

## BANKRUPTCY LAW

### Shopping for a Chapter 11 Forum

Issues confronting bankruptcy litigators seeking to get their case into the most favorable court

By Timothy Duggan

**B**ankruptcy jurisdiction is a hot topic as of late, with the United States Supreme Court scaling back the types of issues that can be decided by a bankruptcy court. See *Stern v. Marshall*, 131 S.Ct. 2594 (2011). Recently, the United States Bankruptcy Court for the District of New Jersey decided a case that not only touched on the jurisdiction of the bankruptcy court, but enforcement of an arbitration clause in a case where the claims to be arbitrated included an alleged violation of the bankruptcy stay. *In re Microbilt*, 2012 Bankr. LEXIS 5731, \_\_\_ B.R. \_\_ (Bankr. N.J. 2012). Although the bankruptcy court's enforcement of the arbitration clause is of interest, the procedural wrangling between the parties offers an excellent insight into the many legal issues confronting bankruptcy litigators seeking to get their case into the most favorable forum (i.e., forum shopping).

In *Microbilt*, the debtor is in the busi-

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ness of providing online consumer and commercial credit information to businesses (credit unions, auto dealerships, etc.) who use the information to make credit and other business decisions. Microbilt purchases financial data from a variety of companies and in turn resells the information to third parties. Relevant to this article is a certain resale agreement that governs the relationship between Microbilt and its one of its suppliers, Chex Systems, Inc. The resale agreement contains an arbitration clause that requires any controversy or claim arising out of or relating to the agreement to be settled by binding arbitration. When Microbilt and Chex found themselves in a dispute over alleged defaults, Microbilt filed a petition for bankruptcy protection in the United States Bankruptcy Court for the District of New Jersey. The bankruptcy petition was filed before the resale agreement was terminated in order to preserve Microbilt's right to assume the resale agreement and cure any alleged defaults.

Under section 365 of the Bankruptcy Code, a debtor may assume an executory contract even if the debtor is in default under the contract, providing the debtor cures the defaults (and meets other bankruptcy requirements). Here, Microbilt and Chex were not willing to wait too long for the issue to be litigated and within one month of the bankruptcy being filed, Microbilt and Chex each filed a motion asking the court to rule on whether Microbilt could assume the resale agreement and, if so, what defaults

must be cured.

However, before the Bankruptcy Court held a trial on the assumption motions (which ultimately ended in an order allowing assumption, subject to curing defaults), Microbilt filed a complaint in the Bankruptcy Court against Chex and others alleging tortious interference with contract and violation of the bankruptcy stay, for failing to perform under the resale agreement with the intent of damaging Microbilt. Chex immediately filed a motion to dismiss the complaint, alleging that Microbilt failed to state a claim upon which relief may be granted. The dismissal motion was granted in part, denied in part, and Microbilt ultimately was allowed to amend its complaint. It is important to note that the arbitration clause was not put in issue at this time.

Before the amended complaint was filed, Chex filed a motion to withdraw the reference in order to have the adversary proceeding removed to the United States District Court (one of the available forums). Chex made several persuasive arguments, including highlighting problems associated with the bankruptcy court's inability to enter a final judgment in the adversary proceeding based upon the Supreme Court's decision in *Stern v. Marshall*. In denying the motion without prejudice, the district court acknowledged the fact that the bankruptcy court did not have constitutional authority to enter a final judgment in the case, but held that the "interest of justice" favored not withdrawing the reference. The district court found that the record demonstrated that the bankruptcy court had familiarized itself with the parties, their relationships

and disputes, and was uniquely situated to manage the discovery process and potential settlement. It appears the district court was swayed by the substantial motion practice that was conducted by Microbilt and Chex prior to the filing of the withdrawal-of-reference motion, which included the first motion to dismiss, assumption motions and Chex's motion to have the bankruptcy court decide whether the claims alleged by Microbilt were core or noncore proceedings. By this point, the bankruptcy court was knee-deep in the dispute.

After Microbilt filed its amended complaint, Chex filed a second motion to dismiss the complaint, arguing that the matter should proceed by way of arbitration as favored by the Federal Arbitration Act, 9 U.S.C. § 1, et. Seq. (FAA). Chex argued that: (1) the resale agreement has a clear arbitration clause, and (2) all claims alleged by Microbilt fall within the broad purview of the arbitration clause. In response, Microbilt alleged that the tortious interference claims do not arise out of or relate to the resale agreement, and the stay violations are core claims to be decided by the bankruptcy court, not an arbitrator. In addition, Microbilt argued that Chex waived the right to seek arbitration because Chex engaged in substantial litigation before seeking to enforce its arbitration rights. Specifically, Microbilt argued that the parties exchanged discovery and engaged in significant motion practice, including filing the first motion to dismiss, the withdrawal-of-reference motion and the core/noncore motion.

The bankruptcy court began its analysis by noting the strong federal policy in favor of arbitration under the FAA. After finding that the FAA applies and that the resale agreement had a clear arbitration clause, the issue became whether the claims fell within

the scope of the arbitration clause. Also, the bankruptcy court was required to balance the liberal federal policy supporting arbitration with the objectives of the federal bankruptcy law — policies that often clash.

The bankruptcy court framed the inquiry as “whether the arbitration of the claims will interfere with or effect the distribution of the estate.” The fact that a claim may arise under the bankruptcy code is not dispositive; it is how the claim impacts the administration of the estate that controls.

The bankruptcy court reviewed the allegations in the amended complaint and found that:

The arbitration of Counts III and IV will not affect the administration of the Plaintiffs' bankruptcy estates. The disputed conduct did not allow Defendants either to acquire possession or control over Debtors' assets, or advance Defendants' interests over competing creditor constituents. [fn] Moreover, this Court recently confirmed the Debtors' Fourth Amended Plan of reorganization, which provides for a 100% distribution to unsecured creditors, together with post-petition interest at the federal judgment rate ... There is nothing before the Court which suggests or evidenced that arbitration of the stay violation claims will impede the administration of the bankruptcy estates or affect creditor recoveries.

The bankruptcy court also found that the alleged stay violations are inextricably intertwined with the breach-of-contract claims, which clearly fall within the scope of the

arbitration clause. Therefore, the breach of contract claims and claims relating to the stay violation are to be decided by the arbitrator. Although the bankruptcy court did not reach the merits of the alleged stay violation, the bankruptcy court noted that intentional postpetition conduct geared toward depriving a debtor of valuable contractual rights may constitute a willful violation of the automatic stay (footnote no. 3). As for any residual claims, the bankruptcy court exercised its sua sponte power to abstain from deciding this issue.

What does this case teach us? First, even though *Sterns v. Marshall* makes it clear that bankruptcy courts do not have jurisdiction to enter final judgment on core claims involving state law issues, district courts are exercising their discretion and allowing bankruptcy courts to manage discovery and keep cases up to trial. Second, state court claims which may give rise to claims that only arise in bankruptcy cases (i.e., bankruptcy stay violations) do not trump the strong deference directed to enforcing arbitration clauses under the FAA. If adjudication of the claim by an arbitrator would not conflict with fundamental bankruptcy policy or affect the administration of the bankruptcy estate, even core bankruptcy claims may be decided by arbitration. Finally, forum shopping is alive and well, and litigants will spend substantial time and money litigating where a case should be determined. Here, one wonders whether a motion to dismiss the complaint would have been filed if the district court retained the case by granting the withdrawal-of-reference motion. Litigants often favor one forum over another, and state and federal law permit parties to seek an advantageous forum, with certain restrictions. ■