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## **Arbitration and Bankruptcy – You Got Questions, We Got Answers**

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# Arbitration and Bankruptcy – You Got Questions, We Got Answers

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## THE UNEASY RELATIONSHIP BETWEEN ARBITRATION AND BANKRUPTCY

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### *Preface to Symposium Articles*

Bankruptcy law seeks to collect and resolve all disputes against a debtor in one forum, namely the bankruptcy court. Federal arbitration law seeks to enforce agreements to resolve disputes between contracting parties before an arbitrator, and not a judge. Both laws endeavor to promote efficiency in dispute resolution. Yet, when they intersect, confusion, delay, and additional costs may result.

Notably, bankruptcy and arbitration laws do not always conflict and, in certain cases, arbitration may streamline the bankruptcy process. But the relevant statutes and the applicable case law struggle to draw clear and consistent lines to guide the analysis. Fortunately, this Symposium brings together an incredibly talented group of academics to help examine the issues and identify different ways to approach the enforcement of arbitration agreements in bankruptcy.

This Preface first provides some background on the Federal Arbitration Act (the “FAA”)<sup>1</sup> and how courts have interpreted the FAA over the years. It then focuses on case law discussing the FAA, arbitration agreements, and the Bankruptcy Code (the “Code”).<sup>2</sup> This section identifies the issues most often at the center of a potential conflict between the FAA and the Code and the

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\* United States Bankruptcy Court for the District of Maryland. This article is presented as an academic paper and does not express any opinions or positions regarding any issues that may arise, or any parties that may appear, in any cases before Judge Harner. Judge Harner appreciates the assistance of her law clerk, Emily Lamasa; and her paralegal, Kimberly Goodwin-Maigetter; and her intern, Megan Young.

<sup>1</sup> 9 U.S.C. §§ 1–14.

<sup>2</sup> 11 U.S.C. §§ 101 *et seq.*

different approaches taken by courts to address those issues. Finally, the Preface summarizes the four papers being presented at the Symposium and includes an abstract for each.

## **I. Origins of the FAA and Case Law Development**

Prior to the enactment of the FAA, most courts in the United States were reluctant to enforce arbitration agreements.<sup>3</sup> Perhaps they were following the approach of English courts at the time, which viewed arbitration as an attempt to divest the courts of jurisdiction.<sup>4</sup> Perhaps they simply believed that each party was entitled to its day in court.<sup>5</sup> Regardless, the courts'

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<sup>3</sup> See, e.g., *CompuCredit Corp. v. Greenwood*, 565 U.S. 95, 97 (2012) ("The background law governing the issue before us is the Federal Arbitration Act (FAA), 9 U.S.C. § 1 *et seq.*, enacted in 1925 as a response to judicial hostility to arbitration.") (citation omitted).

<sup>4</sup> See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991) ("Its purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts.") (citations omitted); see also Joshua R. Welsh, *Has Expansion of the Federal Arbitration Act Gone Too Far?: Enforcing Arbitration Clauses in Void Ab Initio Contracts*, 86 MARQ. L. REV. 581, 584 (2002) ("The early American judiciary demonstrated an intense hostility toward arbitration. Courts, following English precedent, would generally allow two willing parties to arbitrate their claims, but would refuse to enforce arbitration when a party changed its mind 'on the ground that an 'agreement of the parties cannot oust [the] court of its jurisdiction.'") (footnotes omitted).

<sup>5</sup> In general, courts recognize the potential consequences of forcing parties to arbitrate, which does remove the dispute from the judicial forum. As one district court recognized,

Generally, an agreement to arbitrate a dispute "is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *E.M. Diagnostic Sys., Inc. v. Local 169, Int'l Bd of Teamsters, Chauffeurs, Warehousemen & Helpers of Am.*, 812 F.2d 91, 94 (3d Cir. 1987) (quoting *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960)). The Federal Arbitration Act ("FAA") applies to arbitration clauses contained in contracts involving matters of interstate commerce. See 9 U.S.C. § 2; *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). When a party, whose claims are subject to the FAA, refuses to arbitrate same the district court must decipher whether the claims are arbitrable. *Medtronic Ave, Inc. v. Advanced Cardiovascular Sys., Inc.*, 247 F.3d 44, 54 (3d Cir. 2001) (citing *AT&T Tech., Inc. v. Comm'n. Workers of Am.*, 475 U.S. 643, 649 (1986)). "In the absence of any express provision excluding a particular grievance from arbitration, ... only the most forceful evidence of a purpose to exclude the claim from arbitration can prevail." *AT&T Tech.*, 475 U.S. at 654 (quotations omitted); see *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 54 (3d Cir. 1980) ("Before a party to a lawsuit can be ordered to arbitrate and thus be deprived of a day in court, there should be an express, unequivocal agreement to that effect.").

*Alfa Adhesives v. A. Duie Pyle, Inc.*, 2018 WL 2317532, at \*2 (D.N.J. May 22, 2018).

unwillingness to enforce arbitration agreements did not go unnoticed, and Congress stepped in to remedy this perceived problem.

Congress passed the FAA in 1925,<sup>6</sup> modeled largely after New York’s arbitration statute.<sup>7</sup> The FAA defines the rights and remedies of parties to an arbitration agreement (including a contract containing an arbitration clause) and was intended to ensure that such agreements were “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”<sup>8</sup> In general, the FAA allows a party to an arbitration agreement to request that a court stay litigation concerning the contract and compel arbitration; it gives arbitrators certain powers; and it facilitates the enforcement of arbitral awards.<sup>9</sup>

#### **A. The Courts’ General Approach to the FAA**

The FAA required courts to look anew at arbitration agreements and their proper role in dispute resolution. Some courts and commentators initially focused on the enforcement of

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<sup>6</sup> “The FAA was enacted in 1925, 43 Stat. 883, and then reenacted and codified in 1947 as Title 9 of the United States Code.” *E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 288 (2002).

<sup>7</sup> New York enacted the first arbitration statute in 1920. *See, e.g.*, Jill I. Gross, *Justice Scalia’s Hat Trick and the Supreme Court’s Flawed Understanding of Twenty-First Century Arbitration*, 81 BROOK. L. REV. 111, 117 (2015) (“Increased court congestion in the early twentieth century and the growing popularity of arbitration as a cheaper and faster means of resolving disputes arising out of commercial transactions led merchants, particularly in New York, to lobby for an arbitration statute. The drafters of the 1920 New York Arbitration Act, the first arbitration statute in the country, intended it to reverse the common law revocability doctrine.”) (footnotes omitted). As the Supreme Court explained,

The text of the FAA was based upon that of New York’s arbitration statute. *See* S.Rep. No. 536, 68th Cong., 1st Sess., 3 (1924) (“The bill ... follows the lines of the New York arbitration law enacted in 1920 ...”). The New York Arbitration Law incorporated pre-existing provisions of the New York Code of Civil Procedure. *See* 1920 N.Y. Laws p. 806. Section 2373 of the code said that, upon application by a party for a confirmation order, “the court must grant such an order, unless the award is vacated, modified, or corrected, as prescribed by the next two sections.” 2 N.Y. Ann.Code Civ. Proc. (Stover 6th ed.1902) (hereinafter Stover).

*Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 589 n.7 (2008). For an overview of the origins of arbitration generally, see John Bruce Lewis & Dustin M. Dow, *Searching for Clarity Amid Confusion: An Examination of the Standards for Determining Waiver and Revival of the Right to Arbitrate*, 67 U. KAN. L. REV. 327, 331–32 (2018).

<sup>8</sup> 9 U.S.C. § 2.

