NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. CC-08-1282-PaDC
ARUNDOTECH, LLC,	Bk. No. SV 08-11458 GM
Debtor.	
RICO CORPORATION,	
Appellant,	
v.	**M E M O R A N D U M**[1]
ARUNDOTECH, LLC,	
Appellee.	

Argued and Submitted on February 18, 2009
at Pasadena, California

Filed - May 4, 2009

Appeal from the United States Bankruptcy Court
for the Central District of California

Hon. Geraldine Mund, Bankruptcy Judge, Presiding.

Before: PAPPAS, DUNN and CARLSON[2], Bankruptcy Judges.

[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. (See 9th Cir. BAP Rule 8013-1.)

[2] Hon. Thomas E. Carlson, U.S. Bankruptcy Judge for the Northern District of California, sitting by designation.

Appellant Rico Corporation ("Rico") appeals an order of the bankruptcy court granting its motion for relief from the automatic stay, but attaching a condition to that relief. Because there was inadequate factual support for that condition, we conclude that the bankruptcy court abused its discretion, and therefore reverse and remand for further proceedings.

FACTS

In December 2004, the chapter 11[3] debtor, Arundotech LLC ("Debtor"), and Rico entered into a contract under which Debtor agreed to supply, and Rico agreed to purchase, reed cane used in the manufacture of woodwind instrument reeds. The contract included a provision requiring that "[a]ny controversy or claim arising out of or relating to this agreement or breach thereof which cannot be settled through negotiation shall be settled by arbitration in accordance with the rules of the American Arbitration Association. . . . [E]ach party shall bear their own costs and fees associated with the arbitration."

On November 21, 2007, Debtor commenced an arbitration proceeding alleging that Rico had breached their contract, seeking an award of damages in the sum of $415,000. Under the applicable rules, this dispute would have been heard and decided by a single arbitrator. However, Rico filed a counterclaim in the arbitration alleging that it was Debtor that had breached the contract by

[3] Unless specified otherwise, all references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532. The Federal Rules of Bankruptcy Procedure, Rules 1001-9037, are referred to as Rules. The Federal Rules of Civil Procedure are referred to as Civil Rules.

delivering substandard goods. In its counterclaim, Rico also asserted claims against two of Debtor's shareholders, George Nielsen and Michael Nicholson (the "Principals"), neither of whom signed or guaranteed the contract. Rico's counterclaim sought damages "in excess of $1,000,000." Because Rico claimed damages in excess of $1,000,000, and because Rico did not agree to proceed before a single arbitrator, under the rules governing the arbitration,[4] the dispute was referred to a panel of three arbitrators.

On January 7, 2008, Debtor moved in the arbitration to strike the third-party claims against the Principals, and to proceed before a single arbitrator. Debtor contended that Rico had grossly exaggerated the amount of its counterclaim for the sole purpose of driving up the expense to Debtor of participating in the arbitration. The arbitration authority declined to make an evaluation of the prima facie validity of Rico's claim, and instead referred Debtor's motion to the arbitration panel for disposition.

Apparently dissatisfied with these developments, on March 11, 2008, Debtor filed a petition for relief under chapter 11. Debtor's bankruptcy schedules list as assets the claim against Rico (valued at $415,000) and other assets valued at $18,113. In addition to Rico's claim, and unliquidated arbitration costs of $50,000, Debtor lists thirteen secured and unsecured claims totaling $57,456.

On June 11, 2008, Rico filed a proof of claim in the bankruptcy case in the amount of $1,200,000.

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[4] Am. Arb. Ass'n Comm'l Arb. R. R-1(c), L-2(a).

On August 31, 2008, Debtor commenced an adversary proceeding against Rico seeking breach of contract damages, declaratory relief, and disallowance of Rico's creditor's claim.

