

NOT FOR PUBLICATION

MAY 04 2009

HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

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.)	MEMORANDUM¹	
)		
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 CARLSON², 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.

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

7

8

FACTS

9 In December 2004, the chapter 11³ debtor, Arundotech LLC
10 ("Debtor"), and Rico entered into a contract under which Debtor
11 agreed to supply, and Rico agreed to purchase, reed cane used in
12 the manufacture of woodwind instrument reeds. The contract
13 included a provision requiring that "[a]ny controversy or claim
14 arising out of or relating to this agreement or breach thereof
15 which cannot be settled through negotiation shall be settled by
16 arbitration in accordance with the rules of the American
17 Arbitration Association. . . . [E]ach party shall bear their own
18 costs and fees associated with the arbitration."

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

25

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

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

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

18 Apparently dissatisfied with these developments, on March 11,
19 2008, Debtor filed a petition for relief under chapter 11.
20 Debtor's bankruptcy schedules list as assets the claim against Rico
21 (valued at \$415,000) and other assets valued at \$18,113. In
22 addition to Rico's claim, and unliquidated arbitration costs of
23 \$50,000, Debtor lists thirteen secured and unsecured claims
24 totaling \$57,456.

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

27

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

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

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

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

26
27 ⁵ Debtor apparently reasoned that, had the arbitration been
28 conducted by one arbitrator, Debtor and Rico would have to share
the cost equally. Since Rico's counterclaim had, in Debtor's view,

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

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

10 Rico timely appealed the stay relief order.

11

12

JURISDICTION

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

19

20

ISSUE

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

24 ////

25 ////

26

27 _____
28 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.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

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

1 constituting a noncore⁶ proceeding in favor of resolving that
2 dispute in the bankruptcy court. In its decision, the Panel
3 acknowledged the strong federal policy in favor of enforcement of
4 privately made arbitration agreements, and noted that the
5 bankruptcy courts' jurisdiction over noncore matters under 28
6 U.S.C. § 1334(b) is nonexclusive. 176 B.R. at 200; see also Mor-
7 Ben Ins. Mkts. Corp. v. Trident Gen. Ins. Co., Ltd. (In re Mor-Ben
8 Ins. Mkts. Corp.), 73 B.R. 644, 649, (9th Cir. BAP 1987) (affirming
9 a bankruptcy court's orders staying bankruptcy proceedings in favor
10 of arbitration); Bender Shipbuilding & Repair Co., Inc. v. Morgan
11 (In re Morgan), 28 B.R. 3, 5 (9th Cir. BAP 1983) (reversing
12 bankruptcy court's order in chapter 11 case staying arbitration of
13 a breach of contract action).

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

23 ⁶ Gurga involved a claim by the chapter 11 debtor against MCI
24 for a prebankruptcy breach of a phone service billing contract. In
25 rejecting the debtor's arguments seeking to stay the arbitration,
26 the Panel observed, "Despite [the debtor's] attempts to frame the
27 issues herein as core, we find that the claims are noncore. . . .
28 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.

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

10 It is true that, on occasion, a conflict may arise between the
11 policies of the Federal Arbitration Act and those of the Bankruptcy
12 Code "'where bankruptcy policy exerts an inexorable pull towards
13 centralization.'" U.S. Lines, 197 F.3d at 640 (citation omitted).
14 Such a conflict between the Federal Arbitration Act and Bankruptcy
15 Code is unlikely in noncore proceedings, and more likely in core
16 proceedings, but according to the reasoning in some decisions,
17 "even a determination that a proceeding is core will not
18 automatically give the bankruptcy court discretion to stay
19 arbitration." Id.; accord Whiting-Turner Contracting Co. v. Elec.
20 Mach. Enter., Inc. (In re Elec. Mach. Enter., Inc.), 479 F.3d 791,
21 796 (11th Cir. 2007); MBNA Am. Bank, N.A. v. Hill (In re Hill), 436
22 F.3d 104, 108 (2d Cir. 2006); Mintze v. Am. Gen. Fin. Servs., Inc.
23 (In re Mintze), 434 F.3d 222, 229 (3d Cir. 2006); Gandy v. Gandy
24 (In re Gandy), 299 F.3d 489, 496 (5th Cir. 2002). As one court has
25 noted, in deciding whether to allow arbitration of a core dispute,
26 a bankruptcy court must "'carefully determine whether any
27 underlying purpose of the Bankruptcy Code would be adversely

28

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

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

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

28 ////

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

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

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

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

27 The form of relief from the automatic stay that should be
28 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,

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

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

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

24

25

26 ⁷ The bankruptcy court's tentative ruling was not docketed,
27 nor included by the parties in the record on appeal. We infer the
28 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).

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

8 THE COURT: You're still going back to arbitration. The
9 debtor chose it. The contract calls for it. There's a
strong federal policy to enforce arbitration agreements.

10 However, . . . what the debtor chose was the basic
11 contract arbitration and then you have this counterclaim
12 in the arbitration which may cost a lot more money. If
13 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.

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

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

17 [RICO'S COUNSEL]: The debtor now has no obligation to pay
18 for the arbitration, and we have nobody to recover it
19 from if we prevail. Your Honor has varied the terms of
the contract. It does not call for a single arbitrator.
20 It calls just that the AAA rules will apply. And you've
effectively amended the AAA rules.

21 THE COURT: That's the way it is. Would you rather [have] me -

22 [RICO'S COUNSEL]: So the debtor has no reason to settle.

23 THE COURT: Would you rather [have] me deny relief from stay?

24 [RICO'S COUNSEL]: No.

25 THE COURT: Okay. So that's going to be where that is,
26 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
27 everybody has a reason to settle this thing.

