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Arbitration and Bankruptcy: An Overview of the Current Case Law

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In order to understand some of the decisions that have been issued in the last few years addressing requests to compel arbitration of matters before bankruptcy courts, it is necessary to briefly cover the backdrop of the two overarching statutes that govern them and the tension between them. Arbitration is governed by the Federal Arbitration Act (FAA) and directs courts to stay proceedings that are subject to agreements to arbitrate.[1] Meanwhile, core proceedings arising in a case under the Bankruptcy Code[2] are to be heard and determined by bankruptcy judges.[3]

When a dispute that is subject to an arbitration agreement arises in a bankruptcy case, these statutes conflict with each other in dictating the forum that should handle the dispute. Thus, it is necessary to analyze in each case which statute should control by focusing initially on the underlying congressional intent.

The analysis often begins with the U.S. Supreme Court's decision in *McMahon*.[4] To determine congressional intent, the Court assessed the following: "(1) the statute's text, (2) the statute's legislative history, or (3) an 'inherent conflict between arbitration and the statute's underlying purposes.'"[5] Further, while *McMahon* might be the starting point,[6] the determination historically has hinged on whether the matter is core or non-core.

In the decades following *McMahon*, the Supreme Court has issued multiple decisions[7] evincing a general deference to arbitration by virtue of the FAA.[8] However, that deference is not unlimited. In a recent decision, Justice Elena Kagan delivered the opinion of a unanimous Court that pushed back on lower courts' invocation of the supposed "strong federal policy favoring arbitration," rejecting the Eighth Circuit's (and other circuit courts') addition of an arbitration-specific requirement of prejudice to general federal waiver law.[9] In the cases discussed in this article, the court conducted a fact-intensive, case-by-case approach to enforcement of arbitration agreements, with attention to consent.

The Easy Bright Line: Stay and Discharge Violations

Before getting into decisions involving case-specific, fact-based inquiries, let's highlight one scenario in which courts seem to be in violent agreement that arbitrability is impermissible: stay and discharge violations. The automatic stay "is one of the 'fundamental debtor protections' offered by bankruptcy law and gives the debtor a 'breathing spell' from being pressured by creditors that drove the debtor to bankruptcy."[10] Similarly, the Bankruptcy

1 Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*
2 11 U.S.C. § 101, *et seq.*
3 28 U.S.C. § 157(b).
4 *Shearson/Am. Exp. Inc. v. McMahon*, 482 U.S. 220 (1987).
5 *Mintze v. Am. Gen. Fin. Servs. Inc. (In re Mintze)*, 434 F.3d 222, 229 (3d Cir. 2006) (quoting *McMahon*, 482 U.S. at 227).
6 *Id.*; *see also MBNA Am. Bank NA v. Hill*, 436 F.2d 104, 110 (2d Cir. 2006) (discussing whether arbitrating dispute jeopardizes Bankruptcy Code's objectives); *Phillips v. Congelton LLC (In re White Mountain Mining Co. LLC)*, 403 F.3d 164, 170 (4th Cir. 2005) (considering whether dispute could not be arbitrated because it involved core issue that would substantially interfere with debtor's ability to reorganize).
7 *See, e.g., Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612 (May 21, 2018) (employees' right to collective action under National Labor Relations Act does not conflict with FAA). The *Lewis* court noted, "In many cases over many years, this Court has heard and rejected efforts to conjure conflicts between the Arbitration Act and other federal statutes. In fact, this Court has rejected *every* such effort to date." (emphasis in original). *Id.* at 1627. *See also Henry Schein Inc. v. Archer & White Sales Inc.*, 139 S. Ct. 524 (Jan. 8, 2019) (FAA does not contain "wholly groundless" exception to arbitrability).
8 Previous *ABI Journal* articles have covered some of these key Supreme Court cases, when the Court opined on when arbitration clauses should be honored under federal statutes and whether statutory exceptions apply, and these cases will not be fully reiterated herein. *See* Leslie A. Berkoff, Candice L. Kline & Simran Merchant, "A Contest of Wills, or Deference Due? Arbitration and Bankruptcy," XLIII *ABI Journal* 8, 30-31, 59-60, August 2024, abi.org/abi-journal/a-contest-of-wills-or-deference-due-arbitration-and-bankruptcy (last visited Sept. 22, 2025).
9 *Morgan v. Sundance Inc.*, 596 U.S. 411, 416-17 (2022).
10 *Rogne v. Digit. Forensics Corp.*, 2025 U.S. Dist. LEXIS 5865, at *6 n. 3 (D. Minn. Jan. 13, 2025).

