

United States District Court, S.D. New York.

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No. 00 Civ. 6793 (LTS). (S.D.N.Y. Aug 24, 2001)

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Decided August 24, 2001

□ IN RE THE SINGER COMPANY v. AKAI ELECTRIC COMPANY LIMITED

In re THE SINGER COMPANY N.V., et al., Debtors. JOSEPH A. PARDO, as Trustee for THE SINGER CREDITOR TRUST, Plaintiff-Appellee, v. AKAI ELECTRIC COMPANY LIMITED, Defendant-Appellant.

· No. 00 Civ. 6793 (LTS).

· United States District Court, S.D. New York.

· August 24, 2001.

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OPINION AND ORDER

LAURA TAYLOR SWAIN, United States District Judge.

Akai Electric Company Limited ("Akai") appeals from an August 10, 2000 order of the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court Order") denying, for reasons stated on the record of the bankruptcy proceeding, Akai's motion to compel arbitration and for a stay of an adversary proceeding commenced by the debtor, The Singer Company N.V., pending arbitration of the issues raised therein.¹ For the reasons stated below, the order of the Bankruptcy Court is reversed.

1.

Consistent with an order entered in the underlying bankruptcy case on September 21, 2000, Joseph A. Pardo, as Trustee for the Singer Creditor Trust, has been substituted for Singer as Plaintiff-Appellee here. Under the confirmed plan of reorganization in the bankruptcy case, the Singer Creditor Trust succeeded to all of the debtor's rights in various assets, including this litigation. See *infra* note 3 and accompanying text. For convenience the Court will, however, refer to Appellee in this opinion as "Singer."

This Court has jurisdiction of the instant appeal pursuant to section 158(a)(1) of Title 28 of the United States Code (West Supp. 2001) and Rule 8001 of the Federal Rules of Bankruptcy Procedure (West Supp. 2001).

BACKGROUND

The material facts are not in dispute. Singer and Akai, a Japanese corporation, entered into a written agreement in 1996 for the sale by Akai to Singer of certain assets and trademark rights relating to a water purifier business (the "Agreement"). The Agreement also provided for Singer's appointment of Akai as its exclusive distributor of certain water purification products in Japan, and for Singer's appointment of Akai as an "OEM" manufacturer of certain water purification products. Record on Appeal ("Rec.") Item 1, Exh. 1 (Amended Complaint); Brief of Appellant Akai Limited ("Akai Br.") at 3. Section seven of the Agreement provided in pertinent part:

This Agreement shall be governed by and construed in accordance with Japanese law. Any controversy or claim between the parties hereto, including those arising out of or relating to this Agreement or to the breach thereof or to the relationship between the parties, whether such claim is based on Japanese law, or the law of any other country, whether federal, state, regional or municipal and whether it is grounded in common law or statutory law, shall be settled exclusively by arbitration in Tokyo, Japan, in accordance with the rules of the Japanese Commercial Arbitration Association ("JCAA") and judgment upon the award rendered by the arbitrators shall be final and binding upon the parties and may be entered in any court having jurisdiction thereof, provided, however, that nothing contained in this Section 7 shall in any way limit the right of either party to prosecute, in any court having jurisdiction thereof, its rights under the law . . . to recover payment of any amount due from the other party pursuant to the terms of this Agreement. . . .

Rec. Item 2, Exh 1, Exh 1, at § 7(a).2

2.

Neither party disputes the contractual validity or applicability of the arbitration clause. The question here is whether it should be enforced in the context of the Singer bankruptcy proceedings.

Singer and certain of its affiliates commenced Chapter 11 reorganization proceedings pursuant to the federal Bankruptcy Code (11 U.S.C. § 101 et seq. (the "Bankruptcy Code")) in September 1999 and February 2000. On December 21, 1999, the Bankruptcy Court entered a "Bar Date Order" setting a deadline for persons holding pre-petition claims against the bankruptcy estate to file proofs asserting those claims in the proceeding. The bar date set for non-governmental creditors' claims was March 1, 2000. Supplement to Record on Appeal, Item 8 (Singer Objection to Claim). Akai, asserting that it had not been paid substantial sums for work performed pursuant to the Agreement, filed a proof of claim on March 1, 2000, seeking payment of such sums and asserting that the claim is secured by a right of setoff with respect to any and all claims of Singer against Akai. Rec. Item 2, Exh. 2, at Exh. A (Proof of Claim). Thereafter Singer, alleging that although it had paid the requisite basic consideration under the Agreement, Akai had failed to transfer the water purification-related assets in accordance with the Agreement and had improperly retained profits from post-transaction water purification sales, commenced an adversary proceeding in the Bankruptcy Court (the "Adversary Proceeding"). In the Adversary Proceeding, Singer seeks rescission of the Agreement and the return of the monies paid thereunder or, in the alternative, an award of damages in at least the amount Singer paid under the Agreement. Singer filed an Amended Complaint in the Adversary Proceeding on May 25, 2000. Rec. Item 2, Exh. 1.