On August 26, 2008, Rico filed a motion for relief from stay in the bankruptcy case requesting that the stay be terminated so that the arbitration proceeding could proceed to resolve the parties' contract dispute. Rico argued that the bankruptcy court should grant stay relief for "cause" under § 362(d)(1) because the bankruptcy case had been filed by Debtor in bad faith to frustrate the arbitration. Rico also contended that the parties' dispute was a non-core proceeding, that it involved non-debtor parties not subject to suit in the bankruptcy court, and that a single trial in the arbitration would be the most efficient way to resolve the competing claims. Alternatively, Rico argued, even if the dispute was a core proceeding, the bankruptcy court must grant relief from stay because arbitration of the dispute would not frustrate any policy of the Bankruptcy Code. Debtor opposed the motion, arguing that it would be more equitable and cost-efficient to resolve the contest in the pending adversary proceeding.

The bankruptcy court conducted a hearing on Rico's motion on September 23, 2008. At the hearing, Debtor's arbitration attorney requested, among other things, that if the bankruptcy court was inclined to allow the arbitration to proceed, it should condition relief from the stay by requiring that Rico pay five-sixths of the arbitrators' cost.[5] Rico countered that the parties' contract

[5] Debtor apparently reasoned that, had the arbitration been conducted by one arbitrator, Debtor and Rico would have to share the cost equally. Since Rico's counterclaim had, in Debtor's view,

provided that each party was to bear its own costs of arbitration, and that the number of arbitrators is a matter for the arbitration authority to determine, not the bankruptcy court.

After considering the arguments of the parties, the bankruptcy judge decided to grant Rico's motion for relief from stay, but only upon the condition that Rico pay five-sixths of the cost of the arbitrators' fees in the event the arbitration proceeded before more than one arbitrator. On October 14, 2008, the bankruptcy judge entered an order confirming this ruling.

Rico timely appealed the stay relief order.

JURISDICTION

The bankruptcy court had jurisdiction over the stay relief motion under 28 U.S.C. § 1334(b) and § 157(b)(2)(G). The Panel has jurisdiction to review final orders under 28 U.S.C. § 158, and an order granting relief from the automatic stay is a final order. Nat'l Envtl. Waste Corp. v. Riverside (In re Nat'l Envtl. Waste Corp.), 129 F.3d 1052, 1054 (9th Cir. 1997).

ISSUE

Did the bankruptcy court abuse its discretion in conditioning its order for stay relief by requiring that Rico pay five-sixths of the cost of having more than one arbitrator?

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triggered the need for another two arbitrators, Rico should pay all of that additional expense, in addition to half the cost of the original arbitrator. Thus, Debtor urged that Rico pay five-sixths of the total cost.

STANDARDS OF REVIEW

An order regarding relief from the automatic stay by the bankruptcy court is reviewed for abuse of discretion. Moldo v. Matsco, Inc. (In re Cybernetic Servs., Inc.), 252 F.3d 1039, 1045 (9th Cir. 2001). A bankruptcy court's decision regarding stay relief will be reversed on appeal only if "'based on an erroneous conclusion of law or when the record contains no evidence on which the trial court rationally could have based that decision.'" Delaney-Morin v. Day (In re Delaney-Morin), 304 B.R. 365, 368 (9th Cir. BAP 2003) (quoting Vanderpark Prop., Inc. v. Buchbinder (In re Windmill Farms, Inc.), 841 F.2d 1467, 1472 (9th Cir. 1988) (citation omitted)).

DISCUSSION

A. Arbitration and Core vs. Noncore Proceedings

One of Rico's arguments can be quickly dispatched. Rico argues that, even if the parties' dispute is a core proceeding, the bankruptcy court lacked any discretion to determine whether the arbitration proceeding should proceed or, as in this case, to attach conditions to the continuation of the arbitration proceeding. However, under the facts in this appeal, the Panel need not decide this question.

In a somewhat different context, in MCI Telecomm. Corp. v. Gurga (In re Gurga), 176 B.R. 196 (9th Cir. BAP 1994), this Panel held, based upon decisions of the United States Supreme Court interpreting the Federal Arbitration Act, 9 U.S.C. § 2, that a bankruptcy court lacks discretion to stay arbitration of a dispute

constituting a noncore[6] proceeding in favor of resolving that dispute in the bankruptcy court. In its decision, the Panel acknowledged the strong federal policy in favor of enforcement of privately made arbitration agreements, and noted that the bankruptcy courts' jurisdiction over noncore matters under 28 U.S.C. § 1334(b) is nonexclusive. 176 B.R. at 200; see also Mor-Ben Ins. Mkts. Corp. v. Trident Gen. Ins. Co., Ltd. (In re Mor-Ben Ins. Mkts. Corp.), 73 B.R. 644, 649, (9th Cir. BAP 1987) (affirming a bankruptcy court's orders staying bankruptcy proceedings in favor of arbitration); Bender Shipbuilding & Repair Co., Inc. v. Morgan (In re Morgan), 28 B.R. 3, 5 (9th Cir. BAP 1983) (reversing bankruptcy court's order in chapter 11 case staying arbitration of a breach of contract action).