Code's central purpose is to "allow … debtors to get a 'fresh start' by discharging their debts."[11]

Earlier this year, guided by these fundamental tenets of the Code, two district court judges — in the District of Minnesota and the Western District of Virginia — each affirmed the decisions of the bankruptcy courts below denying arbitration on litigation arising from, respectively, the defendant's discharge and stay violations.[12] At issue in both cases was a defendant who repeatedly sought to collect on a debt that was either discharged[13] or subject to the automatic stay.[14]

At the heart of these decisions was the conflict that arbitrating such disputes would create with the Code's underlying purposes. As the district court in *Goldman Sachs v. Brown* found, "arbitrating Plaintiffs' claims would inherently conflict with the Bankruptcy Code's objectives, as it could undermine the Bankruptcy Court's authority to (1) enforce the automatic stay to protect debtors and creditors' rights and (2) provide a single centralized forum for resolving disputes related to the Plaintiffs' bankruptcy proceedings."[15]

Court Allows Some Claims to Proceed to Arbitration

In many cases, the conflict between arbitration and the Bankruptcy Code is not as clear-cut. In *In re Innvantage Group*, Hon. **David D. Cleary** found that certain claims brought by a debtor against a creditor were subject to arbitration, while other claims, involving questions of bankruptcy law, were to be determined by the court.[16] In this case, the debtor (a subcontractor) had confirmed a bankruptcy plan and, subsequent to confirmation, filed an adversary proceeding in the bankruptcy court against a contract counterparty seeking a money judgment.[17] The counterparty sought to compel arbitration, noting that the underlying agreement called for arbitration of "all disputes" and, in the context of its motion, referenced various bankruptcy law claims, including estoppel based on the debtor's failure to schedule the claim.[18] In determining the motion, Judge Cleary, pointing to one of his own prior decisions,[19] reiterated the court's view that

> there is no national policy favoring arbitration. The federal policy is about treating arbitration contracts like all others, ... [and] [w]hen an arbitration demand is made in a bankruptcy case ... a bankruptcy court should enforce the bilateral arbitration agreement, or its *in rem* jurisdiction over the claims under the Bankruptcy Code.[20]

In *In re Johnson*, the court had determined that when reviewing both the arbitration agreement and the conflict with the Bankruptcy Code, the analysis should turn on the conflict as it relates to the particular claim in dispute.[21] Now, in *Innvantage*, there were two claims: one for a money judgment, and the other for a declaratory judgment finding that the creditor could not assert a setoff defense in light of the bankruptcy filing.[22] The court found that the debtor's claim for a money judgment could be arbitrated, as the confirmed plan did not address or rely on liquidation of this account receivable.[23] As a result, the court saw no issue with allowing an arbitrator to determine that claim.[24]

However, in respect of the setoff determination, the court found that it would be inappropriate for an arbitrator to determine this claim, as it relied on issues of bankruptcy law under § 553 of the Bankruptcy Code, and whether, in light of confirmation, the creditor retained an enforceable claim.[25] Judge Cleary determined that once the arbitrator liquidated the claim, the parties were to return to the bankruptcy court for a ruling on the creditor's defenses to the liquidated claim.[26] While the question could be raised as to whether it would have been more efficient for the bankruptcy court to hear both claims together, the analysis was predicated on the tension between the FAA and Bankruptcy Code, as well as deference to the agreement to arbitrate.[27]

