration in the context of a debtor in possession’s motion to employ special counsel to

80 Id. at 1022.
81 Id. at 1024.
83 523 B.R. at 602.
84 Id. at 613–14; see also Turner v. Frascella Enters. (In re Frascella Enters.), 349 B.R. 421, 430 (Bankr. E.D. Pa. 2006) (invalidating arbitration agreement between consumer borrowers and lender, based on borrowers’ claims that arbitration agreement was procedurally and substantively unconscionable and assertion that arbitral forum would severely diminish borrowers’ rights under consumer protection laws).
86 306 B.R. at 392.
litigate a pending adversary proceeding. The special counsel’s application to be retained included mandatory provisions for arbitration in California of fee dispute and claims of malpractice. The court denied the application as the court found the special counsel’s costs were not a permissible exercise of business judgment.

However, the bankruptcy court stated that the provision for mandatory arbitration of fee disputes and malpractice claims would impermissibly divest it of jurisdiction to address fee disputes and malpractice claims when raised as a defense to a fee application, and in some instances would run afoul of the district court’s exclusive jurisdiction under 28 U.S.C. § 1334(e)(2) to address “all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to disclosure requirements under section 327.”

Judge Teel stated that the provisions for mandatory arbitration of fee dispute and malpractice claims must be stricken to the extent applicable to malpractice claims raised in defense to the special counsel’s claims.

CONCLUSION

While federal circuits and bankruptcy courts seem to agree that, in a non-core proceeding, a bankruptcy court does not have discretion to deny enforcement of an arbitration provision, courts are split in their decisions on whether a bankruptcy court can or should deny enforcement of an arbitration provision in a core bankruptcy proceeding.

As a practical matter, it appears that a bankruptcy court will most often deny enforcement of an arbitration provision when the arbitration proceedings would most seriously interfere with a debtor’s efforts to reorganize.

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88 Id.
89 Id.
90 Id. at 2.
91 In re BHI International, Inc., supra.
92 Id.