<sup>9</sup> *See, e.g.*, 9 U.S.C. §§ 3, 4, 7, 10, 11.

arbitration agreements between “merchants of equal bargaining power” under the FAA.<sup>10</sup> Interestingly, the Supreme Court also hinted at this purpose in its early FAA decisions, with dissenting Justices highlighting it more prominently in later ones.<sup>11</sup>

This initial focus was grounded in the contractual nature of the arbitration rights and the needs of the commercial marketplace. For example, if two sophisticated parties agree to an arbitration clause, that dispute resolution mechanism is arguably factored into the pricing of the contract and should be enforced to provide each party the benefit of its bargain. This approach also

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<sup>10</sup> For example, one commentator has explained,

Congress intended the Act to govern arbitration agreements between merchants; that is, “parties presumed to be of approximately equal bargaining strength . . . .” According to Julius Henry Cohen, general counsel for the New York State Chamber of Commerce and principal drafter of the Act, arbitration was “peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of fact—quantity, quality, time of delivery, compliance with terms of payment, excuses for non-performance, and the like. It has a place also in the determination of the simpler questions of law—the questions of law which arise out of these daily relations between merchants as to the passage of title, the existence of warranties, or the questions of law which are complementary to the questions of fact which we have just mentioned.”

Rhonda Wasserman, *Legal Process in A Box, or What Class Action Waivers Teach Us About Law-Making*, 44 LOY. U. CHI. L.J. 391, 396 (2012) (footnotes omitted); *see also* Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration: Hearing Before a Subcomm. of the Comm. on the Judiciary on S. 4213 and S. 4214, before a Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 14 (1923) (statement of W. H. H. Piatt, Chairman, ABA Comm. on Commerce, Trade, and Commercial Law) (explaining that the FAA “is purely an act to give the merchants the right or the privilege of sitting down and agreeing with each other as to what their damages are, if they want to do it”). For lower court opinions invoking this concept, *see, e.g., Jones v. Santander Consumer USA Inc.*, No. 4:19-CV-00811-BRW, 2020 WL 4113045, at \*2 (E.D. Ark. July 20, 2020), *appeal dismissed*, No. 20-2728, 2020 WL 8569425 (8th Cir. Sept. 17, 2020) (“Congress enacted the FAA in 1925 ‘to enable merchants of roughly equal bargaining power to enter into binding agreements to arbitrate commercial disputes.’ The limited purpose of the FAA at the time of enactment was to overcome ‘then-existing judicial hostility’ to the arbitration of disputed between businesses.”) (footnotes omitted); *Rickard v. Teynor’s Homes, Inc.*, 279 F. Supp. 2d 910, 921 (N.D. Ohio 2003) (“The creators of the FAA understood that arbitration agreements historically were entered into in the commercial or contractual context where the parties were sophisticated and deliberately desired to avoid the expense and delay attendant on the civil trial system.”) (collecting commentary on issue) (footnotes omitted).

<sup>11</sup> *See, e.g., Prima Paint Corp. v. Flood & Conklin Manuf. Co.*, 388 U.S. 395, 403 n. 9 (1967) (“We note that categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power are expressly excluded from the reach of the Act.”); *Wilko v. Swan*, 346 U.S. 427, 435 (1953), *overruled by Rodriguez de Quijas v. Shearson/Am. Exp., Inc.*, 490 U.S. 477 (1989) (rejecting arbitration agreement that would conflict with purpose of federal securities laws to protect buyers who are often at a bargaining disadvantage); *see also Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1642–43 (2018) (J. Ginsburg, dissenting) (“The legislative hearings and debate leading up to the FAA’s passage evidence Congress’ aim to enable merchants of roughly equal bargaining power to enter into binding agreements to arbitrate *commercial* disputes.”) (emphasis in original); *DIRECTV, Inc. v. Imburgia*, 577 U.S. 47, 70 (2015) (J. Ginsburg, dissenting) (“The Court has suggested that these anticonsumer outcomes flow inexorably from the text and purpose of the FAA. But Congress passed the FAA in 1925 as a response to the reluctance of some judges to enforce commercial arbitration agreements between merchants with relatively equal bargaining power.”).

aligns with the legislative history of the FAA<sup>12</sup> and the notion that, by enacting the FAA, Congress sought to have courts treat arbitration agreements in the same manner as they would any other contract.<sup>13</sup>

Over the years, however, the Supreme Court has expanded the reach of the FAA and articulated a federal policy “favoring arbitration.”<sup>14</sup> This shift in focus has led to courts enforcing arbitration agreements concerning employment claims and securities claims, as well as those raised in state courts.<sup>15</sup> In several of these instances, courts are arguably enforcing arbitration provisions

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<sup>12</sup> See, e.g., *Epic Sys. Corp.*, 138 S. Ct. at 1643 (J. Ginsburg, dissenting) (“Congress, it bears repetition, envisioned application of the Arbitration Act to voluntary, negotiated agreements. See, e.g., 65 Cong. Rec. 1931 (remarks of Rep. Graham) (the FAA provides an ‘opportunity to enforce ... an agreement to arbitrate, when voluntarily placed in the document by the parties to it’). Congress never endorsed a policy favoring arbitration where one party sets the terms of an agreement while the other is left to ‘take it or leave it.’ Hearing 9 (remarks of Sen. Walsh) (quotation marks omitted); see *Prima Paint Corp.*, 388 U.S. at 403, n. 9 (“We note that categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power are expressly excluded from the reach of the Act. See § 1.”).

<sup>13</sup> See Jodi Wilson, *How the Supreme Court Thwarted the Purpose of the Federal Arbitration Act*, 63 CASE W. RES. L. REV. 91, 93 (2012) (“As reflected in both the House Report and the Senate Report, the purpose of the FAA was to place arbitration agreements on the ‘same footing as other contracts’ and thereby overcome judicial hostility to arbitration.”) (footnote omitted); see also *E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 293 (2002) (observing that “[t]he FAA directs courts to place arbitration agreements on equal footing with other contracts”); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).

<sup>14</sup> As explained below, even the Supreme Court has acknowledged this shift. See *infra* note 24. Whether it moved the Court’s decisions closer to, or away from, the intended purpose of the FAA is subject to debate. For authority supporting a more limited view of the FAA, see, e.g., *supra* notes 10–13 and accompanying text. For a contrary perspective, see, e.g., *infra* notes 32–38 and accompanying text and Stephen J. Ware, *A Short Defense of Southland, Casarotto, and Other Long-Controversial Arbitration Decisions*, 30 LOY. CONSUMER L. REV. 303, 317–18 (2018). Professor Ware succinctly summarized the latter position as follows,

[T]he text of FAA section 2 did not make enforceable only arbitration agreements between “commercial entities” or “merchants” or “businesses.” It made enforceable all arbitration agreements in all sorts of contracts “involving commerce” between all sorts of parties, except for “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.” While the FAA’s legislative history reflects concerns about non-employment adhesion contracts, such as insurance policies, these concerns did not find their way into the statute’s text. So, under mainstream approaches to statutory interpretation that, for good reasons, prioritize statutory text far above legislative history, it is enough to say Congress knew how to except types of parties from FAA section 2 and chose to except some employees but not any consumers. Consequently, if consumers make arbitration agreements “involving commerce,” then those agreements are covered by the FAA.