Court Does Not Allow Arbitration over a Usury Claim

In *Bridger Steel*, the chapter 7 trustee had commenced an adversary proceeding to disallow a claim, avoid a lien and recover preferential transfers, and determined that the underlying agreement was a loan that contained a usurious interest rate.[28] In response, the creditor sought to compel arbitration of certain claims on the basis of an arbitration clause in the underlying merchant agreement, which was the predicate for the claim that it had filed in the original chapter 11 case.[29]

Specifically, the creditor contended that the trustee was bound by the provisions of the underlying contract and must arbitrate any claim that it characterized as noncore.[30] The creditor suggested that the bankruptcy court consider staying its ruling on any core claims while the balance of the claims were arbitrated, as certain claims flowed from an initial determination as to whether the transaction was a loan and was usurious, which, the creditor argued, involved non-bankruptcy-related questions.[31]

Hon. **Benjamin P. Hursh** started the analysis by relying on Ninth Circuit law, which dictates that "when considering whether to enforce an arbitration agreement ... [there are] two limited inquiries: (i) whether a valid arbitration agreement exists and (ii) whether the agreement encompasses the disputes at issue."[32] The court noted that in this instance, there

11 *Id.* at *6.
12 *Id.*; *See Rogne*, *supra* n.10; *Goldman Sachs Bank USA v. Brown*, 2025 U.S. Dist. LEXIS 48032 (W.D. Va. March 17, 2025).
13 *Rogne*, *supra* n.10 at *3 (describing multiple collection efforts despite notice of bankruptcy, as well as post-discharge collection notices).
14 *Goldman Sachs*, *supra* n.12 at * 3 (alleging post-petition notices and demands for pre-petition debts).
15 *Id.* at *8.
16 *Innvantage Grp. Inc. . Millie and Severson Inc. (In re Innvantage Grp. Inc.)*, 669 B.R. 193, 200-01 (Bankr. N.D. Ill. 2025).
17 *Id.* at 196-97.
18 *Id.* at 198.
19 *See Johnson v. S.A.I.L. LLC (In re Johnson)*, 649 B.R. 735 (Bankr. N.D. Ill. 2023).
20 *In re Innvantage Grp.*, 669 B.R. at 199 (quoting *In re Johnson*, 649 B.R. at 740-41).
21 *In re Johnson*, 649 B.R. at 747.
22 *In re Innvantage Grp.*, 669 B.R. at 196.
23 *Id.* at 200.
24 *Id.*
25 *Id.* at 200-01.
26 *Id.*
27 *See In re Innvantage Grp.*, 669 B.R. at 199-201.
28 *In re Bridger Steel Inc.*, No. 2:23-bk-20019, 2024 WL 4377452, at *1 (Bankr. D. Mont. Sept. 30, 2024).
29 *Id.* at *2.
30 *Id.*
31 *Id.*
32 *Id.* at *3 (citing *Nguyen v. Barnes & Noble Inc.*, 763 F.3d 1171, 1175 (9th Cir. 2014)).

was no binding agreement between the parties, as the debtor — and not the chapter 7 trustee — was party to the agreement in question. Therefore, the creditor had to first establish that it had a binding agreement with the debtor that was enforceable against the trustee.[33] For purposes of its analysis, the court presumed that there was a valid agreement between the debtor and creditor.[34]

The court rejected the defendant's blanket analysis that a trustee is bound by the debtor's pre-petition agreement, and instead looked to the Third Circuit's decision in *Hays*[35] for guidance. In *Hays*, the Third Circuit held "that the trustee is bound to arbitrate all of its claims that are derived from the rights of the debtor under section 541 [of the Bankruptcy Code]."[36] The Third Circuit drew distinctions between such claims and "causes of action unique to the trustee under the Bankruptcy Act and not derivative of the bankrupt,"[37] finding that that claims derivative of a debtor's rights might be subject to arbitration, whereas those exclusive to a debtor-in-possession or a trustee (*i.e.*, derivative of the Bankruptcy Code) were not.[38] Applying this analysis to the instant case, Judge Hursh found that the preference claim was unique to the trustee, and there was no governing arbitration agreement in respect of the same.[39]