While Gurga dealt with a noncore dispute, neither the Ninth Circuit nor this Panel has decided whether that decision's mandate in favor of arbitration applies to contests that are, under the bankruptcy jurisdictional statutes, core proceedings. There is considerable disagreement concerning this question in courts outside our circuit. In determining whether arbitration should proceed, some courts have highlighted that one of the central objectives of bankruptcy is to centralize disputes regarding

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[6] Gurga involved a claim by the chapter 11 debtor against MCI for a prebankruptcy breach of a phone service billing contract. In rejecting the debtor's arguments seeking to stay the arbitration, the Panel observed, "Despite [the debtor's] attempts to frame the issues herein as core, we find that the claims are noncore. . . . Here, the amounts, if any, owed to [the debtor] by MCI are in dispute and this dispute rests on breach of contract issues. In fact, [the debtor] made a prepetition demand for arbitration of the dispute, described at that time as breach of contract and accounting causes of action. Breach of contract actions are noncore claims. See 28 U.S.C. § 157." 176 B.R. at 199.

property of the estate and the payment of creditors, so that the estate can be administered efficiently. Phillips v. Mowbray, LLC (In re White Mountain Mining Co., LLC), 403 F.3d 164, 169-70 (4th Cir. 2005); U.S. Lines v. Am. S.S. Owners Prot. & Indem. Ass'n, Inc. (In re U.S. Lines), 197 F.3d 631, 640 (2d Cir. 1999). At the same time, some courts have observed that Congress "did not envision all bankruptcy related matters being adjudicated in . . . bankruptcy court." Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1157 (3d Cir. 1989).

It is true that, on occasion, a conflict may arise between the policies of the Federal Arbitration Act and those of the Bankruptcy Code "'where bankruptcy policy exerts an inexorable pull towards centralization.'" U.S. Lines, 197 F.3d at 640 (citation omitted). Such a conflict between the Federal Arbitration Act and Bankruptcy Code is unlikely in noncore proceedings, and more likely in core proceedings, but according to the reasoning in some decisions, "even a determination that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration." Id.; accord Whiting-Turner Contracting Co. v. Elec. Mach. Enter., Inc. (In re Elec. Mach. Enter., Inc.), 479 F.3d 791, 796 (11th Cir. 2007); MBNA Am. Bank, N.A. v. Hill (In re Hill), 436 F.3d 104, 108 (2d Cir. 2006); Mintze v. Am. Gen. Fin. Servs., Inc. (In re Mintze), 434 F.3d 222, 229 (3d Cir. 2006); Gandy v. Gandy (In re Gandy), 299 F.3d 489, 496 (5th Cir. 2002). As one court has noted, in deciding whether to allow arbitration of a core dispute, a bankruptcy court must "'carefully determine whether any underlying purpose of the Bankruptcy Code would be adversely

affected by enforcing an arbitration clause.'" U.S. Lines, 197 F.3d at 640 (citation omitted).

The dispute in this appeal arises out of a contract containing an arbitration provision, in which both parties seek damages from one another for alleged breaches. Prior to the filing of Debtor's chapter 11 case, both parties sought arbitration of that dispute. However, after the bankruptcy was commenced, Rico filed a proof of claim in the bankruptcy case, and Debtor commenced an adversary proceeding against Rico seeking not only recovery of its damages, but also disallowance of Rico's claim. Under the bankruptcy jurisdictional statutes, both "allowance or disallowance of claims against the estate" and "counterclaims by the estate against persons filing claims against the estate" constitute core proceedings. 28 U.S.C. § 157(b)(2)(B) and (C).