*Id.*

<sup>15</sup> See, e.g., *Epic Sys. Corp.*, 138 S. Ct. at 1627 (collecting cases); *Southland Corp. v. Keating*, 465 U.S. 1, 14 (1984) (applying the FAA to state courts and stating that “[t]o confine the scope of the Act to arbitrations sought to be enforced in federal courts would frustrate what we believe Congress intended to be a broad enactment appropriate in scope to meet the large problems Congress was addressing”).

in contracts involving parties of *unequal* bargaining power. Whether the FAA does or should extend to contracts of adhesion is subject to debate.<sup>16</sup> Indeed, very few contracts seem to escape the reach of the FAA.<sup>17</sup>

## **B. Select Supreme Court Cases Addressing the FAA**

A quick review of a few key Supreme Court cases will help to illustrate the general progression of case law interpreting the FAA. It also will provide a nice foundation for discussing the intersection of bankruptcy law and arbitration law.

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<sup>16</sup> A contract of adhesion is defined as a contract presented on a “take it or leave it” basis and may be enforceable under certain circumstances, depending on the applicable law. *See, e.g., Am. Gen. Life & Acc. Ins. Co. v. Wood*, 429 F.3d 83, 88 (4th Cir. 2005) (explaining the nature of an adhesion contract and that, under West Virginia law, “‘where a party alleges that the arbitration provision was unconscionable or was thrust upon him because he was unwary and taken advantage of, or that the contract was one of adhesion, the question of whether an arbitration provision was bargained for and valid is a matter of law for the court to determine by reference to the entire contract, the nature of the contracting parties, and the nature of the undertakings covered by the contract’”) (citations omitted); *see also Graham v. United Servs. Auto. Ass’n*, No. CV-20-02210-PHX-DWL, 2021 WL 2780865, at \*4 (D. Ariz. July 2, 2021) (explaining approach of Arizona courts to contracts of adhesion and enforcing arbitration provision in employment agreement alleged to be a contract of adhesion); *Trulove Dirt Works, LLC v. Bacar Constructors, Inc.*, No. 3:20-CV-3058, 2020 WL 8182217, at \*3 (W.D. Ark. Nov. 18, 2020) (explaining that in a similar case before the Tennessee Court of Appeals, “[t]he court first determined that the subcontract was not one of adhesion, despite the fact that the subcontractor’s representative claimed in an affidavit that—aside from the price of services—the subcontract was presented to him on a take-it-or-leave-it basis. ... Since the subcontract itself was not one of adhesion, the court concluded that it was ‘unnecessary to examine the arbitration clause to determine its reasonableness.’”) (citations omitted).

For academic analysis of these issues, *see, e.g.,* Robert W. Emerson & Zachary R. Hunt, *Franchisees, Consumers, and Employees: Choice and Arbitration*, 13 WM. & MARY BUS. L. REV. 487 (2022); Ronald G. Aronovsky, *Starting Over: Letting States Regulate Adhesion Arbitration Agreements*, 71 SYRACUSE L. REV. 1019, 1020 (2021); Stephen J. Ware, *The Centrist Case for Enforcing Adhesive Arbitration Agreements*, 23 HARV. NEGOT. L. REV. 29 (2017); Stephan Landsman, *ADR and the Cost of Compulsion*, 57 STAN. L. REV. 1593, 1596 (2005); Anne Brafford, *Arbitration Clauses in Consumer Contracts of Adhesion: Fair Play or Trap for the Weak and Unwary?*, 21 J. CORP. L. 331, 332 (1996).

In addition, similar issues and analysis arise in cases involving class action waivers in arbitration agreements. *See, e.g., Chalk v. T-Mobile USA, Inc.*, 560 F.3d 1087, 1097 (9th Cir. 2009) (finding class action waiver in arbitration agreement to be a contract of adhesion that was procedurally acceptable but substantively unconscionable under Oregon law).

<sup>17</sup> *See, e.g., Jones v. Santander Consumer USA Inc.*, No. 4:19-CV-00811-BRW, 2020 WL 4113045, at \*2 (E.D. Ark. July 20, 2020), *appeal dismissed*, No. 20-2728, 2020 WL 8569425 (8th Cir. Sept. 17, 2020) (“Today, despite clear legislative intent and history to the contrary, the FAA may apply to any contractual dispute, between any party or entity, regarding any subject, and regardless of any state consumer protection law or state constitutional provision. Clearly, with this backdrop, the FAA applies to the contract at issue here.”).



In its early decisions, the Supreme Court scrutinized whether the subject dispute was covered by the FAA, focusing on the language of section 2 of the FAA and whether the matters involved arbitration agreements in maritime or commerce transactions.<sup>18</sup> In fact, in *Bernhardt*, the Court rejected the Court of Appeals’ suggestion that the reference to maritime and commerce transactions limited the scope of only section 2 of the FAA and that section 3 of the FAA applied to *all* arbitration agreements. The Court responded, “We disagree with that reading of the Act. Sections 1, 2, and 3 are integral parts of a whole.”<sup>19</sup> This led the Court to hold that the employment dispute before it fell outside the scope of the FAA.

The Supreme Court’s language concerning the purpose of the FAA also was more reserved in its early cases. For example, in *Wilko v. Swan*, the Court stated that “[t]he United States Arbitration Act establishes by statute the *desirability of arbitration* as an alternative to the complications of litigation.”<sup>20</sup> It also suggested that the FAA might not apply in disputes involving parties of unequal bargaining power. With respect to the securities margin contract at issue in *Wilko*, the Court observed, “While a buyer and seller of securities, under some circumstances, may deal at arm’s length on equal terms, it is clear that the Securities Act was drafted with an eye to

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<sup>18</sup> See, e.g., *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 201 (1956). Some courts and commentators have noted an expansion of the Supreme Court’s interpretation of “commerce” under the FAA over the years. See, e.g., *Santangelo Law Offices, P.C. v. Touchstone Home Health, LLC (In re Touchstone Home Health, LLC)*, 572 B.R. 255, 267 (Bankr. D. Colo. 2017) (“A trilogy of U.S. Supreme Court decisions—cited both by the Law Firm and the Debtor—helps define the ultra-broad scope of the interstate commerce requirement under the FAA: *Allied-Bruce Terminix Co., Inc. v. Dobson*, 513 U.S. 265, 274–5, 115 S.Ct. 834, 130 L.Ed.2d 753 (1995); *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 121 S.Ct. 1302, 149 L.Ed.2d 234 (2001); and *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52, 123 S.Ct. 2037, 156 L.Ed.2d 46 (2003). ... Searching for conduct ‘affecting’ interstate commerce under the termite eradication agreement, the U.S. Supreme Court observed that the defendant companies had multistate operations and some of ‘the termite-treating and house-repairing material’ used by the defendant companies on the local residence ‘came from outside Alabama.... These exceedingly slim connections to interstate commerce caused a majority of U.S. Supreme Court to rule that the FAA applied.’) (some citations omitted). The other issue often discussed in early FAA cases involved the role of the federal courts in diversity cases. The issue was addressed by the Court in *Bernhardt* and subsequent cases. See *infra* note 31.

<sup>19</sup> *Bernhardt*, 350 U.S. at 201.

<sup>20</sup> *Wilko v. Swan*, 346 U.S. 427, 431–33 (1953) (emphasis added), *overruled by Shearson/Am. Exp., Inc.*, 490 U.S. 477 (1989).

the disadvantages under which buyers labor.”<sup>21</sup> Considering the relevant provisions of statutes before it, the Court concluded that a waiver of forum prior to an actual dispute was prohibited by the Securities Act.<sup>22</sup> The Court therefore found the arbitration provision in the margin agreement invalid.

