

# Winter Leadership Conference

# The Intersection of Arbitration and Bankruptcy

Hosted by the Business Reorganization & Young and New Members Committees

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#### The Intersection of Arbitration and Bankruptcy

#### ABI Winter Leadership Conference December 1, 2023, 11:00 a.m. – 12:00 p.m. Scottsdale Arizona

#### I. Circuit Court Case Summaries

- **a.** Shearson/American Express v. McMahon, 482 U.S. 220, 107 S. Ct. 2332 (1987).
- **b.** In re Nat'l Gypsum Co., 118 F.3d 1056 (5th Cir. 1997).
- c. <u>United States Lines, Inc. v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n (In re</u> United States Lines, Inc.), 197 F.3d 631 (2d Cir. 1999).
- **d.** White Mountain Mining Co. v. Congelton, L.L.C. (In re White Mountain), 403 F.3d 164, 167 (4th Cir. 2005).
- e. <u>Mintze v. Am. Fin. Servs., Inc. (In re Mintze)</u>, 434 F.3d 222 (3d Cir. 2006).
- **f.** <u>Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)</u>, 671 F.3d 1011 (9th Cir. 2012).

#### **II.** Discussed Opinions

- a. Acis Capital Mgmt., GP, LLC v. Highland Capital Mgmt., L.P. (In re Acis Capital Mgmt., L.P.), 600 B.R. 541 (Bankr. N.D. Tex. 2019).
- **b.** SC SJ Holdings, LLC, et al., Case No. 21-10549 (Bankr. D. Del.), Doc. No. 181.
- c. <u>Highland Capital Mgmt., L.P. v. Dondero (In re Highland Capital Mgmt., L.P.)</u>, 2021 Bankr. LEXIS 3314 (Bankr. N.D. Tex. Dec. 3, 2021).
- **d.** Murray v. Willkie Farr & Gallagher LLP (In re Murray Energy Holdings Co.), 2023 Bankr. LEXIS 2507 (Bankr. S.D. Ohio Oct. 5, 2023).
- e. <u>CB&I UK Limited</u>, Case No. 23-90795 (Bankr. S.D. Tex.), Doc. No. 99.
- f. <u>Joan Johnson v. S.A.I.L., LLC</u>, Case No. 22-ap-00172 (Bankr. N.D. Ill.), Doc. No. 18.

#### III. Academic Papers

- a. *Must I/May I Arbitrate in Bankruptcy?*, Hon. Stacey G. C. Jernigan, U. S. Bankruptcy Court, N.D. TX (Dallas), Sylvia A. Mayer, S. Mayer Law (Houston, TX), 38<sup>th</sup> Annual Jay L. Westbrook Bankruptcy Conference, October 2019
- **b.** COMPETING EFFICIENCIES: THE PROBLEM OF WHETHER AND WHEN TO REFER DISPUTES TO ARBITRATION IN BANKRUPTCY CASES, Alexis Leventhal and Roni Elias, 24 Am. Bankr. Inst. L. Rev. 133.

#### IV. International Citations of Note

- **a.** FamilyMart China Holding Co Ltd v. Ting Chuan (Cayman Islands) Holding Corporation, [2023] UKPC 33
- **b.** <u>China Evergrande Group v. Triumph Roc International Ltd</u>, [2023] HKCFI 2432, 45.

#### **Case Summaries**

#### a. Shearson/American Express v. McMahon, 482 U.S. 220, 107 S. Ct. 2332 (1987)

In Shearson/American Express, Inc. v. McMahon, the Court articulated a standard for determining when the federal policy in favor of enforcing arbitration agreements must give way to countervailing policies behind a different federal statute. McMahon specifically addressed whether arbitration clauses could be enforced when a plaintiff raised claims against a securities broker under the Racketeer Influenced and Corrupt Organizations Act ("RICO") and section 10(b) of the Securities Exchange Act of 1934 ("the Exchange Act"). McMahon held that arbitration agreements must be enforced unless a different federal statute articulated a policy that would be undermined by the enforcement of the arbitration agreement.

The plaintiffs in *McMahon* had signed brokerage agreements with the defendant, which included an arbitration clause. When the plaintiffs filed complaints in federal court, alleging wrongdoing in the management of their brokerage accounts, the defendants moved to compel arbitration under section 3 of the FAA. The plaintiffs argued that the arbitration agreements could not be enforced regarding claims under RICO and section 10(b) of the Exchange Act because the rights created and the remedies provided by those statutes could not be adequately protected in an arbitral forum.

Regarding this argument about whether arbitration provided an adequate forum to protect the rights guaranteed by RICO and the Exchange Act, the *McMahon* Court drew on its recent decisions extending the FAA. The *McMahon* Court established a default rule favoring arbitration regardless of the source of the rights at issue, and it concluded this default rule would be inapplicable only if the party opposing arbitration could establish that Congress sought to preclude arbitration for such disputes. The Court explained:

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. If Congress intended 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. . . . To defeat application of the Arbitration Act . . . the [party opposing arbitration] must demonstrate that Congress intended to make an exception to the Arbitration Act for claims arising under [the statute], an intention discernible from the text, history, or purposes of the statute.

Given the standard elaborated in *McMahon*, there are three principal ways to determine that Congress intended to create an exception to the federal policies favoring arbitration. First, the text of the other statute can clarify that the disputes falling within its ambit are to be litigated in federal court, not arbitrated. Second, the legislative history of the other statute can indicate that Congress' purpose contradicted the referral of the matter to arbitration. Third, there is an inherent conflict between the FAA's purpose and those of the other statute. Such an inherent conflict might appear from the text or the legislative history of the other statute, but it might also be evidence in the structure of the statutory scheme.

#### b. <u>In re Nat'l Gypsum Co.</u>, 118 F.3d 1056 (5th Cir. 1997)

In 1997, the United States Fifth Circuit Court of Appeals was asked to settle a dispute arising from an agreement entered into in 1985 (the "Wellington Agreement") between National Gypsum, a producer of asbestos containing products, and one of its national insurers, INA. The Fifth Circuit was asked to determine whether the Wellington Agreement, containing an arbitration clause, required enforcement of that arbitration clause where National Gypsum had filed for bankruptcy and the bankruptcy court decided not to stay adversary proceedings pending arbitration between the parties.

National Gypsum had obtained, without objection or appeal by INA, a confirmed reorganization plan. However, two years after the plan was confirmed, INA sought payment of monies advanced and interest thereon under the Wellington Agreement by initiating arbitration proceedings against National Gypsum. In response, National Gypsum filed an adversary proceeding-declaratory judgment complaint in bankruptcy court. The bankruptcy court found that, as the adversary proceeding sought to ascertain whether its reorganization plan precluded INA's claim, it had "core" jurisdiction under 28 U.S.C. section 157(b)(2)(B) and (C) and that the bankruptcy court was the most efficient forum to determine the issues raised. The bankruptcy court refused to abstain or to stay the adversary proceeding pending arbitration.

On appeal, the Fifth Circuit first found that actions to enforce the discharge injunction are core proceedings because they call on a bankruptcy court to construe and enforce its own order, holding that a declaratory judgment action seeking merely a "declaration that collection of an asserted preconfirmation liability is barred by a bankruptcy court's confirmation of a debtor's reorganization plan is a core proceeding arising under title 11." The court then considered whether a bankruptcy court may deny a motion to stay.

In its analysis, the court rejected the view that arbitration of core bankruptcy proceedings is inherently irreconcilable with the Bankruptcy Code, but rather that "nonenforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding, *i.e.*, whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration of the proceeding would conflict with the purposes of the Code." Applying this standard, the court found because the declaratory judgment complaint was central to National Gypsum's confirmed reorganization plan, which was derived from the Bankruptcy Code, the bankruptcy court was within its discretion to refuse to order arbitration of the adversary proceeding as to avoid conflict with the Bankruptcy Code's purpose. However, the court importantly made the distinction that "core" proceedings do not, categorically, give bankruptcy courts the discretion to not enforce arbitration agreements, but that the conflict between enforcement and the purpose of the Code must exist. As the Fifth Circuit explained:

The core/non-core distinction conflates the inquiry in *McMahon* and *Rodriguez* with the mere identification of the jurisdictional basis of a particular bankruptcy proceeding. Not all core bankruptcy proceedings are premised on provisions of the Code that 'inherently conflict' with the Federal Arbitration Act; nor would arbitration of such proceedings jeopardize the objectives of the Bankruptcy Code. Although, as appellees suggest, "the core/ non-core distinction is a practical and

workable one," it is nonetheless too broad. The "discretion" that ACMC and the Trust urge should exist only where a particular bankruptcy proceeding meets the standard for nonenforcement of an arbitration clause in *McMahon*...

The Fifth Circuit established a two-part analysis for determining when a bankruptcy court should refer a matter to arbitration. In the first stage of the analysis, the bankruptcy court would apply *McMahon* in determining the source of the rights that would be subject to arbitration if the arbitration clause were enforced. The crucial determination was whether the arbitrable issues arose from the debtor's pre-petition rights or from the Bankruptcy Code. In the second stage of the analysis, the bankruptcy court would consider issue-specific policy considerations to determine whether the arbitrable question would implicate the third dimension of the *McMahon* test: there is an inherent conflict between the FAA and the Code. Other circuits have taken a different approach, disregarding the first step of the analysis in the *National Gypsum* opinion.

## c. <u>United States Lines, Inc. v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n (In re</u> United States Lines, Inc.), 197 F.3d 631 (2d Cir. 1999)

Two years later, like the Fifth Circuit's approach to determining the enforceability of arbitration clauses, the Second Circuit Court of Appeals considered, first, whether the proceedings are core and, second, whether the bankruptcy court may enjoin arbitration, however, noting that determining the proceeding as "core" will not automatically give the bankruptcy court discretion to stay arbitration in *In re U.S. Lines*.

Here, an asbestos production company filed a voluntary chapter 11 petition and sought a declaratory judgment concerning the rights of creditors, specifically creditors holding claims for asbestos-related injuries for which the debtor had agreed to cover by entering into several Protection & Indemnity insurance policies containing arbitration clauses. The bankruptcy court held that such action was within its core jurisdiction and denied the creditors' motion to compel arbitration of the proceedings.

The Second Circuit first determined that a declaratory judgment action is core as necessary to effectuate an equitable distribution of the bankruptcy estate. The declaratory proceedings directly affect the bankruptcy court's core administrative function of asset allocation among creditors, and they are core. Distinction of core proceedings was important because, as the Second Circuit noted, a conflict between the bankruptcy code and the FAA is lessened in non-core proceedings which are unlikely to present a conflict sufficient to override by implication the presumption in favor of arbitration.

The court reasoned "[i]n exercising its discretion over whether, in core proceedings arbitration provisions ought to be denied effect, the bankruptcy court must still carefully determine whether any underlying purpose of the Bankruptcy Code would be adversely affected by enforcing an arbitration clause." The court held that "it was within the bankruptcy court's discretion to refuse to refer the declaratory judgment proceedings, which it properly found to be core, to arbitration."

## d. White Mountain Mining Co. v. Congelton, L.L.C. (In re White Mountain), 403 F.3d 164, 167 (4th Cir. 2005).

The Fourth Circuit Court of Appeals has largely followed suit with the Second and Fifth circuits. In *White Mountain*, in response to a motion to compel the creditor to submit claims to arbitration under a pre petition agreement and to stay or dismiss the adversary proceedings, the bankruptcy court denied the motion reasoning that because the creditor's complaint sought a determination over whether he was owed money by the debtor, it entailed a core proceedings under 28 U.S.C. section 157(b)(2)(B). 107 The bankruptcy court found the core proceeding trumped the arbitration.

On appeal, the Fourth Circuit noted the *McMahon* line of analysis: "[i]f 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." Under the third inherent conflict line of analysis, and in keeping with the reasoning of *U.S. Lines*, the Fourth Circuit found that, in the bankruptcy setting, congressional intent to permit a bankruptcy court to enjoin arbitration is sufficiently clear to override even international arbitration agreements. 110 The inherent conflict was clear because both the adversary proceeding and the arbitration involved a core issue: determining whether the creditor's advances to the debtor were debt or equity.

#### e. Mintze v. Am. Fin. Servs., Inc. (In re Mintze), 434 F.3d 222 (3d Cir. 2006)

The Third Circuit most recently visited the enforceability of arbitration in bankruptcy proceedings in 2006. The *Mintze* court, relying on the earlier Third Circuit decision in *Hayes*, stated that whether the *McMahon* standard is met determines whether the court has the discretion to deny enforcement of an otherwise applicable arbitration clause. The circuit court clarified: whether core or not, the *McMahon* standard must first be satisfied before the bankruptcy court has the discretion to deny arbitration.

The bankruptcy court had determined that the debtor's rescission claim, based on the Truth in Lending Act ("TILA") and several federal and state consumer protection laws, was sufficient to create an inherent conflict between the Bankruptcy Code's underlying purposes and those of arbitration, concluding the proceeding was best left in the bankruptcy court. However, the Third Circuit stated "[the court] cannot agree with this conclusion" specifically noting the debtor's claims were not created by the Bankruptcy Code. The Third Circuit further noted that without a bankruptcy issue to be decided by the bankruptcy court, "we cannot find an inherent conflict between arbitration of [the debtor's] federal and state consumer protection issues and the underlying purposes of the Bankruptcy Code." The court further noted that the court could not perceive of a sufficiently adverse effect on the underlying purposes of the Bankruptcy Code should the arbitration clause be enforced. Ultimately, the Third Circuit concluded that the "[b]ankruptcy court erred when it determined it had the discretion to deny enforcement of the arbitration provision in the contract between [debtor and creditor]."

## f. Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 671 F.3d 1011 (9th Cir. 2012).

In 2012, the Ninth Circuit held that the arbitration of a claim presented by a creditor would conflict with the purposes of a provision of the Bankruptcy Code and the purposes and policies of the Bankruptcy Code as a whole.

Here, the debtor, Thorpe Insulation Co. ("Thorpe"), distributed and installed asbestos-containing products from 1948-1972. About 12,000 claims for asbestos-related injuries or deaths had been brought against Thorpe with Thorpe's insurers, including Continental Insurance Company ("Continental"), paying more than \$ 180 million defending and indemnifying these claims. In 1985, Continental and Thorpe entered into the Wellington Agreement calling for binding arbitration of coverage disputes. In 1988, Thorpe had exhausted its coverage under Continentals' policies and Continental ceased indemnifying Thorpe. Thorpe then sought "non products" coverage under Continental's policies, asserting that such "non products" coverage was not subject to the policies' liability limits. Continental disputed this and initiated arbitration under the Wellington Agreement. The arbitrator sided with Continental, finding that Thorpe had no remaining coverage rights under Continental's policies. Thorpe appealed, and the parties agreed to settle.

In April 2003, the parties executed an integrated Settlement Agreement and Release (the "Settlement"). The Settlement only released Thorpe's claims against Continental, not the direct action rights of individual asbestos claimants or to the contribution, indemnity, or subrogation rights of other insurers. Lawsuits continued against Thorpe and its insurance coverage with other insurers dwindled. Thorpe considered bankruptcy, hoping to reorganize under section 524(g), a unique mechanism for consolidating asbestos-related assets and liabilities of a debtor into a single trust for the benefit of present and future asbestos claimants, in that it authorizes the bankruptcy court to enter a "channeling injunction" that channels claims to the trust in order to prevent claimants from suing the debtor. The injunction may also bar actions against third party insurers based on asbestos-related claims against the debtor if the third parties contribute to the trust in amounts commensurate with their likely liability and requires that a class of claimants be established and at least 75% approve the plan.

In preparation of filing for bankruptcy, Thorpe negotiated with insurers other than Continental to ensure their funding of the section 524(g) trust. Thorpe also identified and negotiated with potential asbestos claimants to ensure their approval of the section 524(g) trust. Continental contended these actions violated the Settlement Agreement and sought to arbitrate its claim. Arbitration was scheduled for October 16, 2007.

Thorpe filed for chapter 11 bankruptcy on October 15, 2007. Continental filed a proof of claim, which Thorpe objected to and, in response, Continental moved to compel arbitration alleging: (1) Thorpe's pre petition acquisition of the other insurers' contribution; (2) Thorpe's post-petition assignment of such rights to the trust created under the 11 U.S.C. section 524(g) plan; (3) Thorpe's pre-petition encouragement of direct action claims against Continental; and (4) Thorpe's cooperation and participation as a plan proponent in drafting, proposing, and seeking confirmation of a Plan designed to assist asbestos claims and in bringing direct action claims against Continental.

The bankruptcy court denied Continental's motion to compel arbitration and disallowed its claim holding that the allowance or disallowance of Continental's claim was a core matter under 28 U.S.C. section 157(b)(2). 137 The bankruptcy court found that, "as a matter of fundamental bankruptcy policy, only a bankruptcy court should decide whether the manner in which someone has administered a bankruptcy estate gives rise to a claim for damages." Ultimately, the matter in dispute, the bankruptcy court found, was a core matter and had discretion in a case not to send the issue to arbitration. The bankruptcy court further disallowed Continental's claim as a matter of law--finding that Thorpe's actions did not violate the Settlement Agreement. Continental appealed and the district court affirmed. Continental appealed the district court contending that its claim should be arbitrated under the arbitration clause in the Settlement Agreement because the claim is non-core and, even if the claim is core, it should be arbitrated because arbitration would not inherently conflict with the Bankruptcy Code.

Although the Ninth Circuit pointed out the liberal federal policy favoring arbitration agreements under the FAA, citing *McMahon*, the court also pointed out that the FAA's mandate may be overridden by a contrary congressional command. The court had to determine whether Congress intended to make an exception to the FAA for claims arising in bankruptcy proceedings, an intention discernible from the text, history, or purpose of the Bankruptcy Code. The court did, not find such intent in the text or the legislative history of the Bankruptcy Code, but determined there is an inherent conflict between arbitration and the underlying purposes of the Bankruptcy Code.

Ultimately, the Ninth Circuit found that regardless of whether the proceeding was core or not, the *McMahon* standard must still be met--that is, a bankruptcy court may decline to enforce an otherwise applicable arbitration provision only if arbitration would conflict with the underlying purposes of the Bankruptcy Code. The court found that the core/non-core determination is not alone dispositive. Continental's claim was found, however, to be a core proceeding because Continental filed a proof of claim, and Thorpe objected to the claim, so under 28 U.S.C. section 157(b)(2)(B), the allowance or disallowance of that claim was a core proceeding. Continental's claim disputed or affected assets in the 11 U.S.C. section 524(g) trust and the rights of other creditors. Resolution of that claim directly affected the administration of the bankruptcy estate. The court further reasoned that, "because Congress intended that the bankruptcy court oversee all aspects of a 524(g) reorganization, only the bankruptcy court should decide whether the debtor's conduct in the bankruptcy gives rise to a claim for breach of contract. Arbitration in this case would conflict with congressional intent."

The court further noted that "[a]rbitration of a creditor's claim against a debtor, even if conducted expeditiously, prevents the coordinated resolution of debtor-creditor rights and can delay the confirmation of a plan of reorganization." These pragmatic concerns led the court to conclude that the "arbitration of the claim presented by Continental would conflict with the purposes and policies of 524(g) and the Bankruptcy Codes as a whole . . ." and that the bankruptcy court had discretion not to enforce the arbitration clause.



User Name: Alexis Leventhal

Date and Time: Thursday, November 2, 2023 3:16:00PM EDT

**Job Number:** 209597093

#### Document (1)

1. Acis Capital Mgmt., GP, LLC v. Highland Capital Mgmt., L.P. (In re Acis Capital Mgmt., L.P.), 600 B.R. 541

Client/Matter: -None-



## Acis Capital Mgmt., GP, LLC v. Highland Capital Mgmt., L.P. (In re Acis Capital Mgmt., L.P.)

United States Bankruptcy Court for the Northern District of Texas, Dallas Division

April 16, 2019, Decided

CASE NO. 18-30264-SGJ-11, CASE NO. 18-30265-SGJ-11, (Jointly Administered Under Case No. 18-30264-SGJ-11), (Chapter 11), ADVERSARY NO. 18-03078-SGJ

#### Reporter

600 B.R. 541 \*; 2019 Bankr. LEXIS 1228 \*\*

IN RE: ACIS CAPITAL MANAGEMENT, L.P., ACIS CAPITAL MANAGEMENT, GP, LLC, Debtors.ROBIN PHELAN, CHAPTER 11 TRUSTEE, Plaintiff, VS. HIGHLAND CAPITAL MANAGEMENT, L.P., HIGHLAND CLO FUNDING LTD, HIGHLAND HCF ADVISOR, LTD., HIGHLAND CLO MANAGEMENT, LTD., and HIGHLAND CLO HOLDINGS, LTD., Defendants.

Code, including the expeditious and equitable distribution of the assets of a debtor's estate.

#### Outcome

Arbitration motion denied.

#### LexisNexis® Headnotes

#### **Core Terms**

arbitration, Counts, arbitration clause, adversary proceedings, partnership agreement, parties, Restated, Reorganized, bankruptcy court, fraudulent transfer, proof of claim, binding arbitration, arbitration provision, effective, transfer agreement, bankruptcy case, law firm, disputes, prior agreement, no arbitration, counterclaims, overcharged, superseded, entities, purposes, matters, cases, motion to compel arbitration, franchise agreement, license agreement

#### Case Summary

#### Overview

HOLDINGS: [1]-Valid arbitration agreements applied to disputes in this adversary action because, even though agreements between the parties had changed and arbitration clauses had been dropped from the agreements, there were binding arbitration clauses in agreements between the parties at the time the causes of action accrued; [2]-However, the bankruptcy court had discretion under established Fifth Circuit authority to decline to order arbitration because the disputes asserted avoidance theories under 11 U.S.C.S. §§ 542, 544(a), 547, 548, 550 and had transformed into statutory core matters. Enforcing the arbitration clauses here would conflict with the purposes of the Bankruptcy

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Arbitration Agreements

#### HN1[ Arbitration, Arbitrability

The Federal Arbitration Act (FAA) provides that arbitration agreements are always valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. *9 U.S.C.S. § 2*. Thus, the FAA reflects a liberal federal policy favoring arbitration, and requires arbitration agreements to be rigorously enforced according to their terms. The FAA expresses a strong national policy favoring arbitration of disputes, and all doubts concerning the arbitrability of claims should be resolved in favor of arbitration. There is a strong presumption in favor of arbitration and the party seeking to invalidate an arbitration agreement bears the burden of establishing its invalidity.

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration

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600 B.R. 541, \*541; 2019 Bankr. LEXIS 1228, \*\*1228

Act > Arbitration Agreements

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Orders to Compel Arbitration

## <u>HN2</u> | Federal Arbitration Act, Arbitration Agreements

When considering a motion to compel arbitration, the United States Court of Appeals for the Fifth Circuit has held there are two threshold questions: (1) whether an arbitration agreement is valid; and (2) whether the dispute falls within the scope of the agreement. To evaluate the enforceability of an arbitration agreement, courts apply the contract law of the state that governs the agreement, whereas the scope of the agreement is a matter of federal substantive law.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Duties & Functions

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Arbitration Agreements

### <u>HN3</u> **≥** Examiners, Officers & Trustees, Duties & Functions

Case law has stated that a bankruptcy trustee stands in the shoes of the debtor for the purposes of an arbitration clause and the trustee-plaintiff is bound by the clause to the same extent as would the debtor.

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Arbitration Agreements

Business & Corporate Compliance > ... > Contract Formation > Contracts Law > Contract Formation

## <u>HN4</u>[♣] Federal Arbitration Act, Arbitration Agreements

With respect to whether a valid agreement to arbitrate exists, federal courts apply ordinary state-law principles that govern the formation of contracts.

Business & Corporate Compliance > ... > Contract Conditions & Provisions > Contracts Law > Contract Conditions & Provisions

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > Choice of Law

### <u>HN5</u>[♣] Contracts, Contract Conditions & Provisions

Under the Texas rules, in those contract cases in which the parties have agreed to an enforceable choice of law clause, the law of the chosen state must be applied.

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Arbitration Agreements

## <u>HN6</u>[ **\rightarrow**] Federal Arbitration Act, Arbitration Agreements

With respect to determining whether an arbitration agreement applies to a dispute, a court should look at when a cause of action accrued and determine if there was a binding arbitration clause between the parties at that time in the governing version of the agreement.

Bankruptcy Law > Procedural Matters > Adversary Proceedings

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Arbitration Agreements

#### **HN7 L** Procedural Matters, Adversary Proceedings

A bankruptcy court may decline to enforce arbitration clauses when it finds: (a) the underlying nature of the proceeding derives from the provisions of the Bankruptcy Code; and (b) that enforcement of the arbitration provision would conflict with the purposes/goals of the Bankruptcy Code. Some purposes/goals of the Code that might support a denial of arbitration, include: (1) the equitable and expeditious distribution of assets of the Debtor's estate; (2) centralized resolution of pure bankruptcy issues; (3) protection of creditors and reorganizing debtors from piecemeal litigation, and (4) the undisputed power of a bankruptcy court to enforce its orders.

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600 B.R. 541, \*541; 2019 Bankr. LEXIS 1228, \*\*1228

Bankruptcy Law > Procedural
Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Claims > Proof of Claim

#### HN8[基] Jurisdiction, Core Proceedings

The bankruptcy court's quintessential duties are to adjudicate proofs of claim and to provide a central forum for litigation, whenever feasible and jurisdictionally sound. Indeed, when a proof of claim is filed, one of the peculiar powers of the bankruptcy court has been invoked and the nature of estate claims becomes different from their nature following the filing of a proof of claim.

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For Highland CLO Funding, Ltd., Counter-Defendant (18-03078-sgj): Paul Richard Bessette, King & Spalding LLP, Austin, TX; Rebecca T. Matsumura, King & Spalding, Austin, TX.

For Highland Capital Management, L.P., Counter-Defendant (18-03078-sgj): [\*\*2] Jason B. Binford, Holland N. O'Neil, Foley Gardere, Foley & Lardner LLP, Dallas, TX.

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For Robin Phelan, Trustee (18-30264-sgj11): Annmarie Antoniette Chiarello, Winstead PC, Dallas, TX; Jason Alexander Enright, Phillip L. Lamberson, Rakhee V. Patel, Joseph J. Wielebinski, Jr., Winstead PC, Dallas, TX; Matthias Kleinsasser, Forshey & Prostok, L.L.P., Fort Worth, TX; Jeff P. Prostok, Forshey & Prostok, LLP, Ft. Worth, TX; Suzanne K. Rosen, Forshey & Prostok, LLP, Fort Worth, TX.

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For Acis Capital Management GP, LLC, Debtor (18-30265-sgj11): Rakhee V. Patel, Winstead PC, Dallas, TX; Jeff P. Prostok, Forshey & Prostok, LLP, Ft. Worth, TX; Warren A. Usatine, Cole Schotz, PC, Hackensack, NY; Michael D. Warner, Cole Schotz P.C., Fort Worth, TX.

Trustee (18-30265-sgj11): Robin Phelan, Dallas, TX.

For United States Trustee, U.S. Trustee (18-30265-sgj11): Lisa L. Lambert, Office of the United States Trustee, Dallas, TX.

**Judges:** Stacey G.C. Jernigan, United States Bankruptcy Judge.

Opinion by: Stacey G.C. Jernigan

#### Opinion

## [\*543] MEMORANDUM OPINION AND ORDER DENYING MOTION TO COMPEL ARBITRATION [DE # 102]

#### I. Introduction.

Before this court is a Motion to Compel Arbitration (the

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600 B.R. 541, \*543; 2019 Bankr. LEXIS 1228, \*\*3

"Arbitration Motion"), 1 requesting that the bankruptcy court send to arbitration only a *sub-set* of claims asserted in the above-referenced adversary proceeding (the "Adversary Proceeding"). Some procedural context is crucial in analyzing the merits of the Arbitration Motion and, thus, is set forth immediately below.

This Adversary Proceeding has morphed into a large, complex lawsuit—at this stage primarily involving 35 claims, 20 of which are grounded in fraudulent transfer theories. [\*\*4] <sup>2</sup> The Arbitration Motion, as explained below, seeks arbitration of *eight* of the 35 claims (*i.e.*, Counts 1-8).

The Arbitration Motion was filed by party Highland Capital Management, L.P. ("Highland"). Highland and a related company, [\*544] Highland CLO Funding Ltd. ("HCLOF"), were originally the plaintiffs in this Adversary Proceeding, suing the Chapter 11 Trustee for injunctive relief (arguing early during the above-referenced Chapter 11 bankruptcy cases that the Chapter 11 Trustee was interfering with their business rights and decisions, essentially). The Chapter 11 Trustee fired back with 35 counterclaims against Highland and HCLOF (adding three parties related to Highland as third-party defendants with regard to some of those 35 counterclaims). Notably, these 35 counterclaims-as directed toward Highland-were also alleged to be objections to Highland's two \$4,672,140.38 proofs of claim filed in the underlying bankruptcy cases.3 In that regard, the Chapter 11 Trustee stated that his Answer and Counterclaims included "an objection to Highland Capital's proofs of claim pursuant to Federal Rule of Bankruptcy Procedure 3007(b), and the counterclaims asserted herein shall constitute recoupment and/or offset to such proofs of claim, to the [\*\*5] extent such claims are otherwise allowed." In fact, after the 35 counts were articulated in the Chapter 11 Trustee's Answer and Counterclaims, there were 20 paragraphs (¶¶ 252-271, pp. 70-77) solely articulating the Chapter 11 Trustee's objections to Highland's proofs of claim. The Chapter 11 Trustee also filed yet a separate adversary proceeding, Adv. Proc. No. 18-03212, seeking his own injunctive relief, which has recently been consolidated with this Adversary Proceeding.

The Chapter 11 Trustee ultimately proposed and obtained confirmation of a Chapter 11 plan in the underlying bankruptcy cases, and the Reorganized Debtors, now under new ownership and management, were vested in that plan with the counterclaims in this Adversary Proceeding (among other rights and claims). The injunctive relief initially sought by Highland [\*\*6] and HCLOF, as plaintiffs in the Adversary Proceeding, later became mooted by various orders in the bankruptcy cases and such claims were voluntarily dismissed [\*545] without prejudice. Thus, Highland, which is pursuing the Arbitration Motion, now wears the hat of only a defendant (and proof of claimant), and the Reorganized Debtors are the plaintiffs asserting the 35 original "counterclaims" asserted by the Chapter 11 Trustee against Highland (which 35 claims are also

<sup>4</sup>DE # 84, ¶ 6. The Chapter 11 Trustee has argued that the Highland proofs of claim should be disallowed under (i) section 502(b)(1) of the Bankruptcy Code (in that the Highland proofs of claim are allegedly unenforceable against the Debtors under the limited partnership agreement of Acis Capital Management, L.P. and applicable law); (ii) section 502(b)(4) of the Bankruptcy Code (in that the proofs of claim are for services of an insider of the Debtors and allegedly exceed the reasonable value of the services); and (iii) under section 502(d) of the Bankruptcy Code (in that the Trustee has asserted avoidance actions against Highland). Finally, to the extent allowed at all, the Trustee has argued that the Highland proofs of claim should be equitably subordinated under section 510(c) of the Bankruptcy Code. In summary, pursuant to section 502(b) and (d) of the Bankruptcy Code and Federal Rule of Bankruptcy Procedure 3007, the Trustee has sought entry of an order disallowing and expunging the Highland proofs of claim from the Debtors' claims registers. See id. at ¶¶ 251-272.

<sup>&</sup>lt;sup>1</sup> DE # 102.

<sup>&</sup>lt;sup>2</sup>There is also a preference count and a <u>section 550</u> recovery count—thus, 22 out of the 35 claims are chapter 5 avoidance actions and recovery. <u>11 U.S.C. §§ 544, 547, 548</u> & <u>550</u>.

<sup>&</sup>lt;sup>3</sup> See Defendant's Amended Answer, Counterclaims (Including Claim Objections) and Third-Party Claims (DE # 84), filed November 13, 2018, in response to the Original Complaint and Request for Preliminary Injunction of Highland CLO Funding, Ltd and Highland Capital Management Against Chapter 11 Trustee of Acis Capital Management, L.P. and Acis Capital Management GP, LLC (DE # 1), filed May 30, 2018, and also in response to the proofs of claims filed by Highland Capital Management, L.P. (see Proof of Claim No. 27, filed in Case No. 18-30264, and Proof of Claim No. 13 filed in Case No. 18-30265, each in the amount of \$4,672,140.38, with the basis of each of the proofs of claim listed as "Sub-Advisory Services and Shared Services"; these proofs of claim are virtually identical).

<sup>&</sup>lt;sup>5</sup> *Id*.

<sup>&</sup>lt;sup>6</sup> DE # 124.

<sup>&</sup>lt;sup>7</sup> DE # 79.

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objections to Highland's proof of claim). The separate adversary proceeding that was filed by the Chapter 11 Trustee seeking injunctive relief (Adv. Proc. No 18-03212) was consolidated into this Adversary Proceeding, and the style of this Adversary Proceeding was adjusted to reflect that the Chapter 11 Trustee had become situated as plaintiff.<sup>8</sup> But, to be clear, the Reorganized Debtors are actually now plaintiffs in place of the Chapter 11 Trustee. The Reorganized Debtors are Acis Capital Management, L.P. ("Acis LP") and Acis Capital Management GP, LLC ("Acis GP"), and they oppose the Arbitration Motion.<sup>9</sup>

Citing to the Federal Arbitration Act (the "FAA"), 9 U.S.C. § 1 et seq., Highland argues that the bankruptcy court must enter an order compelling [\*\*7] arbitration as to counts 1-8 because: (a) these eight counts revolve around the interpretation of certain prior versions of a Sub-Advisory Agreement and Shared Agreement (later defined); and (b) the aforementioned agreements contained binding arbitration clauses. Highland also requests that the Adversary Proceeding be stayed regarding counts 1-8, pending binding arbitration. The Reorganized Debtors dispute that there are binding arbitration clauses applicable to counts 1-8. As explained further below, the aforementioned agreements were amended many times and the arbitration clauses were eventually eliminated in the last versions of the agreements. The Reorganized Debtors also urge that, even if there are applicable arbitration clauses, the court may and should exercise discretion and decline to order arbitration, since core bankruptcy matters are involved and arbitration would conflict with the purposes of the Bankruptcy Code. For the reasons set forth below, the Arbitration Motion is denied. This means that Counts 1-26 & 33-35 will go forward and be adjudicated in this Adversary Proceeding. 10 But as will be explained in a separate order that is being issued shortly following [\*\*8] this order, there are certain counts complaining of postpetition state law torts and breaches of contract in this Adversary Proceeding

(Counts 27-32) that this court believes should be separated out into a different adversary proceeding and consolidated with a contested matter involving a Highland request for allowance of a postpetition administrative expense claim [DE # 772].

#### II. Background Facts

#### A. First, the Agreements Between the Parties.

As this court has noted on various occasions, Acis LP was formed in the year 2011, and is primarily a CLO portfolio [\*546] manager. 11 Specifically, Acis LP provides fund management services to various special purpose entities that hold CLOs (which is an acronym for "collateralized loan obligations"). Acis LP was providing management services for five such special purpose entities (the "Acis CLOs") as of the time that it and its general partner were put into the abovereferenced involuntary bankruptcy cases "Bankruptcy Cases"). The parties have informally referred to the special purpose entities themselves as the "CLO Issuers" or "CLO Co-Issuers" but, to be clear, these special purpose entities (hereinafter, the "CLO SPEs") are structured as follows: [\*\*9] (a) on the asset side of their balance sheets, the entities own pieces of senior debt owed by large corporations and, therefore, earn revenue from the variable interest payments made by those corporations on such senior debt; and (b) on the liability side of their balance sheets, the entities have obligations in the form of notes (i.e., tranches of fixed interest rate notes) on which the CLO SPEs themselves are obligated-the holders of which notes are mostly institutions and pension funds. The CLO SPEs make a profit, based on the spread or "delta" between: (a) the variable rates of interest paid on the assets that the CLO SPEs own (i.e., the basket of senior notes); and (b) the fixed rates of interest that the CLO SPEs must pay on their own tranches of debt. At the bottom of the CLO SPEs' capital structure is their equity (sometimes referred to as "subordinated notes," but these "notes" are genuinely equity). As portfolio manager, Acis LP manages the CLO SPEs' pools of assets (by buying and selling senior loans to hold in the CLO SPEs' portfolios) and communicates with investors in the CLO SPEs. The CLO SPEs' tranches of notes are traded on the Overthe-Counter market.

<sup>8</sup> DE # 124.

<sup>9</sup> DE # 123.

<sup>&</sup>lt;sup>10</sup>The court notes that a Supplemental Motion to Withdraw the Reference in this Adversary Proceeding has recently been filed by Highland and HCLOF [DE # 134] and that motion will be addressed in due course hereafter. The ruling herein with regard to the Arbitration Motion does not affect such motion and such motion will be separately addressed, after a status conference, and through a report and recommendation to the District Court.

<sup>&</sup>lt;sup>11</sup> Acis LP has managed other funds, from time to time, besides CLOs.

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To be perfectly [\*\*10] clear, none of the CLO SPEs themselves have been in bankruptcy. Only Acis LP which *manages* the CLO business and its general partner, Acis GP, were put into bankruptcy.

Historically, Acis LP has had four main sets of contracts that were at the heart of its business and allowed it to function. They are described below. The second and third agreements set forth below are highly relevant to the Arbitration Motion before the court. The Chapter 11 Trustee, from time-to-time, credibly testified that these agreements collectively created an "ecosystem" that allowed the Acis CLOs to be effectively and efficiently managed by Acis LP.

#### 1. The PMAs with the CLO SPEs.

First, Acis LP has various portfolio management agreements ("PMAs") with the CLO SPEs, pursuant to which Acis LP earns management fees. The PMAs have been the primary "assets" (loosely speaking) of Acis LP. They are what generate revenue for Acis LP.

#### 2. The Sub-Advisory Agreement with Highland.

Second, Acis LP had a Sub-Advisory Agreement (herein so called) with Highland. Pursuant to this agreement, Acis LP essentially sub-contracted for the use of Highland front-office personnel/advisors to perform management services for Acis LP (i.e. [\*\*11], so that Acis LP could fulfill its obligations to the CLO SPEs under the PMAs). Acis LP paid handsome fees to Highland pursuant to this agreement. This agreement was rejected (with bankruptcy court approval) by the Chapter 11 Trustee during the Bankruptcy Cases, when the Chapter 11 Trustee credibly represented that he had not only found resources to [\*547] provide these services at a much lower cost to the estate, but he also had begun to believe that Highland was engaging in stealth efforts to liquidate the Acis CLOs, to the detriment of Acis LP's creditors.

There were five iterations of the Sub-Advisory Agreement between the parties over time: (a) the initial Sub-Advisory Agreement, "made effective January 1. 2011" (which had an arbitration clause at section 16(f));<sup>12</sup> (b) an Amended and Restated Sub-Advisory Agreement, "made" May 5, 2011, "to be effective January 1, 2011" (which also had an arbitration clause

<sup>12</sup> Exh. 1 to Arbitration Motion.

Amended and Restated Sub-Advisory Agreement "made" on July 29, 2016, "to be effective January 1, 2016" [\*\*12] (which had an arbitration clause at section 16(f)):15 and (e) the Third Amended and Restated Sub-Advisory Agreement "dated as of March 17, 2017" (which suddenly contained no arbitration clause, with no explanation). 16 3. The Shared Services Agreement with Highland.

at section 16(f))<sup>13</sup>; (c) an Amendment to Amended and

Restated Sub-Advisory Agreement "entered into as of"

July 1, 2011 (which did not seem to affect in any way

the aforementioned arbitration clause);14 (d) Second

Third, Acis LP also had a Shared Services Agreement (herein so called) with Highland, pursuant to which Acis LP essentially sub-contracted for the use of Highland's back-office services (again, so that Acis LP could fulfill its obligations to the CLO SPEs under the PMAs). To be clear, Acis LP had no employees of its own-only a couple of officers and members. Acis LP paid handsome fees to Highland for the personnel and backoffice services that Highland provided to Acis LP. This agreement was also rejected by the Chapter 11 Trustee during the Bankruptcy Cases (with Bankruptcy Court approval) for the same reasons that the Sub-Advisory Agreement with Highland was rejected.

There were five iterations of the Shared Services Agreement between the parties over time: (a) the initial Shared Services Agreement "effective as of January 1, 2011" (which had an arbitration clause at section 9.14);17 (b) an Amendment to Shared Services Agreement, "entered into as of" July [\*\*13] 1, 2011 (which did not seem to affect in any way the aforementioned arbitration clause);18 (c) a Second Amended and Restated Shared Services Agreement "dated effective January 1, 2015" (which had an arbitration clause at section 9.14);19 (d) a Third Amended and Restated Shared Services Agreement "dated effective as of January 1, 2016 (which had an

<sup>&</sup>lt;sup>13</sup> Exh. 2 to Arbitration Motion.

<sup>&</sup>lt;sup>14</sup> Exh. 3 to Arbitration Motion.

<sup>&</sup>lt;sup>15</sup> Exh. 4 to Arbitration Motion.

<sup>&</sup>lt;sup>16</sup> Exh. 5 to Arbitration Motion.

<sup>&</sup>lt;sup>17</sup> Exh. 6 to Arbitration Motion.

<sup>&</sup>lt;sup>18</sup> Exh. 7 to Arbitration Motion.

<sup>&</sup>lt;sup>19</sup> Exh. 8 to Arbitration Motion.

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arbitration clause at section 9.14);<sup>20</sup> and (e) a Fourth Amended and Restated Shared Services Agreement "dated as of March 17, 2017" (*which suddenly contained no arbitration clause, with no explanation*).<sup>21</sup>

#### 4. The Equity/ALF-PMA.

Fourth, until a few weeks before the Bankruptcy Cases were filed, Acis LP also had yet another portfolio management [\*548] agreement (distinct from its PMAs with the CLO SPEs) whereby Acis LP provided services not just to the CLO SPEs themselves, but separately to the equity holder in the CLO SPEs. This portfolio management agreement with the equity holder in the CLO SPEs is sometimes referred to by the parties as the "ALF PMA," but it would probably be easier to refer to it as the "Equity PMA"22 (for ease of reference, the court will refer to it as the "Equity/ALF PMA"). Acis LP did not earn a specific fee pursuant to the Equity/ALF PMA, but the Chapter 11 [\*\*14] Trustee and others credibly testified during the Bankruptcy Cases that Acis LP considered the agreement valuable and very important, because it essentially gave Acis LP the ability to control the whole Acis CLO eco-system-in other words, it gave Acis LP the ability to make substantial decisions on behalf of the CLO SPEs' equity-distinct from making decisions for the CLO SPEs themselves pursuant to the PMAs. In any event, shortly before the Bankruptcy Cases were filed, agents of Highland and/or others controlling Acis LP: (a) caused Acis LP to terminate this Equity/ALF PMA; and (b) then caused the equity owner to enter into a new Equity PMA with a newly formed offshore entity called Highland HCF Advisor, Ltd. (one of the Defendants in this Adversary Proceeding).

#### 5. Limited Partnership Agreement of Acis LP.

There is actually a fifth agreement that should be mentioned. Although not as integral as the previous four agreements, there was a certain Amended and Restated Agreement of Limited Partnership of Acis Capital Management, L.P., dated to be effective as of

January 1, 2011 (the "LPA"), entered into among the general partner and limited partners of Acis LP. Reorganized Acis has argued [\*\*15] in the Adversary Proceeding that this LPA limited in some respects the compensation that could be paid to Highland under the Sub-Advisory Agreement and the Shared Services Agreement.

## B. Next, the 35 Counts Asserted Against Highland in this Adversary Proceeding.

The Adversary Proceeding, distilled to its essence—and as currently framed-is all about certain activities of Highland and some of its affiliates and actors who controlled it, which activities were allegedly aimed at denuding Acis LP of all of its value, at a time when the former portfolio manager for Acis LP was on the verge of obtaining a very large judgment claim against Acis LP. Specifically, these activities of Highland began soon after: (a) it terminated former Acis CLO manager Joshua Terry ("Terry") in June 2016; (b) it began litigating with him (which litigation was sent to arbitration) in September 2016; and (c) Terry obtained an approximately \$8 million arbitration award against Acis LP in October 2017, which was confirmed by a judgment in December 2017. The activities and counts revolve around: (a) Highland's alleged overcharging of Acis LP by more than \$7 million for fees/expenses under the Sub-Advisory and Shared [\*\*16] Services Agreement, as limited by the LPA (Counts 1-4); (b) alleged fraudulent transfers of value out of Acis LP, by virtue of various amendments and modifications of the Sub-Advisory and Shared Services Agreements (Counts 5-8); (c) an alleged fraudulent transfer as to the Equity/ALF PMA (Counts 9-12); (d) an alleged fraudulent transfer pertaining to [\*549] Acis LP's conveyance away of its so-called ALF Equity (Counts 13-16); (e) an alleged fraudulent transfer of a \$9.5 million note receivable Acis LP held (Counts 17-20); (f) various other fraudulent transfers (Counts 21-24): (a) preferences (Count 25); (h) assertion of a section 550 recovery remedy for the aforementioned avoidance actions (Count 26); and (i) requests for punitive damages, an alter ego/veil piercing remedy, and attorneys' fees (Counts 33-35). There are also some counts complaining of postpetition state law torts and breaches of contract (Counts 27-32).

As mentioned earlier, Highland's Arbitration Motion only requests the court defer to arbitration Counts 1-8—that is the counts relating to: (a) Highland's alleged overcharging of Acis LP by more than \$7 million for

<sup>&</sup>lt;sup>20</sup> Exh. 9 to Arbitration Motion.

<sup>&</sup>lt;sup>21</sup> Exh. 10 to Arbitration Motion.

<sup>&</sup>lt;sup>22</sup> There were actually different iterations of the Equity/ALF PMA including one dated August 10, 2015, and another dated December 22, 2016.

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fees/expenses under the Sub-Advisory and Shared Services Agreement, as [\*\*17] perhaps limited by the LPA (Counts 1-4); and (b) the alleged fraudulent transfers of value out of Acis LP, by virtue of various amendments and modifications of the Sub-Advisory and Shared Services Agreements (Counts 5-8). Highland argues that, since all of these counts pertain to the Sub-Advisory Agreement and Shared Services Agreement between Acis LP and Highland, the arbitration clauses in those agreements dictate that the counts be carved out from this Adversary Proceeding and sent to binding arbitration. Highland acknowledges that these two agreements were amended and restated numerous times, and that the last time they were amended (March 17, 2017) the arbitration clauses were eliminated, but Highland argues that, since all of the activity complained of in Counts 1-8 occurred prior to March 17, 2017, the older iterations of the Sub-Advisory and Shared Services Agreements, with arbitration clauses, govern. Highland zeroes in on the fact that Counts 1-4, at their essence, are assertions that the fees for services charged by Highland in the Sub-Advisory and Shared Services Agreements were excessive for the years 2013, 2014, 2015, and through May 2016 (all before the March 17, 2017 [\*\*18] iteration of the agreements). And Counts 5-8, while articulated as fraudulent transfer claims, pertain to the modifications made to the Sub-Advisory and Shared Services Agreements at various stages up to the March 17, 2017 versions.

The Reorganized Debtors have argued that it is quite clear that the last iterations of the Sub-Advisory and Shared Services Agreements intended to supersede in every way the prior versions. That includes the provisions directing arbitration. And, they argue, it does not matter *when* the causes of action occurred/accrued or not. What matters is that the parties agreed at some point that their disputes would not be sent to arbitration and this was the last governing document.

# C. The Relevant Language in the Sub-Advisory and Shared Services Agreements Pertaining to (i) Arbitration and (ii) Superseding of Prior Agreements.

As mentioned earlier, there was an arbitration clause at Section 16(f) of the Sub-Advisory Agreement until the last March 17, 2017 version. The clause read as follows:

[I]n the event there is an unresolved legal dispute between the parties and/or any of their respective officers, directors, partners, employees, agents, affiliates or other representatives that [\*\*19] involves legal rights or remedies arising from this Agreement, the parties agree to submit their dispute to binding arbitration under the authority of the Federal [\*550] Arbitration Act....<sup>23</sup>

In the Shared Services Agreement, an arbitration clause appeared at Section 9.14, as follows:

As earlier mentioned, these two agreements were later amended and restated several times. The arbitration provisions remained identical until they were completely eliminated in March 2017. The Reorganized Debtor argues that this is a short analysis: there was no longer an operative arbitration provision as of March 17, 2017.

In the March 17, 2017 version of the Shared Services Agreement, the parties agreed "that the courts of the State of Texas and the United States [\*\*20] District Court located in the Northern District of Texas in Dallas are to have exclusive jurisdiction to settle any disputes (whether contractual or noncontractual) which may arise out of or in connection with this Agreement and that accordingly any action arising out of or in connection therewith (together referred to as 'Proceedings') may be brought in such courts."<sup>25</sup>

The same type language appeared in the March 17, 2017 version of the Sub-Advisory Agreement: "The parties unconditionally and irrevocably consent to the exclusive jurisdiction of the courts located in the State of Texas and waive any objection with respect thereto, for the purpose of any action, suit or proceeding arising out of or relating to this Agreement or the transactions contemplated hereby."<sup>26</sup>

More generally, the March 17, 2017 versions of the

<sup>&</sup>lt;sup>23</sup> Exh. 1 of Arbitration Motion, at 7-8.

<sup>&</sup>lt;sup>24</sup> Exh. 6 of Arbitration Motion, at 9-10.

<sup>&</sup>lt;sup>25</sup> Exh. 10 of Arbitration Motion, § 8.04(b).

<sup>&</sup>lt;sup>26</sup> Exh. 5 of Arbitration Motion, § 13.

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agreements each provided that they "amended, restated and replaced the existing agreements *in [their] entirety.*"<sup>27</sup> The March 17, 2017 agreements also each provided that they "supersede[d] all prior agreements and undertakings, both written and oral, between the parties with respect to such subject matter."<sup>28</sup>

In summary, the Reorganized Debtors argue that, under Texas common law, [\*\*21] basic principles of contract interpretation, and the plain language of the March 17, 2017 version of the agreements, there is no agreement to arbitrate. "A contract's plain language controls."29 Because the prior versions of the agreements were "amended, restated and replaced in [their] entirety" with the March 17, 2017 agreements-which not only omit an arbitration provision, but also expressly provide for jurisdiction and venue in Texas state or federal courtsthe Reorganized Debtors argue that there exists no valid agreement to arbitrate between Highland and Acis LP. The court's inquiry can and should end there. But, if the court concludes the arbitration clauses are still applicable, the Reorganized [\*551] Debtors argue that the bankruptcy court has discretion not to compel arbitration when (a) bankruptcy core matters are involved, and (b) arbitration would conflict with the purposes of the Bankruptcy Code. Therefore, this is further reason why the Arbitration Motion should be denied.

#### III. Legal Analysis.

## A. The <u>Federal Arbitration Act</u> and Arbitration Clauses Generally.

HN1 The FAA provides that arbitration agreements are always "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." Thus, the FAA reflects a liberal federal policy favoring arbitration, and requires arbitration agreements to be rigorously

enforced according to their terms.<sup>31</sup> The FAA "expresses a strong national policy favoring arbitration of disputes, and all doubts concerning the arbitrability of claims should be resolved in favor of arbitration."<sup>32</sup> "There is a strong presumption in favor of arbitration and the party seeking to invalidate an arbitration agreement bears the burden of establishing its invalidity."<sup>33</sup>

HN2 When considering a motion to compel arbitration, the Fifth Circuit has held there are two threshold questions: (1) whether an arbitration agreement is valid; and (2) whether the dispute falls within the scope of the agreement. To evaluate the enforceability of an arbitration agreement, courts apply the contract law of the state that governs the agreement, whereas the scope of the agreement is a matter of federal substantive law.

## B. Is There a Valid Agreement to Arbitrate that Applies Here and is Still Enforceable?<sup>37</sup>

 $<sup>^{\</sup>rm 27}\,\text{Exhs.}$  5 and 10 of Arbitration Motion, each at p. 1 (emphasis added).

 $<sup>^{28}</sup>$  Exh. 5 of Arbitration Motion,  $\P$  20; Exh.10 of Arbitration Motion,  $\P$  8.14.

<sup>&</sup>lt;sup>29</sup> Great Am. Ins. Co. v. Primo, 512 S.W.3d 890, 893 (Tex. 2017).

<sup>&</sup>lt;sup>30</sup> <u>9 U.S.C. § 2</u>.

<sup>&</sup>lt;sup>31</sup> See AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 339, 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011) (citations omitted).

<sup>&</sup>lt;sup>32</sup> Primerica Life Ins. Co. v. Brown, 304 F.3d 469, 471 (5th Cir. 2002) (citing Southland Corp. v. Keating, 465 U.S. 1, 10, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984)).

<sup>&</sup>lt;sup>33</sup> Carter v. Countrywide Credit Indus., Inc., 362 F.3d 294, 297 (5th Cir. 2004).

<sup>&</sup>lt;sup>34</sup> See Agere Sys. Inc. v. Samsung Elecs. Co. Ltd., 560 F.3d 337, 339 (5th Cir. 2009).

<sup>&</sup>lt;sup>35</sup> <u>Wash. Mut. Fin. Group, LLC v. Bailey, 364 F.3d 260, 264 (5th Cir. 2004)</u> (citation omitted).

<sup>&</sup>lt;sup>36</sup> Graves v. BP Am., Inc., 568 F.3d 221, 222-23 (5th Cir. 2009); see also Neal v. Hardee's Food Sys., Inc., 918 F.2d 34, 37 (5th Cir. 1990) (under federal law, courts "resolve doubts concerning the scope of coverage of an arbitration clause in a contract in favor of arbitration," and arbitration should not be denied "unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue").

<sup>&</sup>lt;sup>37</sup> The court is assuming, without analysis, that the Chapter 11 Trustee (and the Reorganized Debtors) are bound by the arbitration clauses, if Acis LP affirmatively agreed to be bound by them and would still be bound by them outside of bankruptcy. 

HN3 Case law has stated that a bankruptcy trustee "stands in the shoes of the debtor for the purposes of [an] arbitration clause" and "the trustee-plaintiff is bound by

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HNA With respect to the first element—whether a valid agreement to arbitrate exists—federal courts "apply ordinary state-law principles that govern the formation of contracts." Here, the choice [\*552] of law provisions of the Highland-Acis Agreements state: "This Agreement shall begoverned by the laws of Texas. . . . "39 HNS " "Under the Texas rules, in those contract cases in which the parties have agreed to an enforceable choice of law clause, the law of the chosen state must be applied." Accordingly, [\*\*23] Texas law governs whether the parties are subject to an enforceable agreement to arbitrate.

