By Leslie A. Berkoff, Candice L. Kline and Simran Merchant[1]

A Contest of Wills, or Deference Due? Arbitration and Bankruptcy

Coordinating Editor Leslie A. Berkoff
Moritt Hock & Hamroff LLP; New York

Candice L. Kline
Saul Ewing LLP
Chicago

Simran Merchant
Saul Ewing LLP
Chicago

Leslie Berkoff is a partner with Moritt Hock & Hamroff LLP in New York and chairs the firm's Dispute Resolution Practice Group. Candice Kline is a partner, and Simran Merchant is a summer associate, with Saul Ewing LLP in Chicago.

Arbitration and bankruptcy, despite being creatures of federal statutes, could not be more different from one another, and reconciling their application has proven challenging for both arbitrators and bankruptcy judges in their dispute-resolution forums. Arbitration is governed by the Federal Arbitration Act (FAA)[2] and applicable rules issued by the American Arbitration Association (AAA).

Arbitration is a private process with strong confidentiality protections, and is often binding with limited routes for appeal. Arbitration occurs outside of the public scrutiny between the involved parties typically without regard for third-party concerns. Bankruptcy, on the other hand, is a multi-party public process with few confidentiality protections governed by the Bankruptcy Code and Federal Rules of Bankruptcy Procedure (FRBP), which provide robust appellate rights. Despite the foregoing, arbitration clauses — often the exclusive agreed-upon method for resolving disputes — frequently come up in the bankruptcy forums.

The bankruptcy courts then face challenges in enforcing arbitration clauses, balancing concerns of policy and practicality while attempting to harmonize the FAA with the Bankruptcy Code. Recent decisions in *In re Celsius Network LLC* and *In re Yellow Corp*. demonstrate such a struggle. This article will discuss how the courts have reconciled competing policy considerations to enforce arbitration clauses.[3]

A Longstanding Policy Favors Arbitration Under the FAA

The adoption of the FAA was aimed to counter judicial hostility to arbitration, particularly in commercial agreements between equal parties, and to provide guidance for courts enforcing consumer arbitration agreements.[4] Therein, Congress declared that liberal federal policy favors arbitration clauses.[5] Despite the foregoing, a party opposing arbitration might prevail if evidence shows that "Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue."[6]

To determine congressional intent, the U.S. Supreme Court assesses "(1) the text of the statute; (2) its legislative history; and (3) whether 'an inherent conflict between arbitration and the [statute's] underlying purposes [exists].'"[7] The Court has already opined on when arbitration clauses should be honored under federal statutes and whether certain statutory exceptions apply.

For example, in *Epic Systems v. Lewis*, the Supreme Court upheld the binding nature of arbitration agreements in a labor dispute and rejected an attempt to draw a conflict between the FAA and other federal labor statutes.[8] In that decision, the Court concluded that the FAA's mandate to enforce arbitration agreements for individualized proceedings trumped the National Labor Relations Act (NLRA).[9] Although not a bankruptcy case, *Epic Systems* demonstrates the challenges that courts face when two federal statutes are at odds with each other.

In *New Prime Inc. v. Oliveira*, the Supreme Court relied on an exception in the FAA, providing that FAA does not apply to contracts for employment, when it ruled against enforcing arbitration clause embedded in an independent contractor agreement.[10] The Court addressed whether a court or an arbitrator must determine the applicability of § 1 of the FAA, which applies only to "contracts of employment," and whether that clause applies to independent contractors. Although the Court concluded that any contract for work fell under the FAA's "contracts of employment" definition — including independent contractor contracts — the dispute was nonarbitrable because all "contracts of employment" were exempt from enforcement under the FAA, although state laws may still apply.[11]

In *Lamps Plus Inc. v. Varela*, the Supreme Court confronted whether the arbitration agreement's ambiguity provided sufficient basis for compelling classwide arbitration.[12] In this case, an employee who had signed an ambiguous contract agreeing to