However, we need not in this case decide whether, as was the Panel's decision as to the noncore contest in Gurga, the bankruptcy court must always order arbitration to resolve a dispute which would otherwise constitute a core proceeding. That is because the bankruptcy court did indeed grant stay relief to Rico and order that the dispute be resolved by arbitration rather than through the adversary proceeding in the bankruptcy case. Neither party has questioned the bankruptcy court's decision in this regard. In other words, the issue presented here is not whether the bankruptcy court lacked the discretion to decline to direct the parties to resolve their competing claims via arbitration, but whether the condition attached by the bankruptcy court to the stay relief order was justified.

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B. The bankruptcy court abused its discretion in attaching a condition to its stay relief order concerning payment of arbitration costs.

Section 362(d)(1) provides that, upon request of a party in interest, the bankruptcy court shall grant relief from the automatic stay for "cause." Cause to support stay relief is not specifically defined in the Code, but the parties do not dispute that good cause for relief may exist when, in the bankruptcy court's view, it is more efficient, economical or otherwise desirable that litigation pending in another forum continue so as to liquidate the competing claims of a debtor and a creditor. Simply put, as Congress has observed, the interests of judicial economy and the expeditious and economical determination of litigation for the parties is a fundamental basis for granting stay relief:

> [I]t will often be more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankruptcy estate would result, in order to leave the parties to their chosen forum and to relieve the bankruptcy court from many duties that may be handled elsewhere.

Truebro, Inc. v. Plumberex Specialty Prods., Inc. (In re Plumberex Specialty Prods., Inc.), 311 B.R. 551, 557 (Bankr. C.D. Cal. 2004) (quoting H.R. Rep. No. 95-595, at 341 (1977); S. Rep. No. 95-989, at 50 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5836 (emphasis added)).

The form of relief from the automatic stay that should be afforded by the bankruptcy court to a party is also not precisely specified in the statutes. Instead, § 362(d) provides examples of possible relief, "such as by terminating, annulling, modifying, or conditioning such stay . . . ." As one leading commentator notes,

this approach allows considerable "flexibility" to the bankruptcy court "to fashion relief to the particular circumstances of the case." 3 COLLIER ON BANKRUPTCY ¶¶ 362.07[1] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2005). Indeed, the case law uniformly recognizes that a bankruptcy court has wide discretion in determining the appropriate form of relief from the automatic stay in any particular case. See, e.g., Arkison v. Frontier Asset Mgmt. LLC (In re Skagit P. Corp.), 316 B.R. 330, 369 (9th Cir. BAP 2004) (noting that "section 362 gives the bankruptcy court wide latitude in crafting relief from the automatic stay. Mataya v. Kissinger (In re Kissinger), 72 F.3d 107, 109 (9th Cir.1995)").

However, there are limits to this discretion. Like all discretionary judgments, the bankruptcy court must conform the relief afforded to the facts presented. In particular, any condition placed on a grant of stay relief should be founded upon evidence, and designed to further some goal relevant to the proper administration of the specific case.

In this instance, before the hearing, the bankruptcy court apparently issued a tentative ruling indicating its inclination to grant the motion for stay relief without any conditions, noting that because of the press of its business, the bankruptcy court did not have time available to conduct a prompt trial in the adversary proceeding.[7]

[7] The bankruptcy court's tentative ruling was not docketed, nor included by the parties in the record on appeal. We infer the substance of the tentative ruling from the comments of counsel at the hearing on Rico's motion. Hr'g Tr. 2:10-16 (September 23, 2008).

At the hearing, as he had in its opposition to Rico's motion, Debtor's arbitration counsel expressed his concern about Rico's tactics in filing the counterclaim in the arbitration proceeding, and frustration over the arbitration authority's unwillingness to consider his challenge to the amount of that counterclaim before assigning the contest to three arbitrators, instead of one. The bankruptcy court responded to counsel's concerns:

> THE COURT: You're still going back to arbitration. The debtor chose it. The contract calls for it. There's a strong federal policy to enforce arbitration agreements.
>
> However, . . . what the debtor chose was the basic contract arbitration and then you have this counterclaim in the arbitration which may cost a lot more money. If it remains three arbitrators, then I am going to condition relief from stay upon an order that Rico pays five-sixths of the costs of arbitration.