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

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

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

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

12

13

CONCLUSION

14

15

16

17

18

19

CARLSON, Bankruptcy Judge, concurring:

20

21

22

23

24

25

26

27

28

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.

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

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

23
24 ⁹ Hylland v. Nw. Corp. (In re Nw. Corp.), 319 B.R. 68, 75
25 (D.Del. 2005); Pico Group, Inc. v. Persofsky (In re Pico Group,
26 Inc.), 304 B.R. 170, 174-75 (Bankr. M.D. Pa. 2003); Larocque v.
27 CitiFinancial Mortg. Corp. (In re Larocque), 283 B.R. 640, 641-42
28 (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).

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

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

17 A. The Command of the Arbitration Act

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

20 A written provision in . . . a contract . . . to settle
21 by arbitration a controversy thereafter arising out of
22 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.

23 9 U.S.C. § 2.

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

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

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

15 Conflict between the Arbitration Act and Bankruptcy Code is
16 unlikely in non-core proceedings and more likely in core
17 proceedings, but "even a determination that a proceeding is core
18 will not automatically give the bankruptcy court discretion to stay
19 arbitration." U.S. Lines, 197 F.3d at 640; accord Whiting-Turner
20 Contracting Co. v. Elec. Mach. Enter., Inc. (In re Elec. Mach.
21 Enter., Inc.), 479 F.3d 791, 796, (11th Cir. 2007); Hill, 436 F.3d
22 at 108; Mintze v. Am. Gen. Fin. Services, Inc. (In re Mintze), 434
23 F.3d 222, 229 (3d Cir. 2006); Gandy v. Gandy (In re Gandy), 299
24 F.3d 489, 496 (5th Cir. 2002). "In exercising its discretion over
25 whether, in core proceedings, arbitration provisions ought to be
26 denied effect, the bankruptcy court must still 'carefully determine
27 whether any underlying purpose of the Bankruptcy Code would be

28

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

3 B. Claims and the Arbitration Act

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

10 When Congress enacted general revisions of the bankruptcy
11 laws in 1898 and 1938, it gave 'special attention to the
12 subject of making (the bankruptcy laws) inexpensive in
13 (their) administration.' Moreover, this Court has long
14 recognized that a chief purpose of the bankruptcy laws is
15 'to secure a prompt and effectual administration and
16 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.

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

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

1 Inc. (In re Asousa P'ship), 276 B.R. 55, 60-67 (Bankr. E.D. Pa.
2 2002); Taubman W. Assoc., No. 2 v. Beugen (In re Beugen), 81 B.R.
3 994, 1000-01 (Bankr. N.D. Cal. 1988).

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

17 The bankruptcy court had before it substantial evidence that
18 arbitration would be more costly than trial in the bankruptcy
19 court. The dispute between Debtor and Rico involved numerous
20 claims and counterclaims, and the amount in controversy was more
21 than a million dollars. In such circumstances, it is very likely
22 the cost of three arbitrators would be a substantial sum. The
23 bankruptcy court would also be aware that the bankruptcy estate had
24 very limited resources with which to pay the cost of arbitration.
25 In light of its expertise, the bankruptcy court should be accorded
26 substantial deference in determining whether the cost involved in
27 resolving the dispute via arbitration unduly interferes with the
28

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

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

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

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

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

28 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

1 those provided in the Arbitration Agreement. First, § 4 of the
2 Arbitration Act expressly provides that any order enforcing an
3 arbitration agreement must direct "that such arbitration proceed in
4 the manner provided for in such agreement." 9 U.S.C. § 4. This
5 directive, like the rest of the Arbitration Act, should be enforced
6 in bankruptcy proceedings, unless doing so "'would seriously
7 jeopardize the objectives of the [Bankruptcy] Code.'" U.S. Lines,
8 197 F.3d at 640 (citation omitted). Second, the remedy fashioned
9 by Congress to ensure the prompt and inexpensive resolution of
10 claims against the estate was the creation of a specialized
11 bankruptcy court in which claims could be tried "in a summary
12 manner and not by the slower and more expensive processes of a
13 plenary suit." Katchen, 382 U.S. at 329. Thus, where arbitration
14 of a claim would be too slow or expensive, Katchen suggests that
15 the conflict between the Arbitration Act and the Bankruptcy Code
16 should be resolved by the bankruptcy court trying the claim itself.
17 Third, the very general language in § 362(d) of the Bankruptcy Code
18 authorizing the bankruptcy court to impose conditions on the
19 continuation of the automatic stay does not override the very
20 specific language of § 4 of the Arbitration Act. More
21 specifically, § 362(d) should not be read to authorize a bankruptcy
22 court to order parties to allocate costs in a manner different from
23 that provided in an arbitration agreement, where § 4 of the
24 Arbitration Act very specifically directs that "arbitration proceed
25 in the manner provided for in such agreement," and where the

26
27
28

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

3 The cost provisions of the Arbitration Agreement could
4 properly be reformed only if there was a basis to do so under
5 general principles of contract law. 9 U.S.C. § 2. Addressing a
6 similar question, the First Circuit held that a bankruptcy court
7 could not require that arbitration take place in a location
8 different from that provided in the arbitration agreement, unless
9 the forum-selection clause could be reformed under non-bankruptcy
10 law. Furness v. Wright Medical Tech. (In re Mercurio), 402 F.3d
11 62, 66-67 (1st Cir. 2005). In the present case, the bankruptcy
12 court did not find any basis to reform the cost provisions of the
13 Arbitration Agreement under non-bankruptcy law, nor does Debtor
14 argue on appeal that such grounds exist.

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

25
26 ¹⁰ The bankruptcy court can properly order that any judgment
27 resulting from the arbitration of a claim against the estate be
28 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.

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

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

20
21
22
23
24
25
26
27
28