1 Ms. Merchant is also a law student at the University of Illinois-Chicago School of Law.
2 9 U.S.C. § 1, *et seq.*
3 *See In re Celsius Network LLC*, No. 22-10964, 2024 WL 1719633 (S.D.N.Y. April 22, 2024); *In re Yellow Corp.*, Case No. 23-11069, 2024 WL 1313308 (Bankr. D. Del. March 27, 2024).
4 *See Mintze v. Am. Fin. Servs. Inc. (In re Mintze)*, 434 F.3d 222, 228 (3d Cir. 2006).
5 *See Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 220 (1985).
6 *In re Mintze*, 434 F.3d at 229 (quoting *Shearson/Am. Exp. Inc. v. McMahon*, 482 U.S. 220, 226 (1987) ("*McMahon*")).
7 *McMahon*, 482 U.S. at 226-27 (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 628 (1985)).
8 *Epic Systems v. Lewis*, 584 U.S. 497, 502 (2018).
9 *Id.* at 510.
10 *New Prime Inc. v. Oliveira*, 586 U.S. 105 (2019).
11 *Id.* at 110.
12 *Lamps Plus Inc. v. Varela*, 587 U.S. 176 (2019).

arbitrate his disputes brought a class action on behalf of all employees.[13] Lamps Plus moved to compel arbitration on an individual rather than classwide basis, and to dismiss the lawsuit. Applying California state law, the lower courts found the agreement ambiguous on class claims and construed the provision against Lamps Plus, compelling class arbitration.[14] Lamps Plus appealed, and the Supreme Court reversed,[15] holding that arbitration must arise from consent and not coercion.[16] Applying California's law on ambiguity, the Court found that consent to class arbitration was absent and reversed.[17]

These cases suggest a fact-intensive, case-by-case approach to enforcement of arbitration agreement considerations with a particular emphasis on the existence of consent or a lack thereof. This is especially true in the bankruptcy context.

Bankruptcy Courts Follow *McMahon* but Also Consider the Bankruptcy Code

Bankruptcy courts may hesitate to enforce arbitration clauses because arbitration removes the case from their immediate purview and decision-making power. However, the FRBP support the use of arbitration.

Bankruptcy Rule 9019(c) states that "[o]n stipulation of the parties to any controversy affecting the estate the court may authorize the matter to be submitted to final and binding arbitration." This provision dates to the Bankruptcy Act of 1898 and the 1983 modifications, which allowed a trustee (subject to the court's direction) to submit to arbitration any controversy arising in the settlement of the estate. The legislative history for these statutes is equally supportive of the construct of arbitration.[18]

Consistent with these principles, the Third Circuit in *Mintze* stated that "a bankruptcy court lacks the authority and discretion to deny [an arbitration clause's] enforcement *unless* the party opposing arbitration can establish congressional intent, under the *McMahon* standard, to preclude waiver of judicial remedies for the statutory rights at issue."[19] This determination historically has hinged on whether the matter is core or non-core.

Bankruptcy courts might find "substantially" core matters arbitrable.[20] As previously stated, the *Mintze* decision turned on the "underlying nature of the proceedings, *i.e.*, whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether the arbitration proceeding would conflict with the purposes of the Code."[21] The 2024 decisions in *Celsius* and *Yellow* offer fresh perspectives on reconciling arbitration clauses and bankruptcy, and both suggest a new arbitration-friendly approach.

13 *Id.* at 179.
14 *Id.* at 180.
15 *Id.* at 188.
16 *Id.* at 184 (citing *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010)).
17 *Id.* at 189.
18 *See* Donald L. Swanson, "Bankruptcy's ADR Rules Have Changed a Little over the Past Century," *Mediatbankry: On Bankruptcy and Mediation* (Oct. 6, 2016), *available at* mediatbankry.com/2016/10/06/bankruptcys-adr-rules-have-changed-little-over-the-past-century (unless otherwise specified, all links in this article were last visited on June 28, 2024).
19 *In re Mintze*, 434 F.3d at 229 (emphasis in original); *see also MBNA Am. Bank NA v. Hill*, 436 F.2d 104, 110 (2d Cir. 2006) (whether arbitrating dispute jeopardizes objectives of Bankruptcy Code); *Phillips v. Congelton LLC (In re White Mountain Mining Co.)*, 403 F.3d 164 (4th Cir. 2005) (whether dispute could not be arbitrated because it involved core issue that would substantially interfere with debtor's ability to reorganize).
20 *In re Hostess Brands Inc.*, Case No. 12-22052, 2013 WL 82914, at *4 (Bankr. S.D.N.Y. Jan. 7, 2013).
21 *In re Mintze*, 434 F.3d at 231 (quoting *In re Nat'l Gypsum Co.*, 118 F.3d 1056, 1067 (5th Cir. 1997)).