Hr'g. Tr. 17:9-18.

Counsel for Rico objected to imposition of this condition in the following colloquy:

> [RICO'S COUNSEL]: The debtor now has no obligation to pay for the arbitration, and we have nobody to recover it from if we prevail. Your Honor has varied the terms of the contract. It does not call for a single arbitrator. It calls just that the AAA rules will apply. And you've effectively amended the AAA rules.
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> THE COURT: That's the way it is. Would you rather [have] me –
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> [RICO'S COUNSEL]: So the debtor has no reason to settle.
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> THE COURT: Would you rather [have] me deny relief from stay?
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> [RICO'S COUNSEL]: No.
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> THE COURT: Okay. So that's going to be where that is, and of course the debtor has a reason to settle because – I don't know what the cost of the arbitrators is going to be, but the cost of the attorneys in this case is going to be at least as much if not much greater. So of course everybody has a reason to settle this thing.

Hr'g Tr. 20:6-24 (Emphasis added).

As can be seen, based upon the record and the arguments of counsel, the bankruptcy court decided that the arbitration proceeding should continue, rather than litigating the parties' claims in the bankruptcy court. Reading the record and the stay relief order fairly, we presume that it was the bankruptcy court's intent, in conditioning the stay relief afforded Rico by adjusting the division of the costs of the arbitration between the parties, to protect Debtor from incurring significantly more expense using three arbitrators than a one-arbitrator proceeding would entail. Limiting the litigation costs of a chapter 11 debtor, which is presumably attempting to reorganize its financial affairs, would appear to be a legitimate, traditional concern for a bankruptcy court. In other words, if by proceeding with three arbitrators Debtor's costs would significantly exceed those Debtor would incur by litigating with Rico in the bankruptcy court, that is a justifiable rationale for the court's decision to impose the condition on the arbitration proceedings.

However, in this case, the bankruptcy court candidly acknowledged that it "did not know" what the cost of the arbitration was going to be, nor how much more it would cost Debtor if there were three arbitrators, rather than one, employed to resolve the dispute in that forum. We appreciate the bankruptcy court's comments in this regard, because we, too, have carefully reviewed the record submitted to the bankruptcy court and are unable to find any evidence or information which, quantitatively, establishes the projected cost of the arbitration proceeding using three arbitrators. By the same token, there is no information in the record concerning the comparative cost to the parties of

pursuing the adversary proceeding to a conclusion. Assuming without deciding that the bankruptcy court had the discretion to deny stay relief, without some showing to establish that it would cost Debtor more to arbitrate before three arbitrators than to litigate in the bankruptcy court, we are unable to discern any legitimate basis for the condition attached to stay relief by the bankruptcy court. Because there was no evidence to support its attempt to protect Debtor from the perceived higher cost of using three arbitrators rather than pursuing the adversary proceeding, we must conclude that the bankruptcy court's conditional order for stay relief represents an abuse of discretion.

CONCLUSION

The order of the bankruptcy court is REVERSED, and the matter is remanded to the bankruptcy court for further proceedings consistent with this decision.[8]

CARLSON, Bankruptcy Judge, concurring:

I concur with the decision of the majority to reverse the conditional stay-relief order that is the subject of this appeal. I respectfully disagree with the majority regarding the reasons the bankruptcy court order must be set aside, and regarding the options available to the bankruptcy court upon remand.

[8] Since we reverse the conditional stay relief order, the bankruptcy court should reconsider Rico's motion and decide whether to grant stay relief to arbitrate without condition, to hear evidence and enter an alternative order supported by the evidentiary record, or to order that the dispute be litigated via the adversary proceeding.

The majority holds that the bankruptcy court improperly conditioned relief from stay upon Rico protecting Debtor from certain costs of arbitration, because the record did not support a finding that arbitration would be more costly than trial in the bankruptcy court. I believe that the record did support such a finding. At the same time, however, I believe that the only permissible remedy in such circumstances was for the bankruptcy court to try the dispute itself, and that the bankruptcy court could not properly send the dispute to arbitration under terms different from those specified in the Arbitration Agreement.