Notably, the Supreme Court overruled *Wilko* in 1989,<sup>23</sup> but the shift in the Court’s approach to the FAA started in a very gradual manner prior to that time.<sup>24</sup> Although several cases might demonstrate this shift, the Supreme Court’s decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, is useful because it articulates some of the Court’s prior reasoning while starting to expand the reach of the FAA.<sup>25</sup> In *Prima Paint*, the primary issue was whether the parties’ dispute over the validity of a consulting agreement was subject to arbitration. The United States Court of Appeals for the Second Circuit held that it was, opining that the arbitration provision could be severed from the consulting agreement and enforced as to the parties’ fraud in the inducement claim. The Supreme Court affirmed.

In reaching its decision, the majority opinion first analyzed whether the consulting agreement was covered by section 2 of the FAA. It found the agreement to be related to commerce and, in a footnote, reiterated the suggestion set forth in *Wilko* and other cases that “categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has

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<sup>21</sup> *Id.* at 435.

<sup>22</sup> *Id.*

<sup>23</sup> *Shearson/Am. Exp., Inc.*, 490 U.S. 477 (1989).

<sup>24</sup> Most commentators acknowledge a definite shift in the Supreme Court’s approach to the FAA in or around 1983. The Supreme Court itself has acknowledged this shift. See *Shearson/Am. Exp., Inc.*, 490 U.S. at 481 (“The shift in the Court’s views on arbitration away from those adopted in *Wilko* is shown by the flat statement in *Mitsubishi*: ‘By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.’”) (citation omitted). As discussed herein, however, Supreme Court decisions even prior to 1983 evidenced a shifting in the views of at least certain Justices concerning the scope of the FAA.

<sup>25</sup> *Prima Paint Corp.*, 388 U.S. at 395.

little bargaining power are expressly excluded from the reach of the Act.”<sup>26</sup> The Court then considered whether the parties’ dispute concerning the validity of the agreement nevertheless removed the consulting agreement from the scope of the FAA. The majority said no, holding that so long as the arbitration provision is valid, the federal courts must enforce that provision, even if the validity of the contract itself is at issue.<sup>27</sup>

The dissent in *Prima Paint* strongly disagreed with the majority on several grounds, including whether the consulting agreement was the kind of agreement covered by the FAA.<sup>28</sup> According to the dissent, sections 2 and 3 of the FAA “were plainly designed to protect a person against whom arbitration is sought to be enforced from having to submit his legal issues as to validity of the contract to the arbitrator.”<sup>29</sup> From that premise, the dissent notes that “Prima’s agreement to an arbitration clause in a contract obtained by fraud was no more ‘voluntary’ than an insured’s or employee’s agreement to an arbitration clause in a contract obtained by superior

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<sup>26</sup> *Id.* at 403, n. 9.

<sup>27</sup> Notably, a few years earlier and in a slightly different context, the Court rejected the arbitration of whether the contracts at issue resulted from fraud. *See Moseley v. Elec. & Missile Facilities, Inc.*, 374 U.S. 167, 171 (1963) (“It appears necessary, therefore, that the District Court proceed first to trial of this issue. In considering the question of the sufficiency of the pleadings with reference to the allegation of fraud, we believe that, as alleged here, the issue goes to the arbitration clause itself, since it is contended that it was to be used to effect the fraudulent scheme. If this issue is determined favorably to the petitioner, there can be no arbitration under the subcontracts.”).

<sup>28</sup> The dissent takes issue with the consulting agreement being a transaction in commerce. The dissent notes:

[T]he Court holds that because the consulting agreement was intended to supplement a separate contract for the interstate transfer of assets, it is itself a ‘contract evidencing a transaction involving commerce,’ the language used by Congress to describe contracts the Act was designed to cover. But in light of the legislative history which indicates that the Act was to have a limited application to contracts between merchants for the interstate shipment of goods, and in light of the express failure of Congress to use language making the Act applicable to all contracts which ‘affect commerce,’ the statutory language Congress normally uses when it wishes to exercise its full powers over commerce, I am not at all certain that the Act was intended to apply to this consulting agreement.

*Prima Paint Corp.*, 388 U.S. at 409–10 (J. Black, dissenting) (footnotes omitted).

<sup>29</sup> *Id.* at 413.

bargaining power.”<sup>30</sup> The dissent then goes on to criticize the majority’s adoption of the severability rule and displacing state law with federal arbitration law in the diversity cases.<sup>31</sup>

The differing perspectives on the FAA articulated in *Prima Paint* to some extent foreshadowed the policy debate and analysis shift that would emerge in later Supreme Court decisions. For example, the Court’s subsequent decisions not only overruled or limited its prior rulings on the FAA, but they also framed the discussion differently. The Supreme Court (and, in turn, lower courts) began describing the FAA as establishing “a ‘federal policy favoring arbitration,’ ... [and] requiring that ‘we rigorously enforce agreements to arbitrate.’”<sup>32</sup> In

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<sup>30</sup> *Id.*

<sup>31</sup> Several of the early Supreme Court cases focused on the proper role of the federal courts in diversity cases with respect to the FAA. The majority in *Prima Paint* explained the issue as follows:

The point is made that, whatever the nature of the contract involved here, this case is in federal court solely by reason of diversity of citizenship, and that since the decision in *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938), federal courts are bound in diversity cases to follow state rules of decision in matters which are ‘substantive’ rather than ‘procedural,’ or where the matter is ‘outcome determinative.’ *Guaranty Trust Co. of New York v. York*, 326 U.S. 99, 65 S.Ct. 1464, 89 L.Ed. 2079 (1945). The question in this case, however, is not whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases. See *Bernhardt v. Polygraphic Co.*, *supra*, 350 U.S. at 202, and concurring opinion, at 208, 76 S.Ct. at 275 and at 279. Rather, the question is whether Congress may prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate. The answer to that can only be in the affirmative.

*Id.* at 404–05. Notably, in *Bernhardt*, the Court was slightly more deferential to state law under the *Erie* doctrine in the context of the FAA. See *Bernhardt*, 350 U.S. at 204–05 (“The District Court found that if the parties were in a Vermont court, the agreement to submit to arbitration would not be binding and could be revoked at any time before an award was made. ... We agree with [the District Court] that if arbitration could not be compelled in the Vermont courts, it should not be compelled in the Federal District Court.”).

<sup>32</sup> *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (subjecting certain securities claims to the FAA). To support these propositions, the Court cites its prior decisions in *Moses H. Cone Memorial Hospital v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983) and *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985). Based on a quick survey of the case law, the phrase “federal policy favoring arbitration” first appeared in the Court’s labor dispute decisions in the 1970s. See, e.g., *Gateway Coal Co. v. United Mine Workers of Am.*, 414 U.S. 368, 377 (1974) (“The federal policy favoring arbitration of labor disputes is firmly grounded in congressional command. Section 203(d) of the Labor Management Relations Act, 29 U.S.C. § 173(d).”). The Court then used the phrase when discussing the FAA in 1983 in *Moses H. Cone Mem’l Hosp.*, 460 U.S. at 24 (“Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.”).

*McMahon*, the Court upheld the arbitration of claims under the Exchange Act and RICO,<sup>33</sup> and distinguished both from the Securities Act claims at issue in *Wilko*.<sup>34</sup>

Although the Court in *McMahon* enforced the FAA in the context of other statutory claims, it did not establish a per se rule. Rather, the Court set forth a multi-factor test to evaluate the competing federal statutes before it and, in turn, assist lower courts facing similar issues. The Court explained this analysis as follows,

The Arbitration Act, standing alone, therefore mandates enforcement of agreements to arbitrate statutory claims. Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue. *If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such 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.*<sup>35</sup>

Based on this language, lower courts have refused to enforce arbitration agreements under the Code, as well as certain other federal statutes (particularly those disfavoring pre-dispute agreements).<sup>36</sup>

Despite the willingness of some lower courts to reject arbitration requests under the *McMahon* analysis, the Supreme Court and many lower courts have moved in a slightly different direction. As the Court noted in its 2018 decision, *Epic Systems Corp. v. Lewis*,

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<sup>33</sup> The claims at issue were "a claim brought under § 10(b) of the Securities Exchange Act of 1934 (Exchange Act)" and "a claim brought under the Racketeer Influenced and Corrupt Organizations Act (RICO)." *McMahon*, 482 U.S. at 222.