Here, obviously the parties entered into an agreement to arbitrate in both the Sub-Advisory Agreement (Section 16(f))<sup>41</sup> and the Shared Services Agreement Section 9.14.<sup>42</sup> And, it would seem to be beyond peradventure that this was, at one time, enforceable between the parties, with regard to any disputes that arose regarding the agreements. The tricky conundrum here is that those arbitration provisions were deleted in the most recent iterations of the agreements-that is, the March 17, 2017 versions of the agreements. Highland argues that, since Counts 1-8 involve alleged overcharges under the agreements in years 2013-2016, and alleged fraudulent transfers up to March 17, 2017 (such fraudulent transfers allegedly occurring by virtue of modifications to the agreements that were made up to March 17, 2017), the pre-March 17, 2017 version of the agreements must be applied with respect to these Counts 1-8 and, thus, the arbitration provisions apply. In other words, what matters is when causes of action accrue not when they are ultimately asserted.

the clause to the same extent as would the debtor." Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1153 (3d Cir. 1989); see also Janvey v. Alguire, No. 3:09-CV-0724-N, 2014 U.S. Dist. LEXIS 193394, 2014 WL 12654910 at \*6 (N.D. Tex. July 30, 2014) (quoting Hays).

The parties have cited a handful of cases to the court, but the one [\*\*24] that the court believes is most analogous is the Coffman v. Provost \* Umphrey Law Firm, L.L.P. case. 43 In the Coffman case, the plaintiff was a former non-equity partner of a law firm and brought a lawsuit against the firm and its equity partners, alleging inter alia, breach of contract, breach of fiduciary duty, violations of Title VII and/or the Texas Commission on Human Rights Act ("TCHRA"), and violations of the Equal Pay Act. The law firm filed a motion to compel arbitration with regard to all of these claims. The law firm's motion to compel was based upon various partnership agreements which governed the law firm. The original partnership agreement was first effective on August 26, 1986, and the plaintiff did not sign that agreement. Subsequent to that time, however, the original partnership agreement was amended and restated on several occasions. The plaintiff admitted that she signed four partnership agreement documents: (1) a Restated Partnership Agreement of Provost \* Umphrey Law Firm, L.L.P.-Effective January 1, 1994 ("1994 Partnership Agreement"); (2) a Restated Partnership Agreement of Provost \* Umphrey Law Firm, L.L.P.-Effective January 1, 1996 ("1996 Partnership Agreement"); [\*\*25] (3) an Amendment No. 1 to the Restated Partnership Agreement of Provost \* Umphrey Law Firm, L.L.P., Dated January 1, 1996-Effective January 1, 1997 ("1996 Amendment No. 1"); and (4) a Partnership Agreement of Provost \* Umphrey Law Firm, L.L.P., As Restated - Effective [\*553] January 1, 1998 ("1998 Partnership Agreement"). The earlier two agreements-i.e., the 1994 and 1996 Partnership Agreements-did not contain an arbitration clause. The 1996 Amendment No. 1 and the 1998 Partnership Agreement, on the other hand, both contained an identical arbitration clause as follows:

Binding Arbitration. The equity partners and non-equity partners shall make a good faith effort to settle any dispute or claim arising under this partnership agreement. If the equity or non-equity partners fail to resolve a dispute or claim, such equity or non-equity partner shall submit the dispute or claim to binding arbitration under the rules of the American Arbitration Association then in effect. Judgment on arbitration awards may be entered by any court of competent jurisdiction.<sup>44</sup>

<sup>&</sup>lt;sup>38</sup> First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 944, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995); see also Wash. Mut. Fin. Grp., LLC v. Bailey, 364 F.3d 260, 264 (5th Cir. 2004).

<sup>&</sup>lt;sup>39</sup> See, e.g., Exh. 1 to Arbitration Motion, § 16(a); Exh. 5 to Arbitration Motion, § 13; Exh. 6 to Arbitration Motion, § 9.05; Exh. 10 to Arbitration Motion, § 8.04(a).

<sup>&</sup>lt;sup>40</sup> Resolution Trust Corp. v. Northpark Joint Venture, 958 F.2d 1313, 1318 (5th Cir. 1992) (citing DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 678 (Tex. 1990)).

<sup>&</sup>lt;sup>41</sup> Exhs. 1-4 of the Arbitration Motion.

<sup>&</sup>lt;sup>42</sup> Exhs. 6-9 of the Arbitration Motion.

<sup>43</sup> *Id. at 723*.

<sup>&</sup>lt;sup>44</sup> Coffman v. Provost \* Umphrey Law Firm, L.L.P., 161 F. Supp. 2d 720 (E.D. Tex. 2001).

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Additionally, all four of the above-referenced partnership agreements contained an integration clause stating that "[t]his agreement contains the entire agreement . [\*\*26] . . and all prior agreements . . . are terminated."<sup>45</sup>

Interestingly, the plaintiff conceded that claims she asserted involving the 1996 Amendment No. 1 and the 1998 Partnership Agreement were required to go to arbitration (such claims requested determinations regarding: (1) the enforceability of the 1996 Amendment No. 1 and the 1998 Partnership Agreement; (2) breach of the 1996 Amendment No. 1 and the 1998 Partnership Agreement; (3) repudiation; and (4) breach of the duty of good faith and fair dealing). However, the plaintiff disagreed that her remaining claims were also required to go to arbitration and those were: (a) breach of the 1994 and 1996 Partnership Agreements; (b) breach of fiduciary duty; (c) violations of Title VII and/or TCHRA; and (d) violations of the Equal Pay Act. The district court granted in part and denied in part the motion to compel arbitration, holding that: (1) the plaintiff's contract claims arising under *earlier* partnership agreements, which *did* not contain arbitration clauses, were not arbitrable; (2) a common law breach of fiduciary duty claim was arbitrable under the agreements (it appears that these claims arose after the 1996 Amendment [\*\*27] No. 1 and 1998 Partnership Agreement); and (3) statutory sex-based discrimination claims were not arbitrable under the agreements.<sup>46</sup>

Relevant to the case at bar, the Coffman court noted, first, that the conduct underlying the alleged breaches of the 1994 and 1996 contracts occurred at a time when no arbitration clause was in effect. The plaintiff's complaint specifically alleged that, during the time the four agreements were in effect, the law firm failed to properly calculate Plaintiff's compensation, failed to promote her, and deprived her of benefits from a tobacco case. The court noted that, if the law firm did participate in such conduct during the time that the 1994 and 1996 Partnership Agreements were in effect, such conduct could not have "arisen under" the 1996 Amendment No. 1 or the 1998 Partnership Agreement because those agreements did not even exist at that time. But, to the extent that the conduct Plaintiff complained of occurred when the 1996 Amendment No. 1 and the 1998 Partnership Agreement were in effect,

her claims would be subject to arbitration.<sup>47</sup>

[\*554] The court further noted that the arbitration clause should not be interpreted as [\*\*28] covering the plaintiff's claims for breach of the 1994 and 1996 Partnership Agreements because the plain grammatical language of the arbitration clause gave no indication that it would apply retroactively. "To interpret the arbitration clause to apply retroactively would cause Plaintiff to forego her vested right to litigate an accrued claim."

47 Id. at 726 (citing Sec. Watch, Inc. v. Sentinel Sys., Inc., 176 F.3d 369, 372 (6th Cir. 1999) (arbitration provision in 1994 shipping agreement did not cover conduct that occurred under prior shipping agreements); Necchi S.p.A. v. Necchi Sewing Mach. Sales Corp., 348 F.2d 693, 698 (2d Cir. 1965) (claim based on conduct which had arisen "prior to" effective date of arbitration clause was not within scope of arbitration agreement); Hendrick v. Brown & Root, Inc., 50 F. Supp. 2d 527, 533-34 (E.D.Va. 1999) (arbitration clause in fourth contract did not cover conduct that occurred when third contract was in effect); Connett v. Justus Enters. of Kansas, Inc., Civ. A. No. 87-1739-T, 1989 U.S. Dist. LEXIS 3529, 1989 WL 47071, at \*2 (D. Kan. March 21, 1989) (arbitration clause did not apply when alleged fraudulent conduct occurred before plaintiff executed contract with arbitration clause); George Wash. Univ. v. Scott, 711 A.2d 1257, 1260-61 (D.C. Ct. App. 1998) (conduct that occurred before arbitration clause took effect was not arbitrable).

48 Coffman, 161 F. Supp. 2d at 726-27 (citing Sec. Watch, 176 F.3d at 372-73 (arbitration clause did not reach disputes arising under earlier agreements because it is "nonsensical to suggest that [the plaintiff] would abandon its established right to litigate disputes arising under the [prior] contracts"); Choice Sec. Sys. v. AT&T Corp, No. 97-1774, 1998 U.S. App. LEXIS 6594, 1998 WL 153254, at \*1 (1st Cir. Feb.25, 1998) (arbitration clause in 1994 contracts did not apply to pre-1994 contracts when the language of the arbitration clause did not indicate "that the parties ever contemplated so radical a retroactive renegotiation of their earlier agreements"); Hendrick, 50 F. Supp. 2d at 535 (arbitration clause was not retroactive when the text of the clause expressed no language providing that it "reache[d] back in time to require an employee to arbitrate a claim which had accrued before the contract was signed or the [arbitration clause] took effect"); Connett, 1989 U.S. Dist. LEXIS 3529, 1989 WL 47071, at \*2 (arbitration clause did not apply retroactively when it did not specify that it applied to past conduct); Kenworth of Dothan, Inc. v. Bruner-Wells Trucking, Inc., 745 So. 2d 271, 275-76 (Ala. 1999) (arbitration clause was not retroactive when language of the clause did not so state); George Wash. Univ., 711 A.2d at 1261 (arbitration clause was not retroactive when "the arbitration clause itself contained no indication whatsoever

<sup>&</sup>lt;sup>45</sup> *Id*.

<sup>&</sup>lt;sup>46</sup> *Id. at 733*.

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Bottom line, the court in *Coffman* seemed to focus on when each cause of action accrued and looked to the agreement that governed at such time. This court agrees with that reasoning and sees no reason why the result should be different in the case at bar, simply because the arbitration clauses in the case at bar were in earlier versions of the Sub-Advisory and Shared Services Agreements as opposed to being in the later versions of those agreements (in other words, the opposite sequence as in the Coffman case).

The Reorganized Debtors have cited a couple of cases that they believe justify a determination that there is no binding arbitration clause in the case at bar. One is the case of Goss-Reid & Assocs. Inc. v. Tekniko Licensing Corp. 49 This case involved a motion to compel arbitration that was denied (which denial [\*\*29] was affirmed by the Fifth Circuit). Like the case at bar, it involved a situation where there had been a succession of agreements, with earlier agreements containing arbitration provisions and the last agreement containing no arbitration clause. Specifically, in the Goss-Reid case, there were three agreements that were relevant. First, a Franchise Agreement between a franchisor named Transformational Technologies, Inc. ("TTI") and a party named Rittenhaus-Tate Organization ("RTO"). RTO was a business owned by Tracy Goss and Sheila [\*555] Reid. The Franchise Agreement, among other things, provided that RTO's owners Tracy Goss and Sheila Reid would be "licensed franchisees of TTI" and would have use of certain of TTI's intellectual property. During the term of the Franchise Agreement, Tracy Goss and Sheila Reid developed certain consulting services technology they called "The Winning Strategy" and it apparently was built off of TTI's intellectual property. This first agreement contained a mandatory arbitration provision. Second, there was a License Agreement between the apparent successor-in-interest of TTI called Tekniko, Inc., on the one hand, and Tracy Goss, Sheila Reid and Goss-Reid & Associates, [\*\*30] Inc. (collectively, "Goss/Reid"), on the other, pursuant to which Goss/Reid obtained a "a non-exclusive license to use the same intellectual property covered by the Franchise Agreement." This second agreement also contained a mandatory arbitration agreement. Third, there was a **Transfer Agreement** that appears to have been entered into by the same parties as the second

agreement (Tekniko, Inc. and Goss/Reid). The Transfer Agreement "permanently transferred [to Goss/Reid] the non-exclusive right to use the intellectual property that was the subject of the prior agreements in exchange for a percentage of [Goss & Reid's] adjusted gross profits for that year." There was no arbitration provision in this third agreement and the agreement did not adopt or refer to the arbitration provisions contained in the earlier agreements. The third agreement stated that it constituted "an amendment to the License Agreement . . between you and this company ('TEKNIKO'), supersedes all prior agreements between you and TEKNIKO and, except as provided below, will terminate your rights and those of TEKNIKO under the License Agreement."

At some subsequent time, Goss/Reid filed a lawsuit alleging improper use [\*\*31] of "The Winning Strategy" by the entities Tekniko Licensing Corporation and Landmark Education Company. These Defendants (hereafter so called) asserted ownership themselves of "The Winning Strategy" based on the Franchise Agreement. The Defendants—citing to the arbitration clauses in both the Franchise Agreement and the License Agreement-filed a motion to compel arbitration, which was denied at the district court level and also at the Fifth Circuit. The district court determined that New York law applied (i.e., the Transfer Agreement was governed by New York law and apparently the parties agreed that New York law applied), and that the Transfer Agreement constituted a novation and extinguished the arbitration provisions of the previous agreements. On appeal, the Fifth Circuit stated that the issue before it was "whether the arbitration provisions of the Franchise and License Agreements were superseded by the Transfer Agreement. Thus, the question before us is one of contractual interpretation."50

The Fifth Circuit stated certain principles that apply under both New York and Texas law. Among other principles, the Fifth Circuit noted that courts construing contracts "should strive to give [\*\*32] effect to the intentions of the parties, as expressed in the terms of the contract." The Transfer Agreement stated that "it supersedes all prior agreements" between Goss/Reid and the predecessor-in-interest of one of the

that its terms would apply . . . before [its effective date]").

<sup>&</sup>lt;sup>49</sup> Goss-Reid & Assocs. Inc. v. Tekniko Licensing Corp., 54 Fed. Appx. 405 (5th Cir. 2002) (per curium opinion which is designated as having no precedential effect).

<sup>&</sup>lt;sup>50</sup> *Id.* at \*1.

<sup>&</sup>lt;sup>51</sup> *Id*.

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Defendants, Tekniko Licensing Corporation. 52 "This type of agreement clearly constitutes a novation under New York [\*556] law."53 The court also noted that it was not appropriate to consider any extrinsic or parol evidence, since there was no ambiguity in the Transfer Agreement. The court further stated that "[t]he only potential ambiguity raised by the Defendants is that the Transfer Agreement refers to itself as an 'amendment to the License Agreement.' Read as a whole, however, the Transfer Agreement plainly manifests an intention to supersede all prior agreements between the parties and, except as specifically provided, to terminate all rights and obligations under the License Agreement."54

The other case that the Reorganized Debtors have significantly relied upon to justify a determination that there is no binding arbitration clause in the case at bar is Valero Energy Corp. v. Teco Pipeline Co.55 In Valero, there had been numerous agreements entered into over time amongst [\*\*33] the litigating parties, all of which involved gas pipelines and transportation rights, and those various agreements were not amendments or restatements of one initial agreement. Rather, there was an Operating Agreement, there were documents that were alleged to create a joint venture or partnership, a Purchase Agreement, an Ownership Agreement, a Transportation Agreement, and a couple of Settlement Agreements entered into later when various disputes arose. One of the key agreements, the so-called Operating Agreement, contained an arbitration clause. When party Teco Pipeline sued party Valero and other related parties, Valero moved to compel arbitration, arguing that the litigation was subject to the arbitration clause in the Operating Agreement. The trial court denied Valero's motion, but the court of appeals reversed.

Teco had argued that the claims it was asserting were not based on the Operating Agreement that contained the arbitration clause but, even if they were, a later Settlement Agreement essentially redefined the parties' relationship—essentially superseding the relationship that had been set forth in the numerous agreements-and it did not have

<sup>52</sup> *Id*.

arbitration [\*\*34] clause. Rather Settlement Agreement stated that:

Each party irrevocably consents and agrees that any legal action, suit or proceeding against any of them with respect to their obligations, liabilities, or any other matter under or arising out of or in connection with this Agreement may be brought in the United States District Court for the Western District of Texas, San Antonio Division, or in the courts of the State of Texas, and hereby irrevocably accepts and submits to the jurisdiction of each of the aforesaid court in personam, generally and unconditionally with respect to any such action, suit or proceeding for itself and in respect of its properties, assets and revenues.56

Teco asserted that the quoted clause provided for the procedure to be used in future disputes, i.e., that the parties would go through judicial channels, not arbitration. Teco also asserted that the intent to revoke the arbitration clause was signified by a typical merger clause contained in the Settlement Agreement. The appeals court disagreed with Teco's argument and determined arbitration was required. First, the court determined that the provision regarding [\*557] litigation applied only to disputes arising under [\*\*35] the Settlement Agreement not the previously executed Operating Agreement, Purchase Agreement, Ownership Agreement, or Transportation Agreements. There was nothing to indicate that all the terms of those previous agreements had been superseded by the Settlement Agreement. In fact, it appeared that only select terms of earlier agreements were being modified. Significantly, the Settlement Agreement referred to an "Amendment No. 1" to the Operating Agreement being attached as an Exhibit D to the Settlement Agreementsuggesting that it remained in intact (except for the amendment attached). Moreover, there was a post-Settlement Agreement letter submitted into evidence stating that the prior Operating Agreement and arbitration provision were still in effect. The court addressed many other arguments made by Teco and, in the end, found nothing had superseded or otherwise revoked the prior arbitration clause.

This bankruptcy court does not consider the Valero or Goss-Reid cases to be dispositive of the situation in the case at bar. Those cases clearly dealt with a myriad of agreements-for example, in Valero, one key agreement had an arbitration clause, and an allegedly

56 Id. at 587.

<sup>&</sup>lt;sup>53</sup> Id. (citing various New York state court cases).

<sup>54</sup> Id. at \*2.

<sup>55</sup> Valero Energy Corp. v. Teco Pipeline Co., 2 S.W.3d 576 (Tex. App. - Houston [14th Dist.] 1999, pet. denied).

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superseding Settlement [\*\*36] Agreement (with no arbitration clause) was determined not to have been intended to supersede or replace the agreement with the arbitration clause. In Goss-Reid, there were also a myriad of agreements (i.e., a franchise agreement, a license agreement and then a transfer agreement), and the last one containing no arbitration clause was held to have been a novation of the prior agreements. In Valero and Goss-Reid, the various agreements were not amendments or restatements of one initial agreement. The case at bar is more analogous to the *Coffman* case (involving amendments and restatements of an initial agreement) and the logic of that holding seems sound to apply here-especially given the fact that there is nothing in the March 17, 2017 version of the agreements that suggests that the agreement to submit disputes to litigation in Texas and the deletion of the arbitration clauses should be applied retroactively. HN6 The court believes it should look at when a cause of action accrued and determine if there was a binding arbitration clause between the parties at that time in the governing version of the agreement. Thus, the court determines that there were valid arbitration agreements that applied [\*\*37] to all disputes arising out of the Sub-Advisory Agreement and Shared Services Agreement to the extent that those disputes involved conduct prior to March 17, 2017. Since Counts 1-8 involve conduct prior to March 17, 2017, Counts 1-8 fall within the scope of the arbitration agreements in the Sub-Advisory Agreement and Shared Series Agreement.

## C. But Wait, this is Bankruptcy and Core Matters and a Proof of Claim Objection are Involved.

The analysis does not end here. Yes, there is an otherwise valid, binding arbitration clause that was contained in each of the Sub-Advisory and Shared Services Agreements (prior to March 17, 2017). And, yes, Counts 1-8 involve conduct and disputes arising under these pre-March 17, 2017 agreements. But what about the fact that these disputes arise in an adversary proceeding that involves mostly, if not entirely, "core" matters (e.g., Counts 5-25 are all fraudulent transfers or preference claims under <u>Section 544</u>, <sup>57</sup> 547, <sup>58</sup> or 548; <sup>59</sup>

[\*558] Count 2 is a <u>Section 542</u> turnover request;<sup>60</sup> Count 26 is a request for Section 550 recovery 61)? And what about the fact that Highland (the counter-party to the Sub-Advisory and Shared Services Agreement who has asked for enforcement of the arbitration clauses in those agreements) [\*\*38] has filed proofs of claim?<sup>62</sup> And what about the fact that Counts 1-8 (as with every count in the Adversary Proceeding) are all urged to be offsets to Highland's proofs of claim?<sup>63</sup> Highland's proofs of claim are based on the post-March 17, 2017 versions of the Sub-Advisory and Shared Services Agreements (i.e., the versions that have no arbitration clauses). Highland has not argued that its proofs of claim are subject to arbitration (likely because they are governed by the post-March 17, 2017 versions of the Sub-Advisory and Shared Services Agreements). But, again, Highland argues that Counts 1-8 must be sent to arbitration, and the Reorganized Debtors argue that each of these counts present potential offsets to Highlands' proofs of claim. As a reminder, these counts

**COUNT 1**: Declaratory Judgment of Ultra Vires Acts by Acis LP in Violation of the LPA (Highland allegedly overcharged expenses by \$7M+ (*i.e.*, excessive fees) under the Sub-Advisory and Shared Services Agreements).

**COUNT 2**: Turnover of Property of the Estate Under § 542 for Unauthorized Overpayments (turnover the \$7M+ overcharged).

**COUNT 3**: Money Had and Received for Overcharges and Unauthorized Overpayments [\*\*39] (again, seeking redress for the \$7M+ overcharged—implicating the Sub-Advisory Agreement and Shared Services Agreement).

**COUNT 4**: Conversion for Unauthorized Overpayments (again, seeking redress for the \$7M+ overcharged implicating the Sub-Advisory Agreement and Shared Services Agreement).

**COUNT 5**: Actual Fraudulent Transfer under § 548 related to the Sub-Advisory Agreement (modifications to the Sub-Advisory Agreement in subsequent iterations

<sup>&</sup>lt;sup>57</sup> See 28 U.S.C. § 157(b)(2)(H).

<sup>&</sup>lt;sup>58</sup> See 28 U.S.C. § 157(b)(2)(F).

<sup>&</sup>lt;sup>59</sup> See <u>28 U.S.C. § 157(b)(2)(H)</u>.

<sup>60</sup> See <u>28 U.S.C. § 157(b)(2)(E)</u>.

<sup>61</sup> See 28 U.S.C. § 157(b)(2)(F) & (H).

<sup>62</sup> See 28 U.S.C. § 157(b)(2)(B).

<sup>63</sup> See 28 U.S.C. § 157(b)(2)(C).

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were allegedly fraudulent transfer, as were payments thereunder).

**COUNT 6**: Actual Fraudulent Transfer Under <u>TUFTA, §</u> <u>24.005(a)(1)</u> related to the Sub-Advisory Agreement (same theory as Count 5, asserted through <u>section 544</u> of the Bankruptcy Code).

**COUNT 7**: Constructive Fraudulent Transfer Under § 548(a)(1)(B) related to the Sub-Advisory Agreement (same facts as Count 5 only constructive not actual fraud).

**COUNT 8**: Constructive Fraudulent Transfer Under <u>TUFTA §§ 24.005(a)(2)</u> and <u>24.006(a)</u> related to the Sub-Advisory Agreement (same facts as Count 5, only constructive fraud under <u>TUFTA</u>, and asserted through <u>section 544 of the Bankruptcy Code</u>).

Thus, to recap, *five of the eight counts that Highland wants arbitrated* (Counts 2, and 5-8) clearly involve statutory core matters.<sup>64</sup> Moreover, *all* of the counts in the Adversary Proceeding are asserted *defensively* to two proofs of claim—meaning [\*\*40] *all eight counts that Highland wants arbitrated* (even Counts 1, 3, and 4) have transformed into statutory core matters.<sup>65</sup> Does

this matter? This court believes yes.

[\*559] The Fifth Circuit has shed some light on this topic in the cases of In re Gandy and In re National Gypsum.66 In those cases, the Fifth Circuit instructed that HN7 1 a bankruptcy court may decline to enforce arbitration clauses when it finds: (a) the underlying nature of the proceeding derives from the provisions of the Bankruptcy Code; and (b) that enforcement of the arbitration provision would conflict with purposes/goals of the Bankruptcy Code.<sup>67</sup> Some purposes/goals of the Code that might support a denial of arbitration, include: (1) the equitable and expeditious distribution of assets of the Debtor's estate; (2) centralized resolution of pure bankruptcy issues; (3) protection of creditors and reorganizing debtors from piecemeal litigation, and (4) the undisputed power of a bankruptcy court to enforce its orders.<sup>68</sup>

The In re Gandy opinion from the Fifth Circuit is worthy of discussion here. In Gandy, an individual [\*\*41] Chapter 11 debtor had first, prepetition, filed a state court lawsuit against various business partners, asserting causes of action against them for making transfers out of a partnership affecting her ownership interests, and the causes of action included breach of contract, negligence, breach of fiduciary duty, fraud and constructive trust. There was an arbitration clause in the applicable partnership agreement and the state court granted a motion to compel arbitration. Then, the debtor filed a Chapter 11 case and removed the state court lawsuit to the bankruptcy court and filed new claims under sections 544, 548, 550, civil "RICO," and alter ego in a separate adversary proceeding, and requested substantive consolidation. The bankruptcy court granted consolidation of the two actions and then the defendants filed a motion to compel arbitration. The bankruptcy court denied the motion, after finding that the debtor

awarded to the Reorganized Debtors under earlier versions of the agreements might result in indemnification claims being asserted back against them by Highland relating to those very claims). The point being that all of Highland's assertions in its proofs of claim seem inextricably intertwined with all the Counts in the Adversary Proceeding.

<sup>64</sup> See <u>28 U.S.C. § 157(b)(2)(E), (F)</u>, and (H).

<sup>65</sup> See 28 U.S.C. § 157(b)(2)(C). This court realizes that, from a Stern v. Marshall perspective, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011), being a statutory "core" matter does not necessarily mean a bankruptcy court has Constitutional authority to issue final orders or judgments in the matter. However, even if this Stern pronouncement has any relevance, when evaluating an arbitration clause/right, the court perceives that the various counterclaims here (i.e., all 35 counts) are likely inexplicably intertwined with the Highland proofs of claim, such that the bankruptcy court would likely have Constitutional authority to adjudicate them. While Highland's proofs of claim merely seek payment for services under the post-March 17, 2017 versions of the agreementswhich is after the time frame that Counts 1-8 implicate-it is not so simple as dividing claims and counterclaims into discreet time periods. For one thing, the Reorganized Debtors argue that modifications to the Sub-Advisory and Shared Services Agreements that increased fees that Highland could charge (and that Highland is now seeking in its proofs of claim) were tantamount to fraudulent transfers. Thus, how does one evaluate the proofs of claim separately from this argument? Additionally, Highland has asserted unliquidated indemnification claims in its proofs of claim that presumably reach back to earlier iterations of the Sub-Advisory and Shared Services Agreement (meaning that claims ultimately

<sup>&</sup>lt;sup>66</sup> Gandy v. Gandy (In re Gandy), 299 F.3d 489 (5th Cir. 2002); Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.), 118 F.3d 1056 (5th Cir. 1997).

<sup>67</sup> Id. at 1069.

<sup>&</sup>lt;sup>68</sup> Id.

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was essentially seeking avoidance of fraudulent transfers. The Fifth Circuit affirmed the bankruptcy court's refusal to enforce an arbitration clause contained in the underlying partnership agreement. The court agreed with the bankruptcy court that the complaint essentially-more than anything [\*\*42] else-sought [\*560] avoidance of fraudulent transfers, and the court not only determined that such rights derived from the Bankruptcy Code (fully acknowledging the fact that there were state law tort claims and breach of contract also asserted) but also-in looking at whether enforcing the arbitration clause would conflict with the purposes of the Bankruptcy Code-noted that one central purpose of the Bankruptcy Code is the expeditious and equitable distribution of the assets of a debtor's estate. The court thought the avoidance actions predominated over the "peripheral" contract and tort claims and, in such a circumstance, "the importance of the federal bankruptcy forum provided by the Code is at its zenith."69 The court stated that "Islome of the purposes of the Code we mentioned in *National Gypsum*<sup>70</sup> as potentially conflicting with the Arbitration Act include the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of the bankruptcy court to enforce its own orders."71

This court believes, like the court in <u>Gandy</u>, that this Adversary Proceeding—more than [\*\*43] anything

69 Gandy, 299 F.3d at 497.

70 In the National Gypsum case, an asbestos litigation trust created under a confirmed plan filed a post-confirmation adversary proceeding against debtor's liability insurer, seeking a declaratory judgment that the plan had discharged its obligations to the insurance company. The insurance company, in response to the litigation, sought to exercise its rights to seek arbitration under a certain agreement. The Fifth Circuit, in affirming the lower courts' refusal to compel arbitration, stated that, "We believe that nonenforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding, i.e., whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration of the proceeding would conflict with the purposes of the Code." Nat'l Gypsum Co., 118 F.3d at 1067. Because the debtor sought to bar the insurance company's actions either by invoking section 524(a)'s discharge injunction or by invoking the terms of a confirmed plan, the proceeding derived entirely from the provisions of the Bankruptcy Code, and, hence, the National Gypsum court would not send the dispute to arbitration.

else-seeks avoidance of fraudulent transfers. Such avoidance theories derive from the Bankruptcy Code. Sections 542, 547, 548 and 550 of the Bankruptcy Code are front and center, as are the "strong arm" powers of section 544(a). Enforcing the arbitration clause here would conflict with the purposes of the Bankruptcy Code-one of the central purposes of which is the expeditious and equitable distribution of the assets of a debtor's estate. The avoidance actions in this Adversary Proceeding predominate over all other counts and, in such a circumstance, "the importance of the federal bankruptcy forum provided by the Code is at its zenith." Arbitrating Counts 1-8 would seriously leopardize the Adversary Proceeding because they are an integral part of determining Highland's proofs of claim and the other core counts in the Adversary Proceeding. HN8 1 The bankruptcy court's quintessential duties are to adjudicate proofs of claim and to provide a central forum for litigation, whenever feasible and jurisdictionally sound. Indeed, in Gandy, the Fifth Circuit noted that when a proof of claim is filed, one of the "peculiar powers" of the bankruptcy court has been invoked and the nature of estate claims becomes "different from [their] nature . . . following [\*\*44] the filing of a proof of claim."72

In summary, this court believes it has discretion under established Fifth Circuit **[\*561]** authority to decline to order arbitration here.<sup>73</sup> It is, therefore,

**ORDERED** that the Arbitration Motion is **DENIED**.

The following constitutes the ruling of the court and has the force and effect therein described.

<sup>&</sup>lt;sup>71</sup> Gandy, 299 F.3d at 500.

<sup>&</sup>lt;sup>72</sup> <u>Id. at 499</u> (citing <u>Wood v. Wood (In re Wood)</u>, 825 F.2d 90, 97 (5th Cir. 1987)).

<sup>73</sup> See also Anderson v. Credit One Bank, N.A. (In re Anderson), 884 F.3d 382, 389-90 (2d Cir. 2018) (in proceeding involving whether section 524 discharge was violated by credit card company whose agreement with debtor contained arbitration clause, Second Circuit held that bankruptcy court had discretion to decline to enforce the arbitration agreement; Second Circuit engaged in a particularized inquiry into the nature of the claim and the facts of the specific bankruptcy and determined that arbitrating claims for violations of the 524 injunction would "seriously jeopardize a particular core bankruptcy proceeding" because: "(1) the discharge injunction is integral to the bankruptcy court's ability to provide debtors with a fresh start, (2) the claim relates to an ongoing matter with continuing court supervision, and (3) the equitable powers of the court to enforce its own injunctions are central to the structure of the Code.").

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600 B.R. 541, \*561; 2019 Bankr. LEXIS 1228, \*\*44

Signed April 16, 2019

/s/ Stacey G.C. Jernigan

**United States Bankruptcy Judge** 

**End of Document** 

Case 21-10549-JTD Doc 181 Filed 04/09/21 Page 1 of 2

Docket #181 Date Filed: 04/09/2021

## IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE

In re:

Chapter 11

SC SJ HOLDINGS LLC, et al.

Case No. 21-10549 (JTD)

Debtors.

(Jointly Administered)

Ref. Docket Nos. 92, 103, 108-13, 126, 129, 130

## ORDER GRANTING MOTION TO (I) MODIFY THE AUTOMATIC STAY TO PERMIT ARBITRATION OF DISPUTES; <u>AND (II) COMPEL ARBITRATION OF DISPUTES</u>

Upon the Motion to (I) Modify the Automatic Stay to Permit Arbitration of Disputes; and (II) Enforce Arbitration Clause Compelling Arbitration of Disputes (the "Motion")<sup>2</sup> filed by Accor Management US Inc. (f/k/a Fairmont Hotels & Resorts (U.S.) Inc.) ("Accor"); and this Court having found that the Motion is a core proceeding pursuant to 28 U.S.C. § 157(b)(2); and this Court having found that due and sufficient notice of the Motion has been given under the particular circumstances; and after due deliberation thereon; and good and sufficient cause appearing therefor,

#### IT IS HEREBY ORDERED THAT:

- 1. The Motion is granted in part, as set forth herein.
- 2. The automatic stay is modified as to both Debtors to allow the arbitration of Accor's claim against them as provided in that certain Amended and Restated Hotel Management Agreement dated as of December 2, 2005 (as further amended, modified, and/or restated, and together

<sup>&</sup>lt;sup>1</sup> The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, include: SC SJ Holdings LLC (5141) and FMT SJ LLC (7200). The mailing address for both Debtors is 3223 Crow Canyon Road, Suite 300 San Ramon, CA 94583.

<sup>&</sup>lt;sup>2</sup> Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Motion.

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with any annexes, exhibits, and ancillary agreements, the "<u>HMA</u>"). Any issue raised regarding the arbitrability of Accor's claim against the Debtors will be decided by the arbitrators.

- 3. The Court shall hold a hearing on the *Motion of Debtors for Order Under Bankruptcy Code Section 502(c) and Bankruptcy Rule 3018 Estimating Maximum Amount of Contingent and Unliquidated Claim of Fairmont Hotels & Resorts (U.S.) Inc.* [D.I. 71] (the "Estimation Motion") on April 29, 2021, at 3:00 p.m. (ET) on the issues set forth on the record at the hearing on the Motion on April 7, 2021 (the "Hearing"), including whether Section 502(c) may be used to liquidate Accor's claim, and if so whether the HMA liquidated damages clause applies and is the sole basis of determining Accor's claim. The parties shall file supplemental briefs with respect to the issues set forth at the Hearing by April 23, 2021, at 4:00 p.m. (ET). If evidence or further argument is necessary, the Court has reserved May 17, 2021, for a further hearing on the Estimation Motion.
  - 4. The terms of this Order are immediately effective and enforceable upon its entry.
- 5. The Court shall retain jurisdiction to hear any and all disputes arising out of the interpretation or enforcement of this Order.

Dated: April 9th, 2021 Wilmington, Delaware

JOHN T. DORSEY UNITED STATES BANKRUPTCY JUDGE



User Name: Alexis Leventhal

Date and Time: Thursday, November 2, 2023 3:16:00PM EDT

Job Number: 209597141

#### Document (1)

1. Highland Cap. Mgmt., L.P. v. Dondero (In re Highland Cap. Mgmt., L.P.), 2021 Bankr. LEXIS 3314

Client/Matter: -None-

As of: November 2, 2023 7:16 PM Z

#### Highland Cap. Mgmt., L.P. v. Dondero (In re Highland Cap. Mgmt., L.P.)

United States Bankruptcy Court for the Northern District of Texas, Dallas Division

December 3, 2021, Decided

Case No. 19-34054-sgj11, Chapter 11, Adversary No. 21-03003-sgj, Adversary No.: 21-03005-sgj, Adversary No.: 21-03007-sgj

#### Reporter

2021 Bankr. LEXIS 3314 \*; 2021 WL 5769320

In re: HIGHLAND CAPITAL MANAGEMENT, L.P., Reorganized Debtor.HIGHLAND CAPITAL MANAGEMENT, L.P., Plaintiff. v. JAMES D. DONDERO, NANCY DONDERO, AND THE DUGABOY INVESTMENT TRUST, Defendants, HIGHLAND CAPITAL MANAGEMENT, L.P., Plaintiff. v. NEXPOINT ADVISORS, L.P., JAMES DONDERO, NANCY DONDERO, AND THE DUGABOY INVESTMENT TRUST, Defendants.HIGHLAND CAPITAL MANAGEMENT, L.P., Plaintiff. v. HIGHLAND CAPITAL MANAGEMENT SERVICES, INC., JAMES DONDERO, NANCY DONDERO, AND THE DUGABOY INVESTMENT TRUST, Defendants.HIGHLAND CAPITAL MANAGEMENT, L.P., Plaintiff. v. HCRE PARTNERS, LLC (n/k/a NEXPOINT REAL ESTATE PARTNERS, LLC), JAMES DONDERO, NANCY DONDERO AND THE DUGABOY INVESTMENT TRUST, Defendants.

Prior History: Highland Capital Mgmt. L.P. v. Nexpoint Real Estate Partners, LLC (In re Highland Capital Mgmt. L.P.), 2021 Bankr. LEXIS 2244 (Bankr. N.D. Tex., July 14, 2021)

Highland Capital Mgmt. L.P. v. Dondero (In re Highland Capital Mgmt. L.P.), 2021 Bankr. LEXIS 1813, 2021 WL 2850562 (Bankr. N.D. Tex., July 6, 2021)
Highland Capital Mgmt. L.P. v. Highland Capital Mgmt. Servs. (In re Highland Capital Mgmt. L.P.), 2021 Bankr. LEXIS 1978 (Bankr. N.D. Tex., July 14, 2021)
Highland Capital Mgmt. L.P. v. Nexpoint Advisors, L.P. (In re Highland Capital Mgmt. L.P.), 2021 Bankr. LEXIS 1820, 2021 WL 2881426 (Bankr. N.D. Tex., July 8, 2021)

#### **Core Terms**

arbitration, arbitration clause, adversary proceedings, Counts, arbitration agreement, executory contract, Receiver, Motions, oral agreement, disputes, Obligor, parties, compel arbitration, receivership, waived, bankruptcy court, invoking, courts, breach of fiduciary duty, fraudulent transfer, Complaints, provisions, discovery, specific performance, obligations, proceedings, Entities, cases

#### **Case Summary**

#### Overview

HOLDINGS: [1]-Arbitration clause in a contract was no longer binding on debtor because the contract was an executory contract duly rejected pursuant to 11 U.S.C.S. § 365 and the arbitration clause should likewise be considered a separate executory agreement rejected; [2]-Even if the arbitration clauses were not invalidated by rejection, the defendants waived any right to invoke the arbitration clause due to their extensive litigation activity over more than eight months before ever mentioning arbitration; [3]-Because the court denied the arbitration requested there was no good cause to stay litigation in the entire adversary proceedings as to multiple counts.

#### Outcome

Arbitration motions and stay motions denied.

#### LexisNexis® Headnotes

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Business & Corporate Compliance > ... > Arbitration > Federal Arbitration Act > Arbitration Agreements

Business & Corporate Compliance > ... > Contracts

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2021 Bankr. LEXIS 3314, \*3314

Law > Contract Conditions & Provisions > Arbitration Clauses

#### HN1 Arbitration, Arbitrability

Arbitration, pursuant to the Federal Arbitration Act (FAA), is entirely a matter of contract. And, where a contract contains a provision in which parties agreed to submit future disputes thereunder to arbitration, these provisions should be enforced according to their terms. Section 4 of the FAA specifically directs a court to order parties to arbitrate upon a request by a party that is entitled to demand arbitration in a written contract. The courts have often stated that the FAA reflects a liberal federal policy favoring arbitration and requires arbitration agreements to be rigorously enforced according to their terms.

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

#### HN2 Arbitration, Arbitrability

It has often been stated that the underlying purposes of the Bankruptcy Code are to: (a) provide debtors and creditors with orderly and effective administration of bankruptcy estates; and (b) centralize disputes over debtors' assets and obligations in one forum. But there is no bankruptcy exception to an arbitration agreement per se—not in any statute and not according to any court so far.

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

#### HN3 Arbitration, Arbitrability

When a bankruptcy court is presented with a core dispute-i.e., one which derives from the provisions of the Bankruptcy Code-it may be permissible for the bankruptcy court to decline to order arbitration; after determining that core disputes are involved, courts tend to employ a framework for analysis derived from a Supreme Court nonbankruptcy case Shearson/Am. Express, Inc. v. McMahon. In a nutshell, the McMahon Court held that a party seeking to avoid arbitration pursuant to an otherwise applicable agreement must show that Congress-in enacting whatever statute is involved (i.e., the Bankruptcy Code) intended to preclude arbitration and that intent must be deducible from: (1) the statute's text; (2) its legislative history; or (3) an inherent conflict between arbitration and the statute's underlying purposes.

Bankruptcy Law > ... > Reorganizations > Debtors in Possession > Powers & Rights

#### HN4 Debtors in Possession, Powers & Rights

Just as a federal receiver is analogous to a bankruptcy trustee, a debtor-in-possession is, of course, statutorily the same as a bankruptcy trustee. 11 U.S.C.S. § 1107.

Bankruptcy Law > ... > Executory Contracts & Unexpired Leases > Powers to Assume & Reject > Executory Contracts

Contracts Law > Remedies > Specific Performance

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Business & Corporate Compliance > ... > Contracts Law > Types of Contracts > Executory Contracts

Bankruptcy Law > Administrative Powers > Executory Contracts & Unexpired Leases > Rejections

## <u>HN5</u> Powers to Assume & Reject, Executory Contracts

If a bankruptcy trustee rejects an executory contract, the rejection, of course, constitutes a breach of the contract and subjects the estate to a claim for money damages on behalf of the injured party. 11 U.S.C.S. § 365(g). Significantly, however, the injured party cannot insist on specific performance by the trustee. Instead, the injured party is treated as having a prepetition claim for damages arising as if the breach occurred immediately before the filing of the bankruptcy petition. Although arbitration survives the contract as a matter of contract law, executory obligations may be avoided by the trustee as a matter of bankruptcy law through the exercise of the trustee's power to reject executory contracts. If specific performance is not available against a trustee, it follows that an arbitration agreement is like any other executory contract which the trustee may reject.

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Waiver

#### **HN6** Arbitration, Arbitrability

Although courts in the Fifth Circuit sometimes apply a presumption against waiver of an arbitration right, the right can certainly be waived. Waiver will be found when the party seeking arbitration substantially invokes the judicial process to the detriment or prejudice of the other party. In this context, prejudice refers to the inherent unfairness—in terms of delay, expense, or damage to a party's legal position—that occurs when the party's opponent forces it to litigate an issue and later seeks to arbitrate that same issue. A party waives arbitration when it engages in some overt act in court that evinces a desire to resolve the arbitrable dispute through litigation rather than arbitration.

**Counsel:** [\*1] For CLO Holdco, Ltd., The Charitable DAF Fund, L.P., Plaintiffs (3:19bk34054): Mazin Ahmad Sbaiti, Sbaiti & Company PLLC, Dallas, TX.

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For Dallas County, Grayson County, Irving ISD, Kaufman County, Creditors: Laurie A. Spindler, Linebarger Goggan Blair & Sampson, LLP, Dallas, TX; Elizabeth [\*3] Weller, LEAD ATTORNEY, Linebarger, Goggan, Blair & Sampson, LLP, Dallas, TX.

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For Jennifer G. Terry, Joshua Terry, Creditors (3:19bk34054): Jeff P. Prostok, Forshey & Prostok, LLP, Ft. Worth, TX; Brian Patrick Shaw, Rogge Dunn Group, PC, Dallas, TX.

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For Atlas IDF, GP, LLC, c/o E. P Keiffer, Atlas IDF, LP, c/o E. P Keiffer, Beacon Mountain, LLC, c/o E. P Keiffer, Hunter Mountain Investment Trust, c/o E. P Keiffer, John Honis, c/o E. P Keiffer, Rand Advisors, LLC, c/o E. P Keiffer, Rand PE Fund I, LP, c/o E. P Keiffer, Rand PE Fund Management, LLC, c/o E. P Keiffer, Creditors (3:19bk34054): Edwin Paul Keiffer, Rochelle McCullough, LLP, Dallas, TX.

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Creditor (3:19bk34054): Larry R. Boyd, LEAD ATTORNEY, Abernathy, Roeder, Boyd & Joplin, McKinney, TX; Emily M. Hahn, LEAD ATTORNEY, Paul M. Lopez, Chad D. Timmons, Abernathy, Roeder, Boyd & Hullett, P.C., McKinney, TX.

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For Argo Partners, Creditor (3:19bk34054): Matthew Gold, Argo Partners, New York, NY.

For Advisors Equity Group, LLC, c/o Wick Phillips Gould & Martin, LLP, Eagle Equity Advisors, LLC, c/o Wick Phillips Gould & Martin LLP, Creditors (3:19bk34054): Lauren Kessler Drawhorn, Wick Phillips Gould & Martin, LLP, Fort Worth, TX.

For NexPoint Real Estate Partners LLC f/k/a HCRE Partners LLC, c/o Wick Phillips Gould & Martin LLP, Creditor (3:19bk34054): Lauren Kessler Drawhorn, Wick Phillips Gould & Martin, LLP, Fort Worth, TX; Brant C. Martin, Wick Phillips Gould & Martin LLP, Fort Worth, TX

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For Contrarian Funds LLC, Creditor (3:19bk34054): Douglas J. Schneller, Rimon P.C., New York, NY.

For Cedar Glade LP, Attn Robert Minkoff, Creditor (3:19bk34054): Kesha Tanabe, Tanabe Law, Minneapolis, MN.

For Get Good Trust, Creditor (3:19bk34054): Greta M. Brouphy, LEAD ATTORNEY, Douglas S. Draper, Warren Horn, Heller, Draper & Horn, L.L.C., New Orleans, LA; Leslie A. Collins, LEAD ATTORNEY, Heller Draper Hayden Patrick & Horn, LLC, New Orleans, LA.

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For Foley Gardere, Foley & Lardner LLP, Spec. Counsel (3:19bk34054): Holland N. O'Neil, Foley Gardere, Foley & Lardner LLP, Dallas, TX.

For Hayward & Associates PLLC, Other Professional (3:19bk34054): Zachery Z. Annable, Hayward PLLC, Dallas, TX.

For Hayward PLLC, Other Professional (3:19bk34054): Zachery Z. Annable, Hayward PLLC, Dallas, TX; Paul Richard Bessette, King & Spalding LLP, Austin, TX; Mark M. Maloney, King & Spalding LLP, Atlanta, GA.

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For NexPoint Advisors, L.P., K&L Gates LLP, NexPoint Capital, Inc., [\*14] K&L Gates LLP, NexPoint Real Estate Strategies Fund, K&L Gates LLP, Interested Party (3:19bk34054): A. Lee Hogewood, III, K&L Gates LLP, Raleigh, NC; Davor Rukavina, Munsch, Hardt, Kopf & Harr, Dallas, TX; Stephen G. Topetzes, LEAD ATTORNEY K&L Gates LLP, Washington, DC; Artoush Varshosaz, K & L Gates LLP, Dallas, TX; Julian Preston Vasek, Munsch Hardt Kopf & Harr P.C., Dallas, TX; James A. Wright, K&L Gates LLP, Boston, MA.

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For Jack Yang, Interested Party (3:19bk34054): Daniel P. Winikka, Loewinsohn Deary Simon Ray LLP, Dallas, TX

For United States Trustee, U.S. Trustee (3:19bk34054): Lisa L. Lambert, Office of the United States Trustee, Dallas, TX.

For Highland Capital Management, L.P., Plaintiff (21-03003-sgj, 21-03005-sgj): Zachery Z. Annable, LEAD ATTORNEY, Melissa S. Hayward, Hayward PLLC, Dallas, TX.

For James Dondero, Defendant (21-03003-sgj, 21-03005-sgj): Michael P. Aigen, Stinson, L.L.P., Dallas, TX; Bryan C. Assink, Clay M. Taylor, Bonds Ellis Eppich Schafer Jones LLP, Fort Worth, TX; Deborah Rose Deitsch-Perez, Stinson Leonard Street, Dallas, TX.

For The Dugaboy Investment Trust, Defendant (21-03003-sgj, 21-03005-sgj): Douglas S. Draper, LEAD ATTORNEYS, Greta M. Brouphy, Heller, Draper & Horn, L.L.C., New Orleans, LA; Leslie A. Collins, Heller [\*18] Draper Hayden Patrick & Horn, LLC, New Orleans, LA.

For Nancy Dondero, Defendant (21-03003-sgj, 21-03005-sgj): Deborah Rose Deitsch-Perez, Stinson Leonard Street, Dallas, TX.

For Official Committee of Unsecured Creditors, Creditor Committee (21-03003-sgj, 21-03005-sgj): Matthew A. Clemente, LEAD ATTORNEY, Sidley Austin LLP, Chicago, IL; Juliana Hoffman, Paige Holden Montgomery, Sidley Austin LLP, Dallas, TX.

For NexPoint Advisors, L.P., Defendant (21-03005-sgj): Davor Rukavina, Munsch, Hardt, Kopf & Harr, Dallas, TX; Julian Preston Vasek, Munsch Hardt Kopf & Harr P.C., Dallas, TX.

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For Highland Capital Management, L.P. (21-03006-sgj, 21-03007-sgj), Plaintiff: Zachery Z. Annable, LEAD ATTORNEY, Melissa S. Hayward, Hayward PLLC, Dallas, TX.

For The Dugaboy Investment Trust (21-03006-sgj, 21-03007-sgj), Defendant: Douglas S. Draper, LEAD ATTORNEY, Greta M. Brouphy, Heller, Draper & Horn, L.L.C., New Orleans, LA; Leslie A. Collins, Heller Draper Hayden Patrick & Horn, LLC, New Orleans, LA.

For Nancy Dondero (21-03006-sgj, 21-03007-sgj), Defendant: Deborah Rose Deitsch-Perez, Stinson Leonard Street, Dallas, TX.

For James Dondero (21-03006-sgj, 21-03007-sgj), Defendant: Bryan C. Assink, Bonds Ellis **[\*19]** Eppich Schafer Jones LLP, Fort Worth, TX; Deborah Rose Deitsch-Perez, Stinson Leonard Street, Dallas, TX.

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For HCRE Partners, LLC (n/k/a NexPoint Real Estate Partners, LLC), Defendant (21-03007-sgj): Michael P. Aigen, Stinson, L.L.P., Dallas, TX; Deborah Rose Deitsch-Perez, Stinson Leonard Street, Dallas, TX; Lauren Kessler Drawhorn, Wick Phillips Gould & Martin, LLP, Fort Worth, TX.

**Judges:** Stacey G.C. Jernigan, United States Bankruptcy Judge.

Opinion by: Stacey G.C. Jernigan

# **Opinion**

# MEMORANDUM OPINION AND ORDER DENYING ARBITRATION REQUEST AND RELATED RELIEF

### I. Introduction and Background

The four above-referenced adversary proceedings,

Adversary Proceeding Nos. 21-3003, 21-3005, 21-3006, and 21-3007, started out as what seemed **[\*20]** like simple suits by a Chapter 11 Debtor to collect on large promissory notes owed to it (collectively, the "Note Adversary Proceedings"). The court held a hearing on November 9, 2021 ("Hearing") on various motions filed by certain defendants in the Note Adversary Proceedings. This Memorandum Opinion and Order addresses certain motions to compel arbitration and to stay these Note Adversary Proceedings while arbitration would be proceeding. For the reasons set forth below, the court will not compel arbitration or stay these Note Adversary Proceedings.

The Note Adversary Proceedings were originally brought many months ago by Plaintiff Highland Capital Management L.P., now a reorganized debtor ("Highland" or "Reorganized Debtor"), again, as simple suits on notes—that is, alleging breach of contract and seeking turnover of amounts owed from the various obligors under the notes (the "Note Obligor Defendants"). Each Note Obligor Defendant was closely related to Highland's former president, James Dondero ("Mr. Dondero),<sup>2</sup> and collectively borrowed tens of millions of dollars from Highland prepetition. The indebtedness was memorialized in a series of demand and term notes. The indebtedness represented [\*21] by those notes remains unpaid.

The Note Adversary Proceedings morphed, so to speak, when the Note Obligor Defendants defended the Note Adversary Proceedings by alleging that an oral agreement existed such that the underlying notes would be forgiven by Highland as compensation to Highland's former president, Mr. Dondero, if certain conditions subsequent occurred. The oral agreement was allegedly made on behalf of Highland, acting through one of its largest limited partners, Dugaboy Investment Trust ("Dugaboy"), which is a family trust of Mr. Dondero, on which the trustee is his sister Nancy Dondero ("Ms.

<sup>&</sup>lt;sup>1</sup> Certain defendants herein earlier filed a motion to withdraw the reference in these Note Adversary Proceedings (arguing that the claims were statutory noncore claims or that the bankruptcy court otherwise did not have Constitutional authority to enter final orders). The District Court accepted the bankruptcy court's report and recommendation that the reference should be withdrawn when these Note Adversary Proceedings are trial-ready with the bankruptcy court acting essentially in the position of a magistrate judge for the District Court prior to trial, presiding over all pretrial matters.

 $<sup>^2\,\</sup>mbox{ln}$  fact, Mr. Dondero personally was an obligor on three notes.

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Dondero").

When this "oral agreement" defense was articulated, this court granted Highland's request for leave to amend its original complaints in each of the Note Adversary Proceedings to allege alternative theories of liability and add Mr. Dondero, 3 Dugaboy, and Ms. Dondero as additional defendants on new counts-the theories being that, if such an oral agreement was made, it may have given rise other causes of action on the part of the actors involved. Highland amended its complaints in each of the Note Adversary Proceedings, adding new Counts III, IV, V, VI, and VII alleging, among [\*22] other things, fraudulent transfers (Counts III and IV), declaratory judgment as to certain provisions of Highland's limited partnership agreement (Count V), breach of fiduciary duty (Count VI), and aiding and abetting breach of fiduciary duty (Count VII) (the "Amended Complaints").

Presently before the court are a set of virtually identical motions filed by Mr. Dondero, Dugaboy, and Ms. Dondero in each of the four Note Adversary Proceedings seeking to compel arbitration as to Counts V, VI, and VII of, and stay litigation altogether in, the Note Adversary Proceedings, pending the arbitration of Counts V, VI, and VII (the *Motion to Compel Arbitration and Stay Litigation* [Doc. 85, 66, 74, and 65, respectively, in each sequentially-numbered Note Adversary Proceeding<sup>4</sup>], the "Arbitration Motions"). Highland timely filed objections to the motions [Doc. 92, 76, 81, and 77] and replies were filed by Mr. Dondero, Dugaboy and Ms. Dondero [Doc. 107, 88, 93, and 88].<sup>5</sup>

As set forth below, Mr. Dondero, Dugaboy, and Ms. Dondero (hereinafter "Dondero/Dugaboy the Defendants") rely on a mandatory arbitration clause in Highland's Limited Partnership Agreement as the basis for their arbitration request. [\*23] To be clear, there are no arbitration clauses in the underlying promissory notes. And the Note Obligor Defendants are not seeking arbitration of the breach of contract claims, turnover claims, or fraudulent transfer claims. It is only the Dondero/Dugaboy Defendants seeking arbitration as to Count V (seeking declaratory judgment as to provisions of the Highland limited partnership agreement) and Counts VI and VII (the fiduciary duty claims). The court denies the Arbitration Motions for the reasons stated below.