The most important consideration in this case is that the stay-relief motion required the bankruptcy court to determine whether the dispute between Rico and Debtor should be resolved by arbitration pursuant to the Arbitration Agreement. The Federal Arbitration Act ("Arbitration Act") directs that federal courts enforce agreements to arbitrate, and the Supreme Court and courts of appeals have strictly enforced that command. In keeping with this case law, bankruptcy courts resolve stay-relief motions involving arbitration by determining whether arbitration is required under the Arbitration Act, rather than under the more general concept of cause set forth in § 362 of the Bankruptcy Code.[9] The relevant question in the present case is whether the bankruptcy

[9] Hylland v. Nw. Corp. (In re Nw. Corp.), 319 B.R. 68, 75 (D.Del. 2005); Pico Group, Inc. v. Persofsky (In re Pico Group, Inc.), 304 B.R. 170, 174-75 (Bankr. M.D. Pa. 2003); Larocque v. CitiFinancial Mortg. Corp. (In re Larocque), 283 B.R. 640, 641-42 (Bankr. D.R.I. 2002); In re Hemphill Bus Sales, Inc., 259 B.R. 865, 867-69 (Bankr. E.D. Tex. 2001); In re Jotan, Inc., 232 B.R. 503, 505-08 (Bankr. M.D. Fla. 1999); In re Spectrum Info. Technologies, Inc., 183 B.R. 360, 362-64 (Bankr. E.D.N.Y. 1995); Cameron v. J.T. Moran Fin. Corp. (In re J.T. Moran Fin. Corp.), 118 B.R. 233, 235 (Bankr. S.D.N.Y. 1990).

court's order directing arbitration on terms different from those of the Arbitration Agreement was consistent with the Arbitration Act, not whether § 362 authorizes the court to impose conditions in granting relief from stay.

As explained in much greater detail below, the Arbitration Act required the bankruptcy court to order arbitration "in the manner provided for in [the arbitration] agreement," unless arbitration conflicted with another congressional policy. The congressional policy with which arbitration might conflict in the present case is Congress's special concern with the prompt and economic resolution of claims against the bankruptcy estate. But because Congress addressed that concern by authorizing the bankruptcy court to try claims in a streamlined manner, no congressional policy authorizes a bankruptcy court to enter an order compelling arbitration without obeying the statutory command that arbitration proceed "in the manner provided for in [the arbitration] agreement." 9 U.S.C. § 4.

A. The Command of the Arbitration Act

The Arbitration Act directs federal courts to enforce agreements to arbitrate disputes.

> 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.

9 U.S.C. § 2.

The Arbitration Act contains no exception for federal statutory claims, even those within the exclusive jurisdiction of the federal courts. Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 227-29 (1987). The provisions of the Arbitration Act may, of course, be overridden by a contrary congressional command.

To establish an exception from the Arbitration Act, the party opposing arbitration must establish that Congress intended to limit or prohibit waiver of judicial remedies for the federal statutory rights at issue. Id. at 227. Such intent must be evident from the text of the statute, from the legislative history of the statute, or from "an inherent conflict between arbitration and the statute's underlying purposes." Id.

The courts have not adopted any blanket rule as to whether Congress intended to preclude the waiver of judicial remedies in bankruptcy proceedings. Rather, they have followed a case-by-case approach in determining when arbitration conflicts with congressional bankruptcy policy. MBNA Am. Bank, N.A. v. Hill, 436 F.3d 104, 108 (2d Cir. 2006); U.S. Lines v. Am. S.S. Owners (In re U.S. Lines), 197 F.3d 631, 640 (2d Cir. 1999).

Conflict between the Arbitration Act and Bankruptcy Code is unlikely in non-core proceedings and more likely in core proceedings, but "even a determination that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration." U.S. Lines, 197 F.3d at 640; accord Whiting-Turner Contracting Co. v. Elec. Mach. Enter., Inc. (In re Elec. Mach. Enter., Inc.), 479 F.3d 791, 796, (11th Cir. 2007); Hill, 436 F.3d at 108; Mintze v. Am. Gen. Fin. Services, Inc. (In re Mintze), 434 F.3d 222, 229 (3d Cir. 2006); Gandy v. Gandy (In re Gandy), 299 F.3d 489, 496 (5th Cir. 2002). "In 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.'" U.S. Lines, 197 F.3d at 640 (citation omitted).