Celsius Court Enforces an Agreement to Arbitrate — Broadly

In *Celsius*, the district court reversed the bankruptcy court's order and held that it should have compelled arbitration to determine whether the claims at issue were arbitrable.[22] The bankruptcy court had assessed whether the parties agreed to arbitrate, the scope of the agreement, whether any federal statutory claims were nonarbitrable and whether the court could balance the proceedings pending arbitration.[23] The district court concluded that such an approach was too narrow.[24]

By way of background, the debtor brought noncore claims against Mawson Infrastructure Group and its affiliates under three agreements, but only one had an arbitration clause.[25] In the adversary proceeding, Mawson moved to compel arbitration.[26] The bankruptcy court found that although the parties agreed to arbitrate, only claims arising under the main co-location agreement were arbitrable.[27] Since the related promissory note and security agreement lacked arbitration, the court reasoned that the clauses and claims arising from those documents were not arbitrable.[28] Finding "no special bankruptcy concerns," the bankruptcy court ordered arbitration of all claims that clearly arose from the co-location agreement only.[29]

On appeal, Hon. Colleen McMahon of the U.S. District Court for the Southern District of New York viewed the arbitration clause as "exceptionally broad."[30] The clause, in block capital letters, provided that the parties would irrevocably and unconditionally submit any dispute to arbitration.[31] Given the foregoing, she concluded that the bankruptcy court erred by limiting arbitration only to claims "arising under" one agreement and not under all three agreements.[32]

Because "arising under" appeared "nowhere" in the arbitration clause and was not a test for arbitrability, Judge McMahon disagreed with the bankruptcy court.[33] She also found the boldface language significant, particularly the phrase "of any nature" to suggest that the parties intended to arbitrate any dispute between themselves.[34] She vacated the order denying arbitration on the six other claims based on the other agreements.[35]

A presumption for arbitrability exists when more than mere reference to AAA rules shows a "clear and convincing" intent to arbitrate.[36] Judge McMahon found that the parties "clearly and unmistakably" agreed to arbitrate anything related "in any way" to the main agreement because there was "much" more than a mere reference to AAA rules.[37] In responding to a question of who should decide arbitrability, Judge McMahon relied on *Henry Schein Inc. v. Archer &*

22 *In re Celsius Network LLC*, No. 22-10964, 2024 WL 1719633 (S.D.N.Y. April 22, 2024).
23 *Id.* at *2.
24 *See In re Celsius Network LLC*, 658 B.R. 643, 659 (Bankr. S.D.N.Y. 2024).
25 *Id.* at 652.
26 *Id.*
27 *Id.* at 664.
28 *Id.*
29 *Id.* at 666.
30 *In re Celsius Network LLC*, No. 22-10964, 2024 WL 1719633, at *3 (S.D.N.Y. April 22, 2024).
31 *Id.* at *6.
32 *Id.*
33 *Id.* at *5.
34 *Id.* at *6.
35 *Id.*
36 *Id.*
37 *Id.*
38 *Henry Schein Inc. v. Archer & White Sale Inc.*, 586 U.S. 63 (2019).

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White Sale Inc.[38] and ruled that arbitrators have the exclusive right to determine whether a dispute is within the scope of an arbitration agreement when the agreement so states "clearly and unmistakably."[39] Judge McMahon concluded that the bankruptcy court "should have sent the entire matter — all [10] claims — to the AAA for arbitration" with the "first order of business ... [being] for the arbitrator to decide which, if any, of the claims are arbitrable."[40]

Yellow Court Applies a Presumption for Arbitration that Bankruptcy May Overcome

In *In re Yellow Corp*., the bankruptcy court applied a presumption for arbitration when deciding whether a debtor must arbitrate claims for withdrawal liability under multiemployer pension plans.[41] When Yellow filed for chapter 11 protection in August 2023, it was part of several multiemployer pension plans regulated by the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA),[42] which holds employers liable for withdrawing from pension plans.[43] After Yellow withdrew from about 20 plans, Central States Pension Fund (the largest of the plans) filed 24 claims for withdrawal liability of $7.8 billion and 21 claims for other liabilities.[44]

The debtors objected to the multiemployer pension plan claims.[45] In response, the multiemployer pension plans filed motions to compel arbitration of their claims despite the bankruptcy stay under § 1401 of the MPPAA.[46] The debtors opposed the motions, arguing that the bankruptcy claims-allowance process should resolve liability.

Allowance or disallowance of these claims would have an enormous impact on the residual equity value of the debtors and all stakeholders. The size and significance of the claims may have been outcome-determinative.