### II. The Agreement Containing the Arbitration Clause

First, a word about what is and is not in dispute regarding the Arbitration Motions. The parties agree that Highland's *Fourth Amended and Restated Agreement of Limited Partnership* (the "LPA")<sup>6</sup> contained Section 6.14, a typical mandatory arbitration provision that requires parties to the LPA to arbitrate certain disputes under certain circumstances (the "Arbitration Clause"):

In the event there is an unresolved legal dispute between the parties and/or any of their respective officers, directors, partners, employees, agents, affiliates or other representatives that involves legal rights or remedies arising from this Agreement, the [\*24] parties agree to submit their dispute to binding arbitration under the authority of the Federal Arbitration Act...

The Arbitration Clause also significantly limited discovery that could occur in arbitration:

The discovery process shall be limited to the

<sup>&</sup>lt;sup>3</sup> Mr. Dondero was actually already a Note Obligor Defendant in Adv. Proc. No. 21-3003, as he as an obligor on three notes.

<sup>&</sup>lt;sup>4</sup> All subsequent "Doc." references in this Memorandum Opinion and Order follow this convention.

<sup>&</sup>lt;sup>5</sup> The court considered these replies despite the lateness of their filing, less than two business days before the Hearing. At the Hearing, Highland noted its displeasure with these replies being filed 37 days after Highland filed its objections but did expressly did not ask the court to strike the replies. The court reminds the parties, as Highland correctly pointed out, that the Local Civil Rules for the Northern District of Texas, and not the Local Bankruptcy Rules, apply to these adversary proceedings in all respects, since the reference to the Bankruptcy Court was withdrawn and this court is conducting all proceedings in the position of a magistrate judge for the District Court. The replies here were required to be filed no later than 14 days following the filing of Highland's objections. See Local Civil Rule 7.1(f).

<sup>&</sup>lt;sup>6</sup> The LPA was executed by Highland's then-general partner, Strand Advisors, Inc., through the individual James Dondero, who was also then Highland's CEO and Highland's majority limited partner, The Dugaboy Investment Trust, James Dondero's family trust, through its trustee, the individual Nancy Dondero, James Dondero's sister. (Various other limited partners also signed the LPA, but they are not Note Obligor Defendants.) The "oral agreement" defense alleges that The Dugaboy Investment Trust, through Nancy Dondero as trustee, as the holder of a Majority Interest (as defined in the LPA), entered into oral agreements on behalf of Highland with James Dondero to forgive the demand notes at the center of these Note Adversary Proceedings if certain conditions subsequent were met.

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following: Each side shall be permitted no more than (i) two party depositions of six hours each, each deposition to be taken pursuant to the Texas Rules of Civil Procedure; (ii) one non-party deposition of six hours; (iii) twenty-five interrogatories: (iv) twenty-five requests for admissions; (v) ten request for production (in response, the producing party shall not be obligated to produce in excess of 5,000 total pages of documents, including electronic documents); and (vi) one request for disclosure pursuant to the Texas Rules of Civil Procedure.

The parties further agree that the LPA, as an executory contract, was rejected under 11 U.S.C. § 365 in connection with the court's order confirming Highland's plan of reorganization in February 2021.

The Dondero/Dugaboy Defendants acknowledge that Counts I—IV of the Amended Complaints (Breach of Contract; Turnover; Fraudulent Transfers under 11 U.S.C. § 548; and Fraudulent Transfers under 11 U.S.C. § 544 and the Texas Uniform Fraudulent Transfer Act) are not [\*25] subject to the Arbitration Clause.

The Dondero/Dugaboy Defendants argue in the Arbitration Motions, however, that Counts V, VI, and VII of the Amended Complaints (seeking a declaratory judgment as to provisions of LPA and claiming breach of fiduciary duty and aiding and abetting of breach of fiduciary duty-all counts that, notably, Highland only added after the Note Obligor Defendants articulated their "oral agreement" defense) are subject to the Arbitration Clause. Highland counters that: (a) the rejection of the LPA excuses Highland from being forced to submit to mandatory arbitration of Counts V, VI, and VII; (b) the Dondero/Dugaboy Defendants have waived the Arbitration Clause by not invoking it at any earlier point in these Note Adversary Proceedings; and (c) the Dondero/Dugaboy Defendants should be judicially estopped from invoking the Arbitration Clause now. Highland also argues that arbitration of some but not all the counts of the Amended Complaints would be inefficient and wasteful, and that any stay of proceedings in this court would do a disservice to the resolution of the admittedly non-arbitrable issues in Counts I—IV.

III. The Significance of the Rejection of the Executory [\*26] Contract (*i.e.*, the LPA) that Contained the Arbitration Clause

The court acknowledges that there is a wealth of federal case law dictating the strong federal policy undergirding the Federal Arbitration Act ("FAA"). See, e.g., Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp., 460 U.S. 1, 24, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983) (describing the FAA as "a congressional declaration of a liberal federal policy favoring arbitration agreements"). The FAA was enacted by Congress in 1925 and became effective in 1926. It is codified at Title 9 of the United States Code and is predicated upon Congress's exercise of the Commerce Clause powers granted in the Constitution. The FAA contemplates the judiciary's respect for and enforcement of private parties' agreements to resolve disputes through arbitration. The FAA provides:

A written provision in ... a 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."<sup>7</sup>

HN1 Thus, arbitration, pursuant to the FAA, is entirely a matter of contract. And, where a contract contains a provision in which parties agreed to submit future disputes thereunder to arbitration, these provisions should be enforced according to their terms. Section 4 of the FAA specifically [\*27] directs a court to order parties to arbitrate upon a request by a party that is entitled to demand arbitration in a written contract. The courts have often stated that the FAA reflects a liberal federal policy favoring arbitration and requires arbitration agreements to be rigorously enforced according to their terms.<sup>8</sup>

The court also notes that some courts have grappled with whether a bankruptcy court needs to treat an arbitration provision in a contract any "less mandatory" than other courts. After all, bankruptcy cases are not like other lawsuits; they are multi-faceted, multi-party, and fast-moving. HN2[1] It has often been stated that the underlying purposes of the Bankruptcy Code are to: (a) provide debtors and creditors with orderly and effective administration of bankruptcy estates; and (b) centralize disputes over debtors' assets and obligations in one forum. But there is no "bankruptcy exception" to an arbitration agreement per se—not in any statute and not according to any court so far. Some courts have opined

<sup>&</sup>lt;sup>7</sup> <u>9 U.S.C. § 2</u>.

<sup>&</sup>lt;sup>8</sup> See <u>AT&T Mobility LLC v. Concepcion</u>, 563 U.S. 333, 339, 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011) (citations omitted).

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or suggested that a bankruptcy court, when presiding over a proceeding involving "non-core" disputes pursuant to 28 U.S.C. § 157(b)-i.e., disputes that are merely related to a bankruptcy case [\*28] and would have been litigated elsewhere but for the broad nexus created by the debtor's bankruptcy filing-generally must abstain from adjudication and direct the parties to arbitration when presented with an applicable arbitration provision. 9 HN3 T But when a bankruptcy court is presented with a "core" dispute-i.e., one which derives from the provisions of the Bankruptcy Code-it may be permissible for the bankruptcy court to decline to order arbitration; after determining that "core" disputes are involved, courts tend to employ a framework for analysis derived from a nonbankruptcy Supreme Court case called Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987). In a nutshell, the McMahon Court held that a party seeking to avoid arbitration pursuant to an otherwise applicable agreement must show that Congress-in enacting whatever statute is involved (i.e., the Bankruptcy Code) intended to preclude arbitration and that intent must be deducible from: (1) the statute's text; (2) its legislative history; or (3) "an inherent conflict between arbitration and the statute's underlying purposes."10 Thus, courts after finding "core" disputes are involved-tend to plow down a complicated trail of considering whether there is an "inherent conflict" between arbitration [\*29] and the Bankruptcy Code in whatever dispute happens to be before the court.

The Fifth Circuit has addressed the topic of enforceability of arbitration clauses in bankruptcy in the cases of *In re Gandy* and *In re Nat'l Gypsum*. <sup>11</sup> In those

<sup>9</sup> At least one court has suggested that there is a "presumption in favor of arbitration [that] usually trumps the lesser interest of bankruptcy courts in adjudicating non-core proceedings." 

MBNA Am. Bank, N.A. v. Hill, 436 F.3d 104, 108 (2d Cir. 2006). But see Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1156-1158 (3d Cir. 1989) (determining there is no discretion to deny arbitration in noncore matters). See also Gandy v. Gandy (In re Gandy), 299 F.3d 489, 496 (5th Cir. 2002) ("it is generally accepted that a bankruptcy court has no discretion to refuse to compel the arbitration of matters not involving 'core' bankruptcy proceedings under 28 U.S.C. § 157(b)"); Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.), 118 F.3d 1056 (5th Cir. 1997) (same).

cases, the Fifth Circuit instructed that a bankruptcy court may refuse to enforce arbitration clauses and may itself adjudicate a dispute when it finds that: (a) a matter is core or derives from rights under the Bankruptcy Code; *and* (b) enforcement of the arbitration provision would irreconcilably conflict with the purposes or goals of the Bankruptcy Code.<sup>12</sup>

While this is all somewhat enlightening, a slightly different argument is presented to this court by Highland in its argument that the bankruptcy court should not compel arbitration. Highland does not deny the existence of any of the above case law nor the fact that Counts V, VI, and VII involve non-core matters that do not derive from rights under the Bankruptcy Code. Rather, Highland argues, these Note Adversary Proceedings present a circumstance that very few courts have addressed. The LPA (or at least the Arbitration Clause) was an executory contract that Highland rejected in its confirmed [\*30] Chapter 11 plan. As noted above, no one disputes that the LPA was rejected pursuant to Bankruptcy Code section 365. The result, argues Highland, is that Highland is no longer bound by the LPA's provisions that impose specific performance obligations on it-provisions such as the Arbitration Clause. A counterparty to a rejected executory contract can merely seek monetary damages, Highland argues, but it cannot force a debtor to *perform* under a rejected executory contract.

Highland's argument finds support in a both lengthy and well-reasoned opinion by District Judge David Godbey of this District — Janvey v. Alguire, 2014 U.S. Dist. LEXIS 193394 (N.D. Tex. Jul. 20, 2014), aff'd on different grounds at 847 F.3d 231 (5th Cir. 2017), dealing with federal receiverships (in which the court made analogies to the bankruptcy process)—as well as in an old law review article written by renowned University of Texas Law School Professor Jay Westbrook (often considered the modern-day expert on executory contracts in bankruptcy). See Jay Westbrook, The Coming Encounter: International Arbitration and Bankruptcy, 67 UNIV. OF MINN. LAW SCHOOL 595 (1983).

The <u>Janvey</u> opinion arose in the context of a federal receivership commenced at the request of the Securities and Exchange Commission in response to the massive R. Allen Stanford Ponzi [\*31] scheme. Ralph S. Janvey was the receiver ("Receiver") who took possession of all

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<sup>10</sup> McMahon, 482 U.S. at 227.

<sup>&</sup>lt;u>1056</u>.

<sup>11</sup> Gandy, 299 F.3d at 489; Nat'l Gypsum Co., 118 F.3d at 12 In re Nat'l Gypsum Co., 118 F.3d at 1068-69.

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receivership assets and records. Pursuant to those powers, the Receiver filed suit against former employees (the "Employee Defendants") who previously worked in various capacities for the Stanford enterprises ("Stanford Entities") and received salary, commissions, bonuses, or later forgiven loans from the Stanford Entities. The Receiver's suit alleged that the Employee Defendants received fraudulent transfers in violation of the Texas Uniform Fraudulent Transfer Act (TUFTA) or, in the alternative, were unjustly enriched at the expense of the creditors of the Receivership Estate. Some of the Employee Defendants filed motions to compel arbitration. According to a later Fifth Circuit opinion, the arbitration agreements were contained in: (1) promissory notes between the Employee Defendants and the company that governed the upfront loan payments that the company awarded to the Employee Defendants when they joined Stanford; (2) the brokerdealer forms that the company submitted to the Financial Industry Regulation Authority (FINRA) when registering the Employee Defendants as brokers: (3) FINRA's internal rules [\*32] governing disputes between brokers and their employers; and (4) the company's Performance Appreciation Rights plan. The arbitration clauses provided that "any controversy arising out of or relating to this Note, or default on this Note, shall be submitted to and settled by arbitration pursuant to the constitution, bylaws, rules and regulations of the National Association of Securities Dealers (NASD)." Janvey v. Alguire, 847 F.3d 231, 237 (5th Cir. 2017).

The issue of whether arbitration was required went back and forth between Judge Godbey and the Fifth Circuit and, ultimately, the precise issue pending before Judge Godbey was whether to deny or grant the motions to compel arbitration based on the question of "whether the Receiver is bound by the arbitration clauses if he sues, as he must, on behalf of the Stanford Entities."

Judge Godbey declined to order arbitration because the Receiver had not adopted the arbitration agreements at issue and because arbitration of the Receiver's claims would frustrate a central purpose of federal equity receiverships. Judge Godbey noted that, before a general requirement to arbitrate exists, a party must first be bound to an arbitration agreement — either as a signatory or through a principle of law [\*33] or equity. Judge Godbey stated that discussions of possible exceptions to this general requirement to arbitrate, like <code>McMahon</code>'s contrary congressional command, <code>are only necessary after such an initial determination</code>. Judge Godbey opined that equity receivers, as non-signatories

to an arbitration agreement, can, in fact, be bound to the arbitration agreement to the same extent receivership entities would be bound. But there remained a significant resultant question: whether the Employee Defendants' arbitration agreements were contracts that the Receiver could *reject*, "an ability that has deep historical roots for both federal equity receivers and bankruptcy trustees and that continues to be an important tool for both."

Applying Professor Vern Countryman's material breach test, Judge Godbey concluded that arbitration agreements must be analyzed as separate executory contracts, based on the nature of the agreement as well as arbitration caselaw regarding severability. Citing Professor Westbrook, he noted that, "'[v]iewed as an independent contractual obligation of the parties, an arbitration agreement is a classic executory contract, since neither side has substantially performed the arbitration [\*34] agreement at the time enforcement is sought.' Westbrook, supra note 26, at 623 (footnote omitted). Furthermore, the appropriate remedy in this circumstance cannot be for the Court to require specific performance by the trustee -i.e., to compel arbitration - because 'injured part[ies] cannot insist on specific performance by the trustee.' See id. at 619 (collecting cases)." Janvey, 2014 U.S. Dist. LEXIS 193394 at \*113.

Judge Godbey went on to opine that the Receiver had rejected the arbitration agreement, that the rejection was proper, and that the Receiver was not bound to arbitrate—further noting that if the court required the Receiver to adopt the arbitration agreements, it would greatly burden and deplete the receivership estate. Such a result, weighed in the balance, would be unjust and inequitable.

The Fifth Circuit ultimately affirmed. 847 F.3d 231 (5th Cir. 2017), but applied a different analysis. It determined that the Stanford entity in whose shoes the Receiver had stepped, for purposes of bringing the TUFTA claims (i.e., Stanford International Bank), was not a signatory to the arbitration agreements and was not otherwise bound by them. The Fifth Circuit also determined that, with regard to one Employee Defendant (Giusti) who stood in a unique position (in that there was an arbitration [\*35] agreement that the Receiver's predecessor was party to and bound), that Guisti waived the right to arbitrate by substantially invoking the judicial process (through the filing of a motion to dismiss, an answer, serving written discovery and answering discovery-which had caused delay and expense). As for Judge Godbey's "broader policy argument" that the federal receivership statutes

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were at odds with the FAA's mandate in favor of arbitration, noting that these were "important concerns," the Fifth Circuit stated that "we are wary of endorsing these broad policy arguments in the absence of specific direction from the Supreme Court." *Id. at 245*. But the Fifth Circuit did not otherwise address the arguments.

While the <u>Janvey</u> case involved a federal receiver, Judge Godbey looked almost entirely to bankruptcy law and to <u>Bankruptcy Code section 365</u> to reach his ruling. This court finds <u>Janvey</u> to be persuasive (and possibly binding) on this court. <u>HN4</u> Moreover, just as a federal receiver is analogous to a bankruptcy trustee, a debtor-in-possession is, of course, statutorily the same as a bankruptcy trustee. See, e.g., 11 U.S.C. § 1107.

HN5 1 To be clear, if a bankruptcy trustee rejects an executory contract, the rejection, of course, constitutes a breach of the contract [\*36] and subjects the estate to a claim for money damages on behalf of the injured party. 11 U.S.C. § 365(g). Significantly, however, the injured party cannot insist on specific performance by the trustee. See Westbrook, The Coming Encounter, at 619 (and numerous cases cited therein). Instead, the injured party is treated as having a prepetition claim for damages arising as if the breach occurred immediately before the filing of the bankruptcy petition. Professor Westbrook notes that the issue then becomes whether such a prepetition claim, including a claim arising from rejection, must be liquidated pursuant to the arbitration clause. Most jurisprudence in the bankruptcy context dealing with arbitration clauses does not analyze this as a traditional executory contract conundrum. And yet, to use Professor Westbrook's words, an arbitration agreement is a classic executory contract, since neither side has substantially performed the arbitration agreement at the time enforcement is sought. Id. at 623. And although "arbitration survives the contract" as a matter of contract law, "executory obligations may be avoided by the trustee as a matter of bankruptcy law through the exercise of the trustee's power to reject [\*37] executory contracts." Id. "If specific performance is not available against a trustee, it follows that an arbitration agreement is like any other executory contract which the trustee may reject." Id. at 624.

The <u>Janvey</u> decision is not the only case to have addressed the effect of rejection on the viability of an arbitration clause within a rejected executory contract. The Dondero/Dugaboy Defendants cite the court to <u>In re Fleming Companies</u>, <u>Inc.</u>, <u>325 B.R. 687 (Bankr. D. Del. 2005)</u>, a case from another bankruptcy court that

predates <u>Janvey</u> by almost a decade, for the proposition that rejection of an executory contract does not prevent a party from invoking an arbitration clause in that contract. With due respect, the court believes the reasoning in <u>Janvey</u> to be more persuasive than the bankruptcy court's in <u>Fleming Cos</u>. (and <u>Janvey</u> is potentially binding precedent on this court). It also bears noting that it was the debtor in <u>Fleming Cos</u>., not the executory contract's counterparty, who was invoking the arbitration clause in the contract the debtor had previously rejected. That distinction is not without significance.

In summary, this court accepts Highland's argument that the LPA was an executory contract duly rejected pursuant to *Bankruptcy Code section 365*, and that the Arbitration Clause should [\*38] likewise be considered a separate executory agreement that was rejected. Accordingly, Highland cannot be forced to specifically perform under the Arbitration Clause or the LPA by mandatorily participating in arbitration of Counts V, VI, and VII. The court defers to the compelling reasoning of Judge Godbey in *Janvey* on this point. The court, like Judge Godbey, also finds as a matter of fact that requiring arbitration in this case would impose undue and unwarranted burdens and expenses on the parties to the detriment of Highland's creditors.

#### IV. Waiver

Even if this court is in error in determining that the Arbitration Clause is no longer binding on Highland because it was rejected pursuant to <u>Bankruptcy Code section 365</u>, the court finds as a matter fact that the Dondero/Dugaboy Defendants have waived any right to invoke the Arbitration Clause. The court has taken judicial notice of its own docket, both in these Note Adversary Proceedings and in the administrative Chapter 11 case, and has considered the entire record of both proceedings, as well as the <u>Declaration of John A. Morris in Support of Debtor's Objection to Motion to Compel Arbitration and Stay Litigation [Doc. 94, 78, 83, and 78]</u>, and the exhibits annexed thereto, [\*39] in making the following findings of fact.

The Note Adversary Proceedings were filed in January 2021 (after Highland earlier made demands on the Note Obligor Defendants or otherwise declared events of default). One of the Note Obligor Defendants (Mr. Dondero) timely answered, pleading an affirmative defense that Highland agreed not collect on the underlying notes—but that answer contained nothing

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more specific than this, nor any mention of arbitration. Amended Answers were later filed by the Note Obligor Defendants, elaborating on and/or adopting the affirmative defense that, through the oral agreement, Highland agreed to forgive the obligations under the notes as compensation to Mr. Dondero "upon fulfillment of conditions precedent." Roughly 90 days after the filing of the Note Adversary Proceedings, the Note Obligor Defendants filed motions to withdraw the reference, which this court spent significant time addressing in making a report and recommendation to the District Court in each Note Adversary Proceeding. No mention of arbitration was made to this court during those proceedings. During a hearing before the court on June 10, 2021, Highland announced its intention to add claims [\*40] against the Dondero/Dugaboy Defendants for breach of fiduciary duty, yet the issue of arbitration was not raised at that point, or a month later when the Dondero/Dugaboy Defendants received a draft of the Amended Complaint adding Counts V, VI, and VII. Pursuant to the parties' agreement, Highland filed that Amended Complaint on August 27, 2021, as the Defendants' "oral agreement" Dondero/Dugaboy defense became clearer. Only on September 1, 2021, did the Dondero/Dugaboy Defendants file their Arbitration Motions and raise the issue of arbitration under the Arbitration Clause for the first time in these proceedings, more than seven months after the litigation began. At the same time, the Dondero/Dugaboy Defendants also pursued extensive discovery, seeking and obtaining responses to interrogatories and documents requests in scope and number significantly more than the Arbitration Clause permitted, all in accordance with pre-trial stipulations the defendants both negotiated with Highland and then asked this court to approve, which the court did.

**HN6** Although courts in the Fifth Circuit sometimes apply a presumption against waiver of an arbitration right, the right can certainly be waived. Waiver [\*41] will be found when the party seeking arbitration substantially invokes the judicial process to the detriment or prejudice of the other party. In this context, prejudice refers to the inherent unfairness—in terms of delay, expense, or damage to a party's legal position—that occurs when the party's opponent forces

it to litigate an issue and later seeks to arbitrate that same issue."<sup>15</sup> A party waives arbitration when it "'engage[s] in some overt act in court that evinces a desire to resolve the arbitrable dispute through litigation rather than arbitration."<sup>16</sup>

While every situation is unique, here the court finds that the Dondero/Dugaboy Defendants waived their right (if any still remained) to demand arbitration, due to their multiple answers, their motions to withdraw the reference, extensive discovery that far exceeded what the Arbitration Clause permitted, and complete silence about the possibility of arbitration for more than eight months. Even though Counts V, VI, and VII were not added by Highland until more than seven months after the Note Adversary Proceedings were filed, the Dondero/Dugaboy Defendants had reason to know that their "oral agreement" affirmative defense [\*42] might implicate the LPA and the Arbitration Clause, and yet they didn't raise the subject of arbitration until many months of litigation activity in the Note Adversary Proceedings had occurred in this court. 17 The resulting delay and expense warrant this court's applying waiver as permitted by the Fifth Circuit authority cited above. This court finds as a matter of fact that the Dondero/Dugaboy Defendants waived the relief they seek in the Arbitration Motions.

## V. Judicial Estoppel, Waste and Inefficiency

Highland also asked the court: (a) to judicially estop the Dondero/Dugaboy Defendants from arguing entitlement to arbitration in light of prior contradictory positions these defendants took in earlier pleadings and arguments before this court, and (b) to decline to order arbitration because of the waste and inefficiency

<sup>&</sup>lt;sup>13</sup> <u>Williams v. Cigna Fin. Advisors, Inc., 56 F.3d 656, 661 (5th Cir. 1995)</u>.

<sup>&</sup>lt;sup>14</sup> Miller Brewing Co. v. Fort Worth Distrib. Co., 781 F.2d 494, 497 (5th Cir. 1986).

<sup>&</sup>lt;sup>15</sup> <u>Subway Equip. Leasing Corp. v. Forte, 169 F.3d 324, 327 (5th Cir. 1999)</u> (quoting <u>Doctor's Assocs., Inc. v. Distajo, 107 F.3d 126, 134 (2d Cir. 1997)</u>).

<sup>&</sup>lt;sup>16</sup> Keytrade USA v. Ain Temouchent M/V, 404 F.3d 891, 897 (5th Cir. 2005) (quoting Republic Ins. Co. v. PAICO Receivables, LLC, 383 F.3d 341, 344 (5th Cir. 2004)). See also Price v. Drexel Burnham Lambert, Inc., 791 F.2d 1156, 1162 (5th Cir. 1986) (party waived arbitration because it "initiated extensive discovery, answered twice, filed motions to dismiss and for summary judgment, filed and obtained two extensions of pre-trial deadlines, all without demanding arbitration").

<sup>&</sup>lt;sup>17</sup>The court notes that all Note Obligor Defendants consist of either Mr. Dondero or entities he controls.

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arbitration would represent for these proceedings. Because the court rules that rejection of the Arbitration Clause precludes Highland's being forced to submit to arbitration, and because the court finds that the Dondero/Dugaboy Defendants waived the relief they sought in the Arbitration Motions, the court need not and does not address Highland's arguments pertaining to [\*43] judicial estoppel or the practical implications of ordering arbitration.

#### VI. Stay of Counts I-IV

Finally, because the court denies the arbitration requested in the Arbitration Motions, there is no good cause to stay litigation in the entire Note Adversary Proceedings. Even if the court has erred in its ruling on the Arbitration Motions, there still exists no good cause to stay the Note Adversary Proceeding as to Counts I-IV. The Dondero/Dugaboy Defendants acknowledge that Counts I-IV are non-arbitrable claims and, moreover, in the event Plaintiff were to prevail on them, it is likely that Plaintiff would not even pursue Counts V-VII. To clarify, if Plaintiff prevails on Counts I and II (i.e., the breach of contract claims and turnover)—which would involve a finding that there was no oral agreement for nonpayment-then all other counts would become moot. And, if the court were to find that there were such an agreement, Plaintiff could potentially still prevail on Counts III and IV (the claims that such an agreement would constitute a fraudulent transfer-also non-arbitrabal). It would seem that only if Plaintiff loses on all of these non-arbitrable claims would it have any interest in pursuing [\*44] Counts V-VII (i.e., an interest in arguing that the oral agreements amounted to breach of fiduciary duty and aiding and abetting breach of fiduciary duty).

The requested stay would also be illogical in this context. The "oral agreement" defense relies on the existence of an oral contract between Highland (via Dugaboy, through its trustee, Ms. Dondero) and Mr. Dondero. The existence of that contract is **not** an arbitrable issue. The implications of that contract's existence are what would potentially be arbitrable. If litigation on Counts I—IV demonstrates that there was no such "oral agreement," then there would be nothing to arbitrate because Counts V—VII would be rendered moot. Staying the litigated determination regarding the existence of the "oral agreement" in favor of arbitrating issues that only arise if there ever were such an agreement strikes the court as backwards. Arbitration should await that determination, not the other way

around.

Accordingly, the Dondero/Dugaboy Defendants' requests to stay the Note Adversary Proceedings have no merit and are denied.

#### **ORDER**

For the reasons stated in the above Memorandum Opinion and Order, the Arbitration Motions and Stay Motions related thereto [\*45] are DENIED.

The following constitutes the ruling of the court and has the force and effect therein described.

Signed December 3, 2021

/s/ Stacey G.C. Jernigan

**United States Bankruptcy Judge** 

**End of Document** 

## **2023 WINTER LEADERSHIP CONFERENCE**



User Name: Alexis Leventhal

Date and Time: Thursday, November 2, 2023 3:17:00PM EDT

**Job Number:** 209597272

# Document (1)

1. Murray v. Willkie Farr & Gallagher LLP (In re Murray Energy Holdings Co.), 2023 Bankr. LEXIS 2507

Client/Matter: -None-

#### **AMERICAN BANKRUPTCY INSTITUTE**



# Murray v. Willkie Farr & Gallagher LLP (In re Murray Energy Holdings Co.)

United States Bankruptcy Court for the Southern District of Ohio, Western Division

October 5, 2023, Decided

Case No. 19-56885, Chapter 11, Adv. Pro. No. 22-2007

#### Reporter

2023 Bankr. LEXIS 2507 \*; \_\_ B.R. \_\_

In re: MURRAY ENERGY HOLDINGS CO., et al., Debtors.Brenda L. Murray, et al., Plaintiffs, v. Willkie Farr & Gallagher LLP, et al., Defendants.

## **Core Terms**

bankruptcy court, arbitration, withdrawal, exculpation, related-to, Plaintiffs', confirmed, arising-in, bankruptcy case, Defendants', proceedings, parties, motion to dismiss, negotiation, cleaned, cases, malpractice claim, district court, gross negligence, arising-under, matters, courts, state court, abstention, adversary proceedings, allegations, malpractice, Settlement, bankruptcy proceedings, disclosure statement

## Case Summary

### Overview

HOLDINGS: [1]-The court declined to abstain from hearing the proceeding because the fact that plaintiffs sought a jury trial did not weigh in favor of abstention; [2]-Plaintiffs' malpractice claim was dismissed because it was barred by the Exculpation Clause; defendants were Exculpated Parties under the Chapter 11 Plan because they were attorneys for the debtor, who was one of the directors and equity holders; [3]-Plaintiffs neither alleged nor argued in their objection to the dismissal motion that defendants engaged in actual fraud or willful misconduct; their contention that defendants' actions constituted "actual malice" was a legal conclusion, not an allegation of fact, and was therefore entitled to no weight.

## Outcome

Dismissal was granted.

### LexisNexis® Headnotes

Bankruptcy Law > Procedural
Matters > Jurisdiction > Federal District Courts

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

## HN1 | Jurisdiction, Federal District Courts

Bankruptcy courts derive their jurisdiction from the district courts. District courts have original and exclusive jurisdiction over all cases under title 11. <u>28 U.S.C.S. § 1334(a)</u>. This is the jurisdiction over the debtor's bankruptcy case itself. The district courts also have original but not exclusive jurisdiction over civil proceedings arising under Title 11, or arising in or related to a case under title 11. <u>28 U.S.C.S. § 1334(b)</u>.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Federal District Courts

#### HN2 | Jurisdiction, Federal District Courts

A district court may refer its jurisdiction to the bankruptcy judges for the district, <u>28 U.S.C.S. § 157(a)</u>, and every district court in the country, including the Southern District of Ohio, has referred bankruptcy cases and proceedings to the bankruptcy courts by issuing a standing order of reference.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Embezzlement & False Representations

**HN3** Exceptions to Discharge, Embezzlement & False Representations

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Proceedings arising under title 11 include actions brought under 11 U.S.C.S. §§ 544(b) and 548 to avoid fraudulent transfers or obligations. Arising-under actions also include proceedings to have a debt declared nondischargeable under 11 U.S.C.S. § 523(a).

Bankruptcy Law > Procedural
Matters > Jurisdiction > Core Proceedings

Bankruptcy Law > Procedural
Matters > Jurisdiction > Federal District Courts

# HN4[♣] Jurisdiction, Core Proceedings

Arising in proceedings are those that, by their very nature, could arise only in bankruptcy cases. An example of a proceeding arising in a bankruptcy case is a motion requesting that a bankruptcy court interpret or enforce its own order. The Sixth Circuit has applied a but for test to determine whether there is arising-in jurisdiction. Matters that arise-under title 11 and arise-in cases under title 11 together comprise core proceedings, 28 U.S.C.S. § 157(b)(2), in which bankruptcy courts generally may enter final judgments.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

# 

Absent consent of the parties, the bankruptcy court may hear proceedings that are related-to a bankruptcy case but must submit proposed findings of fact and conclusions of law to the district court. 28 U.S.C.S. § 157(c)(1). With the consent of all the parties to a related-to proceeding, the bankruptcy court may issue final orders in a related-to proceeding. 28 U.S.C.S. § 157(c)(2).

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

## **HN6** Jurisdiction, Noncore Proceedings

Under the Pacor test for related-to jurisdiction is whether the outcome of the proceeding could have any conceivable effect on the debtor's bankruptcy estate. The Sixth Circuit has adopted the test, albeit with the caveat that situations may arise where an extremely

Proceedings arising under title 11 include actions tenuous connection to the estate would not satisfy the brought under 11 U.S.C.S. §§ 544(b) and 548 to avoid jurisdictional requirement.

Civil Procedure > ... > Removal > Specific Cases Removed > Bankruptcy Related Claims

# <u>HN7</u>[♣] Specific Cases Removed, Bankruptcy Related Claims

For purposes of determining 11 U.S.C.S. § 1334(b) jurisdiction, it is necessary only to determine whether a matter is at least related to the bankruptcy.

Governments > Legislation > Interpretation

## HN8 Legislation, Interpretation

The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters. There are three categories of proceedings over which bankruptcy courts have jurisdiction—those that arise-under, arise-in or relate-to cases under title 11. Under the rule of surplusage, effect should be given to every part of a statute.

Bankruptcy Law > Case Administration > Closing & Reopening Cases > Case Closing

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

# HN9 2 Closing & Reopening Cases, Case Closing

Generally, when a bankruptcy case is closed, there is no longer an estate to be administered, and an action or proceeding cannot have a conceivable effect on an estate that no longer exists, meaning that the bankruptcy court would lack related-to jurisdiction.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

## **HN10** Jurisdiction, Noncore Proceedings

Arising-in jurisdiction exists over a malpractice action if it

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is intricately related to the bankruptcy process, even if it does not involve a debtor or a court-approved professional.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

# HN11 Jurisdiction, Noncore Proceedings

In no-asset Chapter 7 cases, there is no property of the estate to be distributed to creditors, and related-to jurisdiction therefore cannot exist in those cases.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

# **HN12** Jurisdiction, Noncore Proceedings

If a plan creates a trust and shoehorns all claimants into an exclusive mechanism by which those claimants are to be satisfied for years into the future out of that trust, then future disputes over the interpretation or enforcement of the trust would fall into the bankruptcy court's arising in jurisdiction, because such disputes would not have occurred but for the bankruptcy process.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

## HN13 Jurisdiction, Noncore Proceedings

It also ensures that disputes that arise under the Bankruptcy Code (because they are based on a provision of the Code) or arise in a bankruptcy case (because they would not exist but for the bankruptcy) fall within the jurisdiction of the bankruptcy courts even if the disputes could have no conceivable effect on the estate and therefore would not be related to the bankruptcy case.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Federal District Courts

Civil Procedure > ... > Removal > Specific Cases Removed > Bankruptcy Related Claims

Bankruptcy Law > Procedural

Matters > Jurisdiction > Noncore Proceedings

# HN14 Jurisdiction, Federal District Courts

11 U.S.C.S. § 1334(b) identifies four distinct matters that bankruptcy courts have jurisdiction over: (1) cases under title 11; (2) proceedings arising under title 11; (3) proceedings arising in a case under title 11; and (4) proceedings related to a case under title 11. 28 U.S.C.S. § 1334(a), (b). These four categories define jurisdiction conjunctively. Related to jurisdiction is the most expansive category, covering any proceeding that could have a conceivable effect on the administration of the estate. Because "related to" jurisdiction covers any proceeding that would fall under the other forms, courts assessing § 1334(b) jurisdiction therefore need only determine whether the matter is "related to" the bankruptcy.

Torts > Malpractice & Professional Liability > Attorneys

# <u>HN15</u> Malpractice & Professional Liability, Attorneys

Claims of malpractice which originated out of postpetition advice of counsel concerning the bankruptcy itself are matters that fall within arising in jurisdiction.

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

## HN16 Plans, Plan Contents

Proceedings requiring courts to enforce provisions of Chapter 11 plans arise in bankruptcy.

Governments > Courts > Authority to Adjudicate

## HN17 Courts, Authority to Adjudicate

A defense may serve as the basis for arising-in jurisdiction.

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

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Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Orders to Compel Arbitration

# **HN18 L** Arbitration, Arbitrability

When considering a motion to compel arbitration, first, the court must determine whether the parties agreed to arbitrate; second, it must determine the scope of that agreement; third, if federal statutory claims are asserted, it must consider whether Congress intended those claims to be nonarbitrable; and fourth, if the court concludes that some, but not all, of the claims in the action are subject to arbitration, it must determine whether to stay the remainder of the proceedings pending arbitration.

Bankruptcy Law > Procedural

Matters > Jurisdiction > Core Proceedings

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Bankruptcy Law > Procedural
Matters > Jurisdiction > Noncore Proceedings

# **HN19 L** Jurisdiction, Core Proceedings

In a non-core proceeding, a court is generally without discretion to preclude the enforcement of arbitration agreements and the inquiry ends. But if the dispute is a core proceeding, the court moves to the next step in the analysis—whether enforcement of such agreement would inherently conflict with the underlying purposes of the Bankruptcy Code.

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Arbitration Agreements

Business & Corporate
Compliance > ... > Arbitration > Federal Arbitration
Act > Scope

# <u>HN20</u>[基] Arbitration, Arbitrability

The Federal Arbitration Act ("FAA") establishes a federal

policy favoring arbitration and requires courts to rigorously enforce agreements to arbitrate. (cleaned up). The Supreme Court held that, like any statutory directive, the FAA's mandate may be overridden by a contrary congressional command, which will be deducible from the statute's text or legislative history or from an inherent conflict between arbitration and the statute's underlying purposes. Thus, under the FAA's pro-arbitration policy may be overridden by contrary commands in another statute's text or legislative history, or by an inherent conflict between arbitration and the other statute's underlying purposes. In the bankruptcy context, courts generally jump to an assessment of whether an inherent conflict exists, because they find no intent to limit arbitration in the Bankruptcy Code's text or its legislative history.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Core Proceedings

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

# HN21[ Jurisdiction, Core Proceedings

Even in a core proceeding, the standard must be met, meaning 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.

Business & Corporate Compliance > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

## HN22 Arbitration, Arbitrability

In considering whether arbitration would inherently conflict with the Bankruptcy Code, the relevant purposes of the Code include the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.

Bankruptcy Law > ... > Bankruptcy > Case Administration > Bankruptcy Court Powers

Business & Corporate Compliance > ... > Contracts Law > Contract Conditions &

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Provisions > Exculpatory Clauses

abstention is warranted.

## 

Enforcing the Exculpation Clause of the Chapter 11 Plan is tantamount to enforcing an order of the Court. Further, exculpation clauses are a fundamental protection that the Bankruptcy Code permits Chapter 11 plans to afford. Unlike releases, which provide for the relinquishment of claims held by the debtor or third parties against certain nondebtor parties, exculpation clauses establish the standard of care that will trigger liability in future litigation by a non-releasing party against an exculpated party for acts arising out of a debtor's restructuring. Their inclusion in Chapter 11 plans is authorized by 11 U.S.C.S. § 1123(b)(6), which permits Chapter 11 plans to include any appropriate provision not inconsistent with the applicable provisions of the Bankruptcy Code, 11 U.S.C.S. § 1123(b)(6), and § 105(a) of the Code, which empowers courts to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, 11 U.S.C.S. § 105(a). They are a commonplace provision in Chapter 11 plans.

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > Abstention

# <u>HN24</u> **L** Federal & State Interrelationships, Abstention

Mandatory abstention does not apply to core proceedings.

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > Abstention

Evidence > Burdens of Proof > Allocation

# <u>HN25</u> ► Federal & State Interrelationships, Abstention

Because federal courts have an obligation to exercise the jurisdiction properly given to them, there is a presumption in favor of the exercise of federal jurisdiction and against abstention. And the movant bears the burden of establishing that permissive Bankruptcy Law > Procedural
Matters > Jurisdiction > Removal to District Court

## HN26 Jurisdiction, Removal to District Court

The factors courts consider when deciding whether to exercise permissive abstention, include: (1) the effect or lack of effect on the efficient administration of the estate if a court abstains, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable state law, (4) the presence of a related proceeding commenced in state court or other non-bankruptcy court, (5) the jurisdictional basis, if any, other than 28 U.S.C.S. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, (7) the substance rather than form of an asserted core proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden on the court's docket, (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, (12) the presence in the proceeding of nondebtor parties and (13) any unusual or other significant factors.

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > Abstention

Civil Procedure > Preliminary
Considerations > Venue > Forum Non Conveniens

# <u>HN27</u> Federal & State Interrelationships, Abstention

The factors courts consider when deciding whether to equitably remand a case are: (1) Duplicative and uneconomical use of judicial resources in two forums, (2) prejudice to the involuntarily removed parties, (3) forum non conveniens, (4) the state court's ability to handle a suit involving questions of state law, (5) comity considerations, (6) lessened possibility of an inconsistent result and (7) the expertise of the court in which the matter was originally pending. Courts assessing possible permissive abstention have

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considered one or more of these factors, and not necessarily all of them. A court thus need not discuss each factor in the laundry lists developed in prior decisions.

Bankruptcy Law > Procedural
Matters > Jurisdiction > Core Proceedings

# HN28 Jurisdiction, Core Proceedings

A core proceeding is precisely the kind of issue that falls within the expertise of the bankruptcy court, and there is a strong preference for resolving core proceedings in the bankruptcy court.

Civil Procedure > ... > Defenses, Demurrers & Objections > Motions to Dismiss > Failure to State Claim

Civil Procedure > Trials > Jury Trials > Right to Jury Trial

# HN29 Motions to Dismiss, Failure to State Claim

It is well established that the right to a jury trial does not prevent a court from granting a motion to dismiss for failure to state a claim.

Civil Procedure > ... > Defenses, Demurrers & Objections > Motions to Dismiss > Failure to State Claim

Civil

Procedure > ... > Pleadings > Complaints > Require ments for Complaint

# <u>HN30</u>[♣] Motions to Dismiss, Failure to State Claim

To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face. On a motion to dismiss, the Court must construe the complaint in the light most favorable to the plaintiff and accept all allegations as true.

Civil Procedure > ... > Defenses, Demurrers & Objections > Motions to Dismiss > Failure to State

Claim

# <u>HN31</u>[♣] Motions to Dismiss, Failure to State Claim

Exculpation clauses constitute affirmative defenses, which can form the basis for a motion to dismiss for failure to state a claim if the undisputed facts conclusively establish the affirmative defense as a matter of law. Under the right circumstances, when deciding a motion to dismiss for failure to state a claim, a court may consider facts beyond those provided in a complaint.

Civil Procedure > Remedies > Damages > Punitive Damages

Torts > ... > Types of Damages > Punitive Damages > Aggravating Circumstances

## **HN32** Damages, Punitive Damages

Actual malice, necessary for an award of punitive damages, is: (1) that state of mind under which a person's conduct is characterized by hatred, ill will or a spirit of revenge, or (2) a conscious disregard for the rights and safety of other persons that has a great probability of causing substantial harm.

Torts > Negligence > Gross Negligence

# HN33 ♣ Negligence, Gross Negligence

Gross negligence has been defined as the failure to exercise any or very slight care. As the Sixth Circuit has pointed out, negligence does not become gross just by saying so. If the courts are to make any sense of the distinction between gross negligence and simple negligence, the court must ensure that gross negligence is something more than simple negligence with the addition of a vituperative epithet.

Torts > Malpractice & Professional Liability > Attorneys

# <u>HN34</u>[基] Malpractice & Professional Liability, Attorneys

The requirements to establish a cause of action for legal malpractice relating to civil matters are: (1) an attorney-

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client relationship giving rise to a duty, (2) a breach of that duty, and (3) damages proximately caused by the breach.

Civil Procedure > ... > Defenses, Demurrers & Objections > Motions to Dismiss > Failure to State Claim

Torts > Malpractice & Professional Liability > Attorneys

Civil

Procedure > ... > Pleadings > Complaints > Require ments for Complaint

# **HN35 ★** Motions to Dismiss, Failure to State Claim

The requirements to establish a cause of action for legal malpractice relating to civil matters are: (1) an attorneyclient relationship giving rise to a duty, (2) a breach of that duty, and (3) damages proximately caused by the breach. Proximate causation is more appropriately decided on a motion for summary judgment than a motion to dismiss for failure to state a claim. This is because under the familiar rules of notice pleading in federal courts, a complaint should include merely a short and plain statement of the claim, Fed. R. Civ. P. 8(a)(2), and a district court may dismiss a complaint for failure to state a claim only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations. The Sixth Circuit has held that, in applying these rules, courts should presume that general allegations embrace those specific facts necessary to support the claim.

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Civil Procedure > ... > Defenses, Demurrers & Objections > Affirmative Defenses > Releases

Bankruptcy Law > ... > Discharge &
Dischargeability > Effect of Discharge > Effect on
Third Parties

# <u>HN36</u>[基] Plan Contents, Discretionary Provisions

Nonconsensual third-party releases can only be approved when unusual circumstances are present. The Sixth Circuit has held that seven factors must be

present for a non-consensual third-party release to be approved: There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate: The non-debtor has contributed substantial assets to the reorganization; The injunction reorganization. essential to namely. reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; The impacted class, or classes, has overwhelmingly voted to accept the plan: The plan provides a mechanism to pay for all. or substantially all, of the class or classes affected by the injunction; The plan provides an opportunity for those claimants who choose not to settle to recover in full and: The bankruptcy court made a record of specific factual findings that support its conclusions.

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For Drivetrain, LLC, Interested Party (2:19bk56885): Travis Bayer, Dinsmore & Shohl, Cincinnati, OH; Shane M Reil, Young Conaway Stargatt & Taylor LLP, Wilmington, DE.

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For Environmental Law & Policy Center, Interested Party (2:19bk56885): Brady Williamson, Godgrey & Kahn SC, Madison, WI.

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For David Williams, Interested Party (2:19bk56885): Patrick W Carothers, Carothers & Hauswirth LLP, Pittsburgh, PA.

For Asst US Trustee (Cin), Office of the US Trustee, U.S. Trustee (2:19bk56885): Jeremy Shane Flannery, Office of the United States Trustee, Columbus, OH; Monica V Kindt, John W. Peck Federal Building, Cincinnati, OH; Benjamin A Sales, Office of the United States Trustee, Cincinnati, OH.

For Matthew Feldman, Defendant (2:22ap2007): Brad Dennis Brian, Bethany Woodard Kristovich, Munger, Tolles & Olson LLP, Los Angeles, CA; Drew Harrison Campbell, Bricker Graydon LLP, Columbus, OH; Matthew K Donohue, Wilson Sonsini Goodrich & Rosati, P.C., Los Angeles, CA; Bradley Schneider, Kendall Brill & Kelly LLP, Los Angeles, CA; Laura Kimberly Lin, Simpson Thacher & Bartlett LLP, Palo Alto, CA.

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For Michael J. Shaheen, dba:Trustee of the Robert E. Murray Trust, Plaintiff (2:22ap2007): Benjamin R. Ogletree, Verdi & Ogletree PLLC, Washington, DC; Donald J Tennant, Jr, Tennant Law Offices, Wheeling, WV; Kerry Verdi, Verdi & Ogletree PLLC, Washington, DC.

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**Judges:** John E. Hoffman, Jr., United States [\*21] Bankruptcy Judge.

Opinion by: John E. Hoffman, Jr.

# **Opinion**

#### **MEMORANDUM OPINION AND ORDER**

#### I. Introduction

The plaintiffs in this adversary proceeding sued the defendants in state court for legal malpractice, and the defendants removed that action to this Court. A threshold issue is whether the Court has subject-matter jurisdiction to adjudicate the legal malpractice action. The plaintiffs say no, and they have filed a motion to remand the malpractice action to the state court. They also ask the Court to abstain from hearing this adversary proceeding in favor of arbitration. The defendants agree that the malpractice claim, if it is not heard in this Court, should be arbitrated rather than being heard in state court. But the defendants argue that this Court has subject-matter jurisdiction to hear the malpractice claim, should exercise that jurisdiction and should dismiss the malpractice claim under Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim upon which relief can be granted.

Because the enforcement of the second amended Chapter 11 plan ("Chapter 11 Plan") (Doc. 2082-1)<sup>1</sup> of Murray Energy Holdings Co. ("Murray Energy") and its affiliated debtors and debtors in possession ("Debtors") is at issue, the Court has subject-matter jurisdiction [\*22] and will retain the matter rather than remanding it to state court. And because the plaintiffs' claim is barred by the Chapter 11 Plan's exculpation clause, the Court grants the defendants' motion to dismiss the complaint for failure to state a claim upon which relief can be granted.

<sup>&</sup>lt;sup>1</sup> References to "Adv. Doc.\_\_" are to docket entries in this adversary proceeding, and references to "Doc.\_\_" are to docket entries in the main bankruptcy case, Case No. 19-56885. When citing documents in the record, the Court will cite the PDF page number.

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### II. Jurisdiction & Constitutional Authority

For the reasons explained below, the Court has arisingin jurisdiction to hear and determine this matter under 28 U.S.C. § 1334(b) and the general order of reference entered in this district in accordance with 28 U.S.C. § 157(a). Given that the Court has arising-in jurisdiction, this is a core proceeding. See Brown v. Harrington (In re Brown), No. 21-11284-GAO, 2022 U.S. Dist. LEXIS 73690, 2022 WL 1200783, at \*2 (D. Mass. Apr. 22, 2022), aff'd, 55 F.4th 945 (1st Cir. 2022); S. Canaan Cellular Invs., LLC v. Lackawaxen Telecom, Inc. (In re S. Canaan Cellular Invs., LLC), 427 B.R. 85, 90 (Bankr. E.D. Pa. 2010). And because this dispute "stems from the bankruptcy itself," the Court has the constitutional authority to enter a final order. Stern v. Marshall, 564 U.S. 462, 499, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011).

## III. Background

The following background is taken from the parties' filings,<sup>2</sup> the Chapter 11 Plan, the disclosure statement

<sup>2</sup> Several motions, responses and replies are before the Court in this adversary proceeding:

- a. Defendants Willkie Farr & Gallagher LLP, Brian S. Lennon, and Matthew Feldman's Joint Motion to Dismiss the Complaint (Adv. Doc. 9) ("Dismissal Motion"); Substitute Plaintiffs' [\*23] Opposition to Defendants' Joint Motion to Dismiss Complaint ("Opposition to Dismissal Motion") (Adv. Doc. 51); and Defendants' Reply to Plaintiffs' Opposition to Defendants' Joint Motion to Dismiss the Complaint (Adv. Doc. 56);
- b. Plaintiffs' Motion for Remand ("Remand Motion") (Adv. Doc. 42); Corrected Memorandum in Support of Plaintiff's Motion for Remand (Adv. Doc. 47) ("Remand Memorandum"); Defendants' Opposition to Plaintiffs' Motion for Remand ("Remand Opposition") (Adv. Doc. 57); and Reply in Response to Defendants' Opposition to Plaintiffs' Motion for Remand (Adv. Doc. 67);
- c. Defendants' Re-filed Motion for a Stay Pending Arbitration and a Hearing ("Defendants' Arbitration Motion") (Adv. Doc. 60); Plaintiffs' Partial Opposition to Defendants' Re-filed Motion for Stay Pending Arbitration and a Hearing (Adv. Doc. 70); and Defendants' Reply to Plaintiffs' Opposition to Defendants' Motion for a Stay (Adv. Doc. 72); and
- d. Motion to Stay Pending Conclusion of Arbitration ("Plaintiffs' Arbitration Motion") (Adv. Doc. 64);

for the Chapter 11 Plan ("Disclosure Statement") (Doc. 1155-1), and other documents of record in the Debtors' cases of which the Court may take judicial notice.

### A. Events Leading to this Adversary Proceeding

Robert E. Murray ("Mr. Murray") founded Murray Energy in 1998. Disclosure Statement, Doc. 1155-1 at 29. Facing difficult market conditions in the thermal coal industry, which led more than 40 coal companies to seek bankruptcy relief since 2001, the Debtors filed petitions for relief under Chapter 11 of the Bankruptcy Code in October 2019. See id. at 10. At the time, the Debtors together comprised the largest privately owned coal company in the United States, with 13 active mines in six states and in Columbia, South America and annual revenue of approximately \$2.5 billion. See id. at 9.

Less than a year later, the Court confirmed the Chapter 11 Plan by an order entered on August 31, 2020 ("Confirmation Order") (Doc. 2135). Mr. Murray was the Chairman of the Board of Directors of Murray Energy both when the Debtors filed bankruptcy and when their Chapter 11 Plan was confirmed. Disclosure Statement at 29. He also owned all issued and outstanding voting Class A common shares [\*25] in Murray Energy. *Id.* at 22.

The United Mine Workers of America 1974 Pension Plan and Pension Trust ("1974 Plan") held the largest claim against the Debtors. The 1974 Plan "is a multiemployer defined benefit pension plan that provided benefits to more than 87,000 retired miners and their spouses." Dismissal Mot., Adv. Doc. 9 at 12. The Debtors withdrew from the 1974 Plan when they rejected their 2016 collective bargaining agreement with the United Mine Workers through the Chapter 11 Plan. See Order (I) Authorizing, But Not Directing, the Debtors to (A) Reject Certain Collective Bargaining Agreements, (B) Modify Certain Union-Related Retiree Benefits, and (C) Implement the Terms of the Contingent Arrangement Between the Debtors, the United Mine Workers of America, and the Stalking Horse Bidder and (II) Granting Related Relief (Doc. 1455) ("CBA Order").

Memorandum in Support of Plaintiffs' Motion to Stay Pending Conclusion of Arbitration ("Plaintiffs' Arbitration Memorandum" (Doc. 64-1), Defendants' Opposition to [\*24] Plaintiffs' Motion to Stay (Adv. Doc. 71); and Reply in Response to Defendants' Opposition to Plaintiffs' Motion to Stay Pending Conclusion of Arbitration (Adv. Doc. 75).

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The CBA Order provided that

[t]he Debtors' successorship liability and obligations to contribute to the 1974 Pension Plan shall be terminated, and any such obligations shall be deemed rejected upon the Debtors' rejection of the 2016 CBA. For the avoidance of doubt, the termination of the Debtors' obligations with respect to the 1974 Pension [\*26] Plan shall constitute a withdrawal from the 1974 Pension Plan.

Id. at 4.

On the effective date of the Chapter 11 Plan, the Debtors withdrew from the 1974 Plan. Confirmation Order at 22-23 ("In accordance with . . . the [CBA Order] . . . on the Effective Date, the Debtors shall be deemed to have rejected the 2016 CBA and to have modified all retiree benefits . . ., effectuating a complete withdrawal from the 1974 Pension Plan. . . ."). The Debtors' withdrawal triggered statutory withdrawal liability allegedly exceeding \$6.5 billion under the <a href="Employee Retirement Income Security Act of 1974 ("ERISA")">Employee Retirement Income Security Act of 1974 ("ERISA")</a>. Dismissal Mot., Adv. Doc. 9 at 9-10.

