2022

Analysis of Courts' Discretion to Enforce Arbitration of Core Claims

Sarah L. Hautzinger

Follow this and additional works at: https://scholarship.law.stjohns.edu/bankruptcy_research_library

Part of the Bankruptcy Law Commons
Introduction

In general, a bankruptcy court has original and exclusive jurisdiction of chapter 11 bankruptcy cases.\(^1\) However, problems arise when a prepetition contract contains an arbitration clause, and a court must decide if it has discretion to enforce arbitration of a core claim.\(^2\) The statutes that play essential (but competing) roles in a court’s analysis are the Federal Arbitration Act (“FAA”) and the United States Bankruptcy Code (the “Bankruptcy Code”).\(^3\) In sum, “bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach toward dispute resolution.”\(^4\)

In these cases, a bankruptcy court must determine if there are core claims and if it has discretion to enforce arbitration of such claims.\(^5\) Core claims “stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process;” thus, courts have a stronger

---

\(^1\) See 28 U.S.C.A. § 1334.


\(^3\) See Moses v. CashCall, Inc., 781 F.3d 63, 71–72 (4th Cir. 2015).


interest in refusing to enforce arbitration.\textsuperscript{6} However, without any clear guidance from case law or the Bankruptcy Code, courts have split as to whether they have discretion to enforce arbitration of core claims.

This memorandum discusses the applicable considerations in determining whether a core claim must be arbitrated if a prepetition contract contains an arbitration clause. Part I discusses the underlying tension between the FAA and the Bankruptcy Code. Part II explains the key distinctions between core and noncore claims. Part III analyzes the split among bankruptcy courts regarding the discretion a court has (or does not have) to enforce arbitration of a core claim.

**Discussion**

I. A Tension Between the Federal Arbitration Act and the Bankruptcy Code

The Federal Arbitration Act and the Bankruptcy Code are both statutes that are “grounded in important policy considerations concerning efficiency and fairness.”\textsuperscript{7} Despite their similarities, the FAA and the Bankruptcy Code have differing presumptions and goals, and when they diverge, a bankruptcy court must decide which statute will prevail.\textsuperscript{8}

A. The Overarching Presumption of the FAA

The Federal Arbitration Act provides that a written provision in any contract “to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”\textsuperscript{9} Furthermore, the FAA dictates that if a suit is brought concerning any issue involving

---


\textsuperscript{7} In re McPherson, 630 B.R. at 166–67.

\textsuperscript{8} Id. at 167 (discussing the “competing considerations” the bankruptcy court must factor into its decision).

\textsuperscript{9} 9 U.S.C.A. § 2.
an arbitration clause, the trial must be stayed until “such arbitration has been had in accordance with the terms of the agreement.” Practically, the FAA “establishes a liberal federal policy favoring arbitration agreements.” The overarching presumption of the FAA is that “any doubts concerning the scope of arbitrable issues” must be resolved “in favor of arbitration.”

B. The Goals of the Bankruptcy Code

Alternatively, the overarching goal of the Bankruptcy Code is to “balance the rights of many parties with many different contracts, rights, and interests involving a single debtor.” As the Second Circuit has explained, the objectives of the Bankruptcy Code include “the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.”

Ultimately, the Bankruptcy Code seeks to afford debtors the opportunity to a “fresh start in life” without the burden of “the existence of old debts.” Because it provides a debtor-focused, comprehensive approach to the handling of a bankruptcy case, a bankruptcy court must be able to hear and resolve claims as efficiently as possible. Such a centralized forum for claims was important to Congress, which “intended to grant comprehensive jurisdiction to bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected to the bankruptcy case.”

C. The Conflict Between the FAA and the Bankruptcy Code

10 9 U.S.C.A. § 3.
12 Moses, 460 U.S. at 24-25.
13 In re McPherson, 630 B.R. at 167.
14 In re Anderson, 884 F.3d 382, 389 (2d Cir. 2018).
15 In re Bogdanovich, 292 F.3d 104, 107 (2d Cir. 2002).
16 See Moses, 781 F.3d at 71.
Ultimately, when a prepetition contract contains an arbitration clause, a bankruptcy court must decide whether to enforce arbitration or retain authority over core claims. “It is not the right to bankruptcy, to discharge or to any substantive right created in the Bankruptcy Code that would be arbitrated. Instead, the right to have a contract claim decided in the bankruptcy court is at issue.”\textsuperscript{18} Claims that are sent to arbitration can “interfere with the debtor’s chance to complete a fair and efficient . . . reorganization.”\textsuperscript{19} However, a court’s refusal to enforce arbitration appears to run contrary to the presumption that courts must “rigorously enforce agreements to arbitrate.”\textsuperscript{20}