<sup>34</sup> As noted above, the Supreme Court eventually overruled *Wilko* in *Shearson/Am. Exp., Inc.*, 490 U.S. 477 (1989).

<sup>35</sup> *McMahon*, 482 U.S. at 226–27 (emphasis added); see also *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (conducting similar analysis based on *McMahon* factors) (internal citations omitted).

<sup>36</sup> See, e.g., *Lyons v. PNC Bank, Nat'l Ass'n*, 26 F.4th 180 (4th Cir. 2022) (15 U.S.C. § 1639; consumer credit protection); *Matter of Henry*, 944 F.3d 587 (5th Cir. 2019) (Bankruptcy Code); *Cunningham v. Fleetwood Homes of Georgia, Inc.*, 253 F.3d 611 (11th Cir. 2001) (Magnuson-Moss Warranty Act); see also *In re Touchstone Home Health LLC*, 572 B.R. at 272–73 ("Although *McMahon* did not involve the Bankruptcy Code, six U.S. Circuit Courts of Appeals (and a host of district and bankruptcy courts) have determined that the *McMahon* framework applies to FAA arbitration issues arising in bankruptcy cases. In the insolvency context, the *McMahon* framework requires the court to analyze: (1) the text and legislative history of the Bankruptcy Code; and (2) whether there is an inherent conflict between arbitration and the underlying purpose of the Bankruptcy Code.") (footnotes omitted).

In many cases over many years, this Court has heard and rejected efforts to conjure conflicts between the Arbitration Act and other federal statutes. In fact, this Court has rejected *every* such effort to date (save one temporary exception since overruled), with statutes ranging from the Sherman and Clayton Acts to the Age Discrimination in Employment Act, the Credit Repair Organizations Act, the Securities Act of 1933, the Securities Exchange Act of 1934, and the Racketeer Influenced and Corrupt Organizations Act. Throughout, we have made clear that even a statute’s express provision for collective legal actions does not necessarily mean that it precludes “individual attempts at conciliation” through arbitration. And we’ve stressed that the absence of any specific statutory discussion of arbitration or class actions is an important and telling clue that Congress has not displaced the Arbitration Act. Given so much precedent pointing so strongly in one direction, we do not see how we might faithfully turn the other way here.<sup>37</sup>

The Court ultimately determined that arbitration agreements requiring individualized proceedings were enforceable despite section 7 of the National Labor Relations Act, which speaks to union organization and collective action.<sup>38</sup>

Since *Epic*, many lower courts have continued to follow the *McMahon* factors and to evaluate the enforceability of arbitration agreements on a case-by-case basis.<sup>39</sup> Nevertheless, the instances in which courts refuse to enforce arbitration agreements are few and far between. This trend may be the result of judicial interpretation of the FAA or, as suggested by Justice Gorsuch

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<sup>37</sup> *Epic Sys. Corp.*, 138 S. Ct. at 1627 (internal citations omitted).

<sup>38</sup> *Id.*

<sup>39</sup> See, e.g., *Belton v. GE Cap. Retail Bank (In re Belton)*, 961 F.3d 612, 616–17 (2d Cir. 2020), *cert. denied sub nom. GE Cap. Retail Bank v. Belton*, 141 S. Ct. 1513, 209 L. Ed. 2d 252 (2021). In addition, the United States Court of Appeals for the Fourth Circuit invoked the *McMahon* factors to reject an arbitration claim involving a claim under 15 U.S.C. § 1639 (consumer credit protection). See *Lyons v. PNC Bank, Nat’l Ass’n*, 26 F.4th 180 (4th Cir. 2022). The Fourth Circuit explained,

In contrast to the provisions at issue in the cases cited by PNC, which *authorize* a cause of action, § 1639c(e)(3) *expressly prohibits* a covered agreement from *barring* a consumer “from bringing an action in an appropriate district court of the United States, or any other court of competent jurisdiction.” 15 U.S.C. § 1639c(e)(3). There is a substantive difference between finding that arbitration is an appropriate alternative mechanism to enforce a statutorily created right to sue and overriding an express congressional command proscribing waiver of a specific judicial forum. *Cf. Mitsubishi*, 473 U.S. at 628, 105 S.Ct. 3346 (“Having made the bargain to arbitrate, the party should be held to it *unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.*” (emphasis added)); *Gilmer*, 500 U.S. at 26, 111 S.Ct. 1647.

*Id.* at 187.

in *Epic*,<sup>40</sup> may be a very important policy question that Congress must resolve. This trend also may be shifting again, or at least stabilizing, as two recent Supreme Court cases suggest a more restrained approach to the FAA.<sup>41</sup> In any event, it raises numerous issues for bankruptcy courts faced with requests to enforce prepetition arbitration agreements.

## **II. The Treatment of the FAA in Bankruptcy Cases**

The Code contemplates a collective process that facilitates a debtor's fresh financial start while protecting the rights of all creditors.<sup>42</sup> It brings all matters affecting a debtor's financial

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<sup>40</sup> In addressing the arguments of the dissent in *Epic*, Justice Gorsuch states,

The policy may be debatable but the law is clear: Congress has instructed that arbitration agreements like those before us must be enforced as written. While Congress is of course always free to amend this judgment, we see nothing suggesting it did so in the NLRA—much less that it manifested a clear intention to displace the Arbitration Act. Because we can easily read Congress's statutes to work in harmony, that is where our duty lies.

*Epic Sys. Corp.*, 138 S. Ct. at 1632.

<sup>41</sup> See *Morgan v. Sundance, Inc.*, No. 21-328, 2022 WL 1611788 (U.S. May 23, 2022) (holding that normal standard for evaluating contractual waivers applies in the context of arbitration agreements and rejecting a special federal waiver rule to favor arbitration); *Badgerow v. Walters*, 142 S. Ct. 1310 (2022) (holding that federal courts may not look through application to determine jurisdiction with respect to claims to confirm, vacate, or modify arbitral awards under sections 9 and 10 of the FAA). In *Sundance*, Justice Kagan relied on the Court's earlier FAA decisions to explain the federal policy favoring arbitration as follows,

“Th[e] policy,” we have explained, “is merely an acknowledgment of the FAA’s commitment to overrule the judiciary’s longstanding refusal to enforce agreements to arbitrate and to place such agreements upon the same footing as other contracts.” *Granite Rock Co. v. Teamsters*, 561 U.S. 287, 302, 130 S.Ct. 2847, 177 L.Ed.2d 567 (2010) (internal quotation marks omitted). Or in another formulation: The policy is to make “arbitration agreements as enforceable as other contracts, but not more so.” *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n. 12, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967). Accordingly, a court must hold a party to its arbitration contract just as the court would to any other kind. But a court may not devise novel rules to favor arbitration over litigation. See *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 218–221, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985). If an ordinary procedural rule—whether of waiver or forfeiture or what-have-you—would counsel against enforcement of an arbitration contract, then so be it. The federal policy is about treating arbitration contracts like all others, not about fostering arbitration. See *ibid.*; *National Foundation for Cancer Research v. A. G. Edwards & Sons, Inc.*, 821 F.2d 772, 774 (C.A.D.C. 1987) (“The Supreme Court has made clear” that the FAA’s policy “is based upon the enforcement of contract, rather than a preference for arbitration as an alternative dispute resolution mechanism”).

