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The Enforceability of Arbitration Agreements in Bankruptcy Throughout the United States

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I. Introduction

Bankruptcy courts have historically been opposed to the use of arbitration in settling controversies in which a trustee was involved unless both parties agreed.[1] The distrust of the bankruptcy system stemmed from a string of Supreme Court decisions that refused to compel arbitration.[2] Following the introduction of the Federal Arbitration Act in 1925, there has been a slow move towards embracing arbitration by the bankruptcy courts in non-core matters.[3] However, there has been pushback by the bankruptcy courts in enforcing arbitration clauses in core matters that are fundamental to a bankruptcy case.[4]

In determining whether to enforce an arbitration clause in a bankruptcy case, a court must balance the competing interests of the Federal Arbitration Act and the United States Bankruptcy Code.[5] Title 11 of the United States Code, also known as the United States Bankruptcy Code (the

[1] 10 Collier on Bankruptcy, ¶ 9019.05 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), *available at* LEXIS, 10-9019 Collier on Bankruptcy P 9019.05.
[2] *See generally Wilko v. Swan*, 346 U.S. 427 (1953)
[3] *See* 10 Collier on Bankruptcy, ¶ 9019.05 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), *available at* LEXIS, 10-9019 Collier on Bankruptcy P 9019.05; *see also* 9 U.S.C. §2 *et. seq.*
[4] *See id.*; *see also See Acis Capital Mgmt., GP, LLC v. Highland Capital Mgmt., L.P. (In re Acis Capital Mgmt., L.P.)*, 600 B.R. 541, 560–61 (Bankr. N.D. Tex. 2019).
[5] *See* 9 U.S.C. §1 *et. seq.*; *see also* 28 U.S.C. §157(a)(2)(a).

"Bankruptcy Code"), is the source of bankruptcy law in the United States.[6] This balancing act includes an analysis of whether the statutes are directly in conflict with one another.[7] The first step is to determine whether the dispute is core or non-core.[8] Bankruptcy courts generally deny enforcement of arbitration provisions in core matters, but the procedure for doing so varies by jurisdiction. The courts largely agree that bankruptcy courts do not have discretion to deny enforcement of an arbitration agreement in non-core matters.

II. The Federal Arbitration Act in Bankruptcy

The United States Arbitration Act was enacted on February 12, 1925 and is known as the Federal Arbitration Act (hereinafter, the "FAA").[9] The FAA embodies the federal policy favoring arbitration agreements.[10] Congress understood the potential benefits that the law's enactment would provide, including reduction in the "costliness and delays of litigation."[11] Section 2 of the FAA "limits the grounds for denying enforcement of 'written provision[s] in contract[s]' providing for arbitration."[12]

As neither the Bankruptcy Code nor the Bankruptcy Code's legislative history contain an exception to the FAA, the bankruptcy courts have wrestled with whether to enforce an arbitration clause in bankruptcy proceedings. While the bankruptcy courts have begun to enforce arbitration provisions by stating that trustees are bound to arbitration clauses, there is still some pushback.[13]

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[6] *See* 28 U.S.C. §157(a)(2)(a).
[7] *See id.*
[8] *See* 28 U.S.C. §§157(b)(1), *see also* 28 U.S.C. 1334(b).
[9] *See* 9 U.S.C. §1 *et. seq.*
[10] *See Moses H Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) ("The effect of that section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.").
[11] *See*, *e.g.*, H.R. REP. NO. 96, 68th Cong., 1st Sess., 2 (1924).
[12] *Coventry Health Care of Mo., Inc. v. Nevils*, 137 S. Ct. 1190, 1199 (2017).
[13] *Hays & Co. v. Meryl Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1154 (1989) (Finding that the trustee is bound to arbitrate all of its claims that are derived from the rights of the debtor.).

The main concern, therefore, lies in any conflict between the FAA and the Bankruptcy Code. The concern stems from the test of arbitrability articulated by the Supreme Court in *Shearson/American Express v. McMahon*:

> The burden is on the party opposing arbitration . . . to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue . . . [S]uch an intent will be deducible from [the statute's] text or legislative history, . . . or from an inherent conflict between arbitration and the statute's underlying purposes.[14]

In the bankruptcy context, the courts make a distinction between non-core and core matters.[15]

III. Core Proceedings v. Non-Core Proceedings in Bankruptcy

A. Core Proceedings

Core proceedings are those that arise under the Bankruptcy Code or that arise in a case under the Bankruptcy Code.[16] Bankruptcy judges can hear and determine all cases under title 11 and can enter orders and judgements without the involvement of the district court.[17] Core proceedings include, but are not limited to, motions to terminate, annul, or modify the automatic stay, proceedings to determine, avoid, or recover fraudulent conveyances, determinations as to the dischargeability of particular debts, objections to discharges, determinations of the validity, extent, or priority of liens, and confirmations of plans.[18]

