The Continuing Erosion of Arbitration Clauses in Bankruptcy Cases

By Leslie A. Berkoff and Michael C. Troiano

Although federal courts in the US generally give deference to arbitration agreements, consistent with the mandate of the Federal Arbitration Act (FAA), bankruptcy courts often utilise an exception contained in the FAA and subsequent case law to retain jurisdiction over a dispute; this exception provides that courts may preclude arbitration of a dispute where there is an inherent conflict between arbitration and the underlying purposes of the implicated statute. A recent decision in the Ninth Circuit, drawing upon precedent in the circuit, held that a bankruptcy court has the discretion to decline enforcement of an otherwise applicable arbitration provision if the arbitration would conflict with the underlying purposes of the Bankruptcy Code. A 20 January 2021 ruling by the District Court for the S.D. of California, affirming a bankruptcy court decision in the case of *Pillsbury Winthrop Shaw Pittman, LLP ("Pillsbury") v Cuker Interactive, LLC ("Cuker")*, denied the request by Pillsbury to compel arbitration of a dispute with a bankrupt debtor as to whether the law firm's claim for attorney's fees was secured or unsecured pursuant to an arbitration clause in its engagement letter.

The district court first noted that determining whether Pillsbury's claim was secured or unsecured was a core bankruptcy issue, which should be determined by the bankruptcy court, and found that compelling arbitration would conflict with the underlying purposes of the Bankruptcy Code: (1) having bankruptcy law issues decided by bankruptcy courts; (2) centralising resolution of bankruptcy disputes; and (3) avoiding piecemeal litigation.

This decision is consistent with holdings by other circuit courts finding that bankruptcy courts have discretion to refrain from compelling arbitration of core

proceedings, despite arbitration provisions contained in underlying agreements. As for compelling or authorising arbitration of non-core proceedings, there seems to be a variety of approaches utilised across the circuits. Most bankruptcy courts addressing this issue have found that, as a rule, they have no discretion to refrain from compelling arbitration of non-core matters. Several courts, however, have left open the possibility for such discretion, as they limited the importance of the core/non-core distinction and simply analysed whether arbitration of the non-core matter would undermine the goal of reorganisation under the Bankruptcy Code.

Until such time as the matter goes before the US Supreme Court for further review and potential clarification, the existence of an arbitration clause in an agreement does not automatically pave the way for arbitration of a dispute, especially if the dispute in question is determined to be a core matter.

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