To determine whether the FAA applies, a court applies the \textit{McMahon} framework, in which it first determines whether there is an explicit “contrary congressional command” that another statute was intended to preempt the FAA.\textsuperscript{21} Under this framework, a bankruptcy court must decide whether the claim in a bankruptcy case is core or non-core, as described below.\textsuperscript{22} But in general, a bankruptcy court’s finding of a core claim signals that the court may retain authority over the claim because “the characterization of a claim as constitutionally core is indicative of Congressional intent to limit arbitration.”\textsuperscript{23}

\textsuperscript{18} In re Gurga, 176 B.R. 196, 199 (B.A.P. 9th Cir. 1994).
\textsuperscript{19} Moses, 781 F.3d at 74.
\textsuperscript{21} See McMahon, 482 U.S. at 226 (acknowledging that FAA mandates enforcement of many arbitration agreements).
\textsuperscript{22} See In re McPherson, 630 B.R. at 168 (describing use of McMahon framework as “litmus test” for resolution of FAA/Bankruptcy Code disputes); see also In re Roth, 594 B.R. 672, 675 (Bankr. S.D. In. 2018) (McMahon allows bankruptcy courts to “balance the competing public policies of enforcing arbitration agreements and [the] court’s ability to alter the contractual rights of debtors and creditors”).
\textsuperscript{23} In re McPherson, 630 B.R. at 168; see also In re Taylor, 594 B.R. 643, 651 (Bankr. E.D. Va. 2018) (“Constitutionally core claims strike at the heart of the bankruptcy process Congress has established through the Bankruptcy Code.”); In re Anderson, 553 B.R. 221, 230 (S.D.N.Y 2016), aff’d, 884 F.3d 382 (2d Cir. 2018) (holding that arbitration of core claims would “necessarily jeopardize the objectives of the Bankruptcy Code”).
II. The Distinction Between Core and Non-Core Claims

When a prepetition contract contains an arbitration clause, the forum in which the parties’ claims will be decided hinges entirely on the types of claims that are at issue. There are two types of claims: “core” and “non-core” claims.

A. The Standard for Core Claims

In Section 157 of the Bankruptcy Code, Congress outlined a non-exhaustive list detailing which types of proceedings and claims may be defined as “core.” Core claims include “matters concerning the administration of the estate, determinations as to the dischargeability of particular debts, and objections to a debtor’s discharge, among others.” This section is a “nonexclusive list . . . in which . . . bankruptcy courts could constitutionally enter judgment.” Typically, core claims address “more pressing bankruptcy concerns.” As such, bankruptcy courts are “more likely to have discretion to refuse” enforcement of arbitration of core claims.

B. The Standard for Non-Core Claims

In contrast, non-core claims are presumed to include matters not specifically listed in the Bankruptcy Code. The bankruptcy court’s authority is “significantly limited” as to non-core

---

25 See id.
27 In re Homaidan, 587 B.R. at 436.
29 In re Anderson, 884 F.3d at 388.
30 Id. (finding claim at issue was core because it “went to the heart of the ‘fresh start’ guaranteed to debtors” under Bankruptcy Code).
Non-core claims are “matters that are simply ‘related to’ bankruptcy cases.” Therefore, “the presumption in favor of arbitration usually trumps the lesser interest of bankruptcy courts in adjudicating non-core proceedings[.]” meaning the arbitration of non-core claims is typically not at issue.

III. A Split Among Courts Regarding a Court’s Discretion to Send a Core Claim to Arbitration

When presented with a core claim and an arbitration clause in a prepetition contract, “courts are required to inquire into the nature of the claim and the facts of the specific bankruptcy to determine whether enforcing arbitration would inherently conflict with the purposes of the Bankruptcy Code.” However, bankruptcy courts across the nation have grappled with whether they have discretion to enforce arbitration of core claims.

A. The Predominant View: Courts Have Discretion

A majority of courts have concluded that a bankruptcy court has discretion to enforce (or refuse to enforce) an arbitration clause if a core claim is involved. Although these courts ultimately arrive at the same conclusion about a bankruptcy court’s discretion to enforce the arbitration clause, courts differ in the rationales they use to reach that conclusion. As described below, some courts focus on the parties’ apparent wants, others look to the purposes of the Bankruptcy Code, and still others adopt a policy-minded approach.