Construing the motions to compel as motions for stay relief, Hon. **Craig Goldblatt** of the U.S. Bankruptcy Court for the District of Delaware questioned whether the MPPAA mandated arbitration of withdrawal liabilities.[47] He did not lift the stay and concluded that no such mandate to arbitrate existed.[48]

In resolving the statutory conflict, the court recognized that § 502(b) of the Bankruptcy Code states that the "[bankruptcy] court ... shall determine the amount of such claim" when an objection is filed to a proof of claim.[49] However, the MPPAA provided that each party may file a claim to calculate contractual liability, although if there is a dispute, it "shall be resolved through arbitration."[50] An MPPAA arbitration differs from one under the FAA and allows review by a district court under a standard of review like an ordinary appeal.[51]

Harmonizing Both Statutes Is How to Resolve Statutory Conflicts

Confronted with "conflicting federal statutes," the challenge began.[52] Judge Goldblatt said that "courts are 'not at liberty to pick and choose among congressional enactments and must instead strive to give effect to both.'"[53] This approach suggests abandoning notions around the supremacy of bankruptcy.

Harmonizing conflicting statutes that both use "shall" to direct disputes "cannot both be given full effect."[54] To resolve the conflict, Judge Goldblatt had to reconcile the Bankruptcy Code's mandate for bankruptcy courts to resolve claim objections and the MPPAA's mandate to subject the labor dispute to arbitration. Addressing a line of FAA and bankruptcy cases, Judge Goldblatt mused about the utility of multi-factor balancing tests and decided that the conflicting statutes could be "best reconciled by treating the arbitration provisions as creating a *presumption* in favor of stay relief to permit the claim to be liquidated in arbitration."[55] He provided that the presumption "can be overcome in appropriate circumstances where the imperatives of the bankruptcy case so require."[56] The bankruptcy court found that "the unusual circumstances of this case counsel strongly in favor of resolving the withdrawal-liability disputes through the claims-allowance process, notwithstanding the presumption in favor of arbitration."[57]

First, Judge Goldblatt was not convinced that arbitrators would allow other parties, such as other funds, to participate in the arbitration.[58] Second, the bankruptcy court noted that it had scheduled a trial in four months to address this material and important dispute and "conclude[d] that the risk of delay [in arbitration] counsels strongly in favor of denying stay relief."[59] Third, unlike an FAA arbitration, an arbitration under the MPPAA labor law is subject to judicial review, thus an "arbitrator's determination would be reviewed by a district court in essentially the same manner in which this Court's claims allowance decision would be reviewed."[60] Lastly, the bankruptcy court observed that an arbitrator would be disqualified by federal law from entertaining the debtor's planned attacks on Pension Benefit Guaranty Corp. regulations.[61] Although "the presumption in favor of arbitra-

39 *Celsius* at *7.
40 *Id.* at *8.
41 *In re Yellow Corp.*, Case No. 23-11069, 2024 WL 1313308 (Bankr. D. Del. March 27, 2024).
42 29 U.S.C. §§ 1381-1461.
43 *In re Yellow Corp.*, 2024 WL 1313308, at *1.
44 *Id.* at *2.
45 *Id.* at *4.
46 *Id.*
47 *Id.* at *6.
48 *Id.*
49 *Id.*
50 *Id.*
51 *Id.* at *1, 15.
52 *Id.* at *6.
53 *Id.* at *7 (quoting *Epic Sys.*, 584 U.S. at 510).
54 *Id.* at *2.
55 *Id.* at *11 (emphasis in original).
56 *Id.* at *13.
57 *Id.*
58 *Id.* at *14.
59 *Id.*
60 *Id.*
61 *Id.*

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tion is one that should lightly be overcome," the court opted to keep the withdrawal-liability dispute in the bankruptcy claims-allowance process.[62]

Conclusion

While the Supreme Court has not squarely addressed the intersection of bankruptcy law and the FAA, given the Court's ongoing interest in cases involving the FAA generally, future arbitration decisions will offer clarity until an on-point decision occurs. However, as shown herein, resolving the tension between arbitration and bankruptcy requires a balanced approach to harmonizing the two legal frameworks.

Because courts must grapple with reconciling both federal statutes, those dealing with arbitration agreements should continue to evaluate their agreements for enforceability and conflicts with bankruptcy rules and policies. By understanding how courts reconcile these conflicts, parties may better navigate the intersection of arbitration and bankruptcy. abi

62 *Id.* at *15.