B. Claims and the Arbitration Act

One type of proceeding in which congressional bankruptcy policy can conflict with the Arbitration Act is the adjudication of creditors' claims against the bankruptcy estate. Congress expressed its concern for the prompt and inexpensive resolution of claims by vesting bankruptcy courts with authority to try such claims in a streamlined manner, without the right to trial by jury.

> When Congress enacted general revisions of the bankruptcy laws in 1898 and 1938, it gave 'special attention to the subject of making (the bankruptcy laws) inexpensive in (their) administration.' Moreover, this Court has long recognized that a chief purpose of the bankruptcy laws is 'to secure a prompt and effectual administration and settlement of the estate of all bankrupts . . . . It is equally clear that the expressly granted power to 'allow,' 'disallow' and 'reconsider' claims, which is of 'basic importance in the administration of a bankruptcy estate,' is to be exercised in summary proceedings and not by the slower and more expensive processes of a plenary suit.

Katchen v. Landy, 382 U.S. 323, 328-29 (1966) (citations omitted).

Katchen interpreted the power to try claims to include the power to try all issues related to the validity of claims against the estate. Id. at 329. Because the claim of a creditor that has received an avoidable preference may not be allowed until such preference has been returned, the bankruptcy court may try the estate's counterclaim for recovery of a preference as part of the claims-allowance process. Id. at 330-35. Similarly, a compulsory counterclaim asserted by the estate against a creditor filing a proof of claim is also part of the claims-allowance process, because it has a direct bearing on whether, and in what amount, the creditor has an allowable claim. Asousa P'ship v. Pinnacle Foods,

Inc. (In re Asousa P'ship), 276 B.R. 55, 60-67 (Bankr. E.D. Pa. 2002); Taubman W. Assoc., No. 2 v. Beugen (In re Beugen), 81 B.R. 994, 1000-01 (Bankr. N.D. Cal. 1988).

Katchen demonstrates the existence of a conflict between the Arbitration Act and the policies of the Bankruptcy Code where the arbitration of a claim would be unreasonably slow or expensive. Because Rico filed a proof of claim alleging breach of contract, and because Debtor asserts a counterclaim arising from Rico's alleged breach of the same contract, the entire dispute between Rico and Debtor is part of the claims-allowance process, in which speed and economy are paramount considerations. Thus, to the extent the bankruptcy court found that arbitration of the dispute between Debtor and Rico would be materially slower or more expensive than trial in the bankruptcy court, the bankruptcy court could have tried the dispute itself notwithstanding the Arbitration Agreement.

The bankruptcy court had before it substantial evidence that arbitration would be more costly than trial in the bankruptcy court. The dispute between Debtor and Rico involved numerous claims and counterclaims, and the amount in controversy was more than a million dollars. In such circumstances, it is very likely the cost of three arbitrators would be a substantial sum. The bankruptcy court would also be aware that the bankruptcy estate had very limited resources with which to pay the cost of arbitration. In light of its expertise, the bankruptcy court should be accorded substantial deference in determining whether the cost involved in resolving the dispute via arbitration unduly interferes with the

congressional mandate that claims against the estate be resolved promptly and economically.

> Where the bankruptcy court has properly considered the conflicting policies in accordance with law, we acknowledge its exercise of discretion and show due deference to its determination that arbitration will seriously jeopardize a particular . . . bankruptcy proceeding.

U.S. Lines, 197 F.3d at 641. More specifically, the bankruptcy court should not be precluded from finding that arbitration of claims would interfere with the prompt and economic administration of the case simply because it has not been presented with evidence expressly comparing the relative cost and delay of arbitration versus trial in the bankruptcy court.

C. May the Bankruptcy Court Alter the Terms of an Arbitration Agreement?

The present case is complex because the bankruptcy judge neither compelled arbitration nor declined to compel arbitration. The bankruptcy judge instead ordered the arbitration to proceed, but imposed conditions on how that arbitration would proceed. The conditions the court imposed — that the arbitration proceed before a single arbitrator or that Rico pay the entire cost of additional arbitrators — are designed to limit cost to the estate, the basis upon which the court might have declined to compel arbitration. One must therefore ask whether Congress authorized courts to alter the terms of an arbitration agreement as an alternative to not enforcing the arbitration agreement.