While confirmation of the Chapter 11 Plan released the Debtors' ERISA withdrawal liability, the 1974 Plan contended that Mr. Murray was personally responsible for the withdrawal liability. The 1974 Plan further claimed that entities under Mr. Murray's control, including the Robert E. Murray Trust ("Trust"), also had withdrawal liability. Following Mr. Murray's death in October 2020, Michael J. Shaheen ("Mr. Shaheen") became the trustee of the Trust, and Mr. Murray's wife, Brenda L. Murray ("Mrs. Murray"), became executrix of Mr. Murray's estate ("Estate").

In March 2021, several months after confirmation of the [\*27] Chapter 11 Plan, "the 1974 Plan sent a letter to Mrs. Murray, as the personal representative of . . . [Mr. Murray's] Estate, demanding payment of over \$6.5 billion in ERISA withdrawal liability from the Estate and any related 'trust." Compl. ¶ 18, Adv. Doc. 1 at 16. The next day, the 1974 Plan filed a lawsuit in the United States District Court for the District of Columbia. The lawsuit sought payment of more than \$6.5 billion from the Estate and entities "under the control of" Mr. Murray. *Id.* ¶ 19.

It was this potential withdrawal liability to the 1974 Plan that gave rise to the adversary proceeding. In February 2022, Mrs. Murray, as the executrix of the Estate, and Mr. Shaheen as the trustee of the Trust (together with Mrs. Murray, "Plaintiffs"), filed a complaint ("Complaint")

in the Belmont County, Ohio Court of Common Pleas ("State Court").3 The Complaint asserted a single claim for legal malpractice against Willkie Farr & Gallagher LLP, the law firm that represented Mr. Murray and the Trust during the bankruptcy, and two of its partners, Brian Lennon and Matthew Feldman ("Defendants"). The Plaintiffs alleged that the Defendants, in representing Mr. Murray and the Trust during the [\*28] Debtors' bankruptcv proceedings, committed malpractice by (1) failing to negotiate the Chapter 11 Plan so that the claims of the 1974 Plan against Mr. Murray and the Trust were released and (2) failing to advise Mr. Murray that he and the Trust were not being released from claims of the 1974 Plan.

The Defendants removed the State Court action. They then moved to dismiss this adversary proceeding, arguing the Chapter 11 Plan's exculpation clause barred the Plaintiffs' malpractice action and that the Plaintiffs failed to properly plead causation. Opposing dismissal, the Plaintiffs responded that the Court lacks subject-matter jurisdiction over the claim, that the exculpation clause does not bar the claim, and that they have adequately pleaded causation. The Plaintiffs also filed both a motion to remand and a motion to stay pending the conclusion of arbitration, which the Plaintiffs commenced through JAMS in New York, New York in April 2022—one month after filing their Complaint. Pls.' Arbitration Mot., Adv. Doc. 64 at 1.

## B. Relevant Provisions of the Chapter 11 Plan

The Chapter 11 Plan did not release any of the 1974 Plan's claims against Mr. Murray and the Trust. To the contrary, it stated [\*29] as follows:

G. Treatment of 1974 Plan

Notwithstanding release, settlement. any satisfaction, compromise, discharge, exculpation, enjoining, injunction, or similar provision provided in the [Chapter 11] Plan, [the Chapter 11 Plan] will not enjoin, preclude, or limit the 1974 Plan from pursuing any or all claims or Causes of Action the 1974 Plan may have against Released Parties other than the Debtors, the Estates, Murray NewCo and all of Murray NewCo's subsidiaries (including the Stalking Horse Bidder), or the Wind-Down Trust arising from or related to the Debtors' withdrawal from the 1974 Plan. . . . For the avoidance of doubt, any and all claims . . . that the 1974 Plan has

<sup>&</sup>lt;sup>3</sup> The Complaint is Exhibit A to the Notice of Removal (Adv. Doc. 1) ("Notice").

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against any party other than the Debtors, Murray NewCo, and all of Murray NewCo's subsidiaries (including the Stalking Horse Bidder) are preserved and shall be preserved in the Confirmation Order and this paragraph shall preempt any above-referenced release, injunction, settlement, satisfaction, compromise, discharge, exculpation, enjoining, or other similar provision in the [Chapter 11] Plan or Confirmation Order.

Chapter 11 Plan at 61; see also Confirmation Order at 50-51.

The Defendants' request for dismissal is [\*30] based on another provision of the Chapter 11 Plan known as the "Exculpation Clause." It states:

E. Exculpation

[N]o Exculpated Party shall have or incur, and each Exculpated Party is hereby exculpated from, any Cause of Action for any claim related to any act or omission based on the negotiation, execution, and implementation of any transactions approved by the Bankruptcy Court in the Chapter 11 Cases, including the RSA, the Stalking Horse APA, the Disclosure Statement, the [Chapter 11] Plan, the Plan Supplement, the Confirmation Order, or any Restructuring Transaction . . . except for claims related to any act or omission that is determined by Final Order to have constituted actual fraud, willful misconduct, or gross negligence, each solely to the extent as determined by a Final Order of a court of competent jurisdiction[.]

Chapter 11 Plan at 59-60.

The Exculpation Clause only applies to an "Exculpated Party." According to the Chapter 11 Plan:

"Exculpated Party" means collectively, and in each case solely in its capacity as such: (a) the Debtors . . . and (s) with respect to each of the foregoing entities, such Entity and its current and former Affiliates, and such Entities' and their current Affiliates' [\*31] directors, managers, officers, equity holders (regardless of whether such interests are indirectly), held directly or predecessors. participants, successors, and assigns, subsidiaries, and each of their respective current and former equity holders, officers, directors, managers, principals, members, employees, agents, advisory board members, financial advisors, partners [and] attorneys[.]

Id. at 13.

As a director and equity holder of Murray Energy, Mr. Murray was an Exculpated Party under this provision. But the language as to treatment of the 1974 Plan overrode that exculpation and permitted the 1974 Plan to assert its withdrawal claim against him—and now the Estate and the Trust. *Id.* at 61.

## IV. Legal Analysis

#### A. The Court's Jurisdiction

#### 1. An Overview of Bankruptcy Court Jurisdiction

HN1[1] "Bankruptcy courts . . . derive their jurisdiction from the district courts." Wasserman v. Immormino (In re Granger Garage, Inc.), 921 F.2d 74, 77 (6th Cir. 1990). District courts have original and exclusive jurisdiction over "all cases under title 11" (the Bankruptcy Code). 28 U.S.C. § 1334(a). This is the jurisdiction over the debtor's "bankruptcy case itself." Kirk v. Hendon (In re Heinsohn), 231 B.R. 48, 56 (Bankr. E.D. Tenn. 1999), aff'd, 247 B.R. 237 (E.D. Tenn. 2000). The district courts also have original but not exclusive jurisdiction over civil proceedings "arising under Title 11," or arising in or [\*32] related to a case under title 11." 28 U.S.C. § 1334(b).

HN2 A district court may refer its jurisdiction to the bankruptcy judges for the district, 28 U.S.C. § 157(a), and every district court in the country, including the Southern District of Ohio, has referred bankruptcy cases and proceedings to the bankruptcy courts by issuing a standing order of reference. See General Order No. 05-02 (S.D. Ohio Oct. 24, 2005) ("By virtue of 28 U.S.C. §§ 151 and 157(a) and §104 of Title I of the Bankruptcy Amendments Act of 1984, IT IS HEREBY ORDERED that all cases under the Bankruptcy Act and Title 11 of the United States Code and all actions, matters or proceedings arising under Title 11 of the United States Code or arising in or related to a case under the Bankruptcy Act and Title 11 of the United States Code shall be referred to the Bankruptcy Judges for this Judicial District[.]").

Within a bankruptcy case, parties request relief either through contested matters or adversary proceedings. See <u>Federal Rules of Bankruptcy Procedure 7001</u> and <u>9014</u>. District courts, and bankruptcy courts by referral, exercise three categories of jurisdiction over contested matters and adversary proceedings.

The first category is arising-under jurisdiction. HN3[1] "The phrase 'arising under title 11 describes those proceedings that involve a cause of action created or determined by a statutory provision of title 11." Mich. Empl. Sec. Comm'n v. Wolverine Radio Co. (In re Wolverine Radio Co.), 930 F.2d 1132, 1144 (6th Cir. 1991). Proceedings arising under title 11 include actions brought under §§ 544(b) and 548 to avoid [\*33] fraudulent transfers or obligations. See Bavelis v. Doukas (In re Bavelis), 453 B.R. 832, 851 (Bankr. S.D. Ohio 2011). Arising-under actions also include proceedings to: (1) have a debt declared nondischargeable under § 523(a) of the Bankruptcy Code, see Heck v. Adamson (In re Adamson), No. 09-00623, 2010 Bankr. LEXIS 83, 2010 WL 122904, at \*2 (Bankr. D.D.C. Jan. 6, 2010) ("The complaint seeks a declaration that a debt is nondischargeable under 11 U.S.C. § 523(a), and jurisdiction thus lies under the "arising under title 11" prong of the bankruptcy jurisdiction statute, 28 U.S.C. § 1334(b)."); (2) object to a debtor's discharge, see Cotton v. Gensler (In re Cotton), No. 06-51580JDW, 2007 Bankr. LEXIS 1119, 2007 WL 951541, at \*1 (Bankr. M.D. Ga. Mar. 26, 2007) ("'Arising under' cases are those in which the cause of action is created by the Bankruptcy Code, such as . . . objections to discharge."); and (3) hold a creditor liable for violating the discharge injunction, see Daniels v. Howe Law Firm, P.C. (In re Daniels), No. AP 15-5296, 2019 Bankr. LEXIS 2804, 2019 WL 4253846, at \*1 n.1 (Bankr. N.D. Ga. Sept. 5, 2019) ("Plaintiff's claim for sanctions for violations of the discharge injunction arises under the Bankruptcy Code and, therefore, is a core proceeding, over which this Court has subject matter jurisdiction.").

The second category is arising-in jurisdiction. HN4 1 "[A]rising in proceedings are those that, by their very nature, could arise only in bankruptcy cases." Wolverine Radio, 930 F.2d at 1144. An example of a proceeding arising in a bankruptcy case is a motion requesting that a bankruptcy court interpret or enforce its own order. See Sterling Vision, Inc. v. Sterling Optical Corp. (In re Sterling Optical Corp.), 302 B.R. 792, 801 (Bankr. S.D.N.Y. 2003). The Sixth Circuit has applied a "but for" test to determine whether there is arising-in jurisdiction. [\*34] See Lowenbraun v. Canary (In re Lowenbraun), 453 F.3d 314, 321 (6th Cir. 2006) ("Because [the] claims would not exist but for the bankruptcy proceeding, and because [counsel to the Chapter 7 trustee] filed the Contempt Motion to assist in the administration of the estate, [the] state-law action was a core proceeding[.]"). Matters that arise-under title 11 and arise-in cases under title 11 together comprise

"core proceedings," <u>28 U.S.C. § 157(b)(2)</u>, in which bankruptcy courts generally may enter final judgments. <sup>4</sup> <u>Wolverine Radio, 930 F.2d at 1144</u> ("[S]ection 157 apparently equates core proceedings with the categories of 'arising under' and 'arising in' proceedings.") (quoting <u>Wood v. Wood (In re Wood), 825 F.2d 90, 96 (5th Cir. 1987)</u>).

The third category is related-to jurisdiction. HN5[\*] Absent consent of the parties, the bankruptcy court may hear proceedings that are related-to a bankruptcy case but must submit proposed findings of fact and conclusions of law to the district court. See 28 U.S.C. § 157(c)(1). With the consent of all the parties to a related-to proceeding, the bankruptcy court may issue final orders in a related-to proceeding. See 28 U.S.C. § 157(c)(2). The seminal case for determining whether a court has related-to jurisdiction is In re Pacor, Inc., 743 F.2d 984, 994 (3d Cir. 1984). HN6 1 Under Pacor, the test for related-to jurisdiction is whether the outcome of the proceeding could have any conceivable effect on the debtor's bankruptcy estate. Pacor, 743 F.2d at 994 [\*35] . The Sixth Circuit has adopted the Pacor test, "albeit with the caveat that situations may arise where an extremely tenuous connection to the estate would not satisfy the jurisdictional requirement." Wolverine Radio, 930 F.2d at 1142 (cleaned up).

After confirmation, some courts apply a "close nexus" test to determine whether they have related-to jurisdiction. Under the close nexus test, jurisdiction lies in the bankruptcy court "only if the claim affect[s] an integral aspect of the bankruptcy process—there must be a close nexus to the bankruptcy plan or proceeding. Such matters would typically include those that affect the interpretation, implementation, consummation, execution, or administration of the confirmed plan." In re

<sup>&</sup>lt;sup>4</sup> Bankruptcy courts lack the constitutional authority to finally adjudicate so-called *Stern* claims even though the claims are statutorily core under 28 U.S.C. § 157(b)(2). In Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011), the Supreme Court held that "even though bankruptcy courts are statutorily authorized to enter final judgment on a class of bankruptcy-related claims, Article III of the Constitution prohibits bankruptcy courts from finally adjudicating [Stern claims]." Exec. Benefits Ins. Agency v. Arkison, 573 U.S. 25, 28, 134 S. Ct. 2165, 189 L. Ed. 2d 83 (2014). With the consent of all the parties, however, bankruptcy courts may finally adjudicate Stern claims. See Wellness Int'l Network, Ltd. v. Sharif, 575 U.S. 665, 673, 135 S. Ct. 1932, 191 L. Ed. 2d 911 (2015). No party has contended that the claim asserted here is a Stern claim.

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HNRC Dissolution Co., 761 F. App'x 553, 561 n.4 (6th Cir. 2019) (cleaned up). The "Sixth Circuit has not yet endorsed the close nexus test for narrowed post-confirmation jurisdiction." Bavelis v. Doukas, 835 F. App'x 798, 805 (6th Cir. 2020) (cleaned up). But the Sixth Circuit BAP has applied the close nexus test without formally adopting it. Thickstun Bros. Equip. Co. v. Encompass Servs. Corp. (In re Thickstun Bros. Equip. Co.), 344 B.R. 515, 522 (B.A.P. 6th Cir. 2006). And, according to the BAP,

[i]t is difficult to imagine a closer nexus to the Debtor's bankruptcy case and the confirmed Plan than this direct request for interpretation and clarification of the Plan's terms. Indeed, even the most restrictive views of post-confirmation jurisdiction acknowledge that the bankruptcy courts retain jurisdiction to interpret and enforce confirmed plans of reorganization.

Id. (cleaned up).

# 2. A Dispute Over the Meaning [\*36] of Wolverine Radio

The parties' dispute regarding jurisdiction boils down to a disagreement over the meaning of *Wolverine Radio*. Relying on the Fifth Circuit's decision in *Wood*, the Sixth Circuit stated in *Wolverine Radio* that

it is not necessary to distinguish between the three categories under § 1334(b)] (proceedings 'arising under,' 'arising in,' and 'related to' a case under title 11). These references operate conjunctively to define the scope of jurisdiction. HNT Therefore, for purposes of determining section 1334(b) jurisdiction, it is necessary only to determine whether a matter is at least 'related to' the bankruptcy.

### Wolverine Radio, 930 F.2d at 1141.

The Plaintiffs contend that *Wolverine Radio* "treated the 'related to' test as outcome-determinative of the § 1334(b) inquiry in remanding legal malpractice lawsuits (like this one) to state court." Reply in Resp. to Defs.' Opp'n to Pls.' Mot. for Remand (Doc. 65 at 9-10). They argue that other Sixth Circuit and lower court decisions have followed the same analytical path. See id. (citing In re Stewart, 62 F. App'x 610 (6th Cir. 2003), Hart v. Logan (In re Hart), No. 05-8001, 2005 Bankr. LEXIS 1187, 2005 WL 1529581 (B.A.P. 6th Cir. 2005) and Spradlin v. Pikeville Energy Grp., LLC, No. CIV. 12-111-

ART, 2012 U.S. Dist. LEXIS 181696, 2012 WL 6706188, at \*9 (E.D. Ky. Dec. 26, 2012)). Thus, according to the Plaintiffs, because the malpractice claim could not have any conceivable effect on the Debtors' estates, there is no related-to jurisdiction here. And, so the argument goes, under Wolverine Radio and its progeny a lack of related-to jurisdiction [\*37] over a claim is dispositive as to the issue of whether a court has § 1334(b) jurisdiction. Remand Mem. at 9-10.

For their part, the Defendants (1) contend that the Plaintiffs misinterpret Wolverine Radio and (2) argue that the Remand Motion "rests on an erroneous legal premise-that, the determination of whether the Court has jurisdiction over their claim must be determined solely by reference to the 'related to' test[.]" Remand Opp'n at 6. The Defendants then argue that the Court has arising-in jurisdiction over the Plaintiffs' malpractice action because it is "inextricably bound to, and would not exist but for, the Murray Energy bankruptcy. . . . But for the Willkie Defendants' alleged role in negotiating the Chapter 11 Plan, and the Court's confirmation of that plan of reorganization, Plaintiffs' claim would not exist." Notice at 4. According to the Defendants, "[u]nder Sixth Circuit precedent, this suffices to establish arising in jurisdiction over a proceeding." Id.

## 3. Analysis

# a. Arising-in Jurisdiction Does Not Depend on the Existence of Related-to Jurisdiction

The Court concludes that the Plaintiffs' position—that the Court's arising-in jurisdiction must be predicated on its related-to jurisdiction—is [\*38] wrong for at least seven reasons.

HINS First, "[t]he plain meaning of legislation should be conclusive, except in the rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters." United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989) (cleaned up). The plain meaning of § 1334(b) of the Judicial Code establishes three categories of proceedings over which bankruptcy courts have jurisdiction—those that arise-under, arise-in or relate-to cases under title 11. Under the rule of surplusage, effect should be given to every part of § 1334(b). See, e.g., United States v. Coatoam, 245 F.3d 553, 558 (6th Cir. 2001) (applying the rule of surplusage that "discourages courts from adopting a

reading of a statute that renders any part of the statute mere surplusage"). If arising-under and arising-in jurisdiction were predicated on a court's having related-to jurisdiction, there would have been no reason for Congress to have included the arising-under or arising-in categories of jurisdiction in § 1334(b). In other words, a "facial reading of the statute [under which] the three categories were intended to address separate, although perhaps overlapping jurisdictional issues . . . comports with a basic tenet of statutory construction that every word in a statute be given effect." Simmons v. Johnson, Curney & Fields, P.C. (In re Simmons), 205 B.R. 834, 838 (Bankr. W.D. Tex. 1997). As the [\*39] Simmons court also said, this approach is consistent with § 1334(b)'s plain meaning:

What else, after all, could Congress have meant when it made specific provision for jurisdiction over matters that "arise in" bankruptcy? Recalling our obligation to give meaning and effect, if possible, to every word Congress uses in a given statute . . . . There will be overlap with one or more of the other two "reservoirs" of jurisdiction, to be sure, but the use of three different concepts assures that cases that might otherwise fall beyond the margins of one or both of the other two provisions, but which ought otherwise to fall within the "broad grant of jurisdiction" contemplated by Congress, will in fact be included within the federal court's bankruptcy subject matter jurisdiction.

<u>Id. at 840</u>. See also <u>id. at 842, 843 n.21</u> (explaining that if <u>Wood</u> actually meant that related-to jurisdiction subsumes the other two categories of arising-in and arising-under jurisdiction, they would be "read out of the statute altogether").

Second, the Wolverine Radio court cited with approval legislative history recognizing that there can be arising-in jurisdiction even in closed cases over which there would be no related-to jurisdiction:

Very often, issues will arise after [\*40] the case is closed, such as over the validity of a purported reaffirmation agreement, proposed 11 U.S.C. § 524(b), the existence of prohibited post-bankruptcy discrimination, proposed 11 U.S.C. § 525 . . . and so on. The bankruptcy courts will be able to hear these proceedings because they arise under title 11.

Wolverine Radio, 930 F.2d at 1141 n.14 (quoting H.R. Rep. No. 595, 95th Cong., 2d Sess. 445). HN9 ↑ Generally, when a bankruptcy case is closed, there is

no longer an estate to be administered, and an action or proceeding cannot have a conceivable effect on an estate that no longer exists," *Al-Rayes v. Willingham, No. 3:15-CV-107-J-34JBT, 2016 Ohio App. LEXIS 2937, 2016 WL 9527956, at \*2 (M.D. Fla. Mar. 11, 2016)*, meaning that the bankruptcy court would lack related-to jurisdiction. The legislative history that the Sixth Circuit quoted (approvingly) in *Wolverine Radio* thus recognized that bankruptcy courts can have arising-under jurisdiction over matters even if they lack related-to jurisdiction.

Third, Supreme Court and Sixth Circuit cases would have been decided differently if a lack of related-to jurisdiction meant arising-under or arising-in jurisdiction could not exist. In Travelers Indem. Co. v. Bailey, 557 U.S. 137, 129 S. Ct. 2195, 174 L. Ed. 2d 99 (2009), the bankruptcy court had entered orders confirming a Chapter 11 plan and approving a related settlement agreement with the debtor's insurers ("1986 Orders"). More than a decade later, the court issued an order clarifying [\*41] that the 1986 Orders barred actions that had been brought against the insurers. According to the Supreme Court, the only jurisdictional question was whether the bankruptcy court had subject-matter jurisdiction to enter the clarifying order. The Supreme Court held that answering that question was "easy," because "as the Second Circuit recognized, and respondents do not dispute, the Bankruptcy Court plainly had jurisdiction to interpret and enforce its own prior orders." Id. at 151. Although it did not expressly say so, the Supreme Court must have been relying on arising-in jurisdiction. For the bankruptcy court would not have had related-to jurisdiction to enter an order clarifying prior orders entered in connection with a Chapter 11 plan confirmed, and a settlement agreement approved, more than a decade earlier. See In re Cano, 410 B.R. 506, 546 (Bankr. S.D. Tex. 2009) ("In Travelers Indemnity, the Supreme Court held that, postdischarge, a bankruptcy court has jurisdiction to interpret and enforce its own orders even though the bankruptcy case was closed and the claims would not affect the bankruptcy estate.").

Similarly, the Sixth Circuit would have decided *Lowenbraun* differently if the existence of arising-under or arising-in jurisdiction turned on whether the proceeding [\*42] in question could have a conceivable effect on the bankruptcy estate. In *Lowenbraun*, the Sixth Circuit held that the bankruptcy court properly exercised core jurisdiction over a nondebtor's state law claims for libel, slander and abuse of process against a Chapter 7 trustee's counsel. Under the Plaintiffs'

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conception of bankruptcy court jurisdiction, the bankruptcy court in Lowenbraun would have lacked arising-in jurisdiction and thus could not have adjudicated the nondebtor's claims. Why? Because no matter how they shook out, there would have been no conceivable effect on the estate. But the Sixth Circuit found that the claims, which had been removed from state court, were based on counsel's actions in the underlying bankruptcy case and thus "would not exist but for the bankruptcy." Lowenbraun, 453 F.3d at 321. Because the claims would not exist but for the bankruptcy, the Sixth Circuit found that the bankruptcy court had arising-in-jurisdiction over those claims. That is, the Sixth Circuit held that the bankruptcy court had jurisdiction over state law claims between nondebtors that had been removed from state court, despite the fact that the claims could not have any conceivable effect on the bankruptcy estate and therefore could [\*43] not have satisfied the test for related-to jurisdiction.<sup>5</sup>

Fourth, if, as Plaintiffs argue, arising-under or arising-in jurisdiction depended on the existence of related-to jurisdiction, then bankruptcy courts would lack jurisdiction over proceedings that they have undisputed authority to finally adjudicate, including actions relating to the discharge in Chapter 7 debtors' cases. "Over 90% of Chapter 7s are no-asset cases that provide no distribution to unsecured creditors." ABI Commission on Consumer Bankruptcy, Final Report of the ABI Commission on Consumer Bankruptcy 2017-2019 at 93. As stated above, the test for related-to jurisdiction is whether the proceeding could have any conceivable effect on the debtor's bankruptcy estate. HN11 1 In no-asset Chapter 7 cases, there is no property of the estate to be distributed to creditors, and related-to jurisdiction therefore cannot exist in those cases. See Wu v. Rhee (In re Rhee), No. 11-35901, 2011 Bankr. LEXIS 4221, 2011 WL 5240152, at \*2 (Bankr. S.D. Tex. Oct. 31, 2011) ("The argument that subject matter jurisdiction exists because this adversary proceeding is

The Plaintiffs make much of the fact that Lowenbraun involved a lawsuit against the bankruptcy trustee's counsel. But nothing in Lowenbraun suggests that the court's core jurisdiction was based on the status of the defendant. HN10[ ↑] Arising-in jurisdiction exists over a malpractice action if it is "intricately related to the bankruptcy process, even if it does not involve a debtor or a court-approved professional." Waleski v. Montgomery, McCracken, Walker & Rhoads, LLP (In re Tronox), 603 B.R. 712, 721 (Bankr. S.D.N.Y. 2019), aff'd, 2022 U.S. App. LEXIS 30905, 2022 WL 16753119 (2d Cir. Nov. 8, 2022).

related to Rhee's bankruptcy case also fails. Rhee filed a 'no-asset' chapter 7 bankruptcy. Even if the court determines Rhee is liable to Wu, the outcome will have no effect on the estate being administered in bankruptcy. The Wus would collect nothing from the estate."). So if related-to jurisdiction had [\*44] to exist for there to be arising-under or arising-in jurisdiction, bankruptcy courts would lack jurisdiction to adjudicate proceedings-such as nondischargeability actions under § 523(a) of the Bankruptcy Code, contempt proceedings for the violation of the discharge injunction under § 524 and § 105(a), and objections to the debtor's discharge under § 727-over which, as discussed above, they plainly do have arising-under jurisdiction. The outcome of such matters would have no conceivable effect on the bankruptcy estate, meaning there would be no related-to jurisdiction. But bankruptcy courts indisputably still have arising-under jurisdiction to adjudicate these proceedings. As the Simmons court put it, the Plaintiffs' approach "cannot deal with the obvious examples of matters which clearly are within the reach of bankruptcy jurisdiction, but which fall outside the boundaries of 'related to' jurisdiction, as that term has been defined by the courts." Simmons, 205 B.R. at 844 n.22.

Fifth, recognizing the logical fallacy of interpreting Wolverine Radio and Wood the way the Plaintiffs do, most courts deciding the issue have held that bankruptcy courts may have arising-in or arising-under jurisdiction even if they lack related-to jurisdiction. See In re HNRC Dissolution Co., No. 02-14261, 2018 Bankr. LEXIS 1739, 2018 WL 2970722, at \*3 (Bankr. E.D. Ky. June 11, 2018), aff'd, 3 F.4th 912 (6th Cir. 2021) ("Methane argues that the Court [\*45] lacks 'related to' jurisdiction because resolution of the dispute will have no conceivable effect on the administration of the bankruptcy estate. . . . This argument misses the point. The Court has 'arising in' jurisdiction and that is sufficient to adjudicate the . . . issue before the Court."); In re Motors Liquidation Co., 514 B.R. 377, 381 (Bankr. S.D.N.Y. 2014), aff'd, 829 F.3d 135 (2d Cir. 2016) ("'Related to' jurisdiction has nothing to do with the issues here. Bankruptcy courts (and when it matters, district courts) have subject matter jurisdiction to enforce their orders in bankruptcy cases and proceedings under those courts' 'arising in' jurisdiction."); In re Legal Xtranet, Inc., 453 B.R. 699, 705 n.1 (Bankr. W.D. Tex. 2011) (["I]f 'related to' jurisdiction is not found, that does not mean that there can be no bankruptcy subject matter jurisdiction. . . . A matter might, for example, not be 'related to' the bankruptcy case (in the sense of having a conceivable effect on the administration of the

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estate, the formulation adopted by *Wood* for "related to" jurisdiction), yet clearly fall within the bankruptcy subject matter jurisdiction of the federal courts, by virtue of either arising under a provision of title 11 (dischargeability actions are an example) or arising in the bankruptcy case (an action to interpret or enforce a sale order post-bankruptcy [\*46] is an example)."); *In re Kaiser Grp. Int'l, Inc., 421 B.R. 1, 14 (Bankr. D.D.C. 2009)* ("Although 'related to' jurisdiction is considered the broadest of the jurisdictional inquiries under *28 U.S.C. § 1334(b)*, it does not encompass all the other categories. Whether 'related to' jurisdiction exists does not determine whether 'arising in' jurisdiction does."); *Cano, 410 B.R. at 546* (same); *Simmons, 205 B.R. at 841-42* (same).

<u>Simmons</u> is particularly instructive. There, a former Chapter 11 debtor sued the attorneys who represented him during his bankruptcy case for malpractice. The court lacked related-to jurisdiction because Simmons commenced the proceeding nine months after confirmation of his Chapter 11 plan, and there "was thus no further 'estate administration' which could be 'conceivably affected' by the dispute." <u>Id. at 841 n.13</u>. The court also lacked arising-under jurisdiction because the malpractice claim was not based on any provision of the Bankruptcy Code. <u>See id.</u> The court nonetheless held that it had arising-in jurisdiction over the malpractice claim, explaining its reasoning by reference to geometry, logic and theology:

A facial reading of [ 28 U.S.C. § 1334(b)] suggests that the three categories [of arising-under, arising-in and related-to jurisdiction] were intended to address separate, although perhaps overlapping jurisdictional issues. On the [\*47] theory that a picture is worth a thousand words, one might think of the three interlocking circles that are normally used to represent the concept of the Trinity in Christian theology.

[T]he matter clearly belonged in the federal court, not in one or more state courts. And it just as clearly was a dispute which 'arose in' the bankruptcy case (i.e., that is where it had its genesis). The matter would have fallen outside federal bankruptcy jurisdiction were one to have employed a "concentric circle' model (i.e., a model under which it is assumed that 'related to' jurisdiction is the largest of three concentric circles,

subsuming the other two fields.").6

HN12 [1] [1] f a plan creates a trust and shoehorns all claimants into an exclusive mechanism by which those claimants are to be satisfied for years into the future out of that trust, then future disputes over the interpretation or enforcement of the trust would fall into the bankruptcy court's "arising in" jurisdiction, because such disputes would not have occurred but for the bankruptcy process. [S]uch disputes represent an example of why our "three intersecting circles" operates as a better conceptual model than does the oft-assumed "concentric [\*48] circle" model. [Such a] matter would have fallen outside federal bankruptcy jurisdiction were one to have employed a "concentric circle" model (i.e., a model under which it is assumed that "related to" jurisdiction is the largest of three concentric circles, subsuming the other two fields).

Or, to put it in logic terms, "[t]hat a finding of 'related to' jurisdiction is *sufficient* to make a finding of jurisdiction does not necessarily mean that it is *necessary* in order to make the finding of jurisdiction.

### Simmons, 205 B.R. at 838 & n.7, 841 & n.13, 843 n.19.

The Court finds <u>Simmons</u> persuasive. It is consistent with § 1334(b)'s plain meaning, and it gives effect to the statute's enumeration of three jurisdictional categories. <u>HN13</u> It also ensures that disputes that arise under the Bankruptcy Code (because they are based on a provision of the Code) or arise in a bankruptcy case (because they would not exist but for the bankruptcy) fall within the jurisdiction of the bankruptcy courts even if the disputes could have no conceivable effect on the estate and therefore would not be related to the bankruptcy case.

Sixth, the decisions on which the Plaintiffs rely either do not stand for the proposition cited or were wrongly decided. As with Wolverine Radio, the Sixth Circuit's [\*49] Stewart decision and the Sixth Circuit

<sup>&</sup>lt;sup>6</sup> Rather than saying that the three categories of jurisdiction are concentric, the Fifth Circuit in *Wood* and Sixth Circuit in *Wolverine Radio* said that they operate "conjunctively to define the scope of jurisdiction." Conjunctive circles are "conjoining" (joined together) or "connecting" (joined, fastened or linked together), *see* Webster's Third New International Dictionary at 469, 480, as in the concept of the Trinity referred to by the *Simmons* court.

BAP's decision in Hart do not hold that arising-under or arising-in jurisdiction can exist only if the court has related-to jurisdiction. In Stewart, the Sixth Circuit held that the bankruptcy court lacked jurisdiction over a state law claim. Relying on the language from Wolverine Radio guoted above, the court focused on whether there was related-to jurisdiction. But the Sixth Circuit also said that it was not "persuaded by the district court's 'core proceeding' analysis, which is explicitly premised on the conclusion that the . . . complaint necessarily implicates the administration of the estate," a conclusion the Sixth Circuit found to be "incorrect." Stewart, 62 F. App'x at 614. Presumably, if there had been a correct conclusion regarding core jurisdiction (arising-under or arising-in jurisdiction) then the bankruptcy court would have had jurisdiction despite the lack of related-to jurisdiction. In Hart, the Sixth Circuit BAP also relied on Wolverine Radio to say that "it need not decide if there was arisingunder or arising-in jurisdiction if there was no related-to jurisdiction." Hart, 2005 Bankr. LEXIS 1187, 2005 WL 1529581, at \*4. But it then stated that "[a] legal malpractice action does not 'arise under' the Bankruptcy Code," id., which would have been unnecessary [\*50] to say if arising-under jurisdiction had to be predicated on the existence of related-to jurisdiction.

The only case relied on by the Plaintiffs that clearly held that there cannot be arising-under or arising-in jurisdiction if there is no related-to jurisdiction is *Spradlin*. HN14 There, the court said:

Section 1334(b) identifies four distinct matters that bankruptcy courts have jurisdiction over: (1) "cases under title 11"; (2) "proceedings arising under title 11"; (3) proceedings "arising in" a case under title 11; and (4) proceedings "related to" a case under title 11. 28 U.S.C. § 1334(a), (b); In re Wolverine Radio Co., 930 F.2d at 1141. These four categories define jurisdiction "conjunctively." Id. (citing In re Wood, 825 F.2d 90, 93 (5th Cir.1987)). "Related to" jurisdiction is the most expansive category, covering any proceeding that could have a conceivable effect on the administration of the estate. See id. Because "related to" jurisdiction covers any proceeding that would fall under the other forms, [c]ourts assessing § 1334(b) jurisdiction therefore need only determine whether the matter is "related to" the bankruptcy.

The plaintiffs also dedicate a substantial portion of their brief to arguing that the Bankruptcy Court had "arising in" jurisdiction over the complaint. R. 7 at 28-31 (Br.28-31). The Court need [\*51] not

address this issue. Because the Bankruptcy Court did not have "related to" jurisdiction it logically could not have "arising in" jurisdiction. See <u>In re Wolverine Radio Co., 930 F.2d at 1141</u> (reasoning that, if a matter is not at least "related to" a bankruptcy proceeding, it cannot arise in or arise under that proceeding).

<u>Spradlin, 2012 U.S. Dist. LEXIS 181696, 2012 WL 6706188, at \*6, 9</u> (emphasis added). For all the reasons explained above, *Spradlin* misconstrued *Wolverine Radio* and was wrongly decided.

Finally, the language in *Wolverine Radio* and *Wood* suggesting that bankruptcy courts must have related-to jurisdiction over a claim to have arising-in or arising-under jurisdiction is dicta, because no party argued that the jurisdictional question hinged on whether the matters arose under the Bankruptcy Code or arose in the bankruptcy case. *See In re Alma Energy, LLC, 521 B.R. 1, 25-26 (Bankr. E.D. Ky. 2014)* ("Wolverine Radio's statement was dictum. In *Wolverine Radio*, the Sixth Circuit held that the bankruptcy court below did have related-to jurisdiction over the matter in question. Thus, the proposition that 'for purposes of determining *section 1334(b)* jurisdiction, it is necessary only' to assess related-to jurisdiction was not tested by *Wolverine Radio*.").

# b. The Court Has Arising-In Jurisdiction Over the Malpractice Claim

The Plaintiffs contend that the Defendants "cannot manufacture 'arising in' jurisdiction by mischaracterizing the [\*52] allegations in Plaintiffs' Complaint" as relating to the Defendants' negotiation of the Chapter 11 Plan rather than their advice regarding it. Remand Mem. at 9. But for several reasons, the malpractice claim could not have existed "but for" the bankruptcy, and the Court therefore finds that it has arising-in jurisdiction over this action.

First, the dispute would not have existed but for the Debtors' bankruptcy because the Plaintiffs allege harm based on the Defendants' role in negotiations and advice regarding the Chapter 11 Plan. As for negotiations and advice regarding the terms of the Chapter 11 Plan, the Complaint states:

6. Defendants provided legal services and representation to Mr. Murray and the Murray Trust in Ohio, including in the Bankruptcy Proceedings described herein in the U.S. Bankruptcy Court for the Southern District of Ohio.

- 11. Defendants agreed to and did represent the Client in several bankruptcy proceedings, including a Chapter 11 bankruptcy filed by Murray Energy Holdings Company, Murray Energy Corporation ("Company") and other subsidiaries (collectively, "Murray Entities") in the United States Bankruptcy Court for the Southern District of Ohio, Case No. 19-56885 [\*53] (Bankr. S.D. Ohio) ("Bankruptcy Proceeding") in October 2019.
- 14. On September 16, 2020, the Murray Entities emerged from the Bankruptcy Proceeding under the new name American Consolidated Natural Resources through a plan of reorganization. Defendants participated in negotiating the plan of reorganization on behalf of the Client but failed to ensure that Mr. Murray and the Murray Trust were protected from any potential ERISA multiemployer pension plan "withdrawal liability" to the [1974 Plan].
- 15. Even though Willkie held itself out as experienced in "pension plan withdrawal liability disputes," Defendants never warned or advised Mr. Murray that both he personally and the Murray Trust potentially could be subject to billions of dollars in claims for ERISA withdrawal liability by the 1974 Plan due to the lack of protection against such claims under the plan of reorganization that Defendants negotiated, and which the Bankruptcy Court adopted, in the Bankruptcy Proceeding.
- 16. Defendants further failed to warn or advise the Client that the plan of reorganization that Defendants negotiated in the Bankruptcy Proceeding created potentially billions of dollars of financial risks that Mr. Murray [\*54] and the Murray Trust potentially would face in the event of an ERISA withdrawal liability claim.
- 20. The plan of reorganization in the Bankruptcy Proceeding that Defendants negotiated for Mr. Murray—without informing him of, or protecting him and the Murray Trust against, exposure to billions of dollars in ERISA withdrawal liability claims—has subjected Plaintiffs to the ERISA withdrawal liability claims in the D.C. Litigation.

Compl. (Adv. Doc. 1 at 14-17) (emphasis added).

The Plaintiffs characterize the Complaint as only alleging harm from the Defendants' failure to advise Mr. Murray and the Trust properly. But the Complaint alleges harm arising from the Defendants' negotiation of the Chapter 11 Plan. In particular, it states that (1) the

"Defendants participated in negotiating the [Chapter 11] [P]lan on behalf of the Client but failed to ensure that Mr. Murray and the Murray Trust were protected from any potential ERISA multiemployer pension plan 'withdrawal liability' to the [1974 Plan]," Compl., Adv. Doc. 1 at 15, and that (2) the Chapter 11 Plan that "Defendants negotiated for Mr. Murray-without informing him of, or protecting him and the Murray Trust against, exposure to billions [\*55] of dollars in ERISA withdrawal liability claims-has subjected Plaintiffs to the ERISA withdrawal liability claims in the D.C. Litigation." Id. at 17. The allegations concerning the Defendants' advice to Mr. Murray and the Trust, to quote the Chapter 11 Plan, assert a "claim related to any act or omission based on the negotiation [of] the [Chapter 11] Plan." Chapter 11 Plan at 62. "[T]he ordinary meaning of the phrase 'relating to' is a broad one-to stand in some relation; to have bearing or concern; to pertain; refer; to bring into association with or connection with." United States v. Nelson, 985 F.3d 534, 536 (6th Cir. 2021) (cleaned up). The Plaintiffs' claim clearly stands in some relation to the negotiation of the Chapter 11 Plan. The fine distinction the Plaintiffs seek to draw simply does not hold up: it is impossible to separate the negotiation of the Chapter 11 Plan from the Defendants' advice regarding it. HN15 And in any event, "claims of malpractice which originated out of . . . post-petition advi[c]e of counsel concerning the bankruptcy itself are matters that fall within 'arising in' jurisdiction." Simmons, 205 B.R. at 841.

Second, the dispute would not exist but for the Debtors' bankruptcy because the claim involves interpretation and enforcement of the [\*56] Chapter 11 Plan's Exculpation Clause. HN16 Proceedings requiring courts to enforce provisions of Chapter 11 plans arise in bankruptcy. See Mesabi Metallics Co. v. B. Riley FBR, Inc. (In re Essar Steel Minn. LLC), 47 F.4th 193, 199 (3d Cir. 2022) (holding that proceeding requiring the bankruptcy court to interpret and enforce injunctive provisions of Chapter 11 plan is a core proceeding); Instituto Medico Del Norte Inc. v. Condado & LLC (In re Instituto Medico Del Norte Inc.), No. 21-00046, 2022 Bankr. LEXIS 1504, 2022 WL 1721350, at \*2 (Bankr. D.P.R. May 27, 2022) (holding that arising-in jurisdiction existed because the enforcement of a Chapter 11 plan was implicated); In re City of Detroit, Michigan, 614 B.R. 255, 262 (Bankr. E.D. Mich. 2020) (holding that "a proceeding that seeks to enforce the confirmed [plan] . . . is a proceeding 'arising in' a case under title 11, because it is a proceeding that 'by [its] very nature, could arise only in bankruptcy cases."); In re Shefa, LLC, 579 B.R. 438, 440-41 (Bankr. E.D. Mich. 2017),

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aff'd sub nom. <u>City of Southfield v. Shefa, LLC (In re Shefa, LLC), No.18-10073, 2019 U.S. Dist. LEXIS 29232, 2019 WL 911692 (E.D. Mich. Feb. 25, 2019)</u> (same).

HN17 The Defendants assert the Exculpation Clause as a defense against the malpractice claim, and a defense may serve as the basis for arising-in jurisdiction. See Elliott v. Gen. Motors, LLC (In re Motors Liquidation Co.), 829 F.3d 135, 153 (2d Cir. 2016). In Motors Liquidation, creditors with product liability claims against General Motors commenced an adversary proceeding against New GM, the company that had purchased substantially all the assets of General Motors through a free-and-clear sale under § 363 of the Bankruptcy Code. The creditors argued that New GM could not use the free-and-clear provision to absolve itself of old GM's defective product claims. But the Second Circuit held that [\*57] arising-in jurisdiction existed over the dispute because New GM asserted that the free-and-clear provision of the sale order barred the claims against New GM. The Motors Liquidation court further held that "bankruptcy courts have jurisdiction to decide a motion s[eeking] enforcement of a pre-existing injunction issued as part of the bankruptcy court's sale order." Id. at 154 (cleaned up). Similarly, the Defendants here assert that the Chapter 11 Plan's Exculpation Clause bars the Plaintiffs' malpractice claim against them.

Tronox is also highly persuasive. That case involved legal malpractice claims by plaintiffs who had been exposed to chemicals emitted by one of the Chapter 11 debtor's plants. See Tronox, 603 B.R. at 714. Among other things, the plaintiffs argued that their attorneys should have ensured that their recoveries in the bankruptcy case were not diluted by the allowance of claims filed on behalf of persons allegedly injured by another plant's emissions. See id. In particular, the plaintiffs contended that trust distribution procedures incorporated into the debtor's confirmed Chapter 11 plan should have separately classified the plaintiffs' claims and provided their claims with better treatment than the [\*58] other claimants. See id. at 718. Although the defendants in Tronox "at one point argued that the [malpractice] claims [were] 'related to' the prior bankruptcy cases," they later acknowledged that the "sole jurisdictional argument is that the [malpractice] claims 'arose in' the Tronox bankruptcy cases." Id. at 719 n.1. The Tronox court held that it had arising-in jurisdiction for, among others, these reasons:

(1) the "alleged acts of malpractice occurred entirely during the bankruptcy case and in the

context of the bankruptcy proceedings";

- (2) the "alleged misdeeds relate to bankruptcyspecific rights and tasks and could only have arisen in a bankruptcy context,"
- (3) "the claims require consideration and interpretation of this Court's prior orders and rulings," and
- (4) "the asserted claims directly implicate the integrity of the bankruptcy process" because the "theory of the malpractice claims is that different Court orders would have been issued during the Tronox bankruptcy cases [and] different plan terms would have been approved . . . if only the defendants had acted differently."

#### Id. at 722-23.

So too here. Although the Defendants represented Mr. Murray and the Trust before the Debtors' bankruptcy filing, Compl. [\*59] ¶ 13, the Defendants' alleged malpractice occurred entirely during the Debtors' bankruptcy case. Compl. ¶¶ 6, 11, 14-16, 20. The malpractice claim relates to bankruptcy-specific rights release from pension plan withdrawal liability under the Chapter 11 Plan-that could only have arisen in the Debtors' bankruptcy cases. The claims require consideration and interpretation of the Chapter 11 Plan that this Court approved. And the malpractice claim directly implicates the integrity of the bankruptcy process. The Plaintiffs' theory of legal malpractice is that Mr. Murray and the Trust would have been released from ERISA withdrawal liability to the 1974 Plan if only the Defendants had not engaged in malpractice. In other words, according to the Plaintiffs, the Defendants should have represented Mr. Murray in a way that would have resulted in a different Chapter 11 plan being confirmed-one in which, despite the Debtors' withdrawal from the 1974 Plan, Mr. Murray would have had no withdrawal liability. In short, this case closely parallels the facts in *Tronox*.

For all these reasons, the Court concludes that it has jurisdiction over the Plaintiffs' malpractice claim.

#### **B.** Arbitration

After filing the [\*60] Complaint, the Plaintiffs commenced an arbitration through JAMS. Now, both parties ask the Court to stay the adversary proceeding in favor of arbitration—the Plaintiffs unreservedly, the Defendants only if the Court does not dismiss the adversary proceeding for failure to state a claim.

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According to the Plaintiffs, the issue of whether the Exculpation Clause bars their claims must be arbitrated. Pls.' Arbitration Mem. at 9. The engagement letter establishing the lawyer-client relationship between the Defendants and Mr. Murray and the Trust contains the following arbitration provision:

In the event any dispute cannot be resolved informally, you agree to resolve any and all disputes with the Firm, or with any of our lawyers or staff arising from or relating to our work for you including but not limited to disputes over fees and charges or disputes relating to the nature and quality of our services, exclusively through private and confidential binding arbitration in New York City before three neutral arbitrators. The arbitration shall be administered by JAMS pursuant to its Comprehensive Arbitration Rules and Procedures. . . This clause shall not preclude parties from seeking provisional remedies in aid [\*61] of arbitration from a court of appropriate jurisdiction.

Defs.' Arbitration Mot. at 5.

To determine whether the Court must enforce this provision, it must first determine whether the parties agreed to arbitrate and whether the issues fall within the scope of their arbitration agreement. If so, the Court must then determine whether the proceeding at issue is core or non-core. Finally, if the proceeding is core, the Court must determine, under the Supreme Court's decision in <a href="mailto:Shearson/Am. Exp., Inc. v. McMahon, 482">Shearson/Am. Exp., Inc. v. McMahon, 482</a> U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987), whether arbitration would inherently conflict with the Bankruptcy Code's underlying purposes.

## 1. Arbitration Agreement & Scope

As stated, the Court first must determine whether the parties agreed to arbitrate and whether the issues raised in the Complaint fall within the scope of the arbitration provision. **HN18** When considering a motion to compel arbitration:

[F]irst, [the court] must determine whether the parties agreed to arbitrate; second, it must determine the scope of that agreement; third, if federal statutory claims are asserted, it must consider whether Congress intended those claims to be nonarbitrable; and fourth, if the court concludes that some, but not all, of the claims in the action are subject to arbitration, [\*62] it must determine whether to stay the remainder of the

proceedings pending arbitration.

McGee v. Armstrong, 941 F.3d 859, 865 (6th Cir. 2019) (quoting Stout v. J.D. Byrider, 228 F.3d 709, 714 (6th Cir. 2000)).

As for the first and second factors, the parties concur that they agreed to arbitrate and that the scope of the agreement covers the parties' dispute. See Pls.' Arbitration Mem. at 8; Defs.' Arbitration Mot. at 8. The third factor is irrelevant, as neither party asserts a federal statutory claim. The fourth factor does not apply either, as only one claim is at issue. Thus, the parties agree that they have a valid arbitration agreement and their dispute falls within its scope.

### 2. Core vs. Non-Core Proceeding

The Court must next assess whether this adversary proceeding is a core or a non-core proceeding. 

HN19 In "a non-core proceeding, a court is generally without discretion to preclude the enforcement of [arbitration agreements] and the inquiry ends." In re Patriot Solar Grp., LLC, 569 B.R. 451, 457-58 (Bankr. W.D. Mich. 2017); see also Cooker Rest. Corp. v. Seelbinder (In re Cooker Rest. Corp.), 292 B.R. 308, 312 (S.D. Ohio 2003). But if "the dispute is a core proceeding, the court moves to the next step in the analysis—whether enforcement of such agreement would inherently conflict with the underlying purposes of the Bankruptcy Code." Patriot Solar, 569 B.R. at 457-58.

The Court has already determined that this is a core proceeding. But the "fact that the dispute . . . is a core proceeding is [\*63] not in and of itself determinative." See Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.), 118 F.3d 1056, 1067 (5th Cir. 1997); see also In re Eber, 687 F.3d 1123, 1130 (9th Cir. 2012) (same). While bankruptcy courts "are more likely to have discretion to refuse to compel arbitration of core bankruptcy matters," they may still be required to enforce arbitration agreements even in core proceedings. MBNA Am. Bank, N.A. v. Hill, 436 F.3d 104, 108 (2d. Cir. 2006).

# 3. Application of *McMahon*'s "Inherent Conflict" Standard

<u>HN20[1]</u> In <u>McMahon</u>, the Supreme Court discussed the enforcement of arbitration agreements under the

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Federal Arbitration Act ("FAA"), which "establishes a federal policy favoring arbitration" and requires courts to "rigorously enforce agreements to arbitrate." *McMahon*, 482 U.S. at 226 (cleaned up). The Supreme Court held that, "[I]ike any statutory directive, the [FAA]'s mandate may be overridden by a contrary congressional command," which "will be deducible from [the statute's] text or legislative history . . . or from an inherent conflict between arbitration and the statute's underlying purposes." Id. at 227. Thus, under McMahon, the FAA's pro-arbitration policy may be overridden by contrary commands in another statute's text or legislative history, or by an inherent conflict between arbitration and the other statute's underlying purposes. See id. In the bankruptcy context, courts generally jump to an assessment of whether an "inherent conflict" [\*64] exists, because they find no intent to limit arbitration in the Bankruptcy Code's text or its legislative history. See, e.g., Patriot Solar, 569 B.R. at 457 (citing cases).

HN21[1] Even "in a core proceeding, the McMahon standard must be met," meaning "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." Eber, 687 F.3d at 1130 (cleaned up). See also Kraken Inv. Ltd. v. Jacobs (In re Salander-O'Reilly Galleries, LLC), 475 B.R. 9, 25 (S.D.N.Y. 2012) ("Even if the Trustee were bound by the arbitration clause, the Bankruptcy Court did not err in denying arbitration due [to] the conflict between arbitration and the policy of the Bankruptcy Code."); Higgs v. Warranty Grp., No. C2-02-1092, 2007 U.S. Dist. LEXIS 50064, 2007 WL 2034376, at \*6 n.8 (S.D. Ohio July 11, 2007) ("[I]n analyzing whether Congress intended to preclude arbitration of . . . claims, courts apply the *McMahon* test and consider . . . whether an inherent conflict exists between arbitration and the purposes of the statute.").

HN22 \[ \bullet \] In considering whether arbitration would inherently conflict with the Bankruptcy Code, the relevant purposes of the Code include the "goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders." Nat'l Gypsum, 118 F.3d at 1069 (emphasis [\*65] added); see also Anderson v. Credit One Bank, N.A. (In re Anderson), 884 F.3d 382, 389 (2d Cir. 2018) ("The objectives of the Bankruptcy Code relevant to [the inherent conflict] inquiry include . . . the undisputed power of a bankruptcy court to enforce its own orders."); Gandy v. Gandy (In re Gandy), 299 F.3d 489, 500 (5th)

<u>Cir. 2002</u>) (citing the "undisputed power of a bankruptcy court to enforce its own orders" as an underlying purpose when determining whether enforcing an arbitration clause presents an inherent conflict with the Bankruptcy Code); <u>In re Jorge, 568 B.R. 25, 36 (Bankr. N.D. Ohio 2017</u>) ("The parties, whether through a predispute arbitration agreement or any other agreement, cannot strip a court of its inherent power and certainly not the inherent power to enforce its own orders.").

HN23[1] Enforcing the Exculpation Clause of the Chapter 11 Plan is tantamount to enforcing an order of the Court. See In re Cty. of San Mateo v. Peabody Energy Corp. (In re Peabody Energy Corp.), 958 F.3d 717, 721 (8th Cir. 2020) ("[A] confirmed Chapter 11 plan is an order of the bankruptcy court."); CHS, Inc. v. Plaquemines Holdings, L.L.C., 735 F.3d 231, 240 (5th Cir. 2013) (same); McCrary v. Barnett (In re Sea Island Co.), 486 B.R. 559, 566 (S.D. Ga. 2013) (same); In re SS Body Armor I, Inc., No. 10-11255(CSS), 2021 Bankr. LEXIS 1527, 2021 WL 2315177, at \*5 (Bankr. D. Del. June 7, 2021) ("As a general rule, courts have the authority to interpret their own orders-which include confirmed plans."). And the FAA does not divest courts of their authority to interpret their own orders. See PRL USA Holdings, Inc. v. United States Polo Ass'n, Inc., No. 14-cv-764 (RJS), 2015 U.S. Dist. LEXIS 40238, 2015 WL 1442487, at \*6 (S.D.N.Y. Mar. 27, 2015) (holding that "[flederal courts, and federal courts alone, possess the inherent authority to enforce their judgments, and the FAA may not be construed to divest courts of their traditional [\*66] powers to police their own orders.") (cleaned up).