B. Non-core Proceedings

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[14] *Shearson/American Express v. McMahon*, 482 U.S. 220, 226–27 (1987) (internal citations omitted).
[15] 28 U.S.C. §157(a)(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"); *see also Hays & Co. v. Meryl Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1161 (1989). The *Hays* court created the distinction between core and non-core matters in the context of enforcing arbitration.
[16] *See* 28 U.S.C. §§157(b)(1), *see also* 28 U.S.C. 1334(b).
[17] *See* 28 U.S.C. §§157(b)(1).
[18] *See id.*

Non-core matters are those that could exist outside of a bankruptcy case, but still have an effect on the bankruptcy process. Claims pertaining to non-core matters are not creations of federal bankruptcy law, but rather a creation of state law.[19] With respect to non-core matters, a bankruptcy judge may only "submit proposed findings of fact and conclusions of law to the district court."[20] This means that any final judgements are submitted by the district court and not the bankruptcy court.[21]

C. Courts Generally Refrain from Enforcing Arbitration Clauses in Core Matters

Arbitration provisions are far more likely to be enforced in non-core than in core matters.[22] The Supreme Court has spoken on the issue in *AT&T Mobility LLC v. Concepcion*, stating that the test of arbitrability is: whether the risk of error in arbitration is "unacceptable," considering that 9 U.S.C. §10 limits the grounds on which courts can vacate arbitral awards.[23] While this test is very subjective and provides little guidance to the circuit and district courts, there is a circuit split with regards to enforcement of arbitration in core matters fundamental to a bankruptcy proceeding.

The United States Court of Appeals for the First Circuit, in *Prime Healthcare Servs. - Landmark LLC v. United Nurses & Allied Prof'ls, Local 5067,* briefly touched on whether to enforce arbitration clauses in core matters.[24] While the court found that there is no inherent conflict between the FAA and the Bankruptcy Code, it did state that core bankruptcy matters should be resolved in a bankruptcy court and not in arbitration.[25]

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[19] *See* 28 U.S.C. § 157(b)(3).
[20] 28 U.S.C. § 157(c)(1).
[21] *See* 28 U.S.C. §157(c)(2).
[22] *See id.*
[23] *See AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 345 (2011).
[24] *Prime Healthcare Servs. - Landmark LLC v. United Nurses & Allied Prof'ls, Local 5067*, 848 F.3d 41 (1st Cir. 2017).
[25] *See id.* at 49 (distinguishing from *In re United States Lines, Inc.,* 197 F.3d 631 (2d Cir. 1999)).

The United States Court of Appeals for the Second Circuit has evaluated motions to compel arbitration of core matters under the *McMahon* framework.[26] In *MBNA America Bank, N.A. v. Hill*, 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."[27] While the Second Circuit analysis could theoretically allow for a core matter to be decided in arbitration, there has yet to be a case where this has occurred.[28]

Like the Second Circuit, the United States Court of Appeals for the Third Circuit found that the *McMahon* standard needs to be applied when evaluating motions to compel arbitration of core matters.[29] In *In re Mintz*e, the Third Circuit clarified that a core proceeding does not automatically give a bankruptcy court the discretion to deny arbitration.[30] It simply indicates that the *McMahon* standard must still be satisfied before a bankruptcy court has such discretion.[31] The Bankruptcy Court and District Court in *In re Mintze* applied the *McMahon* standard after

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[26] *See Anderson v. Credit One Bank, N.A. (In re Anderson)*, 884 F.3d 382 (2d Cir. 2018) (holding that there was an inherent conflict between arbitration of debtor's claim and the Bankruptcy Code because arbitration of a claim based on an alleged violation of 11 U.S.C.S. § 524(a)(2) would seriously jeopardize a particular core bankruptcy proceeding.); *see also Homahidan v. SLM Corp. (In re Homahidan)*, 587 B.R. 428 (Bankr. E.D.N.Y. 2018) (holding that Court denied creditors' motion to compel Chapter 7 debtor to arbitrate his claims that creditors violated 11 U.S.C.S. § 524 when they demanded that he pay debts he incurred while he was in college that were not student loans and had been discharged.).

[27] *See id.* at 109.

[28] *See Anderson v. Credit One Bank, N.A. (In re Anderson)*, 884 F.3d 382 (2d Cir. 2018) (holding that there was an inherent conflict between arbitration of debtor's claim and the Bankruptcy Code because arbitration of a claim based on an alleged violation of 11 U.S.C.S. § 524(a)(2) would seriously jeopardize a particular core bankruptcy proceeding.); *see also Homaidan v. SLM Corp. (In re Homahidan)*, 587 B.R. 428 (Bankr. E.D.N.Y. 2018) (holding that Court denied creditors' motion to compel Chapter 7 debtor to arbitrate his claims that creditors violated 11 U.S.C.S. § 524 when they demanded that he pay debts he incurred while he was in college that were not student loans and had been discharged.).