*Sundance*, 2022 WL 1611788, at \*4.

<sup>42</sup> See, e.g., Barry E. Adler, *The Creditors’ Bargain Revisited*, 166 U. PA. L. REV. 1853, 1854–55 (2018) (explaining that “at its core, bankruptcy serves creditors as a group when it supplants individual creditor debt collection remedies with a ‘collective debt-collection device’ . . . bankruptcy’s collectivized proceeding is superior to individual creditor actions because individual creditors have perverse incentives to act in their own interests, even if those interests disserve the creditors’ collective interest.”); see also *In re Pier 1 Imports, Inc.*, 615 B.R. 196, 198 (Bankr. E.D. Va.

affairs into a single forum and strives to provide fair and equal treatment to similarly situated creditors. Congress also has provided courts overseeing a debtor's bankruptcy case exclusive jurisdiction over "all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate."<sup>43</sup>

It is against this backdrop that courts evaluate the application of the FAA in matters relating to a bankruptcy case. For most courts, the key factor is whether "Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue."<sup>44</sup> Some courts perform a straightforward analysis evaluating the particular section of the Code in light of the federal policy favoring arbitration under the FAA. Other courts supplement this analysis by considering whether the matter or proceeding before the bankruptcy court is a "core" or "non-core" proceeding under section 157 of title 28 of the U.S. Code.<sup>45</sup>

For courts adopting the core versus non-core approach, a constitutionally core claim<sup>46</sup> is the easier case. In these matters and proceedings,<sup>47</sup> courts generally hold that the bankruptcy court

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2020) (citing Professor Adler for this proposition).

<sup>43</sup> 28 U.S.C. § 1334(e).

<sup>44</sup> *McMahon*, 482 U.S. at 227.

<sup>45</sup> In general,

The bankruptcy court has statutory authority to enter final judgments on core proceedings listed in section 157(c). Neither section 157(c) nor the listing of proceedings therein, however, provides the bankruptcy court with constitutional authority over a claim. Rather, "[a] cause of action is constitutionally core when it 'stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.'" *Allied Title Lending, LLC v. Taylor*, 420 F. Supp. 3d 436, 448 (E.D. Va. 2019) (quoting *Stern v. Marshall*, 564 U.S. 462, 499, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011)).

*Camac Fund, L.P. v. John McDonnell McPherson (In re McPherson)*, 630 B.R. 160, 168 (Bankr. D. Md. 2021).

<sup>46</sup> Section 157 of title 28 of the U.S. Code lists examples of core claims. The Supreme Court has, however, drawn a distinction between a statutory core claim and a constitutionally core claim. A constitutionally core claim "stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Stern v. Marshall*, 564 U.S. 462, 499 (2011). Bankruptcy courts have authority to hear and resolve by final order constitutionally core claims. *See, e.g., Moses v. CashCall, Inc.*, 781 F.3d 63, 70 (4th Cir. 2015) ("[T]he [Supreme] Court has subsequently held that when a bankruptcy court is faced with a claim that is *statutorily* core but *constitutionally* non-core—a so-called 'Stern claim'—it must treat the claim as if it were *statutorily* non-core, submitting proposed findings of fact and conclusions of law to the district court for *de novo* review. *Exec. Benefits Ins. Agency v. Arkison*, 134 S.Ct. 2165, 2173, 189 L.Ed.2d 83 (2014).").

<sup>47</sup> Although these kinds of arbitration issues often arise in the context of an adversary proceeding, they also may occur



has some discretion to retain the matter or proceeding and not enforce the terms of the parties' arbitration agreement.<sup>48</sup> These courts find an inherent conflict in allowing an arbitrator to resolve matters or proceedings that are grounded in the Code itself or that are integral to the debtor's reorganization efforts. A bankruptcy court's discretion is far more limited with respect to non-constitutionally core or non-core proceedings.<sup>49</sup>

Regardless of whether the court invokes a discussion of the bankruptcy court's core jurisdiction, courts appear more likely to deny arbitration if the claim involves foundational bankruptcy protections, such as the automatic stay and the discharge injunction.<sup>50</sup> They do,

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in contest matters under the Code, such as matters involving the application of the automatic stay or the claims administration process.

<sup>48</sup> See, e.g., *Allied Title Lending, LLC v. Taylor*, 420 F. Supp. 3d 436, 448 (E.D. Va. 2019) ("Arbitration of constitutionally core claims 'inherently conflict[s] with the purposes of the Bankruptcy Code,' and therefore a bankruptcy court is generally well within its discretion to refuse arbitration of constitutionally core claims.") (quoting *Moses v. CashCall, Inc.*, 781 F.3d 63, 72 (4th Cir. 2015)). But see *Herrington v. Wells Fargo Bank, Minnesota, N.A. (In re Herrington)*, 374 B.R. 133, 139–40 (Bankr. E.D. Pa. 2007) ("In *Mintze*, the Circuit Court of Appeals held that '[t]he core/non-core distinction does not, however, affect whether a bankruptcy court has the discretion to deny enforcement of an arbitration agreement.' *Mintze v. Am. Gen. Fin. Serv., Inc. (In re Mintze)*, 434 F.3d 222, 229 (3d Cir. 2006). Instead, a bankruptcy court has no discretion not to enforce an arbitration agreement unless Congress intended otherwise."); see also *infra* note 49.

<sup>49</sup> See, e.g., *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011, 1021 (9th Cir. 2012) ("We join our sister circuits in holding 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."); *The Whiting-Turner Contr. Co. v. Elec. Mach. Enterprises, Inc. (In re Elec. Mach. Enterprises, Inc.)*, 479 F.3d 791, 796 (11th Cir. 2007) ("However, even if a proceeding is determined to be a core proceeding, the bankruptcy court must still analyze whether enforcing a valid arbitration agreement would inherently conflict with the underlying purposes of the Bankruptcy Code.") (citations omitted); *Rozell v. Citifinancial Auto Corp. (In re Rozell)*, 357 B.R. 638, 643 (Bankr. N.D. Ala. 2006) (finding arbitration of Truth in Lending Act claims warranted whether claim was characterized as core or non-core).

<sup>50</sup> See, e.g., *Belton v. GE Cap. Retail Bank (In re Belton)*, 961 F.3d 612, 617 (2d Cir. 2020), *cert. denied sub nom. GE Cap. Retail Bank v. Belton*, 141 S. Ct. 1513, 209 L. Ed. 2d 252 (2021) (rejecting arbitration of claims involving alleged violations of discharge injunction); *Matter of Henry*, 944 F.3d 587 (5th Cir. 2019) (rejecting arbitration of claims relating to discharge injunction); *Golden v. Discover Bank (In re Golden)*, 2021 WL 1535784, at \*11 (Bankr. E.D.N.Y. Jan. 25, 2021) (rejecting arbitration of claims involving alleged violations of discharge injunction); *Homaiden v. SLM Corp. (In re Homaidan)*, 587 B.R. 428, 442 (Bankr. E.D.N.Y. 2018) (refusing to compel arbitration of alleged violations of discharge injunction concerning dischargeability of student loans); *In re Jorge*, 568 B.R. 25, 39 (Bankr. N.D. Ohio 2017) (denying arbitration on observing that "[t]he claims for violations of the automatic stay and the discharge injunction are core bankruptcy proceedings and do not implicate interpretation of the Contract; instead, such claims are unique to bankruptcy proceedings (as Verizon acknowledges)"); *Walker v. Got'Cha Towing & Recovery, LLC (In re Walker)*, 551 B.R. 679, 691 (Bankr. M.D. Ga. 2016) (noting that "to require arbitration of a stay violation does not serve the core purpose of the FAA and runs roughshod over the considerations that influence bankruptcy courts not to enforce similar prepetition contractual provisions"); *Merrill v. MBNA America Bank, N.A. (In re Merrill)*, 343 B.R. 1, 11 (Bankr. D. Me. 2006) (bifurcating claims and rejecting arbitration of alleged violations of the automatic stay); see also *Moses v. CashCall, Inc.*, 781 F.3d 63, 70 (4th Cir. 2015) (bifurcating claims and

however, see some role for arbitration in bankruptcy cases. Consequently, courts have enforced arbitration agreements in bankruptcy where the dispute related to an alleged prepetition breach of contract claim, as well as the nondischargeability of certain debts and the recovery of fraudulent transfers.<sup>51</sup> Ultimately, under existing case law, the outcome of any arbitration dispute in bankruptcy is fact-dependent and may vary depending on the applicable circuit law.