32 In re Mintze, 434 F.3d 222, 229 (3d Cir. 2006).
33 MBNA America Bank, N.A., 436 F.3d at 108 (emphasis added).
34 Id.
35 Moses, 781 F.3d at 74.
If the parties to the suit are apparently in favor of arbitration, a bankruptcy court is more likely to find that it has discretion to enforce arbitration of a core claim.\textsuperscript{38} If the “Debtors [are] not opposed to arbitration,” and so long as “the arbitration resolve[s] all matters between the parties,” a bankruptcy court must analyze whether enforcement of an arbitration clause would be permissible.\textsuperscript{39} For example, a Delaware bankruptcy court \textit{should} have engaged in such an analysis because both conditions were met: the parties presented themselves as being in favor of arbitration, and the arbitration would have resolved all matters between the parties.\textsuperscript{40}

Alternatively, a bankruptcy court may find that it has the discretion to enforce arbitration of a core claim so long as the arbitration action would not conflict with the objectives of the Bankruptcy Code.\textsuperscript{41} As discussed above, the Bankruptcy Code’s underlying purposes are to provide the debtor with a centralized forum for resolution of all the debtor’s claims.\textsuperscript{42} In practice, if a court finds that arbitration would ultimately “be helpful in the resolution of [the debtors’] claims,” then arbitration would not “inherently conflict with the underlying purposes of the Bankruptcy Code,” since the Bankruptcy Code’s underlying objectives center around claim resolution.\textsuperscript{43}

Finally, policy-related concerns, such as conservation of judicial resources or avoidance of litigation, permit a court to find that it has discretion to enforce arbitration of a core claim.\textsuperscript{44}

\begin{flushright}
\textsuperscript{38} \textit{See In re} American Classic Voyages, Co., 298 B.R. at 225–26 (noting bankruptcy court does have “some discretion to deny enforcement of the arbitration clause”).
\textsuperscript{39} \textit{Id.} at 226.
\textsuperscript{40} \textit{See id.}
\textsuperscript{41} \textit{See In re} Bill Heard Enterprises, Inc., 400 B.R. at 812.
\textsuperscript{42} \textit{See Moses}, 781 F.3d at 71; \textit{see also In re} Ionosphere Clubs, Inc., 101 B.R. 844, 851 (Bankr. S.D.N.Y. 1989) (noting the “traditional purpose” of bankruptcy legislation is “the reasonably expeditious rehabilitation of financially distressed debtors”).
\textsuperscript{43} \textit{In re} Bill Heard Enterprises, Inc., 400 B.R. at 812.
\end{flushright}
For example, enforcing arbitration might allow a court to avoid “potentially unnecessary litigation in the adversary proceeding,” which helps “conserve[] judicial resources.”

Additionally, a court could find that without arbitration, there would be an “adverse impact on core proceedings” that results in “inefficient delay, duplicate proceedings, or collateral estoppel effect.”

B. The Minority View: Courts Do Not Have Discretion

Some courts have held that they do not have discretion to enforce (or refuse to enforce) arbitration, primarily because the proceedings were not derived from bankruptcy laws.

If a debtor fails to “raise any statutory claims that were created by the Bankruptcy Code,” then there is no conflict between arbitration and the underlying purposes of the Bankruptcy Code. When a court finds there is no conflict, it does not have the discretion to enforce (or refuse to enforce) arbitration. This would apply, for example, when the debtor’s statutory claims are based on federal and state consumer protection laws. Ultimately, if the debtor’s claims are not “derived from the bankruptcy laws,” a court may not find that it has discretion to refuse to enforce arbitration.

Conclusion

45 Id.
47 See, e.g., In re Mintze, 434 F.3d 222, 232 (3d Cir. 2006); In re Cooley, 362 B.R. 514, 523 (Bankr. N.D. Ala. 2007).
48 See In re Mintze, 434 F.3d at 232.
49 Id.
50 Id; see also In re Cooley, 362 B.R. at 522-23 (no discretion to refuse to enforce arbitration because debtor’s claims based on Truth in Lending Act, not Bankruptcy Code).
51 Id.
There is an unresolved dispute among courts regarding their discretion to enforce arbitration of core claims. 52 Until there is a resolution by the Supreme Court, bankruptcy courts face an element of “uncertainty” regarding whether they have discretion to refuse arbitration of core claims. 53

---

52 See generally In re MF Global Holdings, Ltd., 571 B.R. at 96 (holding court does have discretion to enforce or refuse to enforce arbitration); cf. In re Cooley, 362 B.R. at 522–23 (holding court does not have discretion to enforce or refuse to enforce arbitration).
53 See In re McPherson, 630 B.R. at 179 (explaining “the Court dislikes the element of uncertainty” and lack of “clear authority under the Bankruptcy Code or case law giving this Court more discretion to refuse arbitration”).