[29] *See Mintze v. American Gen. Fin. Servs., Inc.* (*In re Mintze*), 434 F.3d 222, 233 (3d Cir. 2006).

[30] *See id.*

[31] *See id.* at 231 (citing *In re Nat'l Gypsum Co.*, 118 F.3d 1056 (5th Cir. 1997)).

determining that the Bankruptcy Court had the discretion to deny arbitration.[32] Those courts applied *McMahon* to determine whether the "Bankruptcy Court *should* have exercised its discretion, rather than to determine whether it had the discretion to exercise."[33] Recent cases still present a pushback to enforcing arbitration clauses, but the Third Circuit Analysis could theoretically allow for a core matter to be decided in arbitration.[34]

The United States Court of Appeals for the Fourth Circuit took a strong stance against arbitration of core matters in *Moses v. CashCall, Inc* and in *In re White Mining Company LLC*.[35] Similar to the Second Circuit and Third Circuit, the Fourth Circuit applied the *McMahon* test in *Moses v. CashCall*.[36] However, it came to the conclusion that "forcing [a debtor] to arbitrate [their] constitutionally core claim would inherently conflict with the purposes of the Bankruptcy Code."[37] This has been interpreted by the bankruptcy courts in the Fourth Circuit to mean that enforcing arbitration in any core matter inherently conflicts with the purpose of the Bankruptcy Code.[38]

Similarly, the United States Court of Appeals for the Fifth Circuit established in *In re Gandy* that enforcing arbitration in any core matter inherently conflicts with the purpose of the Bankruptcy Code.[39] The court followed the *McMahon* framework when reconciling the FAA and

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[32] *See id.* at 230.
[33] *Id.*
[34] *See Claridge Assocs., LLC v. Schepis (In re Pursuit Capital Mgmt., LLC)*, 595 B.R. 631 (Bankr. D. Del. 2018) (Refusing to order arbitration for core matters); *see also Penson Techs. LLC v. Schonfeld Grp. Holdings LLC (In re Penson Worldwide, Inc.)*, 587 B.R. 6 (Bankr. D. Del. 2018) (holding that the trading company's motion to dismiss the LLC's adversary proceedings for lack of jurisdiction or, in the alternative, to abstain from hearing the LLC's claims in favor of trying the case in a New York court.).
[35] *See Moses v. CashCall, Inc.*, 781 F.3d 63 (4th Cir. 2015); *see also Phillips v. Congelton, L.L.C. (In re White Mt. Mining Co., L.L.C.)*, 403 F.3d 164 (4th Cir. 2005).
[36] *See id.*
[37] *Moses v. CashCall, Inc.*, 781 F.3d 63, 72 (4th Cir. 2015).
[38] *See Taylor v. Allied Title Lending, LLC (In re Taylor)*, 594 B.R. 643 (Bankr. E.D. Va. 2018); *see also Little v. Career Educ. Corp. (In re Little)*, 610 B.R. 558 (Bankr. D.S.C. 2020); *see also Matson v. Rescue Rangers, LLC (In re Rescue Rangers, LLC)*, 582 B.R. 669 (Bankr. E.D. Va. 2018).
[39] *See Gandy v. Gandy* (*In re Gandy*), 299 F.3d 489, 500 (5th Cir. 2002) (affirming the bankruptcy court's refusal to enforce an arbitration clause contained in the partnership agreement because the debtor was seeking avoidance of fraudulent transfers).

the Bankruptcy Code.[40] It concluded that arbitration clauses should not be enforced in core matters because core matters are derived entirely from federal rights conferred by the Bankruptcy Code.[41] In *In re Acis Capital Mgmt., L.P.*, the United States Bankruptcy Court for the Northern District of Texas followed *In re Gandy*, finding that it had discretion under the Fifth Circuit authority to decline to order arbitration because enforcing arbitration would inherently conflict with the purposes of title 11 of the Bankruptcy Code.[42]

Unlike the Fourth Circuit and the Fifth Circuit, the United States Court of Appeals for the Ninth Circuit concluded that that the "core/non-core distinction is not dispositive" and ruled that "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."[43] The Ninth Circuit upheld its rationale in *In re EPD Inv. Co., LLC*.[44] When the motion for arbitration involves core matters, the bankruptcy court has discretion to weigh the competing bankruptcy and arbitration interests at stake.[45] The bankruptcy court properly looked to *Thorpe Insulation* and came to the correct conclusion of denying the appellant's motion for arbitration.[46]

The United States Court of Appeals for the Eleventh Circuit briefly touched on whether to enforce arbitration clauses in core matters in *In re Electric Machinery Enterprises*.[47] The