Given this potential variability and the important policy issues in play, some have questioned whether there is a better or different way to approach arbitration in bankruptcy cases. The Symposium papers (summarized in the attached abstracts) consider this question and several related issues. They offer meaningful insights on the current system and provide alternative ways to address arbitration in bankruptcy cases.

### **III. The Symposium Papers**

There is often more than one way to look at any given issue, and the Symposium papers suggest this to be true for matters involving arbitration agreements in bankruptcy. At a very high level, arbitrating a two-party dispute in bankruptcy seems directly at odds with the collective nature

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rejecting arbitration of matters involving claims allowance process); *In re McPherson*, 630 B.R. at 173–77 (bifurcating claims and rejecting arbitration of alleged fraudulent transfer and turnover claims); *Kiskaden v. LVNV Funding, LLC (In re Kiskaden)*, 571 B.R. 226 (Bankr. E.D. Ky. 2017) (rejecting arbitration in context of debtor’s declaratory judgment action concerning validity of prepetition loan); *Larson v. Swift Rock Financial, Inc. (In re Craig)*, 545 B.R. 47 (D. Colo. 2015) (rejecting arbitration of fraudulent transfer claim asserted by bankruptcy trustee). *But see MBNA Am. Bank, N.A. v. Hill*, 436 F.3d 104, 109 (2d Cir. 2006) (permitting arbitration of claims asserted in adversary proceeding, including alleged violations of automatic stay, post-discharge); *In re Banks*, 549 B.R. 257, 268 (Bankr. D. Or. 2016) (compelling arbitration of claims involving alleged violations of automatic stay in chapter 13 case post-confirmation).

<sup>51</sup> See, e.g., *Moses v. CashCall, Inc.*, 781 F.3d at 71 (bifurcating claims and enforcing arbitration of alleged claims under state law); *In re Elec. Mach. Enterprises, Inc.*, 479 F.3d at 791 (enforcing arbitration of claims involving construction subcontract, settlement of funds, and constructive trust); *In re Mintze*, 434 F.3d at 231 (enforcing arbitration of rescission claim under prepetition home equity loan); *In re McPherson*, 630 B.R. at 176–77 (bifurcating claims and enforcing arbitration of alleged breach of contract and federal and state law debt collection claims); *Williams v. Navient Solutions, LLC (In re Williams)*, 564 B.R. 770 (Bankr. S.D. Fla. 2017) (enforcing arbitration with respect to nondischargeability of student loan debt); *In re No Place Like Home, Inc.*, 559 B.R. 863 (Bankr. W.D. Tenn. 2016) (lifting stay to allow arbitration of federal wage and hour claims); *Hix v. Flood (In re Hix)*, 2011 WL 1520013, at \*1 (Bankr. N.D. Ga. Feb. 8, 2011) (enforcing arbitration of claim under construction contract); *In re Merrill*, 343 B.R. at 11 (bifurcating claims and enforcing arbitration of alleged claims under state law); *In re Rozell*, 357 B.R. at 643 (enforcing arbitration of Truth in Lending Act claims).

of the bankruptcy process.<sup>52</sup> Such a view might suggest an inherent conflict between the Code and the FAA in most every instance. With few exceptions, any action in, arising under, or relating to a bankruptcy case in some way affects the debtor's assets or rights in assets, which in turn arguably has some impact, even if marginal, on creditors' collection rights and the debtor's fresh start.

Absent an express Congressional directive, however, should the Code be given such priority over the FAA? Congress could, and perhaps should, clarify the circumstances under which actions involving a debtor are subject to arbitration, but what would be the optimal standard in such a scenario? Congress could declare all arbitration clauses null and void, similar to *ipso facto* clauses, in bankruptcy. Congress could vest bankruptcy courts with the discretion to make such determinations on a case-by-case basis. Congress also could identify certain categories of actions—e.g., automatic stay and discharge violations, chapter 5 avoidance actions, claims administration matters—as non-arbitral, and allow the enforcement of arbitration agreements as to all other matters, if required by the FAA.

The four Symposium papers each approach these issues from a slightly different perspective. Professor Bruce analyzes the refusal of bankruptcy courts to enforce arbitration agreements with respect to class actions and the potential implications of those decisions in subsequent litigation seeking class certification. Professor Casey takes a step back to consider the tension between the stated objectives of the Code and the FAA and then offers potential ways to mitigate that tension with certain guiding principles. Professor Lawless suggests we use foundational principles of law to reframe our thinking about the intersection of bankruptcy law

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<sup>52</sup> See, e.g., *Drennen v. Lloyd's of London (In re Residential Cap., LLC)*, 563 B.R. 756, 767 (Bankr. S.D.N.Y. 2016) (“The Second Circuit has recognized that a Bankruptcy Court has discretion to decline to compel arbitration when a conflict exists between the Bankruptcy Code, which favors centralization of disputes concerning a debtor's estate, and the Arbitration Act, which advocates a decentralized approach to dispute resolution. *Cibro Petroleum Prods. Inc. v. City of Albany (In re Winimo Realty Corp.)*, 270 B.R. 108, 118 (S.D.N.Y. 2001) (quoting *Crysen/Montenay Energy Co. v. Shell Oil Co. (In re Crysen/Montenay Energy Co.)*, 226 F.3d 160, 165 (2d Cir. 2000)).”) (quotations omitted).

and arbitration. Finally, Professor Ware urges a more thoughtful analysis of arbitration agreements as executory contracts under section 365 of the Code and considers the consequences that flow from such an approach.

These papers not only make a meaningful contribution to the bankruptcy/arbitration literature, but they also underscore the need to find a better way to address arbitration agreements in bankruptcy. Existing case law, though thoughtful, presents inconsistent results<sup>53</sup> and creates uncertainty in the law. It is also difficult to navigate. A more precise approach to the issue would eliminate (or at least reduce) litigation over arbitrability and allow the Code and the FAA to serve their respective policy objectives more effectively.

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<sup>53</sup> Compare cases cited *supra* note 50 with cases cited *supra* note 51.

**BANKRUPTCY’S ARBITRATION COUNTER CURRENT AND  
THE FUTURE OF DEBTOR CLASS ACTIONS**

*Written by:*

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Although the Supreme Court has rigorously—and repeatedly—upheld the power of contracting parties to choose arbitration, a counter-current exists in bankruptcy. Bankruptcy courts, district courts, and courts of appeals have limited the effectiveness of arbitration agreements in a variety of bankruptcy matters, and so far, the Supreme Court has declined to interrupt this trend. An upshot for consumer debtors is that arbitration clauses are, at least for now, far less effective at neutralizing class actions in bankruptcy than they are outside of bankruptcy.