Singer filed its proposed plan of reorganization (the "Plan") and disclosure statement on May 26, 2000; the Plan provided for transfer of Singer's rights in respect of certain litigation, including the adversary proceeding against Akai, to a "Singer Creditor Trust." Rec. Item 2, Exh. 3, at viii-ix.³ Akai moved on June 19, 2000, to compel arbitration of the issues raised in the Adversary Proceeding and to stay the Adversary Proceeding pending such arbitration. Singer filed its opposition to Akai's motion on July 20, 2000, and, on July 21, 2000, filed an objection to Akai's proof of claim, thereby initiating litigation in the Bankruptcy Court as to Akai's right to payment thereunder.⁴ The Bankruptcy Court heard oral argument on Akai's motion, and denied the motion in a decision rendered from the bench on August 10, 2000.

3.

The Plan was confirmed on August 24, 2000. Akai Br. at 5.

4.

As noted below, a creditor whose proof of claim is not objected to is entitled to share in relevant dividends from the estate.¹¹ U.S.C.A. § 502(a) (West 1993); see *infra* note 11.

DISCUSSION

The Federal Arbitration Act (the "FAA") (9 U.S.C. § 1 et seq.) provides "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, "thus establishing a federal policy favoring arbitration'. . . [and] requiring that . . ." [federal courts] rigorously enforce agreements to arbitrate. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226, reh'g denied 483 U.S. 1056 (1987) (citations omitted); see also 9 U.S.C.A. §§ 2, 202 (West 1999). "Like any statutory directive, [however,] the Arbitration Act's mandate may be overridden by a contrary congressional command." *McMahon*, 482 U.S. at 226.

The party opposing arbitration carries the burden of showing "that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." Such intent, if present, is to be deduced "'from [the statute's] text or legislative history' . . . or from an inherent conflict between arbitration and the statute's underlying purposes." *Id.* at 227 (citations omitted) (emphasis supplied).

In *United States Lines, Inc. v. American S.S. Owners Mut. Prot. and Indem. Ass'n., Inc.* (In re *United States Lines, Inc.*), 197 F.3d 631 (2d Cir. 1999), cert. denied, 529 U.S. 1038 (2000), the United States Court of Appeals for the Second Circuit weighed the question of the enforceability of arbitration clauses in the context of "core" bankruptcy proceedings.⁵ The U.S. Lines court made it clear that the core nature of a proceeding is not determinative of whether the bankruptcy court has discretion to refuse to compel arbitration pursuant to an otherwise valid agreement:

5.

"Core" proceedings are matters "arising under" the Bankruptcy Code or "arising in" bankruptcy cases. 28 U.S.C.A. § 157(b) (West 1993). Such proceedings, in which the bankruptcy courts have jurisdiction to make substantive determinations, are defined to include, among other things, matters concerning bankruptcy estate administration and the allowance and disallowance of claims against the bankruptcy estate. *Id.* With respect to non-core proceedings, which are merely "related to" bankruptcy cases, the bankruptcy courts are empowered to develop proposed findings of fact and conclusions of law in aid of entry of final orders and judgments by the district courts on substantive issues. 28 U.S.C.A. § 157(c) (West 1993).

Core proceedings implicate more pressing bankruptcy concerns [than non-core matters], but even a determination that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration. 'Certainly not all core bankruptcy proceedings are premised on provisions of the Code that "inherently conflict" with the Federal Arbitration Act; nor would arbitration of such proceedings necessarily jeopardize the objectives of the Bankruptcy Code.' *Insurance Co. of N. Am. v. NGC Settlement Trust Asbestos Claims Management Corp.* (In re *Nat'l Gypsum Co.*), 118 F.3d 1056, 1067 (5th Cir. 1997). *Id.* at 640.