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[40] *See id.*
[41] *See id.* at 495.
[42] See Acis Capital Mgmt., GP, LLC v. Highland Capital Mgmt., L.P. (*In re* Acis *Capital Mgmt., L.P.*), 600 B.R. 541, 557 (Bankr. N.D. Tex. 2019) ("Thus, the court determines that there were valid arbitration agreements that applied to all disputes arising out of the Sub-Advisory Agreement and Shared Services Agreement"); *see also id.* at 560-61 ("In summary, this court believes it has the discretion under the established Fifth Circuit Authority to decline to order arbitration here.").
[43] *See id.*
[44] *In re EPD Inv. Co., LLC*, 821 F.3d 1146 (9th Cir. 2016).
[45] *See id.*
[46] *See id.*
[47] *See Whiting-Turner Contracting Co. v. Elec. Mach. Enters. (In re Elec. Mach. Enters.)*, 479 F.3d 791 (11th Cir. 2007).

Eleventh Circuit concluded that the lower courts erred in their conclusion that the adversary proceeding was core.[48] Despite this conclusion, the court still stated that even if the proceeding was core, the bankruptcy and district court failed to assess "whether enforcing the parties' arbitration agreement would inherently conflict with the underlying purposes of the Bankruptcy Code.[49] The United States Bankruptcy Court in the Southern District of Florida has followed the Eleventh Circuit's reasoning and used the *McMahon* test to determine if enforcing arbitration in that core proceeding conflicts directly with the Bankruptcy Code.[50]

a. Enforcing arbitration clauses in non-core proceedings.

Arbitration provisions are likely to be enforced in non-core matters.[51] The Second Circuit and Eleventh Circuit have held that arbitration should generally be permitted for non-core proceedings.[52] The Third Circuit and Fifth Circuit followed the Second Circuit's rationale stating that there is not enough of a substantial reason to override federal policy favoring arbitration with respect to derivative, non-core matters.[53] The Ninth Circuit has also followed the rationale of the Second Circuit, finding that there is unlikely to be a conflict sufficient enough to override the presumption in favor of arbitration in non-core matters.[54]

The First Circuit has a more nuanced approach. The United States Bankruptcy Court for the District of Massachusetts and the Massachusetts District Court have repeatedly stated that

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[48] *See id.* at 798.
[49] *In re Elec. Mach. Enters.*, 479 F.3d at 796 (11th Cir. 2007).
[50] *In re Providence Fin. Invs., Inc.*, 593 B.R. 884, 891 (Bankr. S.D. Fla. 2018) ("In determining whether a claim is core or non-core, courts are not bound by a plaintiff's characterization and may look beyond the label asserted in the complaint to ascertain the 'claim's true substance.'").
[51] 10 Collier on Bankruptcy, ¶ 9019.05 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), *available at* LEXIS, 10-9019 Collier on Bankruptcy P 9019.05.
[52] *See id.*; *see also MBNA America Bank, N.A. v. Hill*, 436 F.3d 104 (2006) (stating that bankruptcy courts do not have discretion to prevent arbitration in non-core proceedings); *see also Whiting-Turner Contracting Co. v. Elec. Mach. Enters. (In re Elec. Mach. Enters.)*, 479 F.3d 791 (11th Cir. 2007).
[53] *See Gandy v. Gandy* (*In re Gandy*), 299 F.3d 489, 500 (5th Cir. 2002) (affirming the bankruptcy court's refusal to enforce an arbitration clause contained in the partnership agreement because the debtor was seeking avoidance of fraudulent transfers); *see also Mintze v. American Gen. Fin. Servs., Inc.* (*In re* Mintze), 434 F.3d 222, 231 (3d Cir. 2006).
[54] *Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011 (9th Cir. 2012).

while a presumption of arbitration exists in non-core matters, a bankruptcy court must still analyze whether enforcing a valid arbitration agreement would inherently conflict with the underlying purposes of the Bankruptcy Code.[55]

IV. Conclusion

As neither the Bankruptcy Code nor the Bankruptcy Code's legislative history contain an exception to the FAA, the bankruptcy courts have wrestled with whether to enforce an arbitration clause in bankruptcy proceedings. Bankruptcy courts generally deny enforcement of arbitration provisions in core matters, but the procedure for doing so varies by jurisdiction. On the other hand, 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.

[55] *Goldsmith v. Macri Assoc., Inc. (In re E & G Waterworks, LLC)*, 571 B.R. 500, 506 (Bankr. D. Mass. 2017); *see also Sternklar v. Heritage Auction Galleries, Inc. (In re Rarities Grp., Inc.)*, 434 B.R. 1, 10 (D. Mass. 2010); *see also Jalbert v. Zurich Am. Ins. Co. (In re Payton Constr. Corp.)*, 399 B.R. 352, 362 (Bankr. D. Mass. 2009).