I find no basis to conclude that Congress authorized the bankruptcy court to enforce the Arbitration Agreement, but order the parties to share the costs of arbitration on terms other than

those provided in the Arbitration Agreement. First, § 4 of the Arbitration Act expressly provides that any order enforcing an arbitration agreement must direct "that such arbitration proceed in the manner provided for in such agreement." 9 U.S.C. § 4. This directive, like the rest of the Arbitration Act, should be enforced in bankruptcy proceedings, unless doing so "'would seriously jeopardize the objectives of the [Bankruptcy] Code.'" U.S. Lines, 197 F.3d at 640 (citation omitted). Second, the remedy fashioned by Congress to ensure the prompt and inexpensive resolution of claims against the estate was the creation of a specialized bankruptcy court in which claims could be tried "in a summary manner and not by the slower and more expensive processes of a plenary suit." Katchen, 382 U.S. at 329. Thus, where arbitration of a claim would be too slow or expensive, Katchen suggests that the conflict between the Arbitration Act and the Bankruptcy Code should be resolved by the bankruptcy court trying the claim itself. Third, the very general language in § 362(d) of the Bankruptcy Code authorizing the bankruptcy court to impose conditions on the continuation of the automatic stay does not override the very specific language of § 4 of the Arbitration Act. More specifically, § 362(d) should not be read to authorize a bankruptcy court to order parties to allocate costs in a manner different from that provided in an arbitration agreement, where § 4 of the Arbitration Act very specifically directs that "arbitration proceed in the manner provided for in such agreement," and where the

mechanism that Congress has provided for controlling cost is for the bankruptcy court to try the matter itself.[10]

The cost provisions of the Arbitration Agreement could properly be reformed only if there was a basis to do so under general principles of contract law. 9 U.S.C. § 2. Addressing a similar question, the First Circuit held that a bankruptcy court could not require that arbitration take place in a location different from that provided in the arbitration agreement, unless the forum-selection clause could be reformed under non-bankruptcy law. Furness v. Wright Medical Tech. (In re Mercurio), 402 F.3d 62, 66-67 (1st Cir. 2005). In the present case, the bankruptcy court did not find any basis to reform the cost provisions of the Arbitration Agreement under non-bankruptcy law, nor does Debtor argue on appeal that such grounds exist.

Policy considerations also suggest that judges not be permitted to impose conditions on arbitration procedures. While it is not a significant intrusion on the arbitrators to order that the judgment resulting from an arbitration be enforced only through the bankruptcy case, it is a substantial intrusion to direct how many arbitrators must hear a case, or from whom the arbitrators must collect their fee. Indeed, in a practical sense, the imposition of such conditions may constitute a greater intrusion into the arbitration process than refusal to compel arbitration. Moreover, permitting bankruptcy judges to order arbitration but impose such

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[10] The bankruptcy court can properly order that any judgment resulting from the arbitration of a claim against the estate be enforced only in the bankruptcy court, because the centralized, equitable distribution of assets of the estate was a central objective of Congress in enacting the bankruptcy laws. Katchen, 382 U.S. at 336; U.S. Lines, 197 F.3d at 640-41.

conditions may create an unwholesome incentive to compel arbitration but "throw a bone" to the party seeking to avoid arbitration.

The bankruptcy court acted with limited guidance from this circuit in crafting the stay-relief order at issue here. Neither the Ninth Circuit Court of Appeals nor this panel has addressed the interplay between the Arbitration Act and the Bankruptcy Code as extensively as other circuits. I find the case law from those other circuits to be persuasive, and under that case law, the Arbitration Act severely limits the conditions a bankruptcy court may impose when granting relief from stay to permit arbitration. I believe that the bankruptcy court must either grant stay relief without conditions regarding the number of arbitrators or the allocation of costs, or deny stay relief and try the dispute itself. Furthermore, while the bankruptcy court should not be precluded from taking additional evidence, I believe that the bankruptcy court had before it evidence sufficient to enable it to make that choice. Thus, I respectfully concur with the decision of the majority.