Further, exculpation clauses are a fundamental protection that the Bankruptcy Code permits Chapter 11 plans to afford. Unlike releases, which "provide for the relinquishment of claims held by the debtor or third parties against certain nondebtor parties," exculpation clauses "establish the standard of care that will trigger liability in future litigation by a non-releasing party against an exculpated party for acts arising out of a debtor's restructuring." In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444, 501 (Bankr. S.D. Ohio 2021). Their inclusion in Chapter 11 plans is authorized by § 1123(b)(6) of the Bankruptcy Code, which permits Chapter 11 plans to "include any . . . appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]," 11 U.S.C. § 1123(b)(6), and § 105(a) of the Code, which empowers courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]," 11 U.S.C. § 105(a). They are "a

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commonplace provision in Chapter 11 plans." <u>Murray</u> <u>Metallurgical</u>, 623 B.R. at 500.

The central role that exculpation provisions play in the Chapter 11 plan process makes it clear that this Court is the forum in which the Exculpation Clause should be enforced. At issue in Nat'l Gypsum, Anderson and Jorge was whether arbitration was the appropriate forum to [\*67] determine if there had been a violation of the discharge injunction, a concept "fundamental to . . . the practical implementation of a plan of reorganization under Chapter 11." Texaco Inc. v. Sanders (In re Texaco Inc.), 182 B.R. 937, 950 (Bankr. S.D.N.Y. 1995). Like the discharge injunction, exculpation is vitally important to the reorganization of Chapter 11 debtors, as this Court and others have held. See Murray Metallurgical, 623 B.R. at 501 ("As a policy matter, exculpations are necessary to ensure that capable, skilled individuals are willing to assist in the reorganization efforts in chapter 11 cases."") (quoting In re Alpha Nat. Res., Inc., 556 B.R. 249, 260 (Bankr. E.D. Va. 2016)); In re Citadel Broad. Corp., No. BKR. 09-17442 (BRL), 2010 Bankr. LEXIS 1606, 2010 WL 2010808, at \*8 (Bankr, S.D.N.Y. May 19, 2010) ("The Exculpation . . . was vital to the Plan formulation process"). Just so here. As the Court found when it confirmed the Chapter 11 Plan, the Exculpation Clause "is an essential provision of the Plan" because it "affords protection to those parties who constructively participated in and contributed to the Debtors' chapter 11 process and it is appropriately tailored to protect the Exculpated Parties from inappropriate litigation." Confirmation Order at 17.

The dispute here "present[s] core claims that this Court is uniquely positioned to hear and address under the authority it is granted by the Bankruptcy Code, Bankruptcy Rules, and related jurisdictional statutes." Kiskaden v. LVNV Funding, LLC (In re Kiskaden), 571 B.R. 226, 239-40 (Bankr. E.D. Ky. 2017). Thus, in this [\*68] case there is "an inherent conflict under McMahon between the underlying purposes of the Bankruptcy Code and the enforcement of the [arbitration agreement]." Kiskaden, 571 B.R. at 239-40. Because enforcing the parties' arbitration agreement would inherently conflict with the Bankruptcy Code's underlying purpose of permitting bankruptcy courts to enforce their orders confirming Chapter 11 plans, the Court declines to stay this adversary proceeding in favor of arbitration. The Plaintiffs' Arbitration Motion is therefore denied.

The Defendants also contend that the Plaintiffs' Arbitration Motion should be denied because the

Plaintiffs waived their right to arbitrate by suing in the State Court and "then litigating substantive issues before this Court." Defs.' Opp'n to Pls.' Mot. to Stay, Adv. at 3. Having determined that the Plaintiffs' Arbitration Motion should be denied for the reasons explained above, the Court need not decide whether the Plaintiffs waived their right to arbitrate.

#### C. Plaintiffs' Motion for Abstention & Remand

#### 1. Mandatory Abstention

The Plaintiffs ask the Court to abstain under the mandatory abstention provision of § 1334(c)(2), which provides that:

Upon timely motion of a party in a proceeding based upon a State law [\*69] claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

28 U.S.C. § 1334(c)(2) (emphasis added).

HN24 Mandatory abstention does not apply to core proceedings. Lindsey v. Dow Chem. Co. (In re Dow Corning Corp.), 113 F.3d 565, 570 (6th Cir. 1997).

Because this is a core proceeding, mandatory abstention does not apply here.

### 2. Permissive Abstention & Equitable Remand

The Plaintiffs also ask the Court to permissively abstain under 28 U.S.C. § 1334(c)(1) and to equitably remand under 28 U.S.C. § 1452(b), the analyses of which are "essentially identical." Meritage Homes Corp. v. JPMorgan Chase Bank, N.A., 474 B.R. 526, 572-73 (Bankr. S.D. Ohio 2012) (quoting Parrett v. Bank One, N.A. (In re Nat'l Century Fin. Enters., Inc., Inv. Litig.), 323 F. Supp. 2d 861, 885 (S.D. Ohio 2004)) (cleaned up). Both are within the Court's sound discretion. See Morris Black & Sons, Inc. v. 23S23 Constr., Inc. (In re Carriage House Condos. L.P.), 415 B.R. 133, 146 (Bankr. E.D. Pa. 2009).

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HN25 ↑ Because federal courts have an obligation to exercise the jurisdiction properly given to them, there is a presumption in favor of the exercise of federal jurisdiction and against abstention. And [t]he movant bears the burden of establishing that permissive abstention is warranted." Molner v. Reed Smith, LLP (In re Aramid Ent. Fund, LLC), 628 B.R. 584, 594 (Bankr. S.D.N.Y. 2021) (cleaned up).

Section 1334(c)(1) of the Judicial Code governs permissive abstention. It provides in [\*70] pertinent part: "[N]othing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11." 28 U.S.C. § 1334(c)(1).

<u>HN26</u> In a prior opinion, the Court laid out the factors courts consider when deciding whether to exercise permissive abstention, including:

(1) the effect or lack of effect on the efficient administration of the estate if a court abstains, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable state law, (4) the presence of a related proceeding commenced in state court or other non-bankruptcy court, (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case. (7) the substance rather than form of an asserted core proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden on this court's docket, (10) [\*71] the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, (12) the presence in the proceeding of nondebtor parties and (13) any unusual or other significant factors.

# Meritage Homes Corp., 474 B.R. at 573.

<u>HN27</u> In that same opinion, this Court enumerated the factors courts consider when deciding whether to equitably remand a case:

(1) Duplicative and uneconomical use of judicial resources in two forums, (2) prejudice to the involuntarily removed parties, (3) forum non

conveniens, (4) the state court's ability to handle a suit involving questions of state law, (5) comity considerations, (6) lessened possibility of an inconsistent result and (7) the expertise of the court in which the matter was originally pending.

Id. (cleaned up).

"Courts assessing possible permissive abstention have considered one or more of these factors, and not necessarily all [of them]. A court thus need not . . . discuss[] . . . each factor in the laundry lists developed in prior decisions." George Washington Bridge Bus Station & Infrastructure Dev. Fund, LLC v. Port Auth. (In re George Washington Bridge Bus Station Dev. Venture LLC), No. 21-1200 (DSJ), 2022 Bankr. LEXIS 1488, 2022 WL 1714176, at \*6 (Bankr. S.D.N.Y. May 25, 2022) (cleaned up); Tronox, 603 B.R. at 726 (holding that "[t]he factors largely ask the Court to balance the federal interest in efficient bankruptcy administration against the interest [\*72] of comity between state and federal courts" and that "[t]he analysis is not a mechanical or mathematical exercise and the court need not plod through a discussion of each factor in the laundry lists developed in prior decisions.") (cleaned

"As shown by the language of the statute . . . permissive abstention is driven in large part by comity principles." In re Tres Hermanos Dairy, LLC, No. 11-10-14240-TR, 2014 Bankr. LEXIS 198, 2014 WL 176772, at \*4 (Bankr. D.N.M. Jan. 16, 2014). Just as the bankruptcy court in Tres Hermanos Dairy concluded,

[t]he Court [here] does not believe the state court would be offended in the slightest if the Court were to interpret the Confirmation Order. If the tables were turned and a state court elected to interpret one of its orders that was relevant in a bankruptcy case, this Court would welcome the assistance.

*Id.* Here, "[p]rinciples of comity are not offended by declining to remand or abstain from this action[.]" *KeyBank Nat'l Ass'n v. Franklin Advisers, Inc., 600 B.R.*214, 233 (S.D.N.Y. 2019).

The core nature of this dispute favors retaining it. See IRS v. Luongo (In re Luongo), 259 F.3d 323, 331 (5th Cir. 2001) ("Another touchstone of the abstention inquiry is the substantive law governing the material issues. When bankruptcy issues are at the core of a dispute, it would be absurd for a bankruptcy court to abstain from deciding those matters over which it has particular expertise."). HN28 \[ \bigcit \] "A core proceeding is

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'precisely [\*73] the kind of issue that falls within the expertise of the bankruptcy court, and there is a strong preference for resolving core proceedings in the bankruptcy court." Tres Hermanos Dairy, 2014 Bankr. LEXIS 198, 2014 WL 176772, at \*3 (quoting Solis v. Wahl (In re Wahl), No. 12-01038-R, 2012 U.S. Dist. LEXIS 151140, 2012 WL 5199630, at \*3 (N.D. Okla. Oct. 22, 2012)).

According to the Plaintiffs, abstention is warranted because "Plaintiffs' Complaint demands a jury trial . . . and [the] Plaintiffs respectfully will not consent to a jury trial in the bankruptcy court pursuant to 28 U.S.C. § 157(e) or Fed. R. Bankr. P. 9015(b)[.]" Mot. for Remand, Doc. 42 at 26. But the fact that the Plaintiffs seek a jury trial does not weigh in favor of abstention. See Stoner v. Keirns (In re Keirns), 628 B.R. 911, 922 (Bankr. S.D. Ohio 2021) ("[W]hile the Defendant has a right to a jury trial, he is perfectly free to exercise that right in this Court."); Official Comm. of Unsecured Creditors of Schlotzsky's, Inc. v. Grant Thornton LLP (In re-Schlotzsky's, Inc.), 351 B.R. 430, 437 (Bankr. W.D. Tex. 2006) ("Nor ought we to institute a rule of decision that in effect rewards the party seeking abstention if that party insists on being as obstructionist as possible by refusing to consent either to the entry of final judgment by the bankruptcy judge or the conduct of a jury trial by that court."); cf. Cipollone v. Va. True Corp., No. 1:20-CV-972-FB, 2021 U.S. Dist. LEXIS 98983, 2021 WL 2109205, at \*3 (E.D.N.Y. May 25, 2021) (holding in the context of withdrawal of the reference that "[t]he Cipollones' potential entitlement to a jury trial in several months' time does not justify removing this case from the bankruptcy court today, especially where, as here, the bankruptcy court [\*74] has already overseen a number of matters related to the bankrupt estate and acquired what one court describes as a 'wealth of knowledge' about its affairs.").

a jury trial, in any court."); <u>Gong v. Westlend Fin., Inc., No. 2:20-cv-05026 MCS (AGRx), 2020 U.S. Dist. LEXIS 258176, 2020 WL 10964606, at \*6 (C.D. Cal. Dec. 18, 2020)</u> ("Courts frequently grant motions to dismiss under <u>Fed. R. Civ. P. 12(b)(6)</u> even though a party requests a jury trial.").

The degree of relatedness or remoteness of this adversary proceeding to the Debtors' bankruptcy cases also favors retaining it. This lawsuit directly implicates the Exculpation Clause, and as explained above, is a core proceeding, which cuts against abstention or equitable remand. See Christensen v. Tucson Ests., Inc. (In re Tucson Ests., Inc.), 912 F.2d 1162, 1167 (9th Cir. 1990) (noting that "[t]he bankruptcy court in this case chose not [\*75] to abstain because . . . the case is a core proceeding in which the bankruptcy court should enter the final order"); Tubbs v. Agspring Miss. Region, L.L.C., No. CV 3:21-03268, 2022 U.S. Dist. LEXIS 71994, 2022 WL 1164803, at \*10 (W.D. La. Apr. 4, 2022), report and recommendation adopted, No. CV 3:21-03268, 2022 U.S. Dist. LEXIS 71968, 2022 WL 1164014 (W.D. La. Apr. 19, 2022) ("[T]he expertise of the Delaware Bankruptcy Court in handling disputes such as this supports maintenance of this suit in federal court and transfer to the Delaware Bankruptcy Court."); Moelis & Co. v. Wilmington Tr. FSB (In re Gen. Growth Props., Inc.), 460 B.R. 592, 603 (Bankr. S.D.N.Y. 2011) (declining to exercise permissive abstention or equitable remand where the "crux of the dispute involves bankruptcy issues, and the Plan in particular."). As another bankruptcy court said in declining to abstain from hearing a malpractice claim, "[i]t defies logic that a court less acquainted with bankruptcy law will better address issues of alleged malpractice in a bankruptcy context than a bankruptcy court." Woodard v. Sanders (In re SPI Commc'ns & Mktg., Inc.), 112 B.R. 507, 512 (Bankr. N.D.N.Y. 1990). In short, this Court confirmed the Chapter 11 Plan, and now is in the best position to interpret and enforce that Plan's provisions.

For the foregoing reasons, the Court will neither abstain from hearing this adversary proceeding nor equitably remand it to the State Court.

#### D. The Dismissal Motion

In the Dismissal Motion, the Defendants contend that the Plaintiffs' malpractice claim should be dismissed under <u>Rule 12(b)(6) of the Federal Rules of Civil Procedure</u> for two reasons: (1) because it is [\*76] barred by the Exculpation Clause, Dismissal Mot., Adv.

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Doc. 9 at 19-23, and (2) because the Plaintiffs do not adequately plead causation, *id.* at 23-25. While it would not be appropriate to decide the issue of causation on a motion to dismiss, dismissal based on the Exculpation Clause is warranted.

HN30 [↑] "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face."

Ashcroft v. Iqbal, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009) (cleaned up). "On a motion to dismiss, [the Court] must construe the complaint in the light most favorable to the plaintiff and accept all allegations as true." Taylor v. City of Saginaw, 922 F.3d 328, 331 (6th Cir. 2019) (cleaned up). For the purposes of this analysis, the Court therefore accepts as true the allegation that the Defendants failed to warn Mr. Murray and the Trust of their potential ERISA withdrawal liability to the 1974 Plan. 7

# 1. The Exculpation Clause

HN31 [1] Exculpation clauses constitute affirmative defenses, which can form the basis for a motion to dismiss for failure to state a claim if "the undisputed facts conclusively establish [the] affirmative defense as a matter of law." Est. of Barney v. PNC Bank, Nat'l Ass'n, 714 F.3d 920, 926 (6th Cir. 2013) (quoting Hensley Mfg. v. ProPride, Inc., 579 F.3d 603, 613 (6th Cir. 2009)); see also Blixseth v. Cushman & Wakefield of Colorado, Inc., 2013 U.S. Dist. LEXIS 140643, 2013 WL 5446791, at \*10 (D. Colo. Sept. 30, 2013) (holding that breach of contract claim was subject to dismissal for failure to state a claim because [\*77] it was barred by the Chapter 11 plan's exculpation clause); Holmes v. Air Line Pilots Ass'n, Int'l, 745 F. Supp. 2d 176, 198 (E.D.N.Y. 2010) ("Exculpation clauses are properly considered in a *Rule 12(b)(6)* motion to dismiss.").

Under the right circumstances, when deciding a motion to dismiss for failure to state a claim, a court may consider facts beyond those provided in a complaint. See Chavis v. Fuerst, 62 F. App'x 116, 117 (6th Cir. 2003). In Chavis, the district court dismissed the plaintiff's civil rights complaint sua sponte for failure to state a claim. On appeal, the plaintiff argued that the district court improperly dismissed his complaint because, among other things, the court considered matters outside the complaint. The Sixth Circuit affirmed the district court, holding that the plaintiff's "claim that the district court considered matters outside his complaint lacks merit because the district court merely recited facts plainly gleaned from state court opinions, duly cited by the district court, rendered in [the plaintiff's] cases." Id. at 117.

Here, the Court considers the Chapter 11 Plan and its provisions, including the Exculpation Clause, in deciding the Dismissal Motion. That is, the availability of the Exculpation Clause as an affirmative defense may be "plainly gleaned" from the Chapter 11 Plan. The Defendants are Exculpated Parties under the Chapter 11 Plan [\*78] because they were attorneys for Mr. Murray, who was one of Murray Energy's directors and equity holders. See Chapter 11 Plan at 15 (defining Exculpated Party to mean "the Debtors . . . and . . . such Entities' . . . directors, managers, officers, [and] equity holders . . . and each of their respective current and former . . . attorneys . . . ."). And the Exculpation Clause states in pertinent part:

[N]o Exculpated Party shall have or incur, and each Exculpated Party is hereby exculpated from, any Cause of Action for any claim related to any act or omission based on the negotiation, execution, and implementation of any transactions approved by the Bankruptcy Court in the Chapter 11 Cases, including . . . the [Chapter 11] Plan . . . except for claims related to any act or omission that is determined by Final Order to have constituted actual fraud, willful misconduct, or gross negligence[.]

Chapter 11 Plan at 61-62.

According to the Defendants, the Exculpation Clause protects them because the Plaintiffs' malpractice claim relates to an act or omission stemming from the negotiation of the Chapter 11 Plan. For their part, the Plaintiffs contend that the Exculpation Clause does not bar their malpractice claim because it is based on the Defendants' [\*79] actions in advising the Plaintiffs, not negotiating the Chapter 11 Plan.

The Exculpation Clause applies for two reasons. First, as discussed above, and contrary to the Plaintiffs' characterizations, the Complaint alleges harm arising

<sup>&</sup>lt;sup>7</sup> While recognizing that, in the context of a <u>Rule 12(b)(6)</u> dismissal motion, the Court must accept the Complaint's allegations as true, the Defendants have stated that they "did advise [Mr.] Murray that the 1974 Plan's withdrawal liability claim against him and his family would be carved out from the Chapter 11 Plan's releases, including in an email sent to [him] . . . before he executed the Murray Family Settlement[.]" Dismissal Mot. at 10 n.1.

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from the Defendants' negotiation of the Chapter 11 Plan. Second, the Exculpation Clause applies because, as discussed above: (1) the Plaintiffs' malpractice allegations assert a claim "related to any act or omission based on the [Chapter 11 Plan's] negotiation," Chapter 11 Plan at 59; (2) the phrase "relating to" means to stand in some relation to; and (3) the Plaintiffs' claim clearly stands in some relation to the negotiation of the Chapter 11 Plan.

The Confirmation Order states that the Exculpation Clause "is appropriate under applicable law because it was proposed in good faith, was formulated following extensive, good-faith, arm's length negotiations with the Debtors and the Exculpated Parties, and was agreed upon in return for the Exculpated Parties providing benefits to the Debtors." Confirmation Order at 17. From this, the Plaintiffs contend that to invoke the Exculpation Clause's protections, the Defendants must show that they negotiated "with Mr. Murray for the exculpation of claims" and further provided [\*80] benefits to the Plaintiffs in exchange for exculpation. Opp'n to Dismissal Mot. at 9-10. This misconstrues the Confirmation Order. The finding the Plaintiffs rely on refers to negotiations with the Debtors and Exculpated Parties-not with parties such as the Plaintiffs, who assert a claim subject to exculpation under the Exculpation Clause. And the provision refers to benefits to the Debtors, not benefits to parties such as the Plaintiffs.

The Exculpation Clause raises the standard of the Defendants' liability for the Plaintiffs' claim to actual fraud, willful misconduct or gross negligence. The Plaintiffs neither allege in their Complaint nor argue in their objection to the Dismissal Motion that the Defendants engaged in actual fraud or willful misconduct. They also do not allege gross negligence in the Complaint. Rather, they argue in their objection to the Dismissal Motion, Opp'n to Dismissal Mot. at 10, that alleging in their Complaint that "Defendants' actions constitute actual malice and entitle [the] Plaintiffs to an award of punitive damages," Compl. at 19, is equivalent to alleging gross negligence:

Here, the Complaint ¶ 28 alleges that Defendants' malpractice constituted "actual malice" to warrant punitive damages. [\*81]

. . . .

Despite Defendants' breezy disregard of Plaintiffs' malice averment as "conclusory" (Mot. at 14 n.3), the Complaint pleads other facts that Defendants

ignore in establishing Defendants' "conscious disregard" and risk of "substantial harm." To be sure, the Complaint alleges that Defendants were aware of the harm that potential ERISA withdrawal liability posed to Plaintiffs because Defendants hold themselves out as among "the world's foremost practitioners' in [ERISA] '[m]ultiemployer pension plan withdrawal liability disputes." (Compl. ¶ 28.). In fact, Defendants' Motion readily acknowledges that Defendants knew of the danger to Plaintiffs of billions of dollars in potential withdrawal liability claims by the 1974 Plan (but simply blames Mr. Murray for not having figured that out for himself). (See, e.g., Mot. at 9-10; 13-14.). In addition, there is no denying that Defendants' failure to warn or advise Plaintiffs of this danger and how to avoid it threatened substantial harm by exposing Plaintiffs to potential withdrawal liability claims in excess of \$6.5 billion. (Compl. ¶ 28.). Although Defendants may not like them, these allegations meet the plausibility test and must be [\*82] accepted as true. Thus, even if the Exculpation Clause applied, Plaintiffs' allegations of malice more than suffice to bring Plaintiffs' malpractice cause of action within the Clause's exemption for claims rising at least to the level of gross negligence.

Opp'n to Dismissal Mot. at 10-11.

There are several problems with the Plaintiffs' argument. First, their contention that the Defendants' actions constituted "actual malice" is a legal conclusion, not an allegation of fact, and is therefore entitled to no weight. See Ashcroft, 556 U.S. at 678; Viet v. Le, 951 F.3d 818, 823 (6th Cir. 2020) ("[A] plaintiff may not rely on conclusory allegations to proceed past the pleading stage[.]"); Stuart v. Lowe's Home Ctrs., LLC, 737 F. App'x 278, 281 (6th Cir. 2018) (finding a conclusory statement insufficient when complaint merely recited the elements of the claims plaintiffs brought against defendant); Rivera v. NYP Holdings, Inc., No. 114858/06, 847 N.Y.S.2d 904, 16 Misc. 3d 1121[A], 2007 NY Slip Op 51529[U], 2007 WL 2284607, at \*4 (N.Y. Sup. Ct. Aug. 2, 2007), aff'd sub nom. Rivera v. Time Warner Inc., 56 A.D.3d 298, 867 N.Y.S.2d 405 (2008) ("Contrary to plaintiff's assertion, merely amending the complaint to insert the words 'actual malice' will not cure the defect since there are no allegations presented in the complaint that fall within the definition of actual malice. There is nothing magical about the bare recitation of the words 'actual malice."").

<u>HN32</u> The Plaintiffs face another hurdle. "[A]ctual malice, necessary for an award of punitive damages, is

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(1) that state of [\*83] mind under which a person's conduct is characterized by hatred, ill will or a spirit of revenge, or (2) a conscious disregard for the rights and safety of other persons that has a great probability of causing substantial harm." Preston v. Murty, 32 Ohio St. 3d 334, 512 N.E.2d 1174, 1176 (Ohio 1987). The Plaintiffs say they rely on something more than a mere allegation of actual malice. But the contentions they rely on-that the Defendants (1) were aware of the risk that potential ERISA withdrawal liability posed to Plaintiffs and (2) failed to warn the Plaintiffs of this risk, Opp'n to Dismissal Mot. at 11-do not add up to actual malice. Nowhere in the Complaint do the Plaintiffs contend that the Defendants' acted with hatred, ill will, or a spirit of revenge, or that they engaged in extremely reckless behavior revealing a conscious disregard for a great and obvious harm.

Nor do the Plaintiffs allege anything approaching gross negligence. HN33[\*] Gross negligence has been defined as the "failure to exercise any or very slight care." Thompson Elec. v. Bank One, Akron, N.A., 37 Ohio St. 3d 259, 525 N.E.2d 761, 768 (Ohio 1988). As the Sixth Circuit has pointed out, "[n]egligence does not become gross just by saying so." Menuskin v. Williams, 145 F.3d 755, 767 (6th Cir. 1998) (cleaned up); see also Wells v. Walker, 852 F.2d 368, 371 (8th Cir. 1988) ("[T]he descriptions of defendants' conduct in the complaint belie their characterization as anything other than [\*84] ordinary negligence[.]"). "If the courts are to make any sense of the distinction between gross negligence and simple negligence, we must ensure that gross negligence is something more than simple negligence with the addition of a vituperative epithet." Jones v. Sherrill, 827 F.2d 1102, 1106 (6th Cir. 1987) (cleaned up).

Rather than asserting a gross negligence claim, the Plaintiffs assert a garden-variety legal malpractice claim. HN34 [ T] "[T]he requirements to establish a cause of action for legal malpractice relating to civil matters . . . are: (1) an attorney-client relationship giving rise to a duty, (2) a breach of that duty, and (3) damages proximately caused by the breach." Krahn v. Kinney, 43 Ohio St. 3d 103, 538 N.E.2d 1058, 1060 (Ohio 1989). The Plaintiffs allege precisely that:

Defendants breached their duties and obligations to Plaintiffs, including professional standards, duties of care, and fiduciary duties, when they failed to warn the Client of the ramifications of the plan of reorganization that Defendants negotiated as their legal counsel in the Bankruptcy Proceeding. In

particular, Defendants were required to provide competent legal advice informing the Client of the significant risk that the plan of reorganization would expose them to a claim for billions of dollars in ERISA withdrawal liability. [\*85]

Defendants breached their duties to Plaintiffs, including professional standards, duties of care, and fiduciary duties, by failing to provide proper and appropriate legal advice to the Client regarding potential withdrawal liability claims by the 1974 Plan, by failing to warn or advise Mr. Murray to protect himself and the Murray Trust from potential claims for billions of dollars in ERISA withdrawal liability by the 1974 Plan, and by failing to obtain Mr. Murray's informed consent about the impact that the plan of organization could have on Mr. Murray and the Murray Trust.

Compl. at 17-18. In their opposition to the Dismissal Motion, the Plaintiffs themselves describe the Complaint as "plainly stat[ing] a facially plausible claim for legal malpractice[.] Opp'n to Dismissal Mot.

Third, even if the Plaintiffs had asserted a gross negligence claim, there is a question whether the State Court would dismiss the claim as being duplicative of the malpractice claim. While the highest courts of both Ohio and New York<sup>8</sup> have yet to address this question, authority from those states' intermediate appellate courts suggests that the answer would be yes. In this circumstance, "[b]ecause the [highest [\*86] appellate court] has not yet addressed the precise issue presented [here], the Court must predict how the [highest court] would rule." Terlecky v. Nat'l City Mortg. Co. (In re Doutt), No. 10-2198, 2012 Bankr. LEXIS 4077, 2012 WL 3838767, at \*3 (Bankr. S.D. Ohio Aug. 31, 2012). In making this prediction, the Court must follow decisions of a state's intermediate appellate courts to the extent that they are in accord:

[T]he Supreme Court has . . . made no decision on the particular question involved in the present case. On the other hand, the Court of Appeals . . . appears to have supplied a controlling answer to the question here in issue. That being so, we are bound by it, until or unless the Supreme Court of Ohio gives a contrary answer. In these circumstances, it is not for us to exercise our

<sup>&</sup>lt;sup>8</sup> The Court need not decide whether the law of Ohio (where the malpractice action was filed) or the law of New York (which governs the engagement letter between the Defendants and Mr. Murray and the Trust) applies, because the result is the same under the law of both states.

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independent judgment, to look to other jurisdictions, or to speculate as to what the Supreme Court of Ohio might some day decide.

Gettins v. U.S. Life Ins. Co., 221 F.2d 782, 785, 73 Ohio Law Abs. 137 (6th Cir.1955) (citing West v. Am. Tel. & Tel. Co., 311 U.S. 223, 61 S. Ct. 179, 85 L. Ed. 139 (1940)).

Based on its review of the decisions cited below, the Court concludes that the Supreme Court of Ohio and the New York Court of Appeals would hold that a gross negligence claim is duplicative of a malpractice claim and therefore should be dismissed on that basis. See Hillman v. Edwards, No. 08AP-1063, 2009 Ohio 5087, 2009 WL 3087360, at \*5 (Ohio Ct. App. Sept. 17, 2009); Hoffenberg v. Meyers, 73 F. App'x 515, 517 (2d Cir. 2003); Palmeri v. Willkie Farr & Gallagher LLP, 156 A.D.3d 564, 69 N.Y.S.3d 267, 271 (N.Y. App. Div. 2017); Mecca v. Shang, 258 A.D.2d 569, 685 N.Y.S.2d 458, 460 (N.Y. App. Div. 1999).

In Hillman, the plaintiff brought claims for fraudulent misrepresentation, breach of contract and gross negligence. The trial [\*87] court construed those claims as, in essence, asserting a legal malpractice claim. According to the court of appeals, the trial court correctly ruled that "a client's claims that arise out of the manner in which an attorney represents the client within that attorney-client relationship, regardless of the names affixed to the theories of recovery or causes of action, are claims for legal malpractice." Hillman, 2009 Ohio 5087, 2009 WL 3087360, at \*5. The Ohio court of appeals held that the "trial court therefore properly construed the plaintiff's complaint as alleging legal malpractice where the gist of the complaint sounds in malpractice, regardless of the labels given to the causes of actions." Id. (cleaned up). Numerous other Ohio cases agree with Hillman. See Svete v. Cherneskey Heyman & Kress, No. 3:07cv00197, 2009 U.S. Dist. LEXIS 117203, 2009 WL 8435668, at \*10 (S.D. Ohio Nov. 24, 2009), report and recommendation adopted sub nom. Svete v. Cherneskey Heyman & Kress, P.L.L., No. 3:07cv197, 2011 U.S. Dist. LEXIS 109118, 2011 WL 4461323 (S.D. Ohio Sept. 26, 2011) ("Malpractice by any other name still constitutes malpractice. . . . Because each of Svete's claims is based on Defendants' alleged acts or omissions during the LifeTime litigation, his attempt to recast them into something other than a legal malpractice claim lacks merit.") (cleaned up); Silveous v. 5 Starr Salon & Spa, LLC, No. 22AP-456, 2023 Ohio 841, 210 N.E.3d 1020, 2023 WL 2533106, at \*10 (Ohio Ct. App. Mar. 16, 2023)

("A claim against an attorney for actions taken in his professional capacity is a claim sounding in legal malpractice no matter how artfully [\*88] the pleadings attempt to raise some other claim.") (cleaned up); Buckeye Ret. Co., LLC v. Busch, 2017- Ohio 4009, 82 N.E.3d 66, 82 (Ohio Ct. App. 2017) ("An action against one's attorney for damages resulting from the manner in which the attorney represented the client constitutes an action for malpractice, regardless of whether predicated upon contract or tort or whether for indemnification or for direct damages.") (cleaned up); Omega Riggers & Erectors, Inc. v. Koverman, 2016- Ohio 2961, 65 N.E.3d 210, 219 (Ohio Ct. App. 2016) (same).

In *Hoffenberg*, a former client brought claims against his criminal defense attorney for legal malpractice and gross negligence. The district court dismissed the former client's gross negligence claim as being duplicative of his legal malpractice claim, and the Second Circuit held that the district court "properly dismissed [the client's] claim for gross negligence as redundant of his legal malpractice claim." Hoffenberg, 73 F. App'x at 517. And in Palmeri, the New York appellate court held that the trial court "properly dismissed plaintiff's claims for gross negligence, breach of contract, and breach of the implied covenant of good faith and fair dealing as duplicative of his legal malpractice claim, given that they are all based on the same facts and seek the same relief." Palmeri, 69 N.Y.S.3d at 271. Finally, in Mecca, the New York appellate court held that the lower court "should have . . dismissed Dr. Mecca's [\*89] negligent misrepresentation and gross negligence causes of action, since these claims similarly arise from the same facts as his legal malpractice claim and are duplicative of that cause of action." Mecca, 685 N.Y.S.2d at 460.

Based on the foregoing, the Court concludes that the Supreme Court of Ohio and the New York Court of Appeals would hold that a gross negligence claim would be dismissed (and thus the Defendants would never be found grossly negligent by any court) because the claim against the Defendants sounds in malpractice, and a gross negligence claim is duplicative of the malpractice claim. Indeed, the Ohio and New York intermediate appellate courts that have addressed the issue are all in accord, and this Court is required to follow their lead in the absence of other persuasive data that the highest court of the state would decide otherwise. Gettins, 221 F.2d at 785. Thus, despite the Plaintiffs' conclusory allegation that the Defendants acted with actual malice, the claim-which they pleaded only as a "Legal Malpractice/Professional Negligence Claim," Compl. at

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5, falls within the type of claims covered by the Exculpation Clause.

# 2. Causation

The Defendants also move to dismiss this adversary proceeding on the ground that the Plaintiffs failed [\*90] to adequately plead causation. <a href="https://example.com/HN35">HN35</a>[\*] Again, "the requirements to establish a cause of action for legal malpractice relating to civil matters . . . are: (1) an attorney-client relationship giving rise to a duty, (2) a breach of that duty, and (3) damages proximately caused by the breach." Krahn, 538 N.E.2d at 1060.

Proximate causation is more appropriately decided on a motion for summary judgment than a motion to dismiss for failure to state a claim. See, e.g., Trollinger v. Tyson Foods, Inc., 370 F.3d 602, 615 (6th Cir. 2004) (holding that the "traditional proximate-cause problem[s]" of a "weak or insubstantial causal link, a lack of foreseeability, or a speculative or illogical theory of damages" will "more often be fodder for a summaryjudgment motion under Rule 56 than a motion to dismiss under Rule 12(b)(6)."). This is because "[u]nder the familiar rules of notice pleading in federal courts, a complaint should include merely 'a short and plain statement of the claim,' Fed. R. Civ. P. 8(a)(2), and a district court may dismiss a complaint for failure to state a claim 'only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." Id. The Sixth Circuit has held that, in applying these rules, courts should "presume that general allegations embrace those [\*91] specific facts . . . necessary to support the claim." Id. The relevant allegations of the Complaint are that:

As a result of Defendants' negligence and malpractice, Plaintiffs proximately suffered financial harm attributable to Defendants in the form of: (1) attorneys' fees, costs, and expenses incurred to defend against the 1974 Plan's claims for ERISA withdrawal liability in the D.C. Litigation, all of which could have been avoided if Defendants properly had advised the Client in the Bankruptcy Proceeding; (2) attorneys' fees and costs of obtaining legal advice and representation in dealing with other consequences of Defendants' negligence and malpractice; (3) any damages or settlement funds paid as a result of the D.C. Litigation; and (4) other damages, including additional special and compensatory damages, in an amount to be ascertained.

Compl. at 18, 19 (emphasis added). The Plaintiffs further allege that "Defendants disregarded their obligation to inform the Client of this substantial liability and to further advise the Client on how to avoid it." *Id.* at 19

In short, the Complaint implies that there would have been a way for Mr. Murray to avoid ERISA withdrawal liability if only [\*92] he had received different advice from the Defendants. And that implication is entirely speculative. But as in *Trollinger*, given the "unadorned allegations in the complaint and "the requirement that we must assume plaintiffs will be able to prove them," the Court should not grant the motion to dismiss based on a failure to adequately plead causation. *Id. at 619*; see also *Gorsuch v. OneWest Bank, FSB, No. 3:14 CV 152, 2015 U.S. Dist. LEXIS 38697, 2015 WL 2384110, at \*7 (N.D. Ohio May 19, 2015).* 

In Gorsuch, the court found that it was "at least plausible that, had Gorsuch known [certain facts] . . . events would have played out differently [but] [f]act-based issues like these should not be resolved on a motion to dismiss." Id. (citing Trollinger) (cleaned up). As in Gorsuch, the Complaint here raises the issue of whether, had Mr. Murray been warned that he was subject to ERISA withdrawal liability, events would have played out differently. The Plaintiffs do not say how different advice from the Defendants would have changed anything, but given their allegation of proximate cause, their intimation that Mr. Murray could have avoided withdrawal liability, and given that the Court should presume that "general allegations embrace those specific facts . . . necessary to support the claim," Trollinger, 370 F.3d at 615, they have done enough to survive a motion to dismiss based on proximate [\*93] causation. The Court therefore does not find that failure to properly plead proximate causation is a ground for its dismissal of this adversary proceeding; rather, it bases dismissal solely on the Exculpation Clause.

The Court points out, however, that had this case proceeded to summary judgment, the Plaintiffs would have had an uphill battle in attempting to establish proximate causation. The suggestion that Mr. Murray was unaware of his potential withdrawal liability "taxes the credulity of the credulous." Maryland v. King, 569 U.S. 435, 466, 133 S. Ct. 1958, 186 L. Ed. 2d 1 (2013) (Scalia, J., dissenting). After all, he was the Chairman of Murray Energy's board of directors and the owner of 100% of the issued and outstanding voting shares of Murray Energy. UCC Mot. at 7; Disclosure Statement at 21. As such, he was the target of several allegations

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during the Debtors' cases that were addressed in a way that should have made it clear that the 1974 Plan was reserving its rights to pursue claims against him based on the Debtors' withdrawal from the 1974 Plan. On April 15, 2020, the 1974 Plan filed an objection to the Disclosure Statement in which it stated that it had claims for withdrawal liability against Mr. Murray, members of his immediate family, and any entities or trusts [\*94] owned by him or any member of his immediate family. See Objection of the UMWA 1974 Pension Plan and Trust, UMWA 1992 Benefit Plan, and UMWA 1993 Benefit Plan to the Debtors' Motion to Approve the Disclosure Statement (Doc. 1274) at 13. Then, on May 1, 2020, the Official Committee of Unsecured Creditors ("Committee") filed the Motion of the Official Committee of Unsecured Creditors for (I) Leave, Standing, and Authority to Prosecute Certain Claims and Causes of Action on behalf of the Debtors' Estates and (II) Exclusive Rights to Settlement ("UCC Motion") (Doc. 1426). In the UCC Motion, the Committee alleged that:

Between 2016 and 2019, with the Debtors' bankruptcy on the horizon, [Mr.] Murray and Rob Moore [Mr. Murray's nephew, who became the CEO of Murray Energy when Mr. Murray stepped down from that position shortly before the Debtors' bankruptcy filing] paid themselves at least \$70 million (and potentially as much as \$100 million) in excessive "executive compensation" and, together with the other Proposed Defendants, caused the Debtors to make millions of dollars of other transfers for their own benefit. These transfers unfairly and personally enriched the Proposed Defendants to [\*95] the detriment of the Debtors' estates and their creditors, and were made with the knowledge and agreement of the Debtors' Board of Directors and senior management team, which at all relevant times included [Mr.] Murray and Rob Moore. These actions give rise to claims against the Proposed Defendants for avoidance and recovery of constructively fraudulent transfers and for breaches of fiduciary duties, all of which are set forth in further detail in this Motion.

UCC Mot. at 7-8.

On July 29, 2020, the Debtors filed a Motion for Entry of an Order (I) Approving the Debtors' Continued Solicitation of the Amended Plan and the Adequacy of the Supplemental Disclosure in Connection Therewith, and (II) Granting Related Relief (Doc. 1886). This motion sought approval of the Supplemental Disclosure Statement for the Debtors' Second Amended Joint Plan Pursuant to Chapter 11 of the Bankruptcy Code

("Disclosure Statement Supplement"). Among other things, the Disclosure Statement Supplement addressed the settlements of the claims against Mr. Murray and others in the "Murray Family Settlement" and the "UCC Settlement." The Murray Family Settlement was a settlement between the Debtors and Mr. Murray "along [\*96] with his family and related trusts" ("Murray Family Entities"), under which the Murray Family Entities and Robert Moore were defined as "Murray Insiders." The Disclosure Statement Supplement expressly stated:

Among other things, the Murray Family Settlement and the UCC Settlement provide for:

. . .

[T]he preservation of the 1974 Plan's right to pursue litigation arising from or related to the Debtors' withdrawal from the 1974 Plan against Murray Insiders and certain other non-Debtors after the conclusion of these cases on account of their potential direct (but not derivative) claims, including any claim that is peculiar and/or personal to the 1974 Plan. Claims that the 1974 Plan has against the Murray Insiders and other non-Debtors are preserved under the Amended Plan pursuant to the 1974 Carve-Out.

Disclosure Statement Suppl. at 15.9 Mr. Murray was a party to the Murray Family Settlement, so it seems highly unlikely he would not have known that the 1974 Plan was preserving its rights to "pursue litigation arising from or related to the Debtors' withdrawal from the 1974 Plan against [him and the other] Murray Insiders."

Another reason that the Plaintiffs likely would have had a formidable [\*97] challenge in establishing proximate causation is that the 1974 Plan's withdrawal liability claim is a statutory obligation that arose under ERISA based on Murray Energy's withdrawal from the 1974 Plan as of the effective date of the Chapter 11 Plan. See Trs. of Operating Engineers Loc. 324 Pension Fund v. Bourdow Contracting, Inc., 919 F.3d 368, 373 & n.2 (6th Cir. 2019) ("Withdrawal liability is a statutory obligation[.]"); Irigaray Dairy v. Dairy Emps. Union Loc. No. 17 Christian Lab. Ass'n of the United States of Am. Pension Tr., 153 F. Supp. 3d 1217, 1246 (E.D. Cal. 2015) ("[W]ithdrawal liability is a statutory obligation that is imposed because the employer no longer has a contractual obligation to contribute.") (cleaned up).

<sup>&</sup>lt;sup>9</sup> On August 7, 2020, the Court approved the Disclosure Statement Supplement. See Order (I) Approving the Debtors' Continued Solicitation of the Amended Plan and the Adequacy of the Supplemental Disclosure in Connection Therewith, and (II) Granting Related Relief (Doc. 1939).

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Nothing in the Complaint nor the Plaintiffs' Opposition to the Dismissal Motion even hints at how Mr. Murray and the Trust could have been released from ERISA withdrawal liability.

The Plaintiffs do not allege that there was anything the Defendants could have done to keep the Debtors from withdrawing from the 1974 Plan, nor that different legal advice would have allowed Mr. Murray and the Trust to avoid withdrawal liability, or that a third-party release would have been available to them. HN36 Nonconsensual third-party releases can only be approved when "unusual circumstances" are present. Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002).

The Sixth Circuit has held that seven factors must be present for a non-consensual third-party release to be approved:

- There is an identity [\*98] of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;
- The non-debtor has contributed substantial assets to the reorganization;
- The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;
- The impacted class, or classes, has overwhelmingly voted to accept the plan;
- The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;
- The plan provides an opportunity for those claimants who choose not to settle to recover in full and;
- The bankruptcy court made a record of specific factual findings that support its conclusions.

ld.

It seems unlikely that the Plaintiffs could establish the existence of all seven factors in the Debtors' cases. For one, it is unlikely the Plaintiffs can show either that (1) there "is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against [\*99] the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate," or (2) Mr. Murray "contributed substantial assets to [the Debtors'] reorganization." *Id.* Nor can they

establish that "the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor." *Id.* After all, the Chapter 11 Plan was confirmed without any releases of Mr. Murray and the Trust of withdrawal liability to the 1974 Plan. How then could the Chapter 11 Plan have "hinge[d] on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor[?] *Id.* Further, the Chapter 11 Plan, which provides for the repayment of unsecured creditors in the range of 0-1% of their claims, does not "provide[] an opportunity for those claimants who choose not to settle to recover in full." *Id.* 

For all these reasons, it appears unlikely that, had this litigation proceeded to summary judgment, the Plaintiffs could have established proximate causation.

# E. Dismissal with Prejudice

In a footnote in their response to the Dismissal Motion, the Plaintiffs request, "[i]n the [\*100] unlikely event that the Court enters an order granting [the Dismissal] Motion, . . . that it be without prejudice so that Plaintiffs may have an opportunity to file a motion for leave to amend and a proposed amended Complaint." Opp'n to Dismissal Mot. at 18 n.4. Because the Plaintiffs have not filed a motion to amend their complaint or a proposed amended complaint, dismissal will be with prejudice. In fact, the only case the Plaintiffs rely on for dismissal without prejudice, see id., actually undercuts their position. See CNH Am. LLC v. Int'l Union, United Auto., Aerospace & Agric. Implement Workers of Am. (UAW), 645 F.3d 785, 795 (6th Cir. 2011) (holding that "if a party does not file a motion to amend or a proposed amended complaint, it is not an abuse of discretion for the district court to dismiss the claims with prejudice"). See also Jamison v. Stuart Lippman & Assocs., No. 1:21-cv-00050, 2022 U.S. Dist. LEXIS 54967, 2022 WL 896779, at \*2 n.2 (S.D. Ohio Mar. 28, 2022), aff'd, No. 22-3310, 2023 U.S. App. LEXIS 2145, 2023 WL 3194906 (6th Cir. Jan. 26, 2023) ("Dismissal with prejudice is proper as Plaintiff has not filed a motion to amend his Complaint.").

The Sixth Circuit has held that a district court did not abuse its discretion in rejecting a request to amend a complaint made in response to a motion to dismiss where the party seeking to amend her complaint did not "file a formal motion [to amend], provide a proposed amended complaint, or explain how an amendment

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could save her claims," but instead "simply requested [\*101] leave in the event the court granted [the] motion [to dismiss]." Forrester v. Am. Sec. & Prot. Serv. LLC, No. 21-5870, 2022 U.S. App. LEXIS 12959, 2022 WL 1514905, at \*4 (6th Cir. May 13, 2022). Under those circumstances, the Sixth Circuit held that the district court properly denied the plaintiff's request for leave to amend her complaint. Id. Other courts have also rejected such "throwaway requests for amendment related to motion[s] to dismiss." Culy Constr. & Excavating, Inc. v. Laney Directional Drilling Co., No. 2:12-cv-4, 2012 U.S. Dist. LEXIS 197908, 2012 WL 12942602, at \*1 (S.D. Ohio Aug. 13, 2012); see also In re Porsche Cars N. Am., Inc., 880 F. Supp. 2d 801, 882 (S.D. Ohio 2012) ("Plaintiffs' general request for leave to amend their Complaint, in the alternative to their request that this Court deny PCNA's motion [to dismiss], is nothing more than an attempt to use the Court's decision as an advisory opinion enabling them to cure any deficiencies in their Complaint."). Like the plaintiffs in Forrester and these other cases, the Plaintiffs have not moved to amend the Complaint, provided a proposed amended complaint, or explained how an amendment could save their claim. Dismissal of the Complaint with prejudice is therefore appropriate.

V. Conclusion

For all these reasons, (1) the Remand Motion, the Defendants' Arbitration Motion and the Plaintiffs' Arbitration Motion are **DENIED**, and (2) the Dismissal Motion is **GRANTED WITH PREJUDICE**.

IT IS SO ORDERED.

Dated: October 5, 2023

/s/ John E. Hoffman, Jr.

John E. Hoffman, Jr.

United States Bankruptcy [\*102] Judge

# JUDGMENT ENTRY

In accordance with the Memorandum Opinion and Order ("Opinion") entered contemporaneously herewith, (1) the Remand Motion, the Defendants' Arbitration Motion and the Plaintiffs' Arbitration Motion are **DENIED**, and

Alexis Leventhal

(2) summary judgment is granted in favor of the Defendants and the Dismissal Motion is **GRANTED**. The Complaint is **DISMISSED WITH PREJUDICE**.

IT IS SO ORDERED.

Dated: October 5, 2023

/s/ John E. Hoffman, Jr.

John E. Hoffman, Jr.

United States Bankruptcy Judge

**End of Document** 

<sup>&</sup>lt;sup>1</sup> Capitalized terms have the meanings given to them in the Opinion.

CB&I UK Limited, Docket No. 4:23-bk-90795 (Bankr. S.D. Tex. Oct 09, 2023), Court Docket

# **Multiple Documents**

Part	Description
1	Main Document
2	Exhibit Reficar Award
3	Exhibit Proposed WHOA Plan
4	Exhibit Brantley Declaration
5	Exhibit Practice Statement Letter
6	Proposed Order Proposed Order to Lift Stay



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# UNITED STATES BANKRUPTCY COURT NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

In re:		
	)	Case No. 22 B 8837
JOAN JOHNSON,	)	
Debtor.	) ) )	Chapter 13
JOAN JOHNSON,	)	Adv. No. 22 A 172
Plaintiff,	)	710v. 1vo. 22 /1 1/2
V.	)	
	)	
S.A.I.L. LLC,	)	Judge David D. Cleary
Defendant.	)	
	OPINION	

This matter comes before the court on the motion of Defendant S.A.I.L. LLC ("Defendant" or "SAIL") to compel arbitration ("Motion to Compel") of the claims for relief in the complaint ("Complaint") filed against it by Plaintiff Joan Johnson ("Plaintiff," "Debtor" or "Johnson"). The parties appeared in court for status on the Complaint, and the court entered a briefing schedule on the Motion to Compel. Plaintiff timely responded to the Motion to Compel ("Response") and Defendant timely replied ("Reply"). Having reviewed the papers filed and considered the arguments of the parties, the court will enter an order granting in part and denying

# I. INTRODUCTION

in part the Motion to Compel.

One of the "chief purpose[s] of the bankruptcy laws is to secure a prompt and effectual administration and settlement of the estate ... within a limited period, and that provision for summary disposition, without regard to usual modes of trial attended by some necessary delay, is

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one of the means chosen by Congress to effectuate that purpose[.]" *Katchen v. Landy*, 382 U.S. 323, 328-29 (1966) (quotations omitted). A bankruptcy court's jurisdiction is *in rem* jurisdiction, overseeing resolution of claims against and by the estate. *See Cent. Virginia Cmty. Coll. v. Katz*, 546 U.S. 356, 369 (2006) ("Bankruptcy jurisdiction, as understood today and at the time of the framing, is principally *in rem* jurisdiction."). While a bankruptcy court's jurisdiction is not limitless, Congress intended that it would be able to "deal efficiently and expeditiously with all matters connected with the bankruptcy estate[.]" *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995) (quotation omitted).

In this case, Debtor determined that she needed a structured repayment of her claims and discharge of her debts. She filed for relief under chapter 13 of the Bankruptcy Code and proposed a plan to do just that. As the Code provides, SAIL filed a proof of claim ("Claim") that would entitle it to share, with other creditors, in the distributions made under a confirmed chapter 13 plan. In the process of addressing the filed proofs of claim, and moving toward confirmation of her plan, the Debtor objected to SAIL's Claim. According to the chapter 13 Trustee ("Trustee") and Debtor, that claim objection must be resolved before Debtor's plan can be confirmed. Confirmation, of course, will benefit all parties, and successful completion of the confirmed plan will end with creditors being paid in full and with Debtor receiving her discharge.

SAIL, however, has asked that the court pause the claims objection process and send this dispute between itself and Debtor to arbitration, as agreed to by SAIL and Debtor in their prepetition contract. There is no disagreement that efficient, fair and prompt resolution of disputes is a goal of *both* bankruptcy (with multiple parties-in-interest in statutory disputes over estate assets), *see Katchen*, 382 U.S. at 328-29, and arbitration (with parties bound by contractual

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agreements), see Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985) (when agreeing to arbitrate, a party "trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration").

The Supreme Court has guided lower courts to aid their determination of whether to enforce an agreement to arbitrate or to except such an agreement in favor of litigation. See Shearson/American Exp., Inc. v. McMahon, 482 U.S. 220, 227 (1987) [hereinafter, McMahon] ("To defeat application of the Arbitration Act in this case, therefore, the McMahons must demonstrate that Congress intended to make an exception to the Arbitration Act ... an intention discernible from the text, history, or purposes of the statute."). Generally, in commercial disputes, an arbitration agreement between parties must be enforced. The Federal Arbitration Act ("FAA") requires it. See Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 218 (1985) ("[I]nsofar as the language of the [Federal Arbitration] Act guides our disposition of this case, we would conclude that agreements to arbitrate must be enforced, absent a ground for revocation of the contractual agreement."). However, there is no national policy favoring arbitration. See Gotham Holdings, LP v. Health Grades, Inc., 580 F.3d 664, 666 (7th Cir. 2009) ("The Federal Arbitration Act eliminates hostility to private dispute resolution; it does not create a preference for that process."). "The federal policy is about treating arbitration contracts like all others, not about fostering arbitration." Morgan v. Sundance, Inc., U.S. , 142 S. Ct. 1708, 1713 (2022).

When an arbitration demand is made in a bankruptcy case, however, a conflict exists as to whether a bankruptcy court should enforce the bilateral arbitration agreement, or its *in rem* jurisdiction over the claims under the Bankruptcy Code. The court must address the two

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statutory schemes – the FAA and the Bankruptcy Code – and the potential conflict between them. Neither the Supreme Court nor the Seventh Circuit have addressed this narrow issue.

# II. JURISDICTION

The court has jurisdiction over this adversary proceeding under the district court's Internal Operating Procedure 15(a) and 28 U.S.C. § 1334(b), subject to the determination of whether the Clause (defined in section III(B)) removes any of the counts of the Complaint to an arbitral forum. The Motion to Compel is a core proceeding under 28 U.S.C. §§ 157(b)(2)(A), (B), (C) and (O). Venue is proper under 28 U.S.C. § 1409(a).

# III. BACKGROUND

# A. Commencement of the Bankruptcy Case

Joan Johnson filed for relief under chapter 13 on August 5, 2022. As many chapter 13 debtors do, she made a small down payment (\$350) on the flat fee (\$4,500) charged by her attorneys. Debtors often file under chapter 13 because they wish to retain a home or a car, and Johnson is no different; she listed a 2017 Hyundai Santa Fe on Schedule B.

With her petition, Johnson filed a plan ("Plan"). In the Plan, Johnson proposed monthly payments of \$1,130 for 60 months. Under the Plan she would pay the claims against her in full over the proposed term; these include attorneys' fees, priority claims filed by taxing bodies, and unsecured claims. Johnson included a non-standard provision in her plan which would step up monthly payments to the creditor secured by a lien on her car ("Global Lending").

Johnson listed one secured claim in the amount of \$16,425 on Schedule D and a priority claim of \$2,500 on Schedule E. She listed 31 unsecured claims on Schedule F, including a debt owed to SAIL in the amount of \$750. The Bankruptcy Noticing Center sent notice to Johnson's creditors of the date for the meeting of creditors under 11 U.S.C. § 341 as well as of the deadline

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for filing proofs of claim against Johnson's estate. The bar date for both non-government and government claims has passed. Eighteen creditors filed proofs of claim, including SAIL.

Global Lending filed an objection to confirmation, which Johnson resolved with an amended plan ("Amended Plan"). The Amended Plan provided for preconfirmation payments to Global Lending in the amount of \$100 and postconfirmation payments of \$335.

# B. The Relationship With SAIL and Its Claim Against the Estate

According to the allegations in the Complaint, SAIL is a limited liability company with its principal office in Des Plaines, Illinois. It occupies the same premises and has the same managers as Americash Loans, L.L.C. ("Americash") did. Prior to March 23, 2021, Americash made high-interest loans to Illinois residents from storefront locations and over the Internet.