Yet the analysis that has led some courts to refuse arbitration of bankruptcy class action claims stands in tension with the rationales that might support later efforts to certify a debtor class. This tension is most pronounced in the discharge injunction class action cases, in which arbitration has been denied, in part, based on the unwillingness to allow an arbitrator to handle contempt proceedings. It is difficult to reconcile this reality with later attempts to allow those same contempt proceedings to be handled by a judge overseeing a nationwide class. Attorneys and courts handling debtor class actions in cases in which an arbitration agreement with a class-action waiver is present must therefore run a narrow gauntlet through motions to compel arbitration and ultimately class certification.

This article situates the tension between bankruptcy and arbitration within the broader procedural landscape of debtor class actions. It focuses, in particular, on class actions to enforce consumer debtors’ discharges in bankruptcy. It argues that arbitration is inappropriate in these matters, and considers the extent to which contempt-based claims might achieve nationwide class

certification. It also explores the arbitration implications of efforts to broaden the available remedies for discharge violations.

## THE BANKRUPTCY TRIBUNAL

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The United States Bankruptcy Code and the Federal Arbitration Act (FAA) are powerful statutory schemes, each one demanding a broad scope of influence and preempting many other fields laws, state and federal. The capacious nature of these statutes creates a challenging tension when they come into conflict. On the one hand, bankruptcy law is, in its very essence, a procedure of dispute resolution that cannot be waived or altered by contract. On the other hand, the FAA embodies a clear national policy in favor of allowing parties to contract for private dispute resolution procedures.

Resolving that tension requires an examination of important questions about the scope and operation of bankruptcy law. In our view, the interaction between the FAA and the Bankruptcy Code is in fact a version of a familiar and fundamental bankruptcy problem: When, and under what circumstances, should parties be allowed to opt in or out of the “bankruptcy tribunal” for the resolution of bankruptcy and bankruptcy-related matters?

This Article develops a general principle for thinking about that bankruptcy-tribunal problem: A bankruptcy tribunal should be the exclusive tribunal to resolve a legal issue if sending the dispute elsewhere would thwart the Code’s purpose of providing an efficient forum in which to resolve multiparty disputes that involve distressed firms. All questions about whether a dispute should be decided by a bankruptcy tribunal—not just those involving arbitration—can and should

be resolved by applying this principle. We examine this principle in the context of arbitration and then expand to other areas.



## REFRAMING ARBITRATION & BANKRUPTCY

*Written by:  
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University of Illinois College of Law*

Most every analysis of arbitration in bankruptcy is wrong. There is nothing special about bankruptcy. The Federal Arbitration Act (FAA) and the Bankruptcy Code are both congressional enactments of equal dignity. Courts must follow both statutes. Arbitration issues in bankruptcy are nothing more than statutory interpretation issues, requiring the reconciliation of two statutory schemes enacted decades apart and without express guidance on putting them together.

A thick crust of judicial rhetoric has obscured unassailable principles of law that should frame the conversation. Going back to these foundational principles will build a coherent framework about how arbitration and bankruptcy law work together.

This article builds an analysis around four principles to reframe the law about arbitration and bankruptcy. First, a contractual agreement cannot bind third persons who are not party to the contract. Second and somewhat of a corollary to the first principle, bankruptcy jurisdiction is in rem jurisdiction over the bankruptcy estate. An entity without that in rem jurisdiction as well as jurisdiction over the claimants to that res lacks authority to issue binding orders about it. Third, a court has the power to police its own orders. Fourth, a contract signed in one capacity does not bind the person when they act in other capacities. For example, a contract signed in a capacity as a corporate president does not bind the person individually.

**ARBITRATION AGREEMENTS AS EXECUTORY CONTRACTS IN BANKRUPTCY  
AFTER MISSION PROD. HOLDINGS, INC. V. TEMPNOLOGY, LLC**

*Written by:*

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**preliminary draft, please do not cite or quote**

Section 365(a) of the Bankruptcy Code gives the trustee or debtor-in-possession representing a bankruptcy estate the power to choose whether the estate will assume or reject many of the executory contracts formed by the pre-bankruptcy debtor. Several commentators have argued that arbitration law’s separability doctrine should prevent enforcement of executory arbitration agreements rejected under section 365. In contrast, courts nearly always hold that rejection does not prevent enforcement of executory arbitration agreements. However, courts differ in their reasons for this conclusion and most of their reasons fail to address the separability doctrine. This Article integrates the separability doctrine with case law under section 365, including the Supreme Court’s 2019 decision in *Mission Prod. Holdings, Inc. v. Tempnology*,<sup>54</sup> and argues that courts should continue enforcing executory arbitration agreements rejected under section 365.

Section I summarizes the law—in section 365 and cases applying it—on executory contracts in bankruptcy, including the “cum onere,” or all-or-nothing, rule generally requiring the estate to treat all executory portions of a contract as a unified whole for assumption or rejection. This rule is at least ostensibly in some tension with arbitration law’s separability doctrine.

This Article’s second section describes how *Tempnology* corrected some lower courts’ misinterpretations of section 365 and explores *Tempnology*’s somewhat mysterious statement that

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<sup>54</sup> *Mission Prod. Holdings, Inc. v. Tempnology*, 139 S. Ct. 1652, 1657–58 (2019).

after rejection of an executory contract, “all the rights that would ordinarily survive a contract breach, including those conveyed here, remain in place.” Section II suggests that *Tempnology* may distinguish mere promissory rights from property rights—with only the latter being “rights that would ordinarily survive a contract breach.” This distinction between breach of contract claims (which bankruptcy treats harshly) and property interests (which bankruptcy respects) largely tracks the distinction between money damages (the usual remedy for breach of contract) and equitable remedies (usually available for violations of property rights). However, an equitable remedy, specific performance, is the usual remedy for breaches of some contracts and is in the parlance of Law & Economics a “property rule,” because a court’s specific performance order vindicates the non-breaching party’s right to the specific “thing” the breaching party promised rather than allowing the breacher to substitute money damages while keeping the promised “thing.” Consequently, the right to specific performance of an executory contract might be, in *Tempnology*’s words, a right that would “ordinarily survive a contract breach.”

Section III explains that the Federal Arbitration Act requires courts to enforce executory arbitration agreements with the remedy of specific performance—court orders staying litigation and compelling arbitration. Thus, although bankruptcy law is generally leery of awarding specific performance against the bankruptcy estate, courts rightly use the specific performance remedy when enforcing arbitration agreements against the estate, notwithstanding rejection under section 365. And in doing so, courts have—since long before *Tempnology*—treated the right to compel arbitration as, in *Tempnology*’s words, a right that would “ordinarily survive a contract breach.”

This approach, Section IV explains, is consistent with arbitration law’s separability doctrine. Several commentators argue that this doctrine combines with section 365 to permit the trustee or debtor-in possession to sever an arbitration agreement from the contract containing it,

so the estate may reject the arbitration agreement and prevent its enforcement. In contrast, some courts, including the Third Circuit's oft-cited decision in *Hays and Company v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*,<sup>55</sup> may be read to suggest, incorrectly, that an executory arbitration agreement is not an executory contract and thus may not be rejected under section 365. Section IV joins the commentators in arguing that the separability doctrine requires courts to treat an executory arbitration agreement as a separable executory contract that may be rejected under section 365, but Section IV explains that rejection of executory arbitration agreement does not prevent its enforcement with the remedy of specific performance. In fact, such enforcement is required by the Federal Arbitration Act.

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<sup>55</sup> *Hays and Company v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 885 F.2d 1149 (3d Cir. 1989).