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SCOTUS to Decide: Are Bankruptcy Stay Violations Arbitrable?

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The US Supreme Court recently accepted a petition for writ of certiorari to decide once and for all whether a claim for monetary damages for an alleged violation of the Bankruptcy Code's automatic stay provision is arbitrable under the Federal Arbitration Act (FAA). To date, courts have reached differing conclusions on this issue, ultimately resulting in the Supreme Court's decision to accept this appeal.

The FAA states that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 USC § 2. This applies to federal statutory claims too and can only be displaced by a "clear and manifest" congressional command to exclude such claims from arbitration.

Under Supreme Court precedent, that has historically been a high bar to clear. Notwithstanding this high bar, the Fourth Circuit concluded that stay violations are categorically non-arbitrable, even when the terms of an arbitration agreement would be expressly covered by such claims.

The Bankruptcy Stay Violation at Issue

In the underlying case, one debtor had filed for Chapter 13 bankruptcy and listed a credit card debt owed to the defendant among her liabilities, while the other had filed for Chapter 7 protection and done the same. Notwithstanding this, the defendant continued to seek to collect on the credit debt, both in writing and by telephone.

Because of these collection efforts, the debtors initiated an adversary proceeding in bankruptcy court and alleged that the defendant's attempts to collect the debt constituted a willful violation of the bankruptcy stay. Not only that, but the debtors sought to represent a class, consisting of "all individuals in the United States…who currently are in a consumer bankruptcy case or were formerly in a consumer bankruptcy case.. from whom [defendant] made a post-petition demand for pre-petition debt."

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In response, the defendant sought to compel the debtor's claims to arbitration based on an arbitration provision in the credit card agreement that required the parties to arbitrate "any claim." The arbitration provision also contained a class action waiver. Notably, the arbitration provision did not contain a delegation clause and required a court to decide any gateway challenges to arbitrability. The bankruptcy court denied the motion to compel arbitration, finding that a stay violation is a "core" bankruptcy proceeding and that the court has discretion to deny the motion.

The Fourth Circuit Affirms that a Bankruptcy Stay Violation is Not Arbitrable

On appeal, the Fourth Circuit affirmed the lower court's decisions, finding that stay violations are not arbitrable. The court reached that decision based on a host of statutory and public policy grounds. For instance, while the court conceded that under the FAA, public policy favors arbitration, it also favors the "process and relief afforded by the Bankruptcy Code." This policy, the court noted, is grounded in the "comprehensive" jurisdiction Congress granted to bankruptcy courts to deal with "all matters connected with the bankruptcy estate."

To resolve this tension between arbitration and the Bankruptcy Code, the Fourth Circuit considered whether Congress sought to "override" the policy favoring arbitration by a "contrary congressional command" pursuant to the Supreme Court's decision in *Shearson/Am. Express, Inc. v. McMahon*, 482 US 220 (1987). Under *McMahon*, courts must enforce the arbitration of statutory claims unless the statute precludes waiver of judicial remedies, as evidenced by (1) its text, (2) its legislative history, or (3) an "inherent conflict between arbitration and the statute's underlying purposes."

In this case, the Fourth Circuit found such a waiver. It noted that unlike a tort or contract claim, a stay violation is grounded in the Bankruptcy Code itself, which falls within the jurisdictional authority of a bankruptcy court to decide.

The court gave further weight to the fact that a stay violation is a "core" proceeding, noting: "[a] claim for violation of the stay is so critical because the automatic stay is the mechanism that enables the bankruptcy court to harmonize the interests of both debtor and creditors while preserving the debtor's assets for repayment and reorganization of his or her obligations." Thus, to grant the defendant's motion to compel arbitration, the court found:

> would undermine the needed centralization of claims and effectively allow [defendant], after allegedly violating the stay, to assert the primacy of a private contractual right over the collective interests of all other creditors. This would, we conclude, fundamentally interfere with a core purpose of the Bankruptcy Code.

The Fourth Circuit Further Justified its Decision on a Number of Policy Grounds

- It noted that the purpose of the Bankruptcy Code is to ensure bankruptcy laws are "uniform and be uniformly enforced." The court found that arbitration would undermine this purpose because arbitration "individualizes" the disposition of claims such that one arbitrator's decision might differ from another.
- The court likewise found that arbitration of stay violations would "bypass the expertise of bankruptcy judges in favor of private arbitrators, who may not even be lawyers and who normally would not be versed in the complexities of the Bankruptcy Code."
- The Fourth Circuit noted that arbitration of such claims would "constrict the remedies" that Congress provided for a stay violation – noting that punitive damages are available for such violations but that if they were awarded in a private forum, such as arbitration, their deterring effect on others would go unserved.
- Finally, the court distinguished its holding from other circuit courts that reached the opposite conclusion based on the particular facts of those cases.

The Appeal

The defendant appealed the decision to the United States Supreme Court. Ultimately, the court accepted the cert. petition and will decide the following question on appeal:

> Whether, and under what circumstances, a bankruptcy court may override the FAA and refuse to honor a valid arbitration agreement with respect to Section 362(k) claims.

What Comes Next?

The current Supreme Court is incredibly pro-arbitration and has been for many years. Not only that, but the language of the question presented that the court accepted is telling. The question presented presupposes a valid agreement to arbitrate exists and that a court has refused to honor said agreement.

The court has been extremely reluctant, if not outright hostile, to similar challenges seeking to avoid the policies underlying the FAA based on competing statutes. *See e.g. Epic Sys. Corp. v. Lewis*, 584 US 497, 510, 516 (2018). And while the Fourth Circuit is correct that the Bankruptcy Code is "unique," it is not clear that its uniqueness will result in an exception to the well-established rule favoring arbitration of claims under the FAA.

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