Effective March 23, 2021, Illinois enacted the Predatory Loan Prevention Act, 815 ILCS 123/15-1-1 et seq. ("PLPA"). The PLPA limited interest rates to 36%. Johnson alleges in the Complaint that "the managers of Americash devised a new method of making high-interest loans in disguise" in response to the PLPA. Complaint, ¶ 6.

In the spring of 2022, Johnson needed \$4,000. She found SAIL on the Internet, read the material on its website, and borrowed money from it. According to the Consumer Loan Agreement, Security Agreement, and Truth-in-Lending Act Disclosure that SAIL attached to its Claim ("Agreement"), SAIL financed \$4,000 for Johnson, which was distributed as follows:

\$1,000 – given directly to Johnson

\$3,000 – deposited on Johnson's behalf with SAIL's bank

The terms of the loan from SAIL to Johnson include a Jury Trial Waiver and Arbitration Clause ("Clause"). The Clause governs "any and all claims, controversies and/or disputes

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arising from or related in any way" to the Agreement and provides "that all Disputes shall be resolved by binding arbitration pursuant to and under the Federal Arbitration Act[.]"

Johnson had included SAIL in her original schedules as an unsecured creditor. She had not listed SAIL on Schedule D with a secured claim. SAIL filed the Claim, however, alleging that Johnson owes it \$3,741.28, and that it is secured in the amount of \$3,000 by a "Collateral Deposit."

# C. The Amended Plans and Johnson's Objection to SAIL's Claim

# 1. Amended plans

Johnson's Amended Plan treated SAIL's secured claim in section 3.5 by proposing to surrender the "SAIL secured bank account." She amended her schedules to include a "SAIL bank account" in the amount of \$3,000 on Schedule B, and to move her debt to SAIL from Schedule F to Schedule D.

Johnson then filed her second amended plan ("Second Amended Plan"), which removed SAIL from section 3.5. Instead of proposing to surrender the SAIL bank account, Johnson added the following nonstandard provision to section 8.1: "Proof of Claim No. 18 filed by S.A.I.L. LLC on 10/12/22 shall be paid by the trustee in accordance with the final judgment of adversary case no. 22-00172. No payments shall be made on that claim until the adversary is resolved."

# 2. Objection to SAIL's claim

About a week after filing the Amended Plan, Johnson filed the Complaint and commenced this adversary proceeding. In the Complaint, she objected to SAIL's Claim and brought a counterclaim against it.<sup>1</sup>

<sup>&</sup>lt;sup>1</sup> Fed. R. Bankr. P. 3007(b) states: "A party in interest shall not include a demand for relief of a kind specified in Rule 7001 in an objection to the allowance of a claim, but may include the objection in an adversary proceeding."

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- The first claim for relief objects to SAIL's Claim and alleges that the underlying loan is voidable under the PLPA in violation of both the PLPA and the Illinois Consumer Fraud and Deceptive Business Practices Act ("Consumer Fraud Act"). Plaintiff alleges that the \$3,000 which SAIL deposited on her behalf with its bank is a "device, subterfuge, or pretense to evade the requirements" of the PLPA. It also violates the Consumer Fraud Act, because any violation of the PLPA constitutes a violation of the Consumer Fraud Act. Johnson therefore asks that the court void SAIL's Claim and the underlying loan, refund all sums paid on the loan, impose punitive damages and award attorney's fees and costs of litigation.
- The second claim for relief is brought under the Illinois Interest Act. Plaintiff alleges that SAIL charged her unlawful interest and is therefore liable for statutory damages pursuant to the Interest Act, as well as attorney's fees and costs of litigation.
- Plaintiff's third claim seeks relief under the Consumer Fraud Act. She alleges that SAIL made deceptive and misleading representations concerning the nature of the transaction for the purpose of inducing her to enter into that transaction. As in Count I, Johnson asks that the court void SAIL's Claim and the underlying loan, refund all sums paid on the loan, impose punitive damages and award attorney's fees and costs of litigation.

# 3. Motion to compel arbitration

SAIL did not file an answer to the Complaint, or a motion to dismiss. Instead, it promptly filed this Motion to Compel.

In order to address the validity of SAIL's Claim, Debtor filed the adversary proceeding, seeking relief in a judicial forum. By filing the Motion to Compel, SAIL has asked the court to

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enforce the arbitration agreement set forth in its loan documents so that the parties resolve the claim objection and counterclaim through arbitration.

If Johnson can confirm the Second Amended Plan and complete the payments it requires, she is eligible for a discharge of her debts. As the court noted in the Introduction, however, the Trustee and the Debtor have continued the confirmation hearing and contend that Debtor's objection to SAIL's Claim must be resolved before the Second Amended Plan can be confirmed. The Trustee filed a motion to dismiss Johnson's case for unreasonable delay in September 2022, about a month before Johnson filed this adversary proceeding. The Trustee's motion to dismiss and confirmation of Johnson's Second Amended Plan have been put on hold until SAIL's Motion to Compel is resolved. Since disbursements to creditors will not begin until a plan is confirmed, creditors are waiting for payment on their claims while this dispute is pending.

# IV. CONTENTIONS OF THE PARTIES

In the Motion to Compel, SAIL argues that arbitration agreements must be rigorously enforced, and that the Supreme Court has instructed lower courts to implement those agreements so long as they are enforceable. To determine whether to send this dispute to an arbitral forum, SAIL argues, this court must consider if the parties agreed to arbitrate, if the dispute falls within the arbitration clause, and if any nonarbitrable claims should be stayed pending the conclusion of arbitration. For these propositions, SAIL cites *Pereira v. Urthbox, Inc.* (*In re Try The World, Inc.*), No. 18-11764-JLG, 2021 WL 3502607, at \*7 (Bankr. S.D.N.Y. Aug. 9, 2021).

SAIL argues that Debtor agreed to arbitrate all disputes. SAIL also asserts that Debtor's claims are not core, although it offers that a bankruptcy court may exercise discretion to decline to enforce a valid arbitration agreement if a dispute is core. Since Johnson's claims fall within the scope of the Clause and, in SAIL's opinion are non-core, this court has no discretion to deny

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the Motion to Compel. Alternatively, if any claims are core, SAIL asks the court to order arbitration for any non-core claims.

In her Response, Debtor does not dispute that she signed a contract with SAIL that contains an arbitration clause which covers all "disputes." But, she contends that arbitration is not to be preferred, only to be enforced on the same footing as other contracts. She distinguishes *Argon Credit*, the only case SAIL cites in support for its contention that her claims are non-core, and argues that her objection and counterclaim are core. *In re Argon Credit*, *LLC*, No. 16-39654, 2018 WL 4562542, at \*1 (Bankr. N.D. Ill. Sept. 21, 2018).

Johnson further asserts that resolution of her objection and counterclaim is material to her reorganization. "If SAIL's loan is invalid, other creditors ... will be paid more quickly." Response, p. 9. All of her claims are intertwined, because all turn on a finding that SAIL used a device or artifice to evade the PLPA. She directs the court to *Citibank*, *N.A. v. Park-Kenilworth Industries*, *Inc.*, 109 B.R. 321 (N.D. Ill. 1989), as an example of a district court treating the entire controversy as a core proceeding. If this court allows any of her claims to be resolved outside the bankruptcy case, Johnson contends that this would substantially interfere with her efforts to reorganize, and also would be inconsistent with the purposes of the Bankruptcy Code.

In its Reply, SAIL reiterates its contention that Johnson's claims are not core. It criticizes Johnson's case citations in support of her argument that her claims are core, asserting that none of those cases involved an enforceable arbitration clause or entirely state law claims. It reminds the court that Johnson's claims arise from state law, and that in *Argon Credit* the court held that "[c]ore proceedings are actions by or against the debtor ... [in] that the Code itself is the source of the claimant's right or remedy[.]" 2018 WL 4562542, at \*5 (quotation omitted). Here, SAIL asserts that the claims are not.

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However, in conclusion, SAIL argues that even if Johnson's claims are core, the court "must have a compelling reason ... to deviate from Congress's strong preference that the arbitration agreement be enforced." Reply, p. 3. It contends that Johnson has not shown an inherent conflict between arbitration and the purpose of the Bankruptcy Code. This is so because, by itself, the core nature of a claim for relief does not create an inherent conflict between the FAA and the Code. Furthermore, Johnson's claims are procedurally but not substantively core, and therefore do not conflict with any Bankruptcy Code policy. Her claims are matters of state law and her agreement to arbitrate disputes must be enforced.

# V. ANALYSIS

# A. Objection to Claim and Counterclaim: The Adversary Proceeding

As the court described in section III(C)(2), Johnson brought three claims for relief in this adversary proceeding. The first claim for relief is brought under the PLPA and the Consumer Fraud Act. Johnson alleges that SAIL violated both statutes, and she asks that the court void SAIL's Claim and the underlying loan. She also requests a refund of all sums paid on the loan, imposition of punitive damages and an award of attorney's fees and costs of litigation.

Johnson's second claim for relief is brought under the Interest Act, and she asks for statutory damages as well as attorney's fees and costs of litigation. Finally, Johnson's third claim seeks relief under the Consumer Fraud Act. She alleges that SAIL made deceptive and misleading representations concerning the nature of the transaction for the purpose of inducing her to enter into that transaction. As in the first count of the Complaint, Johnson asks that the court void SAIL's Claim and the underlying loan, refund all sums paid on the loan, impose punitive damages and award attorney's fees and costs of litigation.

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# B. The Federal Arbitration Act and Enforcement of Arbitration Demands

Congress enacted the FAA "in 1925 in response to widespread judicial hostility to arbitration agreements." *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 339 (2011). *See Viking River Cruises, Inc. v. Moriana*, \_\_\_ U.S. \_\_\_\_, 142 S. Ct. 1906, 1917 (2022). "Before 1925, English and American common law courts routinely refused to enforce agreements to arbitrate disputes." *Epic Systems Corp. v. Lewis*, \_\_\_ U.S. \_\_\_\_, 138 S. Ct. 1612, 1621 (2018).

The primary substantive provision of the FAA is found in section 2:

A written provision in any ... contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract or as otherwise provided in chapter 4.

The Supreme Court has interpreted section 2 as containing "two clauses: An enforcement mandate, which renders agreements to arbitrate enforceable as a matter of federal law, and a saving clause, which permits invalidation of arbitration clauses on grounds applicable to any contract." *Viking River Cruises*, 142 S. Ct. at 1917 (quotation omitted).

Section 2 is a congressional declaration favoring enforcement of arbitration agreements. See Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). However, "[t]he federal policy is about treating arbitration contracts like all others, not about fostering arbitration." Morgan, 142 S. Ct. at 1713. See also Volt Info. Scis., Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 476 (1989) ("There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate."). As the Seventh Circuit confirmed, the FAA "eliminates hostility to private dispute resolution; it does not create a preference for that process." Gotham Holdings, 580 F.3d at 666.

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"[T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute." *Mitsubishi Motors*, 473 U.S. at 626.

Johnson does not dispute that she signed the Agreement and that it contains the Clause covering "any and all claims, controversies and/or disputes arising from or related in any way to this Agreement...". Response, p. 6. The next question, therefore, is whether the Clause should be enforced.

Because "[t]he preeminent concern of Congress in passing the [Federal Arbitration] Act was to enforce *private* agreements into which parties had entered," courts must "rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation[.]" *Dean Witter*, 470 U.S. at 221 (emphasis added). *See McMahon*, 482 U.S. at 226 ("The Arbitration Act, standing alone, therefore mandates enforcement of agreements to arbitrate statutory claims."); *Moses H. Cone*, 460 U.S. at 20 ("[T]he relevant federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement.") (footnote omitted).

As is the case with any statutory directive, the FAA's "mandate may be overridden by a contrary congressional command." *McMahon*, 482 U.S. at 226.

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.

*Id.* at 227 (quotation omitted).

The party seeking to prevent arbitration "bears the burden of proving that the claims at issue are unsuitable for arbitration." *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 91 (2000). *See McMahon*, 482 U.S. at 227 ("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

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issue."); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) ("the burden is on Gilmer to show that Congress intended to preclude a waiver of a judicial forum").

When confronted with two Acts of Congress allegedly touching on the same topic, this Court is not at liberty to pick and choose among congressional enactments and must instead strive to give effect to both. A party seeking to suggest that two statutes cannot be harmonized, and that one displaces the other, bears the *heavy burden of showing a clearly expressed congressional intention* that such a result should follow.

Epic, 138 S. Ct. at 1624 (quotations omitted) (emphasis added). See, e.g., McMahon, 482 U.S. at 238 ("there is nothing in the text of the RICO statute that even arguably evinces congressional intent to exclude civil RICO claims from the dictates of the Arbitration Act"); Morton v. Mancari, 417 U.S. 535, 551 (1974) (the intent of the legislature to repeal a statute must be "clear and manifest," finding that the Equal Employment Opportunity Act did not repeal a statute implementing a preference for Native Americans) (quotation omitted).

# C. Exceptions to Enforcement: Conflict with the Bankruptcy Code

1. Whether a claim is excepted from arbitration does not turn necessarily on whether it is core or non-core

There is no dispute between the parties or for this court that a valid arbitration agreement concerning arbitrable claims exists. The question is whether any of those claims should be excepted from arbitration.

In order to determine whether Debtor has met her heavy burden of showing a clearly expressed congressional intention "to preclude a waiver of judicial remedies for the statutory rights at issue[,]" *Green Tree*, 531 U.S. at 90, the court may consider three different sources. "That intent must be deducible from (1) the statute's text; (2) its legislative history; or (3) 'an inherent conflict between arbitration and the statute's underlying purposes." *Moses v. CashCall, Inc.*, 781 F.3d 63, 71 (4th Cir. 2015) (quoting *McMahon*, 482 U.S. at 227).

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Neither the Supreme Court nor any Circuit Court of Appeals has found that the Bankruptcy Code's text or legislative history clearly express an intent to except claims from arbitration. *See, e.g., Jalbert v. Zurich Am. Ins. Co. (In re Payton Const. Corp.)*, 399 B.R. 352, 361 (Bankr. D. Mass. 2009) ("The parties and authorities agree that neither the text nor the legislative history of the Bankruptcy Code and related statutes clearly expresses a Congressional intention to preclude (or not) a waiver of judicial remedies for the statutory rights under the Code."). The key question, therefore, is whether there is an inherent conflict between arbitration and the underlying purposes of the Code in relation to the particular dispute for which a party seeks to enforce an arbitration clause. *See McMahon*, 482 U.S. at 227.

It should be apparent that if there is an inherent conflict between arbitration and the purposes of the Bankruptcy Code, then it is not relevant whether the dispute is core or non-core. Yet courts, and in this case, the parties, have focused on this question. *See In re Anderson*, 884 F.3d 382, 387 (2d Cir. 2018) ("[T]he specific question posed in this case ... whether arbitration may be compelled in this bankruptcy proceeding ... requires the bankruptcy court to determine first whether the issue involves a 'core' or 'non-core' proceeding[.]"); *In re Thorpe Insulation Co.*, 671 F.3d 1011, 1020 (9th Cir. 2012) ("Several of our sister circuits that have addressed the issue have considered, as a threshold matter, a distinction between core and non-core proceedings.").

Although the parties argue the distinctions between core and non-core matters as the foundation to their respective positions on arbitrability, the answer to the question of whether a matter is core or non-core dictates whether a bankruptcy court may enter final judgment without obtaining consent, or whether it may only submit proposed findings of fact and conclusions of law to the district court. 28 U.S.C. § 157(c)(1). It should not be used as a bright line in

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determining the enforceability of arbitration clauses. Arbitration of both core and non-core matters can inherently conflict with the jurisdiction of the bankruptcy court and its ability to enforce provisions of the Bankruptcy Code. Whether a matter is core or non-core is simply a factor to consider when determining if there is an inherent conflict.

# 2. Whether there is an inherent conflict between the FAA and the Bankruptcy Code

# a. Purposes of the Bankruptcy Code

As the court stated in the Introduction, Congress intended to grant comprehensive jurisdiction to bankruptcy courts so that they might "deal efficiently and expeditiously with all matters connected with the bankruptcy estate[.]" *Celotex*, 514 U.S. at 308 (quotation omitted). One of the primary "purpose[s] of the bankruptcy laws is to secure a prompt and effectual administration and settlement of the estate ... within a limited period, and that provision for summary disposition, without regard to usual modes of trial attended by some necessary delay, is one of the means chosen by Congress to effectuate that purpose[.]" *Katchen*, 382 U.S. at 328-29. It gave the bankruptcy court *in rem* jurisdiction – the power to adjudicate matters against property of the estate. *See Cent. Virginia Cmty. Coll.*, 546 U.S. at 362 ("Bankruptcy jurisdiction, at its core, is *in rem.*").

By centralizing disputes regarding the debtor's assets and obligations, the Bankruptcy Code protects "both debtors and creditors from piecemeal litigation and conflicting judgments. Ease and centrality of administration are thus foundational characteristics of bankruptcy law." *CashCall*, 781 F.3d at 72 (citations and quotation omitted). Bankruptcy brings all interested parties to one forum, and provides the court with expansive jurisdiction to adjudicate rights among those parties relating to the debtor's property.

The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction--

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(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate[.]

28 U.S.C. § 1334(e).

The Code is designed to facilitate the timely, cost-effective resolution of all claims.

Creditors are entitled to the filing and confirmation of a timely plan in chapter 13, *see* 11 U.S.C. § 1307(c)(1) ("cause" to convert or dismiss a case includes "unreasonable delay by the debtor that is prejudicial to creditors"), and for disbursements under that plan to begin in a reasonable time. Creditors and interested parties — "a party in interest" — can object to claims against the estate. 11 U.S.C. § 502(a). Congress provided the bankruptcy court with the powers and procedures to exercise its *in rem* jurisdiction over all parties claiming a right or interest in or against the estate.

# b. Bankruptcy disputes - core and non-core matters

While the designation of a matter as core or non-core is not dispositive as to whether an arbitration clause should be enforced, it does inform the analysis required of the bankruptcy court, which is to inquire as to whether there is an inherent conflict between the FAA and the Bankruptcy Code. 28 U.S.C. § 157(b)(2)(B) provides that the "allowance or disallowance of claims against the estate" are core claims. Objections to the allowance of claims against the estate must be grounded in one of the nine exceptions described in 11 U.S.C. § 502(b). The first of these exceptions provides that the court shall not allow a claim against the estate to the extent that "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured[.]" 11 U.S.C. § 502(b)(1). Therefore, objections to claims that seek disallowance on the grounds that the claim is unenforceable under state law are statutorily core matters.

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The Supreme Court has distinguished, however, between statutorily core claims and constitutionally core claims. *See Stern v. Marshall*, 564 U.S. 462, 482 (2011) ("Although we conclude that § 157(b)(2)(C) permits the Bankruptcy Court to enter final judgment on Vickie's counterclaim, Article III of the Constitution does not."). The Court provided the framework for determining whether a dispute is constitutionally core. Disputed matters that "stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process," *id.* at 499, are constitutionally core.

To assess the latter half of the *Stern* test, courts generally look to see if a "common nucleus of law and fact" exists to inextricably intertwine the claims and counterclaims. Furthermore, for a counterclaim to be necessarily resolved in ruling on the proof of claim, the relationship must be such that resolution of the counterclaim would alter the amount sought by the claimant. Moreover, a counterclaim that seeks to reduce the amount that debtors owe to a claimant should be contrasted with the situation where a bankruptcy estate is seeking affirmative monetary relief from a claimant to augment the bankruptcy estate. In other words, a counterclaim by the estate based in state law must seek to directly reduce or recoup the amount claimed in order to be resolved in ruling on the proof of claim.

TP, Inc. v. Bank of Am., N.A. (In re TP, Inc.), 479 B.R. 373, 384-85 (Bankr. E.D.N.C. 2012) (citations and quotations omitted). See Pulaski v. Dakota Fin., LLC (In re Pulaski), 475 B.R. 681, 688 (Bankr. W.D. Wis. 2012) ("[W]hen the debtor's claim and the validity of the creditor's claim are sufficiently tied together, the bankruptcy court is authorized under Stern to enter a final judgment."). An objection to claim under section 502, which is a dispute that would not exist but for the Bankruptcy Code, is constitutionally core. If the objector includes a state-law counterclaim against the creditor that would necessarily be resolved in the claims allowance process, as Stern tells us, that would also be constitutionally core.

Therefore, counterclaims may be constitutionally core if they "seek to directly reduce or recoup the amount claimed[.]" *TP*, 479 B.R. at 385. *See Allied Title Lending, LLC v. Taylor*, 420 F. Supp. 3d 436, 449-50 (E.D. Va. 2019) (finding to be constitutionally core the claim for

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relief in complaint that objected to creditor's claim on the grounds that it should be disallowed because the underlying credit agreement violated the state's usury statute and thus was null and void), appeal dismissed, 2022 WL 1563625 (4th Cir. Feb. 10, 2022); Kiskaden v. LVNV Funding, LLC (In re Kiskaden), 571 B.R. 226, 235-36 (Bankr. E.D. Ky. 2017) (finding to be constitutionally core the claim for relief in complaint that objected to creditor's claim on the grounds that it should be disallowed because the underlying loan was void under the Kentucky Consumer Loan Act). See also Camac Fund, L.P. v. McPherson (In re McPherson), 630 B.R. 160, 173-75 (Bankr. D. Md. 2021) (fraudulent transfer claim was part of the claims administration process); In re Olde Prairie Block Owner, LLC, 457 B.R. 692, 698-99 (Bankr. N.D. Ill. 2011) (counterclaims were core proceedings because they raised affirmative defenses to the validity of the creditor's claim and had to be resolved before creditor's claim could be allowed). But see Kramer v. Mahia (In re Khan), 2014 WL 10474969 (E.D.N.Y. Dec. 24, 2014) (action to avoid and recover proceeds of a mortgage as a fraudulent conveyance under New York Debtor and Creditor Law was a non-core matter).

The difference between core and non-core determines whether the bankruptcy court can enter a final judgment or must instead submit proposed findings of fact and conclusions of law to the district court. 28 U.S.C. § 157(c). But, the bankruptcy court has jurisdiction to hear both. Significantly, the distinction does not definitively determine whether there is an inherent conflict between arbitration and the purposes of the Bankruptcy Code.

# c. Sending some matters to arbitration may inherently conflict with the Bankruptcy Code

Is there an inherent conflict between arbitration of a claim and the purposes of the Bankruptcy Code? "Arbitration is inconsistent with centralized decision-making because permitting an arbitrator to decide a core issue would make debtor-creditor rights contingent upon

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an arbitrator's ruling rather than the ruling of the bankruptcy judge assigned to hear the debtor's case." *Phillips v. Congelton, L.L.C.* (*In re White Mountain Mining Co., L.L.C.*), 403 F.3d 164, 169 (4th Cir. 2005) (quotation omitted).

[The debtor] filed a Chapter 13 petition under the Bankruptcy Code and a five-year plan to reorganize her financial affairs....

It is thus apparent that resolution of [debtor's] claim that the Loan Agreement she entered into ... was illegal could directly impact claims against her estate and her plan for financial reorganization .... Therefore, we conclude that forcing [the debtor] to arbitrate her constitutionally core claim would inherently conflict with the purposes of the Bankruptcy Code[.]

CashCall, 781 F.3d at 72-3 (citations and quotation omitted).

This case presents an even clearer example of why a bankruptcy court's decision to bow out of deciding a claim objection and refer it to arbitration would conflict with the purposes of the Code. In *CashCall*, the debtor had already confirmed her chapter 13 plan. In this case, confirmation of Johnson's plan is on hold while this objection to claim is resolved. *See Thorpe Insulation*, 671 F.3d at 1023 (Writing in the chapter 11 context that "[a]rbitration of a creditor's claim against a debtor, even if conducted expeditiously, prevents the coordinated resolution of debtor-creditor rights and can delay the confirmation of a plan of reorganization.").

Furthermore, the *CashCall* panel had to hypothesize that even though her "unsecured creditors are currently anticipated to receive nothing under Moses' confirmed plan [that] does not mean that they never will." *Id.* at 73. Johnson's unsecured creditors, however, expect to be paid in full and must wait for resolution of this dispute before disbursements can begin.

As discussed above in section 2(a), the Bankruptcy Code brings together various parties in interest, centralizing disputes regarding the debtor's assets and obligations. The bankruptcy court has *in rem* jurisdiction over property of the estate and the several parties in interest making claims against it. Arbitration proceedings, meanwhile, have "bilateral arbitration as the

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prototype of the individualized and informal form" protected by the FAA. *Viking River Cruises*, 142 S. Ct. at 1921. While there is a contract between Johnson and SAIL, with an arbitration clause, there are strangers to that clause and that contract who are parties in interest in the bankruptcy case. "The Federal Arbitration Act does not promote arbitration at the expense of strangers." *Gotham Holdings*, 580 F.3d at 666.

The Bankruptcy Code is a unique piece of legislation in that the forum in which it is implemented is not party-specific or bilateral. This is evident even in the names of bankruptcy cases. While traditional lawsuits are captioned as Plaintiff vs. Defendant, bankruptcy cases are styled as In re Debtor's Name. The Code provides a comprehensive jurisdictional structure to bankruptcy courts so that they can deal with all of the rights, interests and obligations of the varied parties who appear and seek to be heard. The right to be heard in chapter 11 cases, for example, is so expansive that it is codified at 11 U.S.C. § 1109(b): "A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."

While a bankruptcy court's jurisdiction is not limitless, Congress equipped it with "comprehensive jurisdiction ... so that [it] might deal efficiently and expeditiously with all matters connected with the bankruptcy estate[.]" *Celotex*, 514 U.S. at 308 (quotation omitted). This protects "reorganizing debtors and their creditors from piecemeal litigation ... so that reorganization can proceed efficiently, unimpeded by uncoordinated proceedings in other arenas." *White Mountain Mining*, 403 F.3d at 170 (quotation omitted).

In *White Mountain Mining*, the bankruptcy court found that enforcing an arbitration clause and staying an adversary proceeding would substantially interfere with the debtor's efforts

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to reorganize. Since resolution of the issue "was critical to the debtor's ability to formulate a plan of reorganization, the court would resolve the adversary proceeding on an expedited basis." *Id.* Although *White Mountain Mining* involved a chapter 11 case and Johnson filed for relief under chapter 13, they have in common that neither reorganization could proceed until the issue at hand was resolved. Keeping that issue in bankruptcy court rather than sending it out to arbitration "would allow all creditors, owners and parties in interest to participate in a centralized proceeding at a minimum of cost." *Id.* (quotation omitted).

Although the Seventh Circuit has not yet written on this issue, other Circuit Courts of Appeal have affirmed a bankruptcy court's rejection of a request to send a disputed matter to arbitration when doing so would conflict with the purposes of the Bankruptcy Code. See Anderson, 884 F.3d at 387 ("If the bankruptcy court determines that arbitration would create a severe conflict with the purposes of the Bankruptcy Code, it has discretion to conclude that Congress intended to override the Arbitration Act's general policy favoring the enforcement of arbitration agreements.") (quotation omitted); In re EPD Inv. Co., LLC, 821 F.3d 1146, 1150 (9th Cir. 2016) ("The bankruptcy court properly applied *Thorpe Insulation* to determine that the arbitration provisions at issue conflicted with Bankruptcy Code purposes of having bankruptcy law issues decided by bankruptcy courts; of centralizing resolution of bankruptcy disputes; and of protecting parties from piecemeal litigation."); CashCall, 781 F.3d at 72 ("With respect to Moses' first claim, the constitutionally core claim, we conclude that sending it to arbitration would pose an inherent conflict with the Bankruptcy Code[.]"); In re Gandy, 299 F.3d 489, 495 (5th Cir. 2002) ("A bankruptcy court does possess discretion, however, to refuse to enforce an otherwise applicable arbitration agreement when the underlying nature of a proceeding derives exclusively from the provisions of the Bankruptcy Code and the arbitration of the proceeding

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conflicts with the purpose of the Code."); *In re U.S. Lines, Inc.*, 197 F.3d 631, 641 (2d Cir. 1999) (finding that "need for a centralized proceeding" supported the conclusion that "[i]t was within the bankruptcy court's discretion to refuse to refer the declaratory judgment proceedings, which it properly found to be core, to arbitration"). *Cf. MBNA Am. Bank, N.A. v. Hill*, 436 F.3d 104, 110 (2d Cir. 2006) ("These factors distinguish Hill's case from cases where appellate courts have held that bankruptcy courts had discretion to refuse to stay proceedings pending arbitration. In those cases, resolution of the arbitrable claims directly implicated matters central to the purposes and policies of the Bankruptcy Code.").

Trial-level courts have also written about their decisions to refuse to enforce arbitration agreements when doing so would conflict with the purposes of the Bankruptcy Code. For example, the *Acis Capital Management* court declined to enforce "an otherwise valid, binding arbitration clause" because all eight counts that the defendant sought to arbitrate had been "asserted *defensively* to two proofs of claim – meaning ... transformed into statutory core matters." *Phelan v. Highland Cap. Mgmt., L.P.* (*In re Acis Cap. Mgmt., L.P.*), 600 B.R. 541, 557-58 (Bankr. N.D. Tex. 2019) (footnote omitted). It found that "[e]nforcing the arbitration clause here would conflict with the purposes of the Bankruptcy Code[.]" *Id.* at 560. *See Larson v. Swift Rock Fin., Inc.* (*In re Craig*), 545 B.R. 47, 54 (D. Colo. 2015) ("[T]here is an inherent conflict between arbitration of the CUDMSA claim ... and the underlying purposes of the Bankruptcy Code.... In the context of this case, enforcing arbitration would substantially undermine the orderly, efficient, and effective administration of the bankruptcy estate."); *Roth v. Butler University* (*In re Roth*), 594 B.R. 672, 677 (Bankr. S.D. Ind. 2018) ("Allowing an arbitrator to determine dischargeability creates an inherent conflict with the Bankruptcy Code[.]"); *Lischwe v. ClearOne Advantage, LLC* (*In re Erwin*), No. 15-06713-5-DMW, 2018 WL 1614160, at \*12

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(Bankr. E.D.N.C. Mar. 30, 2018) ("To send both the core and non-core claims or even just to send the non-core UDTP Claim to arbitration would have a significant adverse effect upon the adjudication of these claims and upon the fundamental purposes of the Bankruptcy Code and would risk compromising the Debtor's rights under North Carolina law.").

# D. Resolution of Debtor's Objection and Counterclaim

At this time, Debtor's case is essentially on hold while awaiting a resolution of SAIL's Motion to Compel. She cannot move forward with the hearing on confirmation of the Second Amended Plan, and creditors cannot receive payment on their claims, while this issue remains unresolved. While proposing to treat all claims and address the issues of all parties in interest in the case, progress is stalled because SAIL would like to arbitrate the Claim *it filed in this case*.

# 1. Count I

In Count I, Johnson asks this court to void SAIL's proof of claim and the underlying loan because SAIL violated both the PLPA and the Consumer Fraud Act. This is not a private right of action but instead a basis for Johnson's objection to SAIL's Claim; that it is unenforceable under state law.

SAIL argues (mistakenly attributing the *Argon Credit* decision to the undersigned) that "[t]his Court has examined claims attacking the validity of a loan agreement before and found them to be non-core claims." Motion to Compel, p. 7 (citing *Argon Credit*, 2018 WL 4562542, at \*5).

This court does not need to disagree with the well-reasoned decision in *Argon Credit* to come to a different conclusion in this case, because the facts and procedural posture of the two cases are different. In *Argon Credit*, the court found "that the arbitrations at issue are neither actions by nor against the Debtor; rather, they are actions by third-parties against third-parties.

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This fact weighs against core classification." *Id.*, at \*6 (footnote omitted). Furthermore, "in no way does the matter sought to be arbitrated involve the allowance or disallowance of claims against this estate, nor would it *necessarily* be resolved in adjudicating any proof of claim currently filed against this estate." *Id.*, at \*7.

This proceeding, by contrast, involves claims for relief by a debtor against a creditor who filed a proof of claim in her bankruptcy case. Therefore, it is an action by the Debtor.

Furthermore, the basis of Johnson's claim for relief in Count I is that SAIL's Claim is unenforceable under state law. Resolution of that claim for relief involves the allowance or disallowance of a claim against this estate. 11 U.S.C. § 502(b). It must necessarily be resolved in adjudicating SAIL's Claim. Simply put, it is constitutionally core.

Debtor also seeks a refund of all sums paid on the loan as well as punitive damages and an award of attorney's fees and costs. This request must be resolved to determine the amount due on SAIL's Claim. *See Olde Prairie Block*, 457 B.R. at 699. Debtor's plan will not be confirmed, creditors will not receive distributions, and Debtor's discharge will not issue until the claim objection is resolved. If arbitration is permitted, there is an inherent conflict with the Bankruptcy Code. The Clause will not be enforced.

# 2. Count II

In Count II, Johnson seeks damages under the Illinois Interest Act. This is not an objection to SAIL's Claim, nor must it be resolved in order to determine the amount due on that claim. It also is non-core.

Johnson argues that this claim for relief is core because "[w]hether the loan violated the Interest Act depends on whether it violated the PLPA[.]" Response, p. 8. That may be so, but it does not make a claim under the Illinois Interest Act core. It remains unnecessary to resolve this

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claim for relief in order to determine the amount of SAIL's Claim against the bankruptcy estate.

Johnson seeks an award of damages under this count, and not a declaration that SAIL's Claim is unenforceable under state law.

Equally unavailing is Johnson's argument that "if Debtor recovers damages from SAIL, other creditors will again be paid more quickly." Response, p. 9. She provides no authority for the proposition that this type of impact on her creditors is equivalent to resolving the amount of a claim against her estate or that the recovery of damages is necessary to confirmation of the Second Amended Plan. Unlike the first claim for relief, Count II does not "seek to directly reduce or recoup the amount claimed[.]" *TP*, 479 B.R. at 385.

One could argue that the court has *in rem* jurisdiction over this claim, and that granting the Motion to Compel and requiring arbitration of the Illinois Interest Act claim might conflict with the Bankruptcy Code. In this case, however, the facts clearly justify granting the Motion to Compel as to Count II. This claim for relief arises solely under state law. Any recovery under this count would not impact Johnson's plan.

[Debtor's] non-core claim ... demands money damages for [the creditor's] alleged violations of the North Carolina Debt Collection Act. Although the success or failure of the non-core claim may have ancillary effects on [Debtor's] bankruptcy – primarily through the enlargement of the underlying estate due to any damages received – any such results are simply too attenuated, and indeed extrinsic to the bankruptcy, to constitute an "inherent conflict" with the Bankruptcy Code's purpose of facilitating an efficient reorganization.

CashCall, 781 F.3d at 82 (Gregory, J., concurring) (statutory citation omitted).

Moreover, this court often confirms chapter 13 plans that provide for turnover of the non-exempt proceeds of a lawsuit, typically one pending in another forum. The unusual nature of this claim as compared to run-of-the-mill personal injury litigation does not make it any less amenable to resolution by a different forum, in this situation an arbitral forum.

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In fact, because of the unique nature of a chapter 13 case (as opposed to a chapter 11 case), the Trustee or an unsecured creditor may request modification of the plan "[a]t any time after confirmation of the plan but before the completion of payments under such plan[.]" 11 U.S.C. § 1329(a). Such modifications include increasing or reducing the amount of payments on claims of a particular class, or altering the amount of the distribution to a creditor "to the extent necessary to take account of any payment of such claim other than under the plan[.]" 11 U.S.C. §§ 1329(a)(1), (3). There is no explicit standard in the Bankruptcy Code for determining when a modification that falls within section 1329 should be approved. *See Germeraad v. Powers*, 826 F.3d 962, 971 (7th Cir. 2016). The decision on a motion to modify plan is left to the discretion of the bankruptcy judge. *See Matter of Witkowski*, 16 F.3d 739, 746 (7th Cir. 1994).

Therefore, if it is necessary, the court can consider a motion to modify Johnson's plan after the count seeking relief under the Illinois Interest Act has been resolved through arbitration.

Some courts have held that a motion to compel arbitration of a non-core claim must be granted, even if doing so would inherently conflict with the purposes of the Bankruptcy Code. *See CashCall*, 781 F.3d at 76 (dissenting from the majority opinion and finding that sending a non-core claim to arbitration while the bankruptcy court retained jurisdiction over core claims would "inherently conflict with the purposes of the Bankruptcy Code"); *McPherson*, 630 B.R. at 177 ("[P]recedent requires more than a finding that arbitration would potentially conflict with the purposes of the Bankruptcy Code to refuse arbitration. Rather, the conflict must be inherent and sufficient to override by implication the presumption in favor of arbitration.") (quotations omitted). This court need not address that issue here. Debtor's argument assumes that this claim is core. It is not. Whether core or non-core, however, simply informs the court in its

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determination of conflict. Sending to arbitration the claim under the Illinois Interest Act does not inherently conflict with the purposes of the Bankruptcy Code.

## 3. Count III

In Count III, Johnson alleges that SAIL violated the Consumer Fraud Act by making deceptive and misleading representations concerning the nature of the transaction between herself and SAIL. She asks this court to void SAIL's Claim and the underlying loan.

Although the Consumer Fraud Act does not contain the remedy found in the PLPA that "[a]ny loan made in violation of this Act is null and void and no person or entity shall have any right to collect, attempt to collect, receive, or retain any principal, fee, interest, or charges related to the loan[,]" 815 ILCS 123/15-5-10, it does provide the relief Johnson seeks. "The court, in its discretion may award actual economic damages *or any other relief which the court deems* proper[.]" 815 ILCS 505/10a (emphasis added). See Geske v. PNY Techs., Inc., 503 F. Supp. 3d 687, 710 (N.D. Ill. 2020) ("The statutory text grants courts the power to award broad relief.... 'Any other relief' means any other relief.") (citation omitted).

SAIL argues (again, mistakenly attributing the *Argon Credit* decision to the undersigned) that "[t]his Court has examined claims attacking the validity of a loan agreement before and found them to be non-core claims." Motion to Compel, p. 7 (citing *Argon Credit*, 2018 WL 4562542, at \*5).

As discussed above in section D(1), this court does not need to disagree with *Argon*Credit to come to a different conclusion here. The facts and procedural posture of the two cases are different. In *Argon Credit*, the arbitrations were actions by third parties against third parties.

Furthermore, the matter sought to be arbitrated in *Argon Credit* did not involve the allowance or

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disallowance of claims against this estate, nor would it necessarily be resolved in adjudicating a proof of claim.

Therefore, the analysis for Count III is much the same as it was for Count I. This proceeding involves claims by a debtor against a creditor who filed a proof of claim in her bankruptcy case. Therefore, it is an action by the Debtor. Furthermore, the basis of Johnson's claim for relief is that SAIL's Claim is unenforceable under state law. Resolution of that claim for relief involves the allowance or disallowance of a claim against this estate. 11 U.S.C. § 502(b). It must necessarily be resolved in adjudicating SAIL's Claim. It is constitutionally core.

Debtor also seeks a refund of all sums paid on the loan as well as punitive damages and an award of attorney's fees and costs. This request must be resolved to determine the amount due on SAIL's Claim. *See Olde Prairie Block*, 457 B.R. at 699. Debtor's plan will not be confirmed, creditors will not receive distributions, and the debtor's discharge will not issue until the claim objection is resolved. If arbitration is permitted, there is an inherent conflict with the Bankruptcy Code. The Clause will not be enforced.

This court can resolve the Debtor's objection to SAIL's Claim (Counts I and III) and address confirmation of Johnson's plan. Count II can then proceed to arbitration. Once the arbitration proceeding is concluded, Johnson (or the Trustee, or an unsecured creditor) can bring a motion to modify her plan to provide that any non-exempt proceeds from prosecuting the Illinois Interest Act claim is an additional plan payment and will be distributed to creditors.

## VI. CONCLUSION

For the reasons stated above, the court will enter an order denying the Motion to Compel as to Counts I and III. The court will grant the Motion to Compel as to Count II but stay arbitration until resolution of the objection to SAIL's Claim. Status on the Complaint as well as

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the hearings on confirmation of Johnson's plan, her counsel's application for compensation and the Trustee's motion to dismiss will be continued to a new date as set forth in the order accompanying this opinion.

Date: March 28, 2023

DAVID D. CLEARY

United States Bankruptcy Judge

Must I/May I Arbitrate in Bankruptcy?
Hon. Stacey G. C. Jernigan, U. S. Bankruptcy Court, N.D. TX (Dallas)
Sylvia A. Mayer, S. Mayer Law (Houston, TX)
38<sup>th</sup> Annual Jay L. Westbrook Bankruptcy Conference
October 2019

## I. The Federal Arbitration Act and Arbitration Clauses Generally.

The Federal Arbitration Act ("FAA") was enacted by Congress in 1925 and became effective in 1926. It is codified at Title 9 of the United States Code and is predicated upon Congress's exercise of the Commerce Clause powers granted in the Constitution. The FAA contemplates the judiciary's respect for and enforcement of private parties' agreements to resolve disputes through arbitration. The FAA provides:

"A written provision in . . . a 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."

Thus, arbitration, pursuant to the FAA, is entirely a matter of contract. And, where a contract contains a provision in which parties agreed to submit future disputes thereunder to arbitration, these provisions should be enforced according to their terms. Section 4 of the FAA specifically directs a court to order parties to arbitrate upon a request by a party that is entitled to demand arbitration in a written contract. The courts have often stated that the FAA reflects a liberal federal policy favoring arbitration, and requires arbitration agreements to be rigorously enforced according to their terms.<sup>2</sup> The FAA "expresses a strong national policy favoring arbitration of disputes, and all doubts concerning the arbitrability of claims should be resolved in

<sup>&</sup>lt;sup>1</sup> 9 U.S.C. § 2.

<sup>&</sup>lt;sup>2</sup> See AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 339 (2011) (citations omitted).

favor of arbitration."<sup>3</sup> A party seeking to invalidate an arbitration agreement bears the burden of establishing its invalidity.<sup>4</sup>

When a court is confronted in any litigation with a party's motion to compel arbitration, the Fifth Circuit has generally held there are two threshold questions: (1) whether an arbitration agreement is valid (that is, whether the parties entered into any arbitration agreement at all); and (2) whether the parties' dispute falls within the scope of (or is covered by) the agreement.<sup>5</sup> To evaluate the first prong, courts apply the contract law of the state that governs the agreement.<sup>6</sup> With regard to the second prong—*i.e.*, whether the dispute falls within the scope of what the parties agreed would be arbitrated (sometimes referred to as the "arbitrability question")—courts have held that this "gating" issue is a matter of federal substantive law.<sup>7</sup> Note that sometimes arbitration agreements have "delegation clauses," delegating this "arbitrability question" to an arbitrator to decide—arguably, an odd chicken/egg conundrum. In other words, the agreement is drafted so that a court is supposed to send any contested question of whether a dispute between the parties falls within the arbitration clause to an arbitrator for him or her to decide. "When an agreement contains a valid delegation clause, the court, absent exceptional circumstances,

<sup>&</sup>lt;sup>3</sup> Primerica Life Ins. Co. v. Brown, 304 F.3d 469, 471 (5th Cir. 2002) (citing Southland Corp. v. Keating, 465 U.S. 1, 10 (1984)).

<sup>&</sup>lt;sup>4</sup> Carter v. Countrywide Credit Indus., Inc., 362 F.3d 294, 297 (5th Cir. 2004).

<sup>&</sup>lt;sup>5</sup> See Kubala v. Supreme Prod. Servs., Inc., 830 F.3d 199, 201 (5th Cir. 2016); Agere Sys. Inc. v. Samsung Elec. Co. Ltd., 560 F.3d 337, 339 (5th Cir. 2009).

<sup>&</sup>lt;sup>6</sup> Wash. Mut. Fin. Group, LLC v. Bailey, 364 F.3d 260, 264 (5th Cir. 2004) (citation omitted).

<sup>&</sup>lt;sup>7</sup> Graves v. BP America, Inc., 568 F.3d 221, 222-23 (5th Cir. 2009). Under federal law, courts "resolve doubts concerning the scope of coverage of an arbitration clause in a contract in favor of arbitration." Neal v. Hardee's Food Sys., Inc., 918 F.2d 34, 37 (5th Cir. 1990). Thus, the party seeking to compel arbitration need only show that the arbitration clause can plausibly be read to cover the dispute at issue. See id.

must 'refer a claim to arbitration to allow the arbitrator to decide gateway arbitrability issues.'"8

Obviously, this sets up a potential game of ping pong. More on this topic later, in the discussion of the Supreme Court's *Schein* case.<sup>9</sup>

# II. But What if a Party to the Contract is in Bankruptcy?

Does a bankruptcy court need to treat an arbitration provision in a contract any "less mandatory" than other courts? After all, bankruptcy cases aren't like other lawsuits. They are multi-faceted, multi-party, and fast-moving. And the protagonist at the center of it all—the debtor—is normally insolvent. The antagonists are clamoring to get their fair share of a limited res. It has often been stated that the underlying purposes of the Bankruptcy Code are to: (a) provide debtors and creditors with orderly and effective administration of debtors' estates, and (b) centralize disputes over debtors' assets and obligations in one forum. It would seem that, when arbitration meets bankruptcy, an inherent conflict almost always exists between two strong policies: the policy favoring enforcement of arbitration agreements and the policy favoring centralized resolution of disputes involving a debtor and its assets in the bankruptcy court. As one court noted, "Disputes that involve both the Bankruptcy Code and the Arbitration Act often present conflicts of near polar extremes: bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach toward dispute resolution." 10

Well, the answer right off the bat is that there is **no** "bankruptcy exception" to an arbitration agreement *per se*. Not in any statute and not according to any court so far. There has

<sup>&</sup>lt;sup>8</sup> In re Griffin, 585 B.R. 794 (Bankr. S.D. Miss. 2018) (quoting Kubala, 830 F.3d at 202).

<sup>&</sup>lt;sup>9</sup> Henry Schein, Inc. v. Archer & White Sales, Inc., 139 S.Ct. 524 (2019).

<sup>&</sup>lt;sup>10</sup> U.S. Lines, Inc. v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n, Inc. (In re U.S. Lines, Inc.), 197 F.3d 631 640 (2d Cir. 1999).

been a proliferation of bankruptcy jurisprudence in recent years in which courts have grappled with what should be done when a debtor was party to a prepetition agreement containing a mandatory arbitration clause. In fact, at the current writing, at least six circuit courts of appeal have weighed in on the topic. Their analyses can be distilled as follows (although there are variations among the circuits):

## A. Non-Core Dispute? Motions to Compel Arbitration Will Be Granted.

Most courts have opined or suggested that a bankruptcy court, when presiding over a proceeding involving "non-core" disputes pursuant to 28 U.S.C. § 157(b)—i.e., disputes that have only a tenuous relationship to a bankruptcy case and would have been litigated elsewhere but for the broad nexus created by the debtor's bankruptcy filing—generally must abstain from adjudication and direct the parties to arbitration when presented with an applicable arbitration provision.<sup>11</sup>

B. <u>Core Dispute or Predominately Core Disputes?</u> Bankruptcy Court Has Discretion to Refuse to Compel Arbitration (But . . . It's Complicated).

When a bankruptcy court is presented with a "core" dispute—i.e., one which derives from the provisions of the Bankruptcy Code—it may be permissible for the bankruptcy court to decline to order arbitration. The word "may" should be strongly emphasized—because simply being a "core" matter does not end the analysis. 12 Rather the courts, after determining that

<sup>&</sup>lt;sup>11</sup> At least one court has suggested that there is a "presumption in favor of arbitration [that] usually trumps the lesser interest of bankruptcy courts in adjudicating non-core proceedings." *MBNA Am. Bank, N.A. v. Hill,* 436 F.3d 104, 108 (2d Cir. 2006). *But see Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1156-1158 (3d Cir. 1989) (determining there is no discretion to deny arbitration in non-core matters). *See also Gandy v. Gandy (In re Gandy)*, 299 F.3d 489, 496 (5th Cir. 2002) ("it is generally accepted that a bankruptcy court has no discretion to refuse to compel the arbitration of matters not involving 'core' bankruptcy proceedings under 28 U.S.C. § 157(b)"); *Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.)*, 118 F.3d 1056 (5th Cir. 1997) (same).

<sup>&</sup>lt;sup>12</sup> By the way, courts have generally held that a trustee in bankruptcy is bound by an arbitration agreement, the same as the debtor. *See Hays*, 885. F.2d at 1153 ("The question with which we are presented is whether the trustee is bound by that agreement signed by the debtor before entering Chapter 11 bankruptcy. We hold that the trustee-

"core" disputes are involved, tend to employ a framework for analysis derived from a nonbankruptcy Supreme Court case called *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987). In a nutshell, the *McMahon* Court held that a party seeking to avoid arbitration pursuant to an otherwise applicable agreement must show that Congress—in enacting whatever statute is involved (*i.e.*, the Bankruptcy Code) intended to preclude arbitration and that intent must be deducible from (1) the statute's text; (2) its legislative history; or (3) "an inherent conflict between arbitration and the statute's underlying purposes." Thus, courts—after finding "core" disputes are involved—tend to plow down a complicated trail of considering whether there is an "inherent conflict" between arbitration and the Bankruptcy Code in whatever dispute happens to be before the court. The *McMahon* case—which courts have, perhaps, interpreted to grant more discretion to the bankruptcy courts than is justified (based on very recent Supreme Court nonbankruptcy cases) is discussed toward the back of these materials in the *Supreme Court Cases* section.

# III. Fifth Circuit Authority.

The Fifth Circuit has addressed the topic of enforceability of arbitration clauses in bankruptcy in the cases of *In re Gandy* and *In re Nat'l Gypsum*.<sup>14</sup> In those cases, the Fifth Circuit instructed that a bankruptcy court may refuse to enforce arbitration clauses and may itself adjudicate a dispute when it finds that: (a) a matter is core or derives from rights under the Bankruptcy Code; *and* (b) enforcement of the arbitration provision would irreconcilably conflict

plaintiff stands in the shoes of the debtor for the purposes of the arbitration clause and that the trustee-plaintiff is bound by the clause to the same extent as would the debtor.").

<sup>&</sup>lt;sup>13</sup> McMahon, 482 U.S. at 227.

<sup>&</sup>lt;sup>14</sup> Gandy, 299 F.3d at 489; Nat'l Gypsum Co., 118 F.3d at 1056.

with the purposes/goals of the Bankruptcy Code. 15 As alluded to above, this second prong should not be overlooked. The Fifth Circuit has declined to adopt a position that categorically finds arbitration of core bankruptcy proceedings always inherently irreconcilable with the Bankruptcy Code. The Fifth Circuit has been careful to emphasize that, in order to refuse to enforce an arbitration clause, *there must be an inherent conflict with the purposes of the Bankruptcy Code*. So what are some of these purposes/goals of the Bankruptcy Code that the Fifth Circuit has acknowledged? Some purposes/goals of the Bankruptcy Code that might support a denial of arbitration, include: (1) the equitable and expeditious distribution of assets of the debtor's estate; (2) centralized resolution of pure bankruptcy issues; (3) protection of creditors and reorganizing debtors from piecemeal litigation, and (4) the undisputed power of a bankruptcy court to enforce its orders. 16 Query: When would some of these purposes and goals of the Bankruptcy Code *not* be present in the situation of a "core" dispute? It is somewhat hard to imagine—although the Fifth Circuit in *Nat'l Gypsum* (discussed below) attempted to come up with some illustrations.

The *In re Gandy* opinion is worthy of further discussion. In *Gandy*, an individual Chapter 11 debtor had first, prepetition, filed a state court lawsuit against former business partners, asserting causes of action against them for making transfers out of a partnership affecting her ownership interests, and the causes of action included breach of contract, negligence, breach of fiduciary duty, fraud and constructive trust. Then the debtor removed the lawsuit to the bankruptcy court and filed new claims under Sections 544, 548, 550, civil "RICO," alter ego, and requested substantive consolidation. The Fifth Circuit affirmed the bankruptcy

<sup>&</sup>lt;sup>15</sup> In re Nat'l Gypsum Co., 118 F.3d at 1068-69.

<sup>&</sup>lt;sup>16</sup> *Id*.

court's refusal to enforce an arbitration clause contained in the underlying partnership agreement. The Fifth Circuit apparently thought that the complaint essentially—more than anything else—sought avoidance of fraudulent transfers, and the court not only determined that such rights derived from the Bankruptcy Code (arguably glossing over the fact that there were state law tort claims and breach of contract), <sup>17</sup> but also—in looking at whether enforcing the arbitration clause would conflict with the purposes of the Bankruptcy Code—noted that one central purpose of the Bankruptcy Code is the expeditious and equitable distribution of the assets of a debtor's estate. The court thought the avoidance actions predominated over the others and, in such a circumstance, "the importance of the federal bankruptcy forum provided by the Code is at its zenith." The court stated that "[s]ome of the purposes of the Code we mentioned in *Nat'l Gypsum* as potentially conflicting with the Arbitration Act include the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of the bankruptcy court to enforce its own orders."

Nat'l Gypsum is also worthy of discussion.<sup>20</sup> Nat'l Gypsum involved a debtor with mass tort (asbestos-related) claims. Sometime well after confirmation of a Chapter 11 plan, an asbestos litigation trust created under the plan filed an adversary proceeding seeking a declaratory judgment that the plan had discharged its obligations to a certain insurance company

<sup>&</sup>lt;sup>17</sup> Actually, the Fifth Circuit stated: "While some of Debtor's remaining claims do involve her pre-petition legal or equitable rights, the bankruptcy causes of action predominate. The heart of Debtor's complaint concerns the avoidance of fraudulent transfers and implicates non-bankruptcy contractual and tort issues 'in only the most peripheral manner." *Gandy*, 299 F.3d at 497.

<sup>&</sup>lt;sup>18</sup> *Id.* at 497.

<sup>&</sup>lt;sup>19</sup> Id. at 500.

<sup>&</sup>lt;sup>20</sup> In re Nat'l Gypsum Co., 118 F.3d 1056.

with whom it was having problems post-confirmation. The insurance company, in response to the litigation, sought to exercise its rights to seek arbitration under certain agreements. The Fifth Circuit observed that a declaratory judgment action seeking a declaration that pre-confirmation liability was barred by a bankruptcy court's plan confirmation order is a core proceeding under Title 11. The court further stated, "We believe that nonenforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding, i.e., whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration of the proceeding would conflict with the purposes of the Code." Because the debtor sought to bar the insurance company's actions either by invoking section 524(a)'s discharge injunction or by invoking the terms of a confirmed plan, the proceeding derived entirely from the provisions of the Bankruptcy Code and, hence, the *Nat'l Gypsum* court would not send the dispute to arbitration.