With respect to the cause of action seeking to disallow the creditor's claim itself, the court found that the chapter 7 trustee was acting as an estate representative on behalf of all unsecured creditors, given that part of a trustee's role is to examine and allow claims to ensure that all creditors receive an equitable distribution.[40] As such, the court found that this cause of action arises under § 502 of the Bankruptcy Code and is not derivative of a pre-existing right of the debtor and is therefore not arbitrable.[41]

The court turned to those issues that the creditor contended were noncore — the issues addressed to choice of law, determination of whether the underlying agreement was a loan, and, if it was a loan, whether it was usurious.[42] The court found that all of these causes of action were integral components of those attendant to a determination under § 502, providing for the disallowance of the claim, regardless of whether they necessitated an analysis of state law.[43] The court found that by filing a claim seeking to share in any distribution of the debtor's estate, the creditor had put this claim before the bankruptcy court and subjected itself to the trustee's right or obligation to review the claim and object to the same on behalf of the estate.[44]

The court completed its analysis by reviewing the competing tensions and legislative purposes behind the FAA and Bankruptcy Code.[45] The court found that arbitration's "piecemeal" process was in conflict with the Bankruptcy Code's "collective claims-allowance process."[46] The facts underlying all of the causes of action before the court were the same and would require the parties to present them to both the bankruptcy court and the arbitrator for determination.[47] Thus, the court determined that allowing a separate arbitration of these discrete claims would not promote efficiency and, instead, would lead to higher costs, which were "antithetical to the bankruptcy process and a trustee's duty 'to marshal the estate's assets as quickly and efficiently as possible so that creditors' claims may be paid."[48]

Conclusion

As the adoption of dispute-resolution clauses in contracts and agreements becomes increasingly prevalent, as well as the use of arbitration as a means of dispute resolution, there will continue to be cases presented before bankruptcy courts requiring the resolution of the tension between arbitration and bankruptcy. There are various versions of "tests" available, mostly stemming from *McMahon* and its progeny that can be relied on for guidance.

While the Supreme Court has not yet squarely addressed the intersection of the Bankruptcy Code and FAA, given the prevalence with which these types of cases appear before the lower courts, at some point in the future that may change and the Court could weigh in. Whether that eventuality provides more concrete guidance and leads to more efficient resolution of disputes, remains to be seen. abi

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33 *In re Bridger Steel*, 2024 WL 4377452, at *3-4.
34 *Id.*
35 *Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 885 F.2d 1149, 1154 (3d Cir. 1989).
36 *Id.* at 1154.
37 *Id.* at 1155.
38 *See In re Bridger Steel*, 2024 WL 4377452, at *4 (quoting *Bethlehem Steel Corp. v. Moran Towing Corp. (In re Bethlehem Steel Corp.)*, 390 B.R. 784, 791-92 (Bankr. S.D.N.Y. 2008)).
39 *See In re Bridger Steel*, 2024 WL 4377452, at *4.
40 *Id.*
41 *Id.*
42 *Id.* at *5-6.
43 *Id.*
44 *Id.* at *6 (citing *Langenkamp v. Culp*, 498 U.S. 42, 44-45 (1990)) ("[B]y filing a claim against a bankruptcy estate, a creditor triggers the process of 'allowance and disallowance of claims,' thereby subjecting himself to the bankruptcy court's equitable power.").
45 *Id.* at *9.
46 *Id.*
47 *Id.*
48 *Id.* (quoting *Lovering Tubbs Trust v. Hoffman (In re O'Gorman)*, No. 23-60005, 2024 U.S. App. LEXIS 22844, at *19-20 (9th Cir. Sept. 9, 2024)).