It bears emphasizing that the Fifth Circuit noted in *Nat'l Gypsum* that courts "have found the core/non-core distinction useful," but the discretion to deny arbitration does not come down to this simple distinction. This is because of the Supreme Court's mandate in *McMahon*. In that case, where the Court was addressing the arbitrability of claims grounded in other federal statutes—RICO and securities fraud claims brought under the Securities Exchange Act of 1934—the Court stated:

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>21</sup>

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<sup>&</sup>lt;sup>21</sup> McMahon, 482 U.S. at 226-27 (internal citations and quotations omitted) (emphasis added).

The Fifth Circuit addressed these issues again, on the day before this article was due, in a case styled *Henry v. Ed. Fin. Serv (In re Henry)*, No. 18-20809 (5<sup>th</sup> Cir. Oct. 17, 2019). There, in the context of an adversary proceeding brought post-discharge by a Chapter 13 debtor against a student loan lender, asserting that recent correspondences of the lender were violative of her discharge (brought on behalf of the debtor and a putative class of similarly situated plaintiffs), the Fifth Circuit upheld the bankruptcy court's refusal to order arbitration, pursuant to an arbitration clause in her student loan documentation. The student loan lender had argued that Fifth Circuit precedent (*e.g., Nat'l Gypsum, Gandy*) was no longer good law, following the Supreme Court's recent decision in *Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612 (May 21, 2018) (discussed later in this paper). The Fifth Circuit disagreed, stating that *Nat'l Gypsum's* "doctrinal foundation, i.e., *McMahon*, remains sound."<sup>22</sup>

The Fifth Circuit may tackle these issues again soon, in relation to an appeal of a case called *Willis v. Tower Loan (In re Willis)*, 579 B.R. 381 (Bankr. S.D. Miss. 2017), which was argued before the Fifth Circuit on September 3, 2019. In the *Willis* case, Judge Neil Olack, in a Chapter 7 debtor's adversary proceeding against a consumer lender that made a loan bearing 37.36% interest for Truth-in-Lending Act violations, held that conflicting arbitration provisions indicated there was no meeting of the minds with regard to arbitration. *See also Acis Capital Management, L.P. v. Highland Capital Management,* 600 B.R. 541 (Bankr. N.D. Tex. 2019) (bankruptcy court declined to order arbitration where 30+ count adversary proceeding involved not just disputes under agreements containing arbitration provisions but numerous Chapter 5 avoidance actions).

<sup>22</sup> Slip Op. at 6.

## IV. Other Circuits.

Other Circuit courts around the country have tended to emphasize the significance of the "core" versus "non-core" nature of a dispute in evaluating whether bankruptcy courts have discretion to decline to enforce a contractual arbitration provision. Although, certainly, no courts simply cut off the analysis there, and some Circuits vary slightly from the Fifth Circuit's approach. In fact, certain Circuits seem far less likely to favor bankruptcy court adjudication even when "core" matters are involved and "the importance of the federal bankruptcy forum provided by the Code [might seem to be] at its zenith." Case in point: the Second and Third Circuits.

## A. The Second Circuit—A Little Flip Floppy?

The Second Circuit's evolving authority merits some significant discussion. In 2006, the Second Circuit issued an attention-grabbing opinion in *MBNA Am. Bank, N.A. v. Hill*, 436 F.3d 104 (2d Cir. 2006). In *MBNA*, a Chapter 7 debtor, Ms. Hill, had maintained a personal bank account at MBNA. After opening the account, she later obtained an unsecured loan from MBNA. A year after the loan was made, MBNA validly amended the credit account agreement governing the loan to include a mandatory arbitration provision. After Ms. Hill fell behind making payments on the loan, she authorized MBNA to debit her bank account directly each month. Eventually, Ms. Hill filed a Chapter 7 bankruptcy case. MBNA received timely notice of the case, but it continued (at least once—it is unclear how many times) to withdraw funds

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<sup>&</sup>lt;sup>23</sup> Gandy, 299 F.3d at 497.

from the debtor's bank account to apply toward her prepetition debt. The debtor eventually (approximately four months after her petition date) brought an adversary proceeding asserting that MBNA willfully violated the automatic stay and, also, averring a claim for unjust enrichment. The debtor filed the adversary proceeding as a class action, putatively on behalf of herself and other similarly situated debtors. Note that, by the time the debtor filed her adversary proceeding, the bankruptcy trustee had filed a no asset report declaring the case "fully administered."24 MBNA moved to stay the adversary proceeding and compel arbitration, based upon the arbitration clause contained in Ms. Hill's credit account agreement. The bankruptcy court denied the motion, holding that the bankruptcy court was the "most appropriate forum to adjudicate the matter."<sup>25</sup> MBNA then appealed the ruling to the district court, which reversed *in* part. According to the district court, although the bankruptcy court did not abuse its discretion in refusing to compel arbitration concerning the debtor's "core" automatic stay violation claim, it should not have denied arbitration of the unjust enrichment claim because it was "arbitrable and non-core."26 The debtor then dismissed her unjust enrichment claim, and MBNA appealed to the Second Circuit the district court's ruling concerning the automatic stay violation claims. The Second Circuit somewhat shockingly reversed—determining that the automatic stay violation should go to arbitration.

In the Second Circuit's analysis, while agreeing with the lower courts' conclusion that the debtor's stay violation claim was a "core" proceeding, the court disagreed with their views that arbitration of her claim "would seriously jeopardize the objectives of the Bankruptcy Code

<sup>&</sup>lt;sup>24</sup> MBNA, 436 F.3d at 106.

<sup>&</sup>lt;sup>25</sup> *Id.* at 107.

<sup>&</sup>lt;sup>26</sup> *Id.* at 106.

because: (1) [the debtor's] estate has now been fully administered and her debts have been discharged, so she no longer requires protection of the automatic stay and resolution of the claim would have no effect on her bankruptcy estate; (2) as a purported class action, [the debtor's] claims lack the direct connection to her own bankruptcy case that would weigh in favor of refusing to compel arbitration; and (3) a stay is not so closely related to an injunction that the bankruptcy court is uniquely able to interpret and enforce its provisions." Additionally, the Second Circuit stated that, although "the automatic stay is surely an important provision of the Bankruptcy Code, there is no indication from the statute that any dispute relating to an automatic stay should categorically be exempt from resolution by arbitration." In summary, the Second Circuit reversed the rulings below and remanded the action with directions to grant MBNA's motion to stay the proceedings in favor of arbitration.

The MBNA case seems quite startling—or does it? Did the fact that the debtor brought a class action suit tilt the scales in favor of arbitration? Did that make the action seem less centered around the administration of a bankruptcy estate? And did the fact that the lawsuit was merely about the automatic stay (which courts have held that non-bankruptcy courts can interpret and enforce) also matter somewhat? Perhaps one "take away" here is that, even where a "core" dispute involving arguably the most fundamental debtor protection in the bankruptcy universe (the automatic stay) is involved, a Circuit court might tell you that arbitration is required if there was a contract between the debtor and the creditor containing an arbitration clause.

But wait. Not so fast. The Second Circuit more recently seemed to make an about-face, in a "core" dispute involving somewhat similar facts. *See Anderson v. Credit One Bank NA (In* 

<sup>&</sup>lt;sup>27</sup> *Id.* at 109.

<sup>&</sup>lt;sup>28</sup> *Id.* at 110.

*re Anderson*), 884 F.3d 382 (2d Cir. 2018). This opinion, without a doubt, seems to depart from *MBNA*'s rather high bar set for a bankruptcy court *not* to send a dispute to arbitration—although the Second Circuit stated it was not overturning *MBNA*.

In Anderson, a Chapter 7 debtor, who owed credit card debt to Credit One Bank, had become delinquent on the debt prepetition, and Credit One eventually marked the debt as "charged off" in its internal records (i.e., changed it from a receivable to a loss).<sup>29</sup> Credit One then sold the charged-off account to a third-party buyer. Credit One also reported to the various credit reporting agencies (Experian, Transunion, and Equifax) that Credit One had charged off the debt, it was still unpaid, and the debt had been transferred to a third party. The Chapter 7 debtor later filed his bankruptcy case, which was uneventful, and he obtained a discharge. After the discharge and case-closure, Credit One refused a request by the debtor to amend the information on his credit reports that still reflected his earlier debt to Credit One. The debtor obviously wanted the credit reports to correctly reflect that the debt was now discharged. The debtor thereafter reopened his bankruptcy case and commenced a putative class action against Credit One, alleging that, by "knowingly and willfully failing to update the credit reports of [c]lass [m]embers to signify the debts owing to [Credit One] have been discharged in bankruptcy," Credit One had violated section 524(a)(2) of the Bankruptcy Code.<sup>30</sup> The former debtor further argued that Credit One's refusal to change his credit report was an attempt to coerce the former debtor into paying the discharged debt—a blatant violation of his discharge injunction. Credit One move to stay the adversary proceeding and initiate arbitration in accordance with an arbitration clause in the debtor's cardholder agreement with Credit One. The

<sup>&</sup>lt;sup>29</sup> *In re Anderson*, 884 F.3d at 385.

<sup>&</sup>lt;sup>30</sup> *Id.* at 386 (internal citation omitted).

bankruptcy court held that the former debtor's claims were non-arbitrable because the adversary proceeding raised a core dispute that went to the heart of the "fresh start" guaranteed to debtors by the Bankruptcy Code.

The Second Circuit ultimately affirmed the bankruptcy court's refusal to enforce mandatory arbitration. The Second Circuit began its analysis by noting that a bankruptcy court in these situations must first determine whether the issue involved is a "core" or "non-core" matter. "If the proceeding is 'non-core,' 'bankruptcy courts generally must stay' the proceedings 'in favor of arbitration." But if the matter is "core," the "bankruptcy court is tasked with engaging in a 'particularized inquiry into the nature of the claim and the facts of the specific bankruptcy."<sup>32</sup> The court added that if "the bankruptcy court determines that arbitration would create a 'severe conflict' with the purposes of the Bankruptcy Code, it has discretion to conclude that 'Congress intended to override the Arbitration Act's generally policy favoring the enforcement of arbitration agreements.""33 The court noted that the parties agreed that "core" disputes were involved. The court next shifted to looking into Congressional intent (and whether the federal policy favoring arbitration could be found to have been overridden by contrary congressional intent in connection with section 524 of the Bankruptcy Code). The Second Circuit acknowledged that congressional intent might be established through statutory language or legislative history, but the court refused to consider arguments regarding any statutory text or legislative history, since they were not raised at the lower courts.<sup>34</sup> Instead, the Second Circuit

<sup>&</sup>lt;sup>31</sup> *Id.* at 387 (citing *In re Crysen/Montenay Energy Co.*, 226 F.3d 160, 166 (2d Cir. 2000)).

<sup>&</sup>lt;sup>32</sup> *Id*.

<sup>&</sup>lt;sup>33</sup> *Id.* (citing *MBNA*, 436 F.3d at 108).

<sup>&</sup>lt;sup>34</sup> *Id.* at 388-89.

determined that it "need only consider whether there is an 'inherent conflict between arbitration' and the Bankruptcy Code." <sup>35</sup> Noting the importance of the discharge injunction to the bankruptcy process and the bankruptcy court's power to enforce its own orders, the Second Circuit concluded that arbitration of an alleged discharge order violation would "seriously jeopardize' a particular core bankruptcy proceeding" because "1) the discharge injunction is integral to the bankruptcy court's ability to provide debtors with the fresh start that is the very purpose of the Code; 2) the claim regards an ongoing bankruptcy matter that requires continuing court supervision; and 3) the equitable powers of the bankruptcy court to enforce its own injunctions are central to the structure of the Code."<sup>36</sup> The court added that the "fact that [the debtor's] claim comes in the form of a putative class action does not undermine this conclusion."<sup>37</sup> Ultimately, the Second Circuit determined that arbitration of the debtor's claim would "present[] the sort of inherent conflict with the Bankruptcy Code that would overcome the strong congressional preference for arbitration."<sup>38</sup>

How does one reconcile these two Second Circuit cases? It is very hard, frankly.

Perhaps a great amicus brief submitted by renowned bankruptcy law professors Ralph Brubaker,

Robert Lawless, and Bruce Markell in the *Anderson* case didn't hurt.

B. The Third Circuit—Does the "Core" Label Really Matter?

<sup>&</sup>lt;sup>35</sup> *Id.* at 389.

<sup>&</sup>lt;sup>36</sup> *Id.* at 390.

<sup>&</sup>lt;sup>37</sup> *Id*.

<sup>&</sup>lt;sup>38</sup> *Id.* at 386.

The Third Circuit has seemed quite deferential to arbitration clauses even where "core" disputes are involved. In fact, it seems to suggest that "core" doesn't matter at all. See Mintze v. Am. Gen. Fin. Sycs, Inc. (In re Mintze), 434 F.3d 222, 231-32 (3d Cir. 2006).

In the *Mintze* case, Ms. Mintze, a retired and disabled homeowner living in a row house in Philadelphia with her children, obtained a home equity loan from American General Consumer Discount Company ("AGF"), so that she could fund the replacement of a heater in her home that she could not otherwise afford. This occurred one year before she filed a Chapter 13 bankruptcy case. The loan accrued interest at a rate of 13.44% per annum. The loan agreement contained an arbitration clause providing that "all claims and disputes arising out of, in connection with, or relating to [the] loan" must "be resolved by binding arbitration." Ms. Mintze fell behind on her loan payments and eventually filed a Chapter 13 bankruptcy case. During her case, after AGF filed a proof of claim, Ms. Mintze filed an adversary proceeding in the bankruptcy court seeking, *inter alia*, to enforce a pre-petition rescission of the loan agreement. Ms. Mintze alleged that AGF induced her to enter into an illegal and abusive home equity loan. She sought rescission of AGF's mortgage under the Truth in Lending Act ("TILA") and asserted claims under numerous federal and state consumer protection laws. AGF responded by filing a motion to compel arbitration of the dispute. Noting that the parties had agreed that the dispute was core, the bankruptcy court determined that it had discretion to deny enforcement of the arbitration clause and then decided that the matter was best resolved in the bankruptcy court system because the outcome of Ms. Mintze's rescission claim would affect her bankruptcy plan and the distribution of monies to her other creditors. The district court affirmed on appeal. AGF appealed to the Third Circuit and it reversed.

<sup>&</sup>lt;sup>39</sup> In re Mintze, 434 F.3d at 227.

In examining whether a bankruptcy court has any discretion to adjudicate an arbitrable dispute, the court addressed the Supreme Court's *McMahon* case<sup>40</sup> and opined that the *McMahon* standard must be satisfied before a bankruptcy court has any discretion to deny enforcement of an arbitration clause, and the whole core/non-core distinction does not really matter. "The core/non-core distinction does not, however, affect whether a bankruptcy court has the discretion to deny enforcement of an arbitration agreement [citations omitted]. It merely determines whether the bankruptcy court has the jurisdiction to make a full adjudication. Because this distinction does not affect whether the Bankruptcy Court had the discretion to deny arbitration, we will accept the parties' stipulation that the proceeding was a 'core' proceeding for the purposes of deciding whether the Bankruptcy Court had discretion."<sup>41</sup>

The court went on to provide that a party opposing arbitration is obligated to prove that there is an "inherent conflict between arbitration and the Bankruptcy Code" that manifests Congress' intent to preclude waiver of judicial remedies for the statutory rights at issue.<sup>42</sup> The Third Circuit ruled that no such conflict existed in the case before it. The debtor had not asserted any statutory claims that were created by the Bankruptcy Code in her suit against AGF. Her claims were based on the TILA and several federal and state consumer protection laws. With no bankruptcy substantive law to be decided in the litigation, the Third Circuit concluded that the bankruptcy court erred when it determined it had discretion to deny enforcement of the loan agreement's arbitration provision.<sup>43</sup> Interestingly, the court said nothing about the fact that the

<sup>&</sup>lt;sup>40</sup> Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987).

<sup>&</sup>lt;sup>41</sup> *Mintze*, 434 F.3d at 229.

<sup>&</sup>lt;sup>42</sup> *Id.* at 231.

<sup>&</sup>lt;sup>43</sup> See also Hays & Co. v. Merrill Lynch Pierce Fenner & Smith, Inc., 885 F.2d 1149 (3d Cir. 1989).

home equity lender had filed a proof of claim and that the debtor's claims would essentially be defenses to a proof of claim. What could be more of an inherent conflict with the Bankruptcy Code than arbitrating proofs of claim?

Despite the "backing off" of the core/non-core distinction that the *Mintze* court seemed to suggest is appropriate, other courts still tend to start the analysis there (*i.e.*, a court must first decide if "core" matters derivative of the Bankruptcy Code are involved, to determine whether there is discretion to refuse to honor an arbitration agreement) and, once a determination is made that a core matter is involved, courts apply the *McMahon* standard.

## C. The Fourth Circuit—Panel Couldn't Agree on Much.

A three-member panel of the Fourth Circuit could not agree on much in the case of *Moses v. CashCall Inc.*, 781 F.3d 63 (4th Cir. 2015). The facts of this case are pretty eye-popping. Ms. Moses borrowed \$1,000 prepetition, signing a consumer loan agreement in which she promised to repay the lender \$1,500 and 149% interest, for an effective interest rate of 233.10% per annum. Ms. Moses later filed Chapter 13 and the loan servicer filed a proof of claim. Then Ms. Moses objected to the proof of claim and filed a two-count adversary proceeding against the loan servicer, seeking to declare the loan illegal and void and to obtain damages under the North Carolina Debt Collection Act for the servicer's allegedly illegal debt collection activities. Soon thereafter, the servicer sought to withdraw its proof of claim and stay the proceeding and compel arbitration before a representative of the Cheyenne River Sioux Tribe, stating that Indian tribal law applied to the loan. The bankruptcy court denied the motion to compel. On appeal, a split panel of the Fourth Circuit<sup>44</sup> determined that arbitrating statutorily and constitutionally "core" claims would pose an inherent conflict with the Bankruptcy Code and such claims should be

<sup>&</sup>lt;sup>44</sup> There was a majority, a dissenting, and concurring opinion among the three-judge panel.

adjudicated by the bankruptcy court. But, in contrast, *a debtor's claim seeking damages—i.e.*, count two of the debtor's adversary proceeding—was statutorily *but not constitutionally* "core" and had to be arbitrated. Thus, the court split up her claims in two different fora.

D. The Ninth Circuit—Fairly Consistent in Not Compelling Arbitration in Core Matters. As noted above, the Ninth Circuit has been pretty consistent in not compelling arbitration where core disputes are involved. See, e.g., In re EPD Inv. Co., LLC, 821 F.3d 1146, 1150 (9th Cir. 2016) (Chapter 7 trustee filed adversary proceeding against debtors' attorney and attorney's wife, asserting fraudulent conveyance, subordination, and disallowance of a certain proof of claim; defendants filed a motion to compel arbitration, based on various agreements among the parties that contained arbitration clauses; bankruptcy court denied defendants' motion to compel arbitration; Ninth Circuit affirmed, determining that arbitration of trustee's fraudulent conveyance, subordination, and disallowance causes of action "conflicted with Bankruptcy Code purposes of having bankruptcy law issues decided by bankruptcy courts; of centralizing resolution of bankruptcy disputes; and of protecting parties from piecemeal litigation"); Ackerman v. Eber (In re Eber), 687 F.3d 1123, 1131 (9th Cir. 2012) (in connection with a section 523 action, creditors filed a motion to lift stay and a motion to compel arbitration, asking bankruptcy court to send the disputes back to arbitration that had been commenced prepetition on breach of contract and tort claims; there had been an arbitration provision in the parties' underlying agreements; bankruptcy court refused and Ninth Circuit affirmed, stating that arbitration of whether prepetition claims were dischargeable "would conflict with important bankruptcy principles" and further stating that "allowing an arbitrator to decide issues that are so closely intertwined with dischargeability would 'conflict with the underlying purposes of the Bankruptcy Code"); Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 671

F.3d 1011, 1017, 1021, 1022 (9th Cir. 2012) (an insurance company pursued a breach of contract claim related to the terms of a settlement agreement against an insulation company that was in asbestos-related, Chapter 11 bankruptcy; upon the insulation company's filing for Chapter 11 bankruptcy, the insurance company moved to compel arbitration pursuant to the terms of the settlement agreement; the bankruptcy court denied the motion to compel arbitration, holding that the allowance or disallowance of the insurance company's claim was a core matter, and that it was exercising its discretion to prevent arbitration because: "[a]lthough the conduct of which [the insurance company] complains may have commenced prepetition, the acts of which [it] complain[s], if true, are inextricably intertwined with the manner" in which the insulation company completes its reorganization; the district court affirmed the bankruptcy court's holding, as did the Ninth Circuit, holding that the core versus non-core distinction made by other circuit courts, "though relevant, is not alone dispositive," and explained that it would "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 court went on to adopt the bankruptcy court's rationale that the resolution of the insurance company's claim was a core proceeding, regardless of the fact that the insurance company was attempting to characterize it as a "state law breach of contract claim," because ultimately the insurance company had filed a proof of claim, and under 28 U.S.C. § 157(b)(2)(B), the allowance or disallowance of that claim was a core proceeding; the bankruptcy court had discretion to deny the motion to compel because "the nature of the allegations were such that adjudication of [the insurance company's] claim in any forum other than a bankruptcy court would conflict with fundamental bankruptcy policy").

## E. Eleventh Circuit.

In the case of *The Whiting–Turner Contracting Co. v. Elec. Mach. Enter., Inc.* (In re Elec. Mach. Enter., Inc.), 479 F.3d 791, 796 (11th Cir.2007), a subcontractor that had filed Chapter 11 brought an adversary proceeding to compel turnover of monies allegedly owing to it under its subcontract with a defendant/general contractor. The general contractor moved to compel arbitration pursuant to arbitration agreement between the parties. The bankruptcy court denied the general contractor's motion to compel arbitration. On appeal to the Eleventh Circuit, the court reversed, holding that: (1) the dispute between the general contractor and the Chapter 11 debtor-subcontractor which it hired to perform electrical work on the project, as to how much money was still owing to the debtor-subcontractor for its services, was not a dispute involving any right created by federal bankruptcy law, and was not one that would arise only in bankruptcy, so as not to be within "core" jurisdiction of the bankruptcy court; and (2) even assuming that the bankruptcy court had "core" jurisdiction over dispute, it could not, on that basis alone, decline to enforce the contractual arbitration agreement between parties.

V. What About Waiver? Is that Ever a Possibility—For Example, if a Party to an Arbitration Agreement Participates Heavily in the Bankruptcy Case Before Filing a Motion to Compel Arbitration?

Since federal policy favors arbitration, "[t]here is a strong presumption against finding a waiver of arbitration." However, "[t]he right to arbitrate a dispute, like all contract rights, is subject to waiver." Determining what constitutes a waiver of the right of arbitration is a fact-

<sup>45</sup> Republic Ins. Co. v. PAICO Receivables, LLC, 383 F.3d 341, 344 (5th Cir. 2004).

<sup>&</sup>lt;sup>46</sup> Nicholas v. KBR, Inc., 565 F.3d 904, 907 (5th Cir. 2009).

specific inquiry.<sup>47</sup> The Fifth Circuit has held that "a party waives its right to arbitrate if it (1) 'substantially invokes the judicial process' and (2) thereby causes 'detriment or prejudice' to the other party." <sup>48</sup>

A party might invoke the judicial process when "at the very least, [it] engage[s] in some overt act in court that evinces a desire to resolve the arbitrable dispute through litigation rather than arbitration."<sup>49</sup> Additionally, "[a] party waives arbitration by seeking a decision on the merits before attempting to arbitrate.<sup>50</sup>

# VI. What Has the U. S. Supreme Court Said About Enforcement of Arbitration Clauses?

The answer to this question is "a lot"—although not in the bankruptcy context. It would be an understatement to say that the Court has regularly voiced the sentiment that arbitration is the favored means of resolving disputes.

Recent Supreme Court decisions have thrown into question whether bankruptcy courts should be declining to enforce agreements to arbitrate claims and other issues, even where such issues are core bankruptcy issues.

## A. The Original Seminal Case that Bankruptcy Jurisprudence Has Cited

As mentioned above, the case of *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987), has, until recently, been the seminal case that courts have looked to when confronting how the FAA and the Bankruptcy Code—both being significant federal statutes—can be

<sup>&</sup>lt;sup>47</sup> See Tenneco Resins, Inc. v. Davy Int'l, AG, 770 F.2d 416, 420 (5th Cir. 1985).

<sup>&</sup>lt;sup>48</sup> Al Rushaid v. Nat'l Oilwell Varco, Inc., 757 F.3d 416, 421 (5th Cir. 2014) (quoting Miller Brewing Co. v. Fort Worth Distrib. Co., 781 F.2d 494, 497 (5th Cir. 1986)).

<sup>&</sup>lt;sup>49</sup> Subway Equip. Leasing Corp. v. Forte, 169 F.3d 324, 329 (5th Cir. 1999).

<sup>&</sup>lt;sup>50</sup> Petroleum Pipe Ams. Corp. v. Jindal Saw, Ltd., 575 F.3d 476, 480-81 (5th Cir. 2009).

harmonized. In *McMahon*, the Supreme Court was addressing the arbitrability of federal RICO and securities fraud claims brought under the Securities Exchange Act of 1934. In *McMahon*, the Supreme Court noted that the FAA provides, in pertinent part, that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract." The FAA establishes a federal policy favoring arbitration. However, "[1]ike any statutory directive the Arbitration Act's mandate may be overridden by a contrary congressional command." 53

In *McMahon*, the Supreme Court ultimately constructed a framework under which courts can analyze how the FAA and any particular statute interact. To determine if Congress intended to override the FAA's policy favoring arbitration in a particular statute, courts must examine: (1) the text of the statute; (2) its legislative history; and (3) whether an inherent conflict between arbitration and the underlying purposes of the statute exist.

The various circuits applying the *McMahon* factors to the Bankruptcy Code have found no evidence in the text of the Bankruptcy Code or in the legislative history suggesting that Congress intended to create an exception to the FAA in the Bankruptcy Code. Thus, courts have focused on whether an inherent conflict between arbitration and the underlying purposes of the Bankruptcy Code exists.

## B. Recent Cases

In the past year and a half, the Supreme Court has issued three cases dealing with arbitration. The Supreme Court has continued to send a message that arbitration is a favored

<sup>&</sup>lt;sup>51</sup> 9 U.S.C. § 2.

<sup>&</sup>lt;sup>52</sup> *Id.* at 226.

<sup>&</sup>lt;sup>53</sup> *Id*.

method of resolving disputes and arbitration clauses should be robustly honored. One thing that is noteworthy is that the Court has yet to find any *inherent conflict between arbitration and the underlying purpose of another federal statute*. Sometimes other important federal statutes have been involved (for example in the situation of the *Epic* case below). This obviously begs the question—is the Bankruptcy Code really any different? Will the Supreme Court believe the Bankruptcy Code and bankruptcy system are really that special? See the case summaries below and decide.

## New Prime, Inc. v. Oliveira, 139. S. Ct. 532 (2019)

Facts: Former truck driver, Mr. Oliveira, worked under an operating agreement that treated him as an independent contractor and contained a mandatory arbitration provision. When Mr. Oliveira filed a class action alleging that the trucking company for which he drove, New Prime, denied its drivers lawful wages, New Prime asked the court to invoke its statutory authority under the FAA to compel arbitration. Mr. Oliveira countered that the court lacked authority because § 1 of the FAA excepts from coverage disputes involving "contracts of employment" of certain transportation workers. New Prime insisted that any question regarding § 1's applicability belonged to the arbitrator alone to resolve, or, assuming the court could address the question, that "contracts of employment" referred only to contracts that establish an employer-employee relationship and not to contracts with independent contractors. The District Court and First Circuit agreed with Mr. Oliveira.

**<u>Holding:</u>** The lower courts denied the motion to compel arbitration and the Supreme Court ultimately affirmed.

Reasoning: A court should determine whether a statutory exclusion pursuant to Section 1 of the FAA applies before ordering arbitration. A court's authority to compel arbitration under the FAA does not extend to all private contracts, no matter how emphatically they may express a preference for arbitration. Instead, antecedent statutory provisions limit the scope of a court's powers, pursuant to §§ 3 and 4 of the FAA, to stay litigation and compel arbitration "accord[ing to] the terms" of the parties' agreement. Section 2 of the FAA provides that the FAA applies only when the agreement is set forth as "a written provision in any maritime transaction or a contract evidencing a transaction involving commerce." And § 1 helps define § 2's terms, warning, as relevant here, that "nothing" in the FAA "shall apply" to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." For a court to invoke its statutory authority under §§ 3 and 4, it must first know if the parties' agreement is excluded from the FAA's coverage by the terms of §§ 1 and 2. This sequencing is significant. New Prime noted that the parties' contract contained a "delegation clause,"

giving the arbitrator authority to decide threshold questions of arbitrability, and that the "severability principle" required that both sides take all their disputes to arbitration. But a delegation clause is merely a specialized type of arbitration agreement and is enforceable under §§ 3 and 4 only if it appears in a contract consistent with § 2 that does not trigger § 1's exception. And, the FAA's severability principle applies only if the parties' arbitration agreement appears in a contract that falls within the field §§ 1 and 2 describe. Pp. 537 – 539. Because the FAA's term "contract of employment" refers to any agreement to perform work, Mr. Oliveira's agreement with New Prime fell within § 1's exception. Pp. 538 – 543.

What's Noteworthy: While New Prime affirmed the lower courts' decisions declining to order arbitration, it is noteworthy in that it provides an example of when the Supreme Court will find that a dispute or agreement to arbitrate falls outside the reach of the FAA: when the exception is clearly set forth in the FAA itself. New Prime, authored by Justice Gorsuch, held that because section 1 of the FAA stated that "nothing herein' may be used to compel arbitration in disputes involving the 'contracts of employment' of 'workers engaged in foreign or interstate commerce," the FAA did not give the district court authority to order arbitration on a dispute arising out of a dispute between an interstate trucking company and one of its drivers.

In contrast to *New Prime*, various courts of appeal, have uniformly "found no evidence in the text of the Bankruptcy Code or in the legislative history suggesting that Congress intended to create an exception to the FAA in the Bankruptcy Code." <sup>54</sup>

Henry Schein, Inc. v. Archer & White Sales, Inc., 586 U.S. (139 S.Ct. 524 (for foot note practice purposes) (Jan. 8, 2019)

<u>Facts</u>: Archer & White Sales, Inc. ("Archer & White") sued Pelton Crane's successor-in-interest and Henry Schein, Inc. (collectively, "Schein") in Federal District Court in Texas.<sup>55</sup> Archer & White alleged violations of federal and state antitrust law,<sup>56</sup> seeking both money damages and injunctive relief.<sup>57</sup> The arbitration provision in the contract that governed the parties' relationship provided:

"Disputes . . . Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief . . . ), shall

<sup>&</sup>lt;sup>54</sup> E.g., Ackerman v. Eber, 687 F.3d at 1129.

<sup>&</sup>lt;sup>55</sup> Schein, 139 S. Ct. at 528.

<sup>&</sup>lt;sup>56</sup> Archer & White alleged "violations of Section 1 of the Sherman Antitrust Act and the Texas Free Enterprise and Antitrust Act." Archer & White Sales, Inc. v. Henry Schein, Inc., 878 F.3d 488, 491 (5th Cir. 2017), cert. granted, 138 S. Ct. 2678, 201 L. Ed. 2d 1071 (2018), and vacated and remanded, 139 S. Ct. 524, 202 L. Ed. 2d 480 (2019). Archer & White also alleged Defendants "carried out their conspiracy through a series of unlawful activities, including, but not limited to agreements not to compete, agreements to fix prices, and boycotts." Id. at 491 n.1.

<sup>&</sup>lt;sup>57</sup> Schein, 139 S. Ct. at 528.

be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association [(AAA)]."<sup>58</sup>

Therefore, the parties disagreed about whether their dispute fell within the arbitration provision, and whether an arbitrator or the court had to decide that issue.<sup>59</sup> Schein argued the contract's express incorporation of the American Arbitration Association's rules meant that an arbitrator, and not the court, should decide if the arbitration agreement applied to this particular dispute.<sup>60</sup> Citing Fifth Circuit precedent,<sup>61</sup> Archer & White argued that where Schein's argument for arbitration is "wholly groundless," the court is able to resolve the question.<sup>62</sup>

<u>Procedure</u>: The District Court ruled that Schein's argument for arbitration was wholly groundless and agreed with Archer & White that the Fifth Circuit's wholly groundless exception applies.<sup>63</sup> Thus, the District Court denied Schein's motion to compel arbitration.<sup>64</sup> The Fifth Circuit affirmed.<sup>65</sup> In light of a circuit split regarding the wholly groundless exception's consistency with the FAA, the Supreme Court granted certiorari to hear the case.<sup>66</sup>

<u>Issue</u>: Under federal law, is the wholly groundless exception to arbitrability inconsistent with the FAA and Supreme Court precedent?

<u>Held</u>: The wholly groundless exception is inconsistent with the FAA and Supreme Court precedent.<sup>67</sup> Courts must enforce contracts that delegate threshold arbitrability questions to an arbitrator.<sup>68</sup> The Supreme Court vacated the judgment and remanded the case to

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<sup>58</sup> Id.
<sup>59</sup> Id.
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<sup>61</sup> Douglas v. Regions Bank, 757 F.3d 460, 464 (5th Cir. 2014), abrogated by Henry Schein, Inc. v. Archer & White Sales, Inc., 139 S. Ct. 524, 202 L. Ed. 2d 480 (2019).

<sup>63</sup> *Id*.

<sup>60</sup> *Id*.

<sup>64</sup> *Id*.

<sup>65</sup> *Id*.

<sup>66</sup> Id.

<sup>67</sup> *Id.* at 531.

<sup>68</sup> *Id*.

<sup>&</sup>lt;sup>62</sup> Schein, 139 S. Ct. at 528. Many federal courts, including the Fifth Circuit, refer to the "wholly groundless" exception to the FAA. *Id*.

address whether the contract delegated the arbitrability question to an arbitrator.<sup>69</sup> Justice Kavanaugh wrote the opinion for a unanimous Court.

## **Reasoning**: The FAA provides:

"A written provision in . . . a contract evidencing a transaction involving commerce 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."

Arbitration is a matter of contract.<sup>71</sup> Parties may contract to arbitrate "'gateway' questions of 'arbitrability,'" and the FAA also operates on those agreements to arbitrate.<sup>72</sup> The Supreme Court rejected four Archer & White arguments:

First, Archer & White argued FAA §§ 3 and 4 (respectively, a court must be satisfied the issue is preferable to arbitration, and a court must be satisfied the making of the arbitration agreement is not at issue) provide an opportunity for the court to intervene. But, "[t]he Supreme Court has consistently held that parties may delegate threshold arbitrability questions to the arbitrator, so long as the parties' agreement does so by 'clear and unmistakable' evidence."

Second, Archer & White argued FAA § 10, which provides for back-end judicial review if an arbitrator has "exceeded" his or her "powers," should also apply to front-end questions of arbitrability. However, this interpretation is inconsistent with how Congress designed the FAA, and the Supreme Court should not redesign legislation. Third, Archer & White argued sending the arbitrability question to an arbitrator wastes time and money if the argument for arbitration is wholly groundless, because the arbitrator will conclude the dispute is not arbitrable, and the parties will wind up back in court. However, the statutory text does not provide for the wholly groundless exception. Also, even if the wholly groundless exception might save time and money in

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<sup>69</sup> Id.

<sup>70</sup> 9 U.S.C. § 2.

<sup>71</sup> Id.

<sup>72</sup> Id.; Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 67-70 (2010); see also First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943 (1995).

<sup>73</sup> 9 U.S.C. §§ 3, 4; Schein, 139 S. Ct. at 530.

<sup>74</sup> Schein, 139 S. Ct. at 530.

<sup>75</sup> 9 U.S.C. § 10(a)(4).

<sup>76</sup> Id. at 530.
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some individual cases, the exception would likely not save time and money systematically. Rather, the exception "would inevitably spark collateral litigation . . . over whether a seemingly unmeritorious argument for arbitration is *wholly* groundless." Fourth, Archer & White argued the wholly groundless exception importantly deters frivolous motions to compel arbitration. It But, arbitrators can already respond to frivolous motions by ruling a claim is not arbitrable, or by imposing fee-shifting and cost-shifting sanctions. Additionally, the statutory text does not provide for the wholly groundless exception.

Therefore, the wholly groundless exception is inconsistent with the FAA and Supreme Court precedent. Arbitrators get to decide the arbitrability question.<sup>84</sup>

<u>Ouery:</u> But how should this work if the bankruptcy court decides that arbitration presents an inherent conflict with the Bankruptcy Code in a particular dispute? Is it okay to bypass the arbitrability question in this situation?

Epic Systems Corp. v. Lewis, 138 S. Ct. 1612 (May 21, 2018)

<u>Facts</u>: Employers and employees entered into employment contracts that provided for individualized arbitration proceedings to resolve employment disputes between the parties. Employees attempted to bring class action proceedings under the Fair Labor Standards Act (FLSA), arguing that the National Labor Relations Act (NLRA) mandated that employees have the right to act collectively, and that such mandate took such agreements out of the purview of the FAA via the FAA's savings clause. Employers' moved to compel arbitration.

**<u>Holding</u>**: Employers prevail. Arbitration is required.

**Reasoning**: Justice Gorsuch wrote the opinion on behalf of the 5-justice majority, finding that arbitration agreements in employment contracts limiting disputes to individualized arbitration were enforceable. The Court started with the often-articulated principles: The FAA establishes a liberal federal policy favoring arbitration agreements. The FAA requires courts to rigorously enforce arbitration agreements according to their terms, including terms that specify with whom the parties choose to arbitrate their disputes and the rules under which that arbitration will be conducted. Then things get interesting.

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79 Id. at 531.
80 Id.
81 Id.
82 Id.
83 Id.
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84 Id. at 529.

The Court held that the provision of NLRA, which guarantees to workers the right to engage in concerted activities for the purpose of collective bargaining or other mutual aid or protection, does not reflect a clearly expressed and manifest congressional intention to displace the FAA and to outlaw class and collective action waivers, abrogating National Labor Relations Board v. Alternative Entertainment, Inc., 858 F.3d 393. In approaching a claimed conflict between two federal statutes, the court comes armed with the strong presumption that repeals by implication are disfavored and that Congress will specifically address preexisting law when it wishes to suspend its normal operations in a later statute. Respect for the constitutional separation of powers counsels restraint in courts finding irreconcilable conflicts in statutes drafted by Congress, and allowing judges to pick and choose between statutes risks transforming them from expounders of what the law is into policymakers choosing what the law should be. The Court indicated its inclination to find "harmony over conflict in statutory interpretation" between, in this case, the FAA and the NLRA. When confronted with two Acts of Congress allegedly touching on the same topic, the court is not at liberty to pick and choose among congressional enactments and must instead strive to give effect to both. A party seeking to suggest that two federal statutes cannot be harmonized, and that one displaces the other, bears the heavy burden of showing a clearly expressed and manifest congressional intention. In summary, the Court rejected the employees' argument that the NLRA-created right to "engage in . . . concerted activities for the purpose of collective bargaining or other mutual aid or protection" extended to class action and other collective legal proceedings. Rather, the Court noted that the NLRA did not speak specifically to class and collective action proceedings and held that the NLRA did not render agreements to proceed by individualized arbitration unenforceable.

**Query:** If the Supreme Court is confronted with whether there is an inherent conflict between the Bankruptcy Code's policies (*e.g.*, centralized disputes, efficiency of one forum) and the FAA (remember the FAA was enacted before the current Bankruptcy Code), is it going to find an irreconcilable conflict—based on *Epic's* reasoning)?



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1. <u>ARTICLE: COMPETING EFFICIENCIES: THE PROBLEM OF WHETHER AND WHEN TO REFER</u>
DISPUTES TO ARBITRATION IN BANKRUPTCY CASES, 24 Am. Bankr. Inst. L. Rev. 133

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# <u>ARTICLE: COMPETING EFFICIENCIES: THE PROBLEM OF WHETHER AND</u> WHEN TO REFER DISPUTES TO ARBITRATION IN BANKRUPTCY CASES

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#### Reporter

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## **Text**

## [\*133] INTRODUCTION

Since the 1980s, the federal courts have struggled to resolve a conflict between the Bankruptcy Code's <sup>1</sup> policy favoring the centralized resolution of all disputes **[\*134]** related to a bankruptcy estate and the policy favoring the enforcement of **arbitration** agreements embodied by the Federal **Arbitration** Act ("FAA"). <sup>2</sup> When a party enters bankruptcy, and that party is involved in a dispute subject to **arbitration** under the FAA, the question arises whether to resolve the dispute in **arbitration** or within proceedings in bankruptcy court. Answering the question requires resolving a conflict between two powerful federal policies.

Courts have long recognized and deferred to the Bankruptcy Code's policy favoring the bankruptcy court as the sole forum for resolving all disputes concerning a debtor's assets. <sup>3</sup> Courts have similarly recognized the FAA's policy favoring the enforcement of contractual commitments to resolve disputes in **arbitration**. <sup>4</sup> Courts disagree

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<sup>&</sup>lt;sup>1</sup> All references to the "Bankruptcy Code" or "Code" are to 11 U.S.C. §§ 101, et seq. (2012).

<sup>&</sup>lt;sup>2</sup> See <u>9 U.S.C. § 2</u> (2012).

<sup>&</sup>lt;sup>3</sup> See <u>Elscint, Inc. v. First Wis. Fin. Corp. (In re Xonics, Inc.), 813 F.2d 127, 131 (7th Cir. 1987)</u> (reasoning "[t]he bankruptcy jurisdiction is designed to provide a single forum for dealing with all claims to the bankrupt's assets").

<sup>&</sup>lt;sup>4</sup> See Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983) (holding any ambiguities with regard to arbitration clause should be resolved in favor of arbitration).

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about how to balance these conflicting policy objectives, however, and the law is unclear about when and under what circumstances **arbitration** agreements will be enforced in bankruptcy proceedings.

This disagreement is exacerbated by a long simmering conflict within the United States Supreme Court and among commentators about the purpose of the FAA. The predominant view is that the FAA creates a substantive right of contract law that must be enforced in federal and state courts in any dispute that would fall within federal jurisdiction. <sup>5</sup> According to the alternative view, the FAA creates procedural rights in federal courts designed to promote efficient dispute resolution. <sup>6</sup> Existing authority in the Supreme Court and the United States Courts of Appeals does not seem to provide a clear basis for resolving these varied perspectives. In *Shearson/American Express, Inc. v. McMahon*, <sup>7</sup> the Supreme Court established the standard for courts to evaluate whether Congress intended the FAA's policy favoring **arbitration** to yield to the jurisdictional policies behind a countervailing federal statute. *McMahon* has not been uniformly applied by the United States Circuit Courts of Appeals, however. <sup>8</sup>

[\*135] Any contractual relationship can become subject of a dispute in bankruptcy, and because almost any contract can include an **arbitration** clause, the variety of situations in which **arbitration** and bankruptcy can collide is broad. <sup>9</sup> However, the enforceability of **arbitration** clauses arises in three contexts within a bankruptcy case. <sup>10</sup> In the first case, either a Trustee or a Debtor in Possession ("DIP") sues a counter-party to a contract of the Debtor's to recover money on a common-law or statutory claim, typically for breach of contract or fraud, and the counterparty moves to enforce an **arbitration** clause. <sup>11</sup> In the second case, the Trustee or DIP pursues a preference action against one of the debtor's counter-parties to avoid transfers made to the counter-party to the bankruptcy filing. <sup>12</sup> "Again, the counterparty usually moves to enforce the **arbitration** clause, while the Trustee or DIP prefers to have the matter decided by . . . the bankruptcy court." <sup>13</sup> In the third case, "the Trustee or DIP rejects an executory contract and the counter-party to the contract seeks to enforce an **arbitration** clause to determine the damages resulting from the rejection."

This Article will examine whether and to what extent *McMahon*'s analysis can effectively solve the unique policy conflict presented by **arbitration** to resolve disputes involving a bankruptcy estate and to evaluate, in light of the most recent decisions and policy considerations, the proposals for addressing the disjointedness of opinions arising

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<sup>&</sup>lt;sup>5</sup> See, e.g., id. at 25 n.32 (stating although enforcement of the Act is left largely to the states, it is federal policy and should be enforced by federal courts where appropriate).

<sup>&</sup>lt;sup>6</sup> See, e.g., Southland Corp. v. Keating, 465 U.S. 1, 25-27 (1984) (O'Connor, J., dissenting).

<sup>&</sup>lt;sup>7</sup> 482 U.S. 220(1987).

<sup>&</sup>lt;sup>8</sup> See U.S. Lines, Inc. v. Am. Steamship Owners Mut. Prot. & Indem. Ass'n, Inc. (In re U.S. Lines, Inc.), 197 F.3d 631, 640-41 (2d Cir. 1999) (noting courts must carefully determine whether any underlying purpose of the Bankruptcy Code would be adversely affected by enforcing arbitration clause); see also Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 671 F.3d 1011, 1021 (9th Cir. 2012); Mintze v. Am. Gen. Fin. Servs. (In re Mintze), 434 F.3d 222, 229 (3d Cir. 2006); White Mountain Mining Co. v. Congelton, L.L.C. (In re White Mountain), 403 F.3d 164, 168 (4th Cir. 2005); Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.), 118 F.3d 1056, 1066 (5th Cir. 1997).

<sup>&</sup>lt;sup>9</sup> See Paul F. Kirgis, **Arbitration**, Bankruptcy, and Public Policy: A Contractarian Analysis, <u>17 AM. BANKR. INST. L. REV.</u> 503,514 (2009).

<sup>10</sup> See id.

<sup>&</sup>lt;sup>11</sup> See id. at 514-15.

<sup>&</sup>lt;sup>12</sup> See id. 515.

<sup>13</sup> *Id*.

<sup>&</sup>lt;sup>14</sup> *Id.* at 516.

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from the federal courts. To begin, this Article summarizes bankruptcy court jurisdiction and background of the FAA. Next, this Article discusses the United States Supreme Court's decision in *McMahon*, which provides a methodology for courts to determine when other federal statutes should yield to the FAA, and the subsequent interpretation of this decision by several circuit courts. Finally, this Article will discuss three potential solutions, their strengths and limitations. First, it will consider whether the conflict can be resolved by applying existing bankruptcy law principles by treating agreements to arbitrate like other executory contracts affecting the bankruptcy estate. Second, it will explore whether the conflict can be resolved through legislation that would better distinguish between matters that are "core" to the bankruptcy proceeding and those that are "non-core" and that would make the enforcement of **arbitration** agreements easier in non-core matters and more difficult in core matters. Third, it will discuss whether a shift in the burden of proof about the enforceability of **arbitration** agreements would preserve bankruptcy law principles.

## [\*136] I. STATUTORY BACKGROUND

## A. Bankruptcy Jurisdiction

The history and evolution of bankruptcy court jurisdiction demonstrates that the statutory definition of jurisdiction is not dispositive in determining whether a particular matter may be adjudicated within the context of a bankruptcy proceeding. It further demonstrates that the general bankruptcy policy in favor of centralized dispute resolution must give way to fundamental jurisdictional principles.

The Bankruptcy Reform Act of 1978 gave bankruptcy courts expansive authority to enter final judgments on all claims that could affect the bankruptcy estate. <sup>15</sup> This initial broad grant of authority from Congress was subsequently deemed unconstitutional under Article III by the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.* <sup>16</sup>

Article III vests the judicial power of the United States in courts composed of judges with life tenure and undiminished compensation. <sup>17</sup> Bankruptcy courts lack these Article III attributes and, therefore, may finally adjudicate matters that fall within some exception to Article III. <sup>18</sup> The *Marathon* Court found the "public right" exception applies to bankruptcy court jurisdiction regarding disputes involving the restructuring of debtor-creditor relations. <sup>19</sup> However, state law breach of contract actions by the estate against non-creditors were matters of "private right" to which the parties were entitled to an Article III tribunal. <sup>20</sup> The Court concluded Congress' grant of jurisdiction to the bankruptcy courts as provided under the 1978 Act was unconstitutional. <sup>21</sup>

<sup>&</sup>lt;sup>15</sup> See Pub. L. No. 95-598, 95th Cong., *92 Stat. 2549, at 2668 (1978)* (proposing both district courts and bankruptcy courts should have "original and exclusive jurisdiction of all cases under [the Bankruptcy Code]").

<sup>&</sup>lt;sup>16</sup> 458 U.S. 50, 87 (1982) ("[T]he broad grant of jurisdiction to the bankruptcy courts contained in 28 U.S.C. § 147 . . . is unconstitutional.").

<sup>&</sup>lt;sup>17</sup> See <u>U.S. CONST. art. III, § 1</u> ("The Judges . . . shall hold their Offices during good Behaviour [sic], and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.").

<sup>&</sup>lt;sup>18</sup> See <u>Marathon, 458 U.S. at 61</u> ("In short, there is no doubt that the bankruptcy judges created by the Act are not Art. III judges.").

<sup>19</sup> See id. at 71.

<sup>&</sup>lt;sup>20</sup> See id. at 69-72.

<sup>&</sup>lt;sup>21</sup> See id. at 87.

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Congress addressed the unconstitutional aspects of bankruptcy jurisdiction by enacting the Bankruptcy Amendments and Federal Judgeship Act of 1984. <sup>22</sup> The 1984 Act divided all matters that could be referred to the bankruptcy courts into two categories: "core" and "noncore." <sup>23</sup> Under the 1984 Act, bankruptcy courts may hear matters that "arise under" the Bankruptcy Code; "arise in" a case under the [\*137] Bankruptcy Code; or are "related to" a bankruptcy case. <sup>24</sup> The district courts may refer any matter to a bankruptcy court, but the bankruptcy court may enter a final order or judgment for "core" matters only; those matters "arising under" the Bankruptcy Code or "arising in" a case under the Bankruptcy Code. <sup>25</sup> Matters "relating to" a bankruptcy case are defined as "non-core." <sup>26</sup> For non-core matters, the bankruptcy court may make only proposed findings of fact and conclusions of law, which must be submitted to the district court for approval and for the entry of final orders or judgments, unless all parties consent otherwise. <sup>27</sup>

Since the 1984 Act, the core and non-core distinction has become increasingly important and questions have arisen about whether an emphasis on this distinction will shrink bankruptcy court jurisdiction. In *Stern v. Marshall*, <sup>28</sup> the Supreme Court determined, even though bankruptcy courts may be statutorily authorized to enter final judgment on a particular class of bankruptcy-related claims, Article III may still prohibit bankruptcy courts from entering a final judgment on those claims. <sup>29</sup> The Court determined that a counter-claim brought in bankruptcy court and deemed "core" under the statutory scheme, but based solely on state law, could only be resolved in an Article III court and could not be finally adjudicated by a bankruptcy court. <sup>30</sup>

The Court reasoned there was no constitutional basis for giving a bankruptcy court the authority to exercise the judicial power described in Article III and that exercising the judicial power was involved in "the entry of a final, binding judgment by a court with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime."

31 The Stern Court concluded that even matters characterized as "core" by federal statute might not be properly within the bankruptcy court's jurisdictional province. It was not until the Court's holding in Executive Benefits Insurance Agency v. Arkison

32 that it was determined how bankruptcy and district courts should proceed with such "Stern claims."

The Executive Benefits Court held "that when . . . the Constitution does not permit a bankruptcy court to enter final judgment on a bankruptcy-related claim, the relevant statute nevertheless permits a bankruptcy court to issue proposed findings of fact and conclusions of law to be reviewed *de novo* by the district court." <sup>33</sup> This holding addresses one of the gaps left unaddressed by *Stern* by solving the constitutional conflict inherent in the statute.

<sup>&</sup>lt;sup>22</sup> See 28 U.S.C. § 151 (2012).

<sup>23</sup> See id. § 157.

<sup>24</sup> See id.

<sup>&</sup>lt;sup>25</sup> See id. § 157(b)(1), (2).

<sup>&</sup>lt;sup>26</sup> See id. § 157(c)(1).

<sup>&</sup>lt;sup>27</sup> See id. § 157(c)(1), (2).

<sup>28 131</sup> S. Ct. 2594 (2011).

<sup>&</sup>lt;sup>29</sup> See id. at 2596-97.

<sup>30</sup> See id. at 2597.

<sup>31</sup> Id. at 2615 (emphasis omitted).

<sup>&</sup>lt;sup>32</sup> <u>134 S. Ct. 2165 (2014).</u>

<sup>&</sup>lt;sup>33</sup> *Id*.

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The Court will be asked to address [\*138] another unanswered question left by *Stern* and *Executive Benefits*: can the constitutional discrepancy created by the statute be resolved by the consent of the parties? <sup>34</sup> Argument is set for January 14, 2015. <sup>35</sup>

The changing, and diminishing, scope of bankruptcy jurisdiction impacts the matters bankruptcy courts may finally adjudicate including, potentially, those matters subject to **competing arbitration** clauses. This reality may affect the proposed solutions for resolving conflicts created by **arbitration** clauses in bankruptcy proceedings, particularly those proposals that rely on a "core" and "non-core" distinction.

#### B. The Federal Arbitration Act

The most relevant provisions of the FAA are those covering the enforceability of **arbitration** agreements and the mechanisms for obtaining enforcement in the federal courts. Section 2 of the FAA creates a right to the enforcement of **arbitration** agreements. It provides that, for maritime transactions or transactions in interstate commerce, any agreement to arbitrate, whether made pre- or post-dispute, "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." <sup>36</sup>

Sections 3 and 4 of the FAA create a mechanism for enforcing that right in the federal courts. In any action already pending in the United States courts, section 3 provides that, if there is an issue or issues that can be referred to **arbitration** under an enforceable **arbitration** agreement, the court "shall on application of one of the parties stay the trial of the action until such **arbitration** has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such **arbitration**."

37 Section 4 of the FAA also provides a mechanism for enforcing an **arbitration** agreement in disputes where no federal action is pending. If a party to an enforceable **arbitration** agreement fails or refuses to arbitrate under the agreement, and if the arbitral dispute would fall within federal jurisdiction as defined under title 28 of the United States Code, the aggrieved party to the **arbitration** agreement may petition "any United States district court . . . for an order directing that such **arbitration** proceed in the manner provided for in such agreement."

38 Upon such a petition, the district court will determine what the [\*139] **arbitration** agreement requires and shall issue any orders under those requirements.

There are two circumstances under which federal courts will not enforce **arbitration** agreements. First, the agreement will not be enforced if it is void or unenforceable for any of the reasons that any other contract would be void or unenforceable. <sup>40</sup> Second, even a valid and otherwise enforceable **arbitration** agreement can be set aside if, through its enactment of another statute, Congress has expressed its intention that the dispute should not be arbitrated, regardless of whether parties might have agreed between themselves to such **arbitration**. <sup>41</sup>

1. Early Understanding of the FAA's Purpose and Policies

<sup>&</sup>lt;sup>34</sup> See Wellness Int'l Network v. Sharif, 727 F.3d 751, 756 (7th Cir. 2013), cert. granted, 134 S. Ct. 2901 (2014).

<sup>&</sup>lt;sup>35</sup> See Wellness International Network, Limited v. Sharif, SCOTUSBLOG, <a href="http://www.scotusblog.com/case-files/cases/wellness-international-network-limited-v-sharif/">http://www.scotusblog.com/case-files/cases/wellness-international-network-limited-v-sharif/</a> (last visited Dec. 8, 2014).

<sup>36</sup> See 9 U.S.C. § 2 (2012).

<sup>37</sup> See id. § 3.

<sup>38</sup> See id. § 4.

<sup>39</sup> See id.

<sup>&</sup>lt;sup>40</sup> See id. § 2 ("[An **arbitration** provision] . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.").

<sup>&</sup>lt;sup>41</sup> See Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 226 (1987).

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Understanding the purpose of the FAA is crucial to determining whether and when the FAA's policy favoring **arbitration** has been superseded by the **competing** policy behind another federal statute, such as the Bankruptcy Code. Case law interpreting the FAA's purpose and underlying policies has evolved since its enactment in 1925. That evolution has important consequences for analyzing when disputes subject to **arbitration** involving a bankruptcy estate should be arbitrated and when they should be retained by the bankruptcy court.

The enactment of the FAA in 1925 was the product of a long effort by commercial groups, particularly trade associations, to streamline dispute resolution between commercial actors. <sup>42</sup> Before the FAA, many jurisdictions followed the rule that agreements to arbitrate were revocable at will. <sup>43</sup> This judicial hostility to **arbitration** was motivated by several factors, chief among them a distrust of the legal acumen of the persons typically selected as arbitrators and a desire to protect the province of the judiciary from incursion by other kinds of tribunals for resolving disputes. <sup>44</sup> Courts were concerned that parties would erode judicial authority by making contracts to opt out of the judicial system and resolve their disputes in other tribunals. <sup>45</sup> The effect of this rule diminished recourse to **arbitration** because parties [\*140] had relatively little incentive to ever enter into pre-dispute **arbitration** agreements.

Many commercial and trade associations developed **arbitration** procedures to facilitate dispute resolution among their members. The FAA promoted recourse to those procedures by establishing a federal rule that **arbitration** agreements were to be enforced in disputes within federal jurisdiction. <sup>47</sup>

In light of these origins, the FAA was first understood to create a procedural rule for federal courts: if the parties have agreed to **arbitration**, that agreement must be enforced, and federal courts must refer the dispute to the arbitrator. <sup>48</sup> In this respect, the FAA functioned compelling federal courts to enforce a certain forum selection agreement between litigants. If the litigants agreed to resolve their dispute in **arbitration**, they could not later go to federal court to litigate that dispute. Their agreement to arbitrate would be a binding choice of forum. <sup>49</sup> The FAA

<sup>&</sup>lt;sup>42</sup> See David S. Schwartz, If You Love **Arbitration**, Set It Free: How "Mandatory" Undermines "**Arbitration**," <u>8 NEV. L.J. 400</u>, <u>402-06 (2007)</u>.

<sup>&</sup>lt;sup>43</sup> See Julius Henry Cohen & Kenneth Dayton, The New Federal **Arbitration** Law, 12 VA. L. REV. 265, 265 (1926); see also Alan Resnick, The Enforceability of **Arbitration** Clauses in Bankruptcy, 15 AM. BANKR. INST. L. REV. 183, 185-87 (2007).

<sup>&</sup>lt;sup>44</sup> See Resnick, supra note 43, at 185-87; see also Patrick M. Birney, Reawakening Section 1334: Resolving the Conflict Between Bankruptcy and Arbitration Through an Abstention Analysis, 16 AM. BANKR. INST. L. REV. 619, 627-28 (2008) (explaining arbitration before and after Federal Arbitration Act, conflicting federal schemes in arbitration and bankruptcy, and offering suggestions on how to create harmony between both).

<sup>45</sup> See id.

<sup>&</sup>lt;sup>46</sup> See Cohen & Dayton, supra note 43, at 265.

<sup>&</sup>lt;sup>47</sup> See id. at 280; see also Schwartz, supra note 42, at 400.

<sup>&</sup>lt;sup>48</sup> See <u>Allied-Brace Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 289 (1995)</u> (Thomas, J., dissenting); see also <u>Southland Corp. v. Keating, 465 U.S. 1, 25-27 (1984)</u> (O'Connor, J., dissenting); Schwartz, supra note 42, at 403; Christopher R. Drahozal, In Defense of Southland: Reexamining the Legislative History of the Federal **Arbitration** Act, <u>78 NOTRE DAME L. REV. 101, 126 (2002)</u> (questioning legitimacy of Supreme Court decisions on **arbitration** and reexamining legislative history of the Federal **Arbitration** Act).

<sup>&</sup>lt;sup>49</sup> See <u>Southland Corp., 465 U.S. at 27</u> (O'Connor, J., dissenting) ("The bill declares that [**arbitration** contracts] shall be recognized and enforced by the courts of the United States.").

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was not, however, understood to create any rules that state courts had to follow. The FAA was treated as a creature of federal procedure, not of substantive law. <sup>50</sup>

## 2. The Evolving Understanding of the FAA's Objectives

Modem interpretations of the statue and its original purposes have departed from the initial view of the FAA which predominated during the first decades after its enactment. This departure began with a collection of cases involving the FAA, which were decided in the mid-1980s. In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, <sup>51</sup> the Court held that the FAA "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." <sup>52</sup> In this respect, *Moses H. Cone* established a federal rule of contract law--that **arbitration** agreements were always enforceable by their terms. The opinion asserted that the stay provision of section 3 of the FAA would apply in state and in federal court. <sup>53</sup> It also pointed out that "Congress can hardly have meant that an agreement to arbitrate can be enforced against a party who attempts to litigate an arbitrable dispute in federal court, but not against one who sues on the same dispute [\*141] in state court." <sup>54</sup>

In *Southland Corp. v. Keating* 55 the Court went further, concluding that the federal rule mandating the enforcement of **arbitration** agreements be applied in state courts. The Southland majority built upon the ruling in *Moses H. Cone* to hold that section 2 of the "the **Arbitration** Act 'creates a body of federal substantive law' and expressly stated what was implicit in *Prima Paint, i.e.*, the substantive law the Act created was applicable in state and federal courts." 56 The *Southland* majority explained that "the purpose of the act was to assure those who desired **arbitration** and whose contracts related to interstate commerce that their expectations would not be undermined by federal judges, or . . . by state courts or legislatures." 57

In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, <sup>58</sup> the Court considered whether an international agreement to arbitrate could be enforced with respect to a statutory antitrust claim. The Court rejected the argument that **arbitration** agreements should not apply to claims arising from statutory rights. According to the *Mitsubishi* Court, the source of the rights to be arbitrated made no significant difference because "the Act itself provides no basis for disfavoring agreements to arbitrate statutory claims." <sup>59</sup>

A minority of the Supreme Court and many commentators think this understanding of the FAA improperly expands the statute's scope. In her dissenting opinion in *Southland*, Justice O'Connor emphasized the FAA was originally

<sup>&</sup>lt;sup>50</sup> See id. at 28 ("Plainly, a power derived from Congress' Art. III control over federal-court jurisdiction would not by any flight of fancy permit Congress to control proceedings in state courts.").

<sup>&</sup>lt;sup>51</sup> 460 U.S. 1 (1983).

<sup>&</sup>lt;sup>52</sup> See id. at 25 n.32 ("[A]Ithough enforcement of the Act is left in large part to the state courts, it nevertheless represents federal policy to be vindicated by the federal courts where otherwise appropriate.").

<sup>&</sup>lt;sup>53</sup> See id. at 26 n.34 (citing <u>Burke Cnty. Pub. Schs. Bd. of Educ. v. Shaver P'ship., 279 S.E.2d 816, 824 (N.C. 1981)).</u>

<sup>54</sup> See id. (citing Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 (1967)).

<sup>&</sup>lt;sup>55</sup> 465 U.S. 1, 27 (1984) (reversing California Supreme Court's decision not to enforce arbitration agreement).

<sup>&</sup>lt;sup>56</sup> *Id. at 12.* 

<sup>&</sup>lt;sup>57</sup> Id. at 13 (citing Metro Indus. Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, C. J., concurring)).

<sup>&</sup>lt;sup>58</sup> 473 U.S. 614 (1985).

<sup>59</sup> Id. at 627.

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intended to create a procedural rule for the federal courts that would not be binding on state courts. <sup>60</sup> Justice O'Connor also pointed out that the statutory language of the FAA and the structure of the statutory scheme were both contrary to the *Southland* majority's reading of the statute. <sup>61</sup> Accordingly, the enforcement provisions of the FAA specifically and exclusively refer to procedures for enforcing **arbitration** agreements in the federal district courts. <sup>62</sup> Justice O'Connor further concluded that section 2 could not be read to provide a substantive contract right that was binding in state courts. <sup>63</sup>

This disagreement relates to understanding whether and when there is a conflict between the policies behind the FAA and the Code. If the FAA is understood to impose a purely procedural rule for federal courts, the FAA serves only the policy [\*142] of promoting efficient dispute resolution. If bankruptcy disputes permit the centralized resolution of all disputes related to the debtor's estate, serving the interest of **efficiency** may require the rejection of **arbitration** agreements in bankruptcy. But if the FAA creates a substantive federal law of contract that applies with equal force to state and federal courts, then **efficiency** may not be the determinative consideration in deciding whether to enforce **arbitration** agreements for disputes arising within the context of a bankruptcy proceeding.

In the wake of *Southland, Moses H. Cone*, and *Mitsubishi*, the Supreme Court has concluded that the substantive contract right to arbitrate protected by the FAA must be protected over and against any consideration of **efficiency**. <sup>64</sup> In *Dean Witter Reynolds, Inc. v. Byrd*, <sup>65</sup> the Court held that, in a case within federal jurisdiction, pendant claims that can be arbitrated should be sent to **arbitration**. The *Byrd* Court explained that "the **Arbitration** Act requires district courts to compel **arbitration** of pendent arbitral claims when one of the parties files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums." <sup>66</sup> Given that **efficiency** and uniformity are among the principal objectives behind centralizing dispute resolution in the bankruptcy court, *Byrd* indicates those policies may not trump the policy considerations behind the FAA.

3. McMahon and the Method for Resolving Conflicts between the FAA and Other Statutes

In the wake of these decisions, the Supreme Court's opinion in *Shearson/American Express, Inc. v. McMahon* articulated a standard for determining when the federal policy in favor of enforcing **arbitration** agreements must give way to countervailing policies behind a different federal statute. <sup>68</sup> *McMahon* specifically addressed whether **arbitration** clauses could be enforced when a plaintiff raised claims against a securities broker under the Racketeer Influenced and Corrupt Organizations Act ("RICO") <sup>69</sup> and section 10(b) of the Securities Exchange Act of 1934

<sup>60</sup> See Southland Corp., 465 U.S. at 25-27 (O'Connor, J., dissenting).

<sup>&</sup>lt;sup>61</sup> See id. at 29-30 (O'Connor, J., dissenting) (holding federal law enforcing **arbitration** agreements preempts contrary state law).

<sup>62</sup> Id.

<sup>63</sup> Id. at 31.

<sup>&</sup>lt;sup>64</sup> See id. at 10-11, 13 (holding federal law enforcing **arbitration** agreements preempts contrary state law); see also <u>Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983)</u> (affirming enforcement of **arbitration**); <u>Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 638-39 (1985)</u> (reversing finding that antitrust claims not arbitrable).

<sup>65 470</sup> U.S. 213 (1985).

<sup>&</sup>lt;sup>66</sup> *Id*.

<sup>67 482</sup> U.S. 220 (1987).

<sup>&</sup>lt;sup>68</sup> See id. at 237-42 (enforcing **arbitration** agreement absent different federal statute's plain meaning or showing of congressional intent for exception to **Arbitration** Act).

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("the Exchange Act"). <sup>70</sup> *McMahon* held that **arbitration** agreements must be enforced unless a different federal statute articulated **[\*143]** a policy that would be undermined by the enforcement of the **arbitration** agreement. <sup>71</sup>

The plaintiffs in *McMahon* had signed brokerage agreements with the defendant, which included an **arbitration** clause. <sup>72</sup> When the plaintiffs filed complaints in federal court, alleging wrongdoing in the management of their brokerage accounts, the defendants moved to compel **arbitration** under section 3 of the FAA. <sup>73</sup> The plaintiffs argued that the **arbitration** agreements could not be enforced regarding claims under RICO and section 10(b) of the Exchange Act because the rights created and the remedies provided by those statutes could not be adequately protected in an arbitral forum. <sup>74</sup>

Regarding this argument about whether **arbitration** provided an adequate forum to protect the rights guaranteed by RICO and the Exchange Act, the *McMahon* Court drew on its recent decisions extending the FAA. <sup>75</sup> The *McMahon* Court established a default rule favoring **arbitration** regardless of the source of the rights at issue, and it concluded this default rule would be inapplicable only if the party opposing **arbitration** could establish that Congress sought to preclude **arbitration** for such disputes. <sup>76</sup> The Court explained:

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. If Congress intended 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. . . . To defeat application of the **Arbitration** Act . . . the [party opposing **arbitration**] must demonstrate that Congress intended to make an exception to the **Arbitration** Act for claims arising under [the statute], an intention discernible from the text, history, or purposes of the statute. The statute of the statute of the statute. The statute of the statute of the statute of the statute of the statute. The statute of t

Given the standard elaborated in *McMahon*, there are three principal ways to determine that Congress intended to create an exception to the federal policies favoring **arbitration**. <sup>78</sup> First, the text of the other statute can clarify that the disputes falling within its ambit are to be litigated in federal court, not arbitrated. Second, the legislative history of the other statute can indicate that Congress' purpose [\*144] contradicted the referral of the matter to **arbitration**. Third, there is an inherent conflict between the FAA's purpose and those of the other statute. Such an inherent conflict might appear from the text or the legislative history of the other statute, but it might also be evidence in the structure of the statutory scheme.

<sup>69</sup> See 18 U.S.C. § 1961(1) (2012) (defining racketeering activity within act).

<sup>&</sup>lt;sup>70</sup> See 15 U.S.C. § 78i(b) (2006) (describing unlawfulness of manipulative and deceptive practices when purchasing or selling securities).

<sup>71</sup> McMahon, 482 U.S. at 242.

<sup>&</sup>lt;sup>72</sup> Id at 223.

<sup>&</sup>lt;sup>73</sup> *Id. at 224.* 

<sup>74</sup> Id. at 227.

<sup>75</sup> Id. at 228.

<sup>&</sup>lt;sup>76</sup> Id. at 227.

<sup>&</sup>lt;sup>77</sup> Id.

<sup>78</sup> See id.

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It has been difficult to apply the *McMahon* standard to bankruptcy cases because there is little guidance in either the text or the legislative history of the Bankruptcy Code to indicate Congress' intentions about the relative strength of the policies favoring **arbitration** and favoring the centralized resolution of bankruptcy disputes. <sup>79</sup>

## **II. THE CIRCUIT SPLIT REGARDING ARBITRATION IN BANKRUPTCY**

The Second, Third, Fourth, Fifth, and Ninth Circuit Courts have all interpreted the *McMahon* standard in determining the enforceability of an **arbitration** clause in a bankruptcy proceeding. <sup>80</sup> Interpretation has not been uniform, however, and the circuit courts interpreting the Supreme Court holding have emphasized the importance of different considerations and have reached different outcomes. These decisions are discussed chronologically as the findings and holdings of each circuit influence many of the subsequent decisions.

## A. The Fifth Circuit Court of Appeals

In 1997, the United States Fifth Circuit Court of Appeals was asked to settle a dispute arising from an agreement entered into in 1985 (the "Wellington Agreement") 81 between National Gypsum, a producer of asbestos-containing products, and one of its national insurers, INA. 82 The Fifth Circuit was asked to determine whether the Wellington Agreement, containing an **arbitration** clause, required enforcement of that **arbitration** clause where National Gypsum had filed [\*145] for bankruptcy and the bankruptcy court decided not to stay adversary proceedings pending **arbitration** between the parties. 83

National Gypsum had obtained, without objection or appeal by INA, a confirmed reorganization plan. <sup>84</sup> However, two years after the plan was confirmed, INA sought payment of monies advanced and interest thereon under the Wellington Agreement by initiating **arbitration** proceedings against National Gypsum. <sup>85</sup> In response, National Gypsum filed an adversary proceeding-declaratory judgment complaint in bankruptcy court. The bankruptcy court found that, as the adversary proceeding sought to ascertain whether its reorganization plan precluded INA's claim, it had "core" jurisdiction under *28 U.S.C. section 157*(b)(2)(B) and (C) and that the bankruptcy court was the most

<sup>&</sup>lt;sup>79</sup> See Resnick, supra note 43, at 185-87 (citing Note, *Jurisdiction in Bankruptcy Proceedings: A Test Case for the Implied Repeal of the Federal Arbitration Act, <u>117 HARV. L. REV. 2296, 2298 (2004)</u>) (stating it is difficult to apply <i>McMahon* standard to bankruptcy cases).

<sup>80</sup> See U.S. Lines, Inc. v. Am. Steamship Owners Mut. Prot. & Indem. Ass'n, (In re U.S. Lines, Inc.), 197 F.3d 631, 639 (2d Cir. 1999); see also Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 671 F.3d 1011, 1020 (9th Cir. 2012) (each case analyzing McMahon standard); Mintze v. Am. Gen. Fin. Servs. (In re Mintze), 434 F.3d 222, 228 (3d Cir. 2006); White Mountain Mining Co. v. Congelton, L.L.C. (In re White Mountain), 403 F.3d 164, 168 (4th Cir. 2005); Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.), 118 F.3d 1056, 1065 (5th Cir. 1997) (each case analyzing McMahon standard).

<sup>&</sup>lt;sup>81</sup> The Wellington Agreement was a multi-party contract under which a group of companies that made asbestos-containing products and their insurers agreed to establish an "Asbestos Claims Facility" for expediting payment of settlements or judgments to personal injury claimants. According to the Wellington Agreement, the claims facility would make payments and then the companies and their insurers would apportion their respective shares of the payments. See <u>In re Nat'l Gypsum Co., 118 F.3d at 1058-59.</u>

<sup>82</sup> Id. at 1058.

ld. at 1061 ("INA argued that the Bankruptcy Court applied an incorrect standard for determining whether to grant a notion to stay under the Act, that the Bankruptcy Court had a duty to grant a stay pending **arbitration**, and that the Bankruptcy Court did not have core jurisdiction over the adversary proceeding.").

<sup>84</sup> *Id. at 1059.* 

<sup>&</sup>lt;sup>85</sup> *Id.* ("NA demanded payment of \$ 3.866,055 . . . plus \$ 1,027,118 accrued interest . . . INA's demand letter stated that, if payment were not received within thirty days, INA would 'institute formal proceedings to collect the amount due."").

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efficient forum to determine the issues raised. <sup>86</sup> The bankruptcy court refused to abstain or to stay the adversary proceeding pending **arbitration**. <sup>87</sup>

On appeal, the Fifth Circuit first found that actions to enforce the discharge injunction are core proceedings because they call on a bankruptcy court to construe and enforce its own order, <sup>88</sup> holding that a declaratory judgment action seeking merely a "declaration that collection of an asserted preconfirmation liability is barred by a bankruptcy court's confirmation of a debtor's reorganization plan is a core proceeding arising under title 11." <sup>89</sup> The court then considered whether a bankruptcy court may deny a motion to stay.

In its analysis, the court rejected the view that **arbitration** of core bankruptcy proceedings is inherently irreconcilable with the Bankruptcy Code, but rather that "nonenforcement of an otherwise applicable **arbitration** provision turns on the underlying nature of the proceeding, *i.e.*, whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether **arbitration** of the proceeding would conflict with the purposes of the Code." <sup>90</sup> Applying this standard, the court found because the declaratory judgment complaint was central to National Gypsum's confirmed reorganization plan, which was derived from the Bankruptcy Code, the bankruptcy court was within its discretion to refuse to order **arbitration** of the adversary proceeding as to avoid conflict with the [\*146] Bankruptcy Code's purpose. <sup>91</sup> However, the court importantly made the distinction that "core" proceedings do not, categorically, give bankruptcy courts the discretion to not enforce **arbitration** agreements, but that the conflict between enforcement and the purpose of the Code must exist. <sup>92</sup> As the Fifth Circuit explained:

The core/non-core distinction conflates the inquiry in *McMahon* and *Rodriguez* with the mere identification of the jurisdictional basis of a particular bankruptcy proceeding. Not all core bankruptcy proceedings are premised on provisions of the Code that 'inherently conflict' with the Federal **Arbitration** Act; nor would **arbitration** of such proceedings jeopardize the objectives of the Bankruptcy Code. Although, as appellees suggest, "the core/non-core distinction is a practical and workable one," it is nonetheless too broad. The "discretion" that ACMC and the Trust urge should exist only where a particular bankruptcy proceeding meets the standard for nonenforcement of an **arbitration** clause in *McMahon* . . . . <sup>93</sup>

The Fifth Circuit established a two-part analysis for determining when a bankruptcy court should refer a matter to **arbitration**. <sup>94</sup> In the first stage of the analysis, the bankruptcy court would apply *McMahon* in determining the source of the rights that would be subject to **arbitration** if the **arbitration** clause were enforced. <sup>95</sup> The crucial

<sup>86 &</sup>lt;u>Id. at 1060-61.</u>

<sup>87</sup> Id. at 1061.

<sup>88</sup> Id. at 1063 (citing In re Polysat, 152 B.R. 866, 888 (Baal., E.D. Pa. 1993)).

<sup>&</sup>lt;sup>89</sup> *Id.* at 1064 (citing <u>Wood v. Wood (In re Wood), 825 F.2d 90, 92 (5th Cir. 1987);</u> see also <u>28 U.S.C. § 157(b)(2)(B), (C), (0)</u> (2012).

<sup>90</sup> In re Nat'l Gypsum Co., 118 F.3d at 1067.

<sup>&</sup>lt;sup>91</sup> *Id*.

<sup>&</sup>lt;sup>92</sup> See id. ("[N]ot all core bankruptcy proceedings are premised on provisions of the Code that 'inherently conflict' with the Federal **Arbitration** Act; nor would **arbitration** of such proceedings necessarily jeopardize the objectives of the Bankruptcy Code.").

<sup>&</sup>lt;sup>93</sup> *Id*.

<sup>&</sup>lt;sup>94</sup> *Id.* (establishing that "non enforcement of an otherwise applicable **arbitration** turns on the underlying nature of the proceeding . . . and, if so, whether **arbitration** of the proceeding would conflict with the puposes of the Code").

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determination was whether the arbitrable issues arose from the debtor's pre-petition rights or from the Bankruptcy Code. <sup>96</sup> In the second stage of the analysis, the bankruptcy court would consider issue-specific policy considerations to determine whether the arbitrable question would implicate the third dimension of the *McMahon* test: there is an inherent conflict between the FAA and the Code. <sup>97</sup> Other circuits have taken a different approach, disregarding the first step of the analysis in the *National Gypsum* opinion. <sup>98</sup>

## [\*147] B. The Second Circuit Court of Appeals

Two years later, like the Fifth Circuit's approach to determining the enforceability of **arbitration** clauses, the Second Circuit Court of Appeals considered, first, whether the proceedings are core and, second, whether the bankruptcy court may enjoin **arbitration**, however, noting that determining the proceeding as "core" will not automatically give the bankruptcy court discretion to stay **arbitration** in *In re U.S. Lines*.

Here, an asbestos production company filed a voluntary chapter 11 petition and sought a declaratory judgment concerning the rights of creditors, specifically creditors holding claims for asbestos-related injuries for which the debtor had agreed to cover by entering into several Protection & Indemnity insurance policies containing **arbitration** clauses. <sup>100</sup> The bankruptcy court held that such action was within its core jurisdiction and denied the creditors' motion to compel **arbitration** of the proceedings. <sup>101</sup>

The Second Circuit first determined that a declaratory judgment action is core as necessary to effectuate an equitable distribution of the bankruptcy estate. <sup>102</sup> The declaratory proceedings directly affect the bankruptcy court's core administrative function of asset allocation among creditors, and they are core. <sup>103</sup> Distinction of core proceedings was important because, as the Second Circuit noted, a conflict between the bankruptcy code and the FAA is lessened in non-core proceedings which are unlikely to present a conflict sufficient to override by implication the presumption in favor of **arbitration**. <sup>104</sup>

The court reasoned "[i]n exercising its discretion over whether, in core proceedings **arbitration** provisions ought to be denied effect, the bankruptcy court must still carefully determine whether any underlying purpose of the Bankruptcy Code would be adversely affected by enforcing an **arbitration** clause." <sup>105</sup> The court held that "it was

- 95 See id.
- <sup>96</sup> See id. at 1068.
- 97 See id. at 1067.
- <sup>98</sup> See <u>In re Payton Constr. Corp., 399 B.R. 352, 362-63 (Bankr. D. Mass. 2009)</u> (holding "the core or non core status of a particular proceeding is not a dispositive indicator of whether **arbitration** of the matter would conflict with the purpose of the Bankruptcy Code").
- <sup>99</sup> See U.S. Lines, Inc. v. Am. Steamship Owners Mut. Prot. & Indem. Ass'n, (In re U.S. Lines, Inc.), 197 F.3d 631, 637, 640 (2d Cir. 1999) ("Whether a contract proceeding is 'core' depends on (1) whether the contract is antecedent to the reorganization petition, and (2) the degree to which the proceeding is independent of the reorganization, an inquiry that hinges on the nature of the proceeding.").
- 100 Id. at 635.
- 101 Id. at 634.
- 102 See id. at 639.
- 103 See id.
- <sup>104</sup> See id. at 640.
- <sup>105</sup> Id. (citing Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith Inc., 885 F.2d 1149, 1161 (3d Cir. 1989)).

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within the bankruptcy court's discretion to refuse to refer the declaratory judgment proceedings, which it properly found to be core, to **arbitration**." <sup>106</sup>

## [\*148] C. The Fourth Circuit Court of Appeals

The Fourth Circuit Court of Appeals has largely followed suit with the Second and Fifth circuits. In *White Mountain*, in response to a motion to compel the creditor to submit claims to **arbitration** under a pre-petition agreement and to stay or dismiss the adversary proceedings, the bankruptcy court denied the motion reasoning that because the creditor's complaint sought a determination over whether he was owed money by the debtor, it entailed a core proceedings under <u>28 U.S.C. section 157(b)(2)(B)</u>. <sup>107</sup> The bankruptcy court found the core proceeding trumped the **arbitration**. <sup>108</sup>

On appeal, the Fourth Circuit noted the *McMahon* line of analysis: "[i]f 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>109</sup> Under the third inherent conflict line of analysis, and in keeping with the reasoning of *U.S. Lines*, the Fourth Circuit found that, in the bankruptcy setting, congressional intent to permit a bankruptcy court to enjoin **arbitration** is sufficiently clear to override even international **arbitration** agreements. <sup>110</sup> The inherent conflict was clear because both the adversary proceeding and the **arbitration** involved a core issue: determining whether the creditor's advances to the debtor were debt or equity. <sup>111</sup>

## D. The Third Circuit Court of Appeals

The Third Circuit most recently visited the enforceability of **arbitration** in bankruptcy proceedings in 2006. <sup>112</sup> The *Mintze* court, relying on the earlier Third Circuit decision in *Hayes*, stated that whether the *McMahon* standard is met determines whether the court has the discretion to deny enforcement of an otherwise applicable **arbitration** clause. <sup>113</sup> The circuit court clarified: whether core or not, the *McMahon* standard must first be satisfied before the bankruptcy court has the discretion to deny **arbitration**. <sup>114</sup>

The bankruptcy court had determined that the debtor's rescission claim, based on the Truth in Lending Act ("TILA") and several federal and state consumer protection laws, was sufficient to create an inherent conflict between the **[\*149]** Bankruptcy Code's underlying purposes and those of **arbitration**, concluding the proceeding was best left in the bankruptcy court. <sup>115</sup> However, the Third Circuit stated "[the court] cannot agree with this conclusion" specifically noting the debtor's claims were not created by the Bankruptcy Code. <sup>116</sup> The Third Circuit further noted

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106 Id. at 641.
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<sup>107</sup> See White Mountain Mining Co. v. Congelton, L.L.C. (In re White Mountain), 403 F.3d 164, 167 (4th Cir. 2005).

<sup>108</sup> See id.

<sup>109</sup> Id. at 168 (quoting Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 227 (1987)).

<sup>110</sup> See id. at 170.

<sup>111</sup> See id.

<sup>&</sup>lt;sup>112</sup> See Mintze v. Am. Gen. Fin. Servs. (In re Mintze), 434 F.3d 222, 222 (3d Cir. 2006).

<sup>113</sup> See id. at 232.

<sup>114</sup> See id.

<sup>115</sup> See id. at 231.

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that without a bankruptcy issue to be decided by the bankruptcy court, "we cannot find an inherent conflict between **arbitration** of [the debtor's] federal and state consumer protection issues and the underlying purposes of the Bankruptcy Code." <sup>117</sup> The court further noted that the court could not perceive of a sufficiently adverse effect on the underlying purposes of the Bankruptcy Code should the **arbitration** clause be enforced. Ultimately, the Third Circuit concluded that the "[b]ankruptcy court erred when it determined it had the discretion to deny enforcement of the **arbitration** provision in the contract between [debtor and creditor]." <sup>118</sup>

## E. The Ninth Circuit Court of Appeals

In 2012, the Ninth Circuit held that the **arbitration** of a claim presented by a creditor would conflict with the purposes of a provision of the Bankruptcy Code and the purposes and policies of the Bankruptcy Code as a whole.

Here, the debtor, Thorpe Insulation Co. ("Thorpe"), distributed and installed asbestos-containing products from 1948-1972. About 12,000 claims for asbestos-related injuries or deaths had been brought against Thorpe 120 with Thorpe's insurers, including Continental Insurance Company ("Continental"), paying more than \$ 180 million defending and indemnifying these claims. 121 In 1985, Continental and Thorpe entered into the Wellington Agreement calling for binding **arbitration** of coverage disputes. 122 In 1988, Thorpe had exhausted its coverage under Continentals' policies and Continental ceased indemnifying Thorpe. 123 Thorpe then sought "non products" coverage under Continental's policies, asserting that such "non products" coverage was not subject to the policies' liability limits. 124 Continental disputed this and initiated **arbitration** under the Wellington Agreement. The arbitrator sided with Continental, finding that Thorpe had no remaining [\*150] coverage rights under Continental's policies. 125 Thorpe appealed, and the parties agreed to settle. In April 2003, the parties executed an integrated Settlement Agreement and Release (the "Settlement"). 126

The Settlement only released Thorpe's claims against Continental, not the direct action rights of individual asbestos claimants or to the contribution, indemnity, or subrogation rights of other insurers. <sup>127</sup> Lawsuits continued against Thorpe and its insurance coverage with other insurers dwindled. <sup>128</sup> Thorpe considered bankruptcy, hoping to

- 117 Id. at 231-32.
- <sup>118</sup> *Id. at 232*.

- <sup>120</sup> *Id. at 1014.*
- <sup>121</sup> *Id.*
- <sup>122</sup> *Id.*
- <sup>123</sup> *Id.*
- <sup>124</sup> *Id*.
- <sup>125</sup> *Id.*
- <sup>126</sup> *Id*.
- <sup>127</sup> *Id. at 1015.*

<sup>116</sup> Id. (holding statutory claims are based on TILA and several federal and state consumer protection laws).

<sup>119</sup> See Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 671 F.3d 1011, 1024 (9th Cir. 2012) (following lower courts in concluding creditors' claim would overlap with Bankruptcy Code provisions and interfere with section 524(g) process, and determining bankruptcy court had discretion to conclude **arbitration** clause unenforceable).

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reorganize under section 524(g), a unique mechanism for consolidating asbestos-related assets and liabilities of a debtor into a single trust for the benefit of present and future asbestos claimants, in that it authorizes the bankruptcy court to enter a "channeling injunction" that channels claims to the trust in order to prevent claimants from suing the debtor. <sup>129</sup> The injunction may also bar actions against third party insurers based on asbestos-related claims against the debtor if the third parties contribute to the trust in amounts commensurate with their likely liability and requires that a class of claimants be established and at least 75% approve the plan. <sup>130</sup>

In preparation of filing for bankruptcy, Thorpe negotiated with insurers other than Continental to ensure their funding of the section 524(g) trust. <sup>131</sup> Thorpe also identified and negotiated with potential asbestos claimants to ensure their approval of the section 524(g) trust. <sup>132</sup> Continental contended these actions violated the Settlement Agreement and sought to arbitrate its claim. <sup>133</sup> **Arbitration** was scheduled for October 16, 2007. <sup>134</sup> Thorpe filed for chapter 11 bankruptcy on October 15, 2007. <sup>135</sup> Continental filed a proof of claim, which Thorpe objected to and, in response, Continental moved to compel **arbitration** alleging: (1) Thorpe's pre-petition acquisition of the other insurers' contribution; (2) Thorpe's post-petition assignment of such rights to the trust created under the <u>11</u> <u>U.S.C. section 524(g)</u> plan; (3) Thorpe's pre-petition encouragement of direct action claims against Continental; and (4) Thorpe's cooperation and participation as a plan proponent in drafting, proposing, and seeking confirmation of a Plan designed to assist asbestos claims and in bringing direct action claims against Continenta1. <sup>136</sup>

The bankruptcy court denied Continental's motion to compel **arbitration** and disallowed its claim holding that the allowance or disallowance of Continental's [\*151] claim was a core matter under <u>28 U.S.C. section 157(b)(2)</u>. <sup>137</sup> The bankruptcy court found that, "as a matter of fundamental bankruptcy policy, only a bankruptcy court should decide whether the manner in which someone has administered a bankruptcy estate gives rise to a claim for damages." <sup>138</sup> Ultimately, the matter in dispute, the bankruptcy court found, was a core matter and had discretion in a case not to send the issue to **arbitration**. <sup>139</sup> The bankruptcy court further disallowed Continental's claim as a matter of law--finding that Thorpe's actions did not violate the Settlement Agreement. <sup>140</sup> Continental appealed and the district court affirmed. <sup>141</sup> Continental appealed the district court contending that its claim should be

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Id.
Id.; see generally 11 U.S.C. § 524 (2012).
In re Thorpe Insulation Co., 671 F.3d at 1015; see generally 11 U.S.C. § 524 (2012).
In re Thorpe Insulation Co., 671 F.3d at 1015.
Id. at 1016.
Id.
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<sup>138</sup> *Id.* (acknowledging policy arguments favoring **arbitration**, but ultimately deciding that in core matters such as this, bankruptcy court has discretion not to send dispute to **arbitration**).

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139 See id.140 See id.
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<sup>137</sup> *Id. at 1017.* 

<sup>141</sup> See id. at 1019.

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arbitrated under the **arbitration** clause in the Settlement Agreement because the claim is non-core and, even if the claim is core, it should be arbitrated because **arbitration** would not inherently conflict with the Bankruptcy Code. 142

Although the Ninth Circuit pointed out the liberal federal policy favoring **arbitration** agreements under the FAA, citing *McMahon*, the court also pointed out that the FAA's mandate may be overridden by a contrary congressional command <sup>143</sup> The court had to determine whether Congress intended to make an exception to the FAA for claims arising in bankruptcy proceedings, an intention discernible from the text, history, or purpose of the Bankruptcy Code. <sup>144</sup> The court did, not find such intent in the text or the legislative history of the Bankruptcy Code, but determined there is an inherent conflict between **arbitration** and the underlying purposes of the Bankruptcy Code. <sup>145</sup>

Ultimately, the Ninth Circuit found that regardless of whether the proceeding was core or not, the *McMahon* standard must still be met--that is, a bankruptcy court may decline to enforce an otherwise applicable **arbitration** provision only if **arbitration** would conflict with the underlying purposes of the Bankruptcy Code. <sup>146</sup> The court found that the core/non-core determination is not alone dispositive. <sup>147</sup> Continental's claim was found, however, to be a core proceeding because Continental filed a proof of claim, and Thorpe objected to the claim, so under <u>28</u> <u>U.S.C. section 157(b)(2)(B)</u>, the allowance or disallowance of that claim was a core proceeding. <sup>148</sup> Continental's claim disputed or affected assets in the <u>11 U.S.C. [\*152] section 524(g)</u> trust and the rights of other creditors. <sup>149</sup> Resolution of that claim directly affected the administration of the bankruptcy estate.

The court further reasoned that, "because Congress intended that the bankruptcy court oversee all aspects of a 524(g) reorganization, only the bankruptcy court should decide whether the debtor's conduct in the bankruptcy gives rise to a claim for breach of contract. **Arbitration** in this case would conflict with congressional intent." <sup>150</sup> The court further noted that "[a]rbitration of a creditor's claim against a debtor, even if conducted expeditiously, prevents the coordinated resolution of debtor-creditor rights and can delay the confirmation of a plan of reorganization." <sup>151</sup> These pragmatic concerns led the court to conclude that the "**arbitration** of the claim presented by Continental would conflict with the purposes and policies of 524(g) and the Bankruptcy Codes as a whole . . . " and that the bankruptcy court had discretion not to enforce the **arbitration** clause. <sup>152</sup>

F. Comparing and Evaluating the Decisions of the Circuit Courts of Appeals

142	See id at 1018-20.
143	See id. at 1020 (quoting Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 227 (1987)).
144	See id.
145	See id.
146	See id. at 1021.
147	See id.
148	See id. at 1017.
149	See id. at 1021.
150	Id. at 1022.
151	Id. at 1023.
152	Id. at 1024.

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The circuit courts seem nearly unanimous there is no discretion to deny **arbitration** of non-core claims if a valid **arbitration** clause applies. That does not mean, however, that courts have discretion to refuse to enforce valid **arbitration** clauses in core proceedings. Several different tests have emerged when a court may refuse to enforce an **arbitration** agreement in a core proceeding.

The Second and Fourth Circuits find the distinction between core and non-core more central to the *McMahon* analysis, whereas the Third, Fifth, and Ninth Circuits find such distinction, at minimum, dispositive, however, these latter courts circuits take the effort to define the issue as core or non-core. The circuits differ over the enforceability of **arbitration** clauses in core matters where the rights to be vindicated arise solely out of non-bankruptcy law. The Third, Fifth, and Ninth Circuits do not allow courts to refuse to enforce **arbitration** in such circumstances, while the Second and Fourth Circuits appear to allow it. <sup>153</sup>

The Third and Fifth Circuits have held that a bankruptcy court may refuse to enforce an **arbitration** clause if the proceedings are based on Bankruptcy Code provisions and **arbitration** would inherently conflict with the purposes of the Code. <sup>154</sup> The Second and Fourth Circuits have adopted a test providing an additional basis for refusing to enforce an **arbitration** clause. Besides holding that a court may refuse to enforce an **arbitration** agreement involving a core claim if the dispute is based on the Bankruptcy Code and **arbitration** would inherently conflict with the purposes of the Code, a court may also refuse to enforce an **arbitration** [\*153] agreement if **arbitration** of the dispute would jeopardize the objectives of the Code.

To clarify, the circuit courts are in agreement that both district and bankruptcy courts must enforce an otherwise valid **arbitration** clause covering a non-core claim. The courts recognize that non-core claims do not originate from substantive rights created by the Bankruptcy Code. Rather, they are based on state or federal laws outside the Bankruptcy Code. As such, bankruptcy courts can hear them only in their advisory role as adjuncts to the district courts and can provide findings of fact and recommendations. Bankruptcy courts have no discretion to refuse to compel **arbitration** if a district court judge could not refuse to compel **arbitration** when hearing the same claims in a non-bankruptcy context. However, a split has emerged among the circuits when a bankruptcy court may refuse to enforce an **arbitration** agreement covering a core claim.

## **III.** PROPOSED SOLUTIONS FOR RESOLVING THE CIRCUIT SPLIT

The circuit split described in the preceding section mainly arises from a disagreement among the circuit courts about whether it makes a difference for applying *McMahon* that the arbitrable dispute arises from rights created by bankruptcy law or by some other form of law. One way to avoid this dispute is to determine arbitrability on another basis.

## A. Characterizing Arbitration Agreements as Executory Contracts

Under the Bankruptcy Code, an executory contract is one that has yet to be fully performed. <sup>156</sup> The Trustee or DIP has a choice of how to proceed with executory contracts. The Trustee or DIP can reject those contracts or assume them. <sup>157</sup> If the contract is rejected, the contract is treated as breached and the estate is liable for a

<sup>&</sup>lt;sup>153</sup> See Kirgis, supra note 9, at 519-20.

<sup>&</sup>lt;sup>154</sup> See id.

<sup>155</sup> See id. at 520.

<sup>156</sup> See id. at 508.

<sup>&</sup>lt;sup>157</sup> See id. at 509.

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damage claim by the other party to the contract and the other party is excused from further performance of the rejected contract. <sup>158</sup> If the contract is assumed, the Trustee or DIP is bound to perform it as is the other party.

Given executory contracts, some commentators have posited that an agreement to arbitrate, by itself and those included as an **arbitration** clause in a broader agreement, could be an executory contract if the **arbitration** proceeding was not completed. <sup>159</sup> If the parties' dispute was not ripe when the bankruptcy proceedings began, or if the dispute was ripe but the **arbitration** was ongoing at the time of the bankruptcy filing, it would be possible to say that the agreement to arbitrate was not [\*154] fully performed and was therefore executory. <sup>160</sup> This definition requires the agreement to arbitrate be a separate and independent executory contract, as executory contracts must be rejected or assumed in whole. <sup>161</sup>

The problem with treating **arbitration** agreements as executory contracts is that they are often, if not usually, included as clauses in other agreements. <sup>162</sup> It can be difficult or impossible for a Trustee or DIP to make an independent judgment about an agreement to arbitrate. <sup>163</sup> Courts could, however, employ principles of severability to determine whether and when **arbitration** clauses in broader agreements could be enforced on their own. <sup>164</sup> Where a contract is "divisible" or "severable" under state law, however, courts allow the single contract to be separately assumed or rejected. <sup>165</sup>

If **arbitration** agreements are treated as a severable contract, then the Trustee or DIP may reject one, both, or neither of the contracts. <sup>166</sup> Determining whether to reject or assume the **arbitration** agreement could turn on whether assumption of the **arbitration** agreement creates value for the estate. Where the Trustee or DIP rejects the **arbitration** agreement, such rejection constitutes a breach of the agreement and entitles the other party to a prepetition claim for the breach of contract.

B. Legislative Action to Clarify the Distinction between Core and Non-Core Matters

<sup>&</sup>lt;sup>158</sup> See Jay Lawrence Westbrook, A Functional Analysis of Executory Contracts, <u>74 MINN. L. REV. 227, 231 (1989).</u>

<sup>159</sup> See Vern Countryman, Executory Contracts in Bankruptcy: Part I, 57 MINN. L. REV. 439, 460 (1973).

<sup>&</sup>lt;sup>160</sup> See Polina Kushelev, An International Approach to Breaking The Core of the Bankruptcy Code and FAA Conflict, <u>28</u> EMORY BANKR. DEV. J. 355, 370 (2012).

<sup>&</sup>lt;sup>161</sup> See In re Aneco Elec. Const., Inc., 326 B.R. 197, 200 (Bankr. M.D. Fla. 2005).

<sup>&</sup>lt;sup>162</sup> See Kirgis, supra note 9, at 521.

<sup>163</sup> See id.

<sup>&</sup>lt;sup>164</sup> See id. at 522.

<sup>165</sup> See Byrd v. Gardinier (In re Gardinier, Inc.), 831 F.2d 974, 976-78 (11th Cir. 1987), cert. denied, 488 U.S. 853 (1988); In re Adelphia Bus. Solutions, Inc., 322 B.R. 51, 54 n.10 (Bankr. S.D.N.Y. 2005) (citing Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co., 83 F.3d 735, 741 (5th Cir. 1996)); In re Wolflin Oil, L.L.C., 318 B.R. 392, 397 (Bankr. N.D. Tex. 2004); In re Cafeteria Operators, L.P., 299 B.R. 384, 389 (Bankr. N.D. Tex. 2003); In re Plitt Amusement Co. of Wash., Inc., 233 B.R. 837, 847-48 (Bankr. C.D. Cal. 1999); In re Steaks to Go, Inc., 226 B.R. 35, 38 (Bankr. E.D. Mo. 1998); In re Holly's, Inc., 140 B.R. 643, 681 (Bankr. W.D. Mich. 1992); In re Cutters, Inc., 104 B.R. 886, 889 (Bankr. M.D. Tenn. 1989); In re Brentano's, 29 B.R. 881 (Bankr. S.D.N.Y. 1983).

<sup>&</sup>lt;sup>166</sup> Note, *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act, <u>117 HARV. L.</u> <u>REV. 2296, 2314 (2004)</u> (arguing severability is fundamental to law of arbitration because without severability, "either an arbitration clause embedded in a contract would become invalid and therefore moot at the time the clause is most crucial, or parties would be required to enter into a formalist, concurrent signing of a separate arbitration contract").* 

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Another proposed solution is legislative: Congress could enact a rule providing that **arbitration** clauses are not enforceable in core proceedings regardless of whether the causes of action are derived from the debtor or are brought under provisions of the Bankruptcy Code designed to protect the interests of the creditors or the bankruptcy estate. <sup>167</sup> As an exception, bankruptcy courts could still exercise [\*155] their discretionary power to abstain under 18 U.S.C. section 1334(c)(1). <sup>168</sup> And bankruptcy courts should retain supervisory authority over **arbitration** matters referred out of a bankruptcy case. <sup>169</sup>

Advocates of this solution have argued such a rule would be justified by the principles and policy objectives underlying both bankruptcy law and the FAA. <sup>170</sup> The governing principle of federal **arbitration** law is borrowed from foundational principles of contract law--that parties should be required to arbitrate their disputes when they have agreed to do so. <sup>171</sup> Parties should not be compelled to arbitrate disputes they have not agreed to arbitrate. If a debtor is involved in a dispute subject to an **arbitration** agreement, the debtor and the other party to the **arbitration** agreement have agreed to arbitrate. But, once bankruptcy proceedings begin, if that dispute is a core matter of the bankruptcy proceedings, it no longer implicates only the interests of the debtor and the other party. That dispute has the potential to affect the interests of numerous third parties, who never agreed to arbitrate any dispute with the debtor. Permitting **arbitration** in all core matters would require parties to have their interests determined by an arbitrator when they had not agreed to do so. <sup>172</sup>

The same rationale explains why, regarding non-core matters, the default rule should be that **arbitration** agreements would be enforced. <sup>173</sup> Bankruptcy courts should retain discretion to preclude **arbitration** when parties who did not consent to the **arbitration** of the dispute have an interest in resolving that dispute. <sup>174</sup> New legislation could provide for interlocutory appellate review of all decisions regarding the enforceability of a pre-dispute **arbitration** agreement, in both core and non-core matters, and the enforceability of **arbitration** awards. <sup>175</sup> Providing for this appellate review would promote the speedy resolution of matters referred from bankruptcy to **arbitration** and would also assure more consistent results between arbitral decisions and those by the bankruptcy courts.

## C. Shifting the Burden of Proof Regarding the Enforcement of Arbitration Agreements

Another approach to the conflict attempts to reconcile the *McMahon* test and the established rules for enforcing **arbitration** agreements while recognizing **arbitration** implicating bankruptcy estate assets often involves unfairness to other [\*156] creditors who have an interest in the estate but not in the particular dispute to be arbitrated. Under existing principles governing the application of the FAA, and particularly under the standard established in *McMahon*, the party seeking to avoid the enforcement of a facially valid **arbitration** agreement must show that the **arbitration** agreement should not be enforced. But in bankruptcy proceedings, a better course for

<sup>&</sup>lt;sup>167</sup> See Resnick, supra note 43, at 214.

<sup>168</sup> See id.

<sup>&</sup>lt;sup>169</sup> See id. (stating in instances where court abstains from hearing core proceeding, "a mandatory **arbitration** provision governing the dispute should be enforceable" to ensure such governing provision is consistent with rights of all affected parties).

<sup>&</sup>lt;sup>170</sup> See id. at 216-17.

<sup>&</sup>lt;sup>171</sup> See id. at 185-87.

<sup>172</sup> See id. at 218.

<sup>&</sup>lt;sup>173</sup> See id.

<sup>174</sup> See id. at 219.

<sup>&</sup>lt;sup>175</sup> See id.

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advancing the policy objectives of both the Bankruptcy Code and the FAA might be to shift the burden to non-debtors who seek to arbitrate matters affecting assets in the bankruptcy estate.

One of the primary problems with the **arbitration** of disputes implicating a bankruptcy estate is that resolving a dispute through **arbitration** proceedings may cost more and take more time than resolving the dispute as part of the ordinary bankruptcy process. This added expense and delay can be prejudicial to creditors who are not parties to the **arbitration** but who have an interest in how all of the debtor's assets are disposed. An **arbitration** outside of bankruptcy court ties up an asset or assets that could be distributed among other creditors.

If a non-debtor who has an **arbitration** agreement with the debtor wishes to resolve a dispute with the debtor through. **arbitration**, the need to be fair to other creditors and to preserve the fair and efficient disposition of the debtor's assets should require that the non-debtor demonstrate that **arbitration** is warranted. The burden regarding arbitrability should be shifted from the party seeking to avoid **arbitration**, as it is under *McMahon*, as to the party seeking to enforce an **arbitration** agreement—but only when that party is a non-debtor and when the enforcement of the **arbitration** agreement has the potential to delay the resolution of the bankruptcy process. Because of this burden-shifting, the party seeking **arbitration** must show that the reference of the dispute to **arbitration** would not substantially prejudice the creditors and other parties who have an interest in the bankruptcy estate but who would not be involved. 177

In addition, both the bankruptcy court and the district court could exercise expedited judicial review over any **arbitration** award, both in the bankruptcy court's ordinary jurisdiction and of the district court's appellate jurisdiction over the decisions of the bankruptcy court. Such review would assure a reasonable level of consistency with the decisions in the other aspects of the bankruptcy. Such review would not require legislative changes because courts already may expedite both ordinary and appellate review of **arbitration** awards.

#### CONCLUSION

The *McMahon* Court established that, regardless of the kind of case, the question of when to enforce **arbitration** agreements depends upon determining the **[\*157]** predominant Congressional policy objective. <sup>178</sup> If the only policy consideration at stake in a case is the policy favoring **arbitration**, then **arbitration** must be ordered. If there are **competing** policy objectives at stake, the availability of **arbitration** depends upon which policy Congress intended to prevail. Because Congressional intent is the determinative factor here, the best way to determine Congressional intent is for Congress to enact legislation clarifying when **arbitration** should be ordered in a bankruptcy proceeding and when it should not. This need for Congressional action is necessary given that the Supreme Court has forgone an opportunity to further clarify determining the venue, **arbitration** or bankruptcy court, by declining to hear *Thorpe* on appeal. <sup>179</sup>

Should bankruptcy jurisdiction regarding core and non-core matters be clarified, a legislative solution would provide the greatest clarity and definitiveness on the matter of enforcing **arbitration** agreements in bankruptcy proceedings such that bankruptcy courts would have authority to enter final judgments and orders on core matters subject to **arbitration** agreements and should defer non-core matters subject to **arbitration** agreements to the appropriate arbitral tribunal. Distinguishing between core and non-core issues provides a bright-line rule on enforcement of **arbitration** agreements in bankruptcy. This solution would be most effective given the circuit court decisions all involve making a core or non-core distinction if the core and non-core distinction was clear and absolute. 180 As

<sup>&</sup>lt;sup>176</sup> See <u>Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 227 (1987).</u>

<sup>&</sup>lt;sup>177</sup> See Kirgis, supra note 9, at 525.

<sup>&</sup>lt;sup>178</sup> See McMahon, 482 U.S. at 227.

<sup>&</sup>lt;sup>179</sup> See <u>Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 671 F.3d 1011 (9th Cir. 2012),</u> cert. denied, **133** S. Ct. 119 (2012).

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previously discussed, however, this distinction of core and non-core bankruptcy matters is far from well-defined and straightforward in light of the recent Supreme Court decisions on bankruptcy court jurisdiction and the increasing uncertainty of bankruptcy court authority to enter final orders and judgments on certain matters. <sup>181</sup>

Given, however, the apparent shrinking authority of bankruptcy courts to finally adjudicate what have been considered "core" matters and that action from Congress is not forthcoming, the most effective solution for determining when **arbitration** should occur in bankruptcy would be to permit bankruptcy trustees to treat **arbitration** agreements like executory contracts and to perform those contracts when it is in the best interests of the bankruptcy estate to do so. Treating **arbitration** agreements as severable executory contracts removes the need for any court to make the determination that the dispute is "core" or otherwise.

Although this approach provides a practical approach to addressing **arbitration** agreements in the bankruptcy context, it does little in the way of analyzing Congressional intent or recognizing the objectives of the FAA or giving any [\*158] deference to parties and their pre-bankruptcy agreement to arbitrate. This criticism is also fairly made of the recommendation to shift the burden of proof to the non-debtor party seeking enforcement of an **arbitration** agreement. Questions regarding the valuation of the claim giving rise from the rejection of an **arbitration** clause may provide difficulty, however, bankruptcy courts have a long history of providing valuation solutions where the value claim poses difficulty or uncertainty and, such issues are soundly within the bankruptcy courts' core jurisdiction.

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<sup>&</sup>lt;sup>180</sup> See Troy A. McKenzie, Getting to the Core of Stern v. Marshall: History, Expertise & the Separation of Powers, <u>86 AM.</u> BANKR. L.J. 23, 24 (2012) (asserting core/non-core distinction became "commonplace").

<sup>&</sup>lt;sup>181</sup> See generally <u>Stern v. Marshall, 131 S. Ct. 2594, 2601-02 (2011)</u> (stating distinction between core and non-core proceedings); see also <u>Executive Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165, 2174 (2014)</u> (noting Bankruptcy Court's failure to state whether decision was pursuant to core or non-core authority).

<sup>&</sup>lt;sup>182</sup> See, e.g., <u>Durkin v. Benedor Corp. (In re G.I. Indus., Inc.), 204 F.3d 1276, 1280 (9th Cir. 2000);</u> <u>Continental Nat'l Bank of Miami v. Sanchez (In re Toledo), 170 F.3d 1340, 1349-50 (11th Cir. 1999);</u> <u>Wood v. Wood (In re Wood), 825 F.2d 90, 97 (5th Cir. 1987).</u>

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