Acknowledging that the centralization of disputes concerning debtors' property to facilitate efficient reorganization is a "core purpose" of bankruptcy, the U.S. Lines court nonetheless observed that, "by not granting the bankruptcy court exclusive jurisdiction over noncore matters, 'it is clear that in 1984 Congress did not envision all bankruptcy related matters being adjudicated in a single bankruptcy court.'" *Id.* at 640 (quoting *Hays Co. v. Merrill-Lynch, Pierce, Fenner Smith, Inc.*, 885 F.2d 1149, 1157 (3d Cir. 1989)).⁶ A bankruptcy court faced with a motion to compel arbitration in a core proceeding thus must first determine whether the proceeding involves provisions of the Code that so inherently conflict with arbitral resolution that Congressional intent to grant the bankruptcy courts discretion to refuse arbitration can be gleaned from the applicable Bankruptcy Code provisions.

6.

The bankruptcy courts' jurisdiction of core proceedings is non-exclusive as well. The federal courts have original, but not exclusive, jurisdiction of all civil proceedings arising under the Bankruptcy Code, or arising in or related to bankruptcy cases. Exclusive jurisdiction is limited to the bankruptcy "case" itself 28 U.S.C.A. § 1334 (West 1993 Supp. 2001).

As the Fifth Circuit put it in *National Gypsum*, sum a decision relied upon by the Second Circuit in *U.S. Lines*:

[T]he discretion enjoyed by a bankruptcy court to refuse enforcement of an otherwise applicable arbitration provision depends upon a finding that the standard set forth in *McMahon* [for discerning congressional intent to permit refusal of arbitration of a federal statutory claim] has been met.

Insurance Co. of N. America v. NGC Settlement Trust Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.) 118 F.3d 1056, 1066 (5th Cir. 1997). The question of whether a bankruptcy court has discretion to deny a stay pending arbitration is one of law, and is subject to de novo review on appeal. *Id.* at 1064.7

7.

U.S. Lines further teaches that, to the extent the bankruptcy court has such discretion, the central inquiry with respect to the exercise of that discretion is "whether any underlying purpose of the Bankruptcy Code would be adversely affected by enforcing an arbitration clause". . . . [A]n arbitration clause should be enforced 'unless [doing so] would seriously jeopardize the objectives of the Code.'" *U.S. Lines*, 197 F.3d at 640 (citations omitted). This second-stage inquiry "constitutes a mixed question of law and fact with legal conclusions being reviewed de novo and factual determinations being reviewed for clear error." *Id.* at 640-41 (citation omitted).

In *U.S. Lines*, the Second Circuit upheld a bankruptcy court's decision to deny arbitration of a large number of related disputes that turned on the interpretation of insurance policies whose potential proceeds constituted the only funds available to cover a large class of tort claims against the debtor's estate. *U.S. Lines*, 197 F.3d at 635. Because certain provisions of the policies could in effect have reordered the debtor's payments to creditors in a manner inconsistent with the payment provisions of the Bankruptcy Code, a declaratory judgment proceeding relating to the interpretation of the policies "directly affect[ed] the bankruptcy court's core administrative function of asset allocation among creditors" and were therefore held to be core proceedings. *Id.* at 639. In light of the integral relationship between the issues raised in the declaratory judgment proceeding and the bankruptcy court's ability to preserve and equitably distribute estate assets, the complex factual situation there present, involving numerous claims and parties, and the general preference for the bankruptcy court as a forum for resolution of mass tort claims against an insolvent debtor, the Circuit confirmed that the bankruptcy court had possessed the discretion in that case to decline to refer the matter to arbitration and upheld the court's exercise of that discretion, holding that "[t]he bankruptcy court was not clearly erroneous in finding that 'arbitration of the disputes raised in the [declaratory judgment] Complaint would prejudice the Trust's [established to pay creditors'

claims] efforts to preserve the Trust as a means to compensate claimants [against the bankruptcy estate]." Id. at 641 (citation omitted).

The Fifth Circuit's opinion in *National Gypsum* sheds further light on the circumstances under which a core matter may present so inherent a conflict as to establish a basis for bankruptcy court discretion to refuse to refer the matter to arbitration. The Fifth Circuit refuse[d] to find such an inherent conflict based solely on the jurisdictional nature of a bankruptcy proceeding "and held that" nonenforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding, i.e., whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration of the proceeding would conflict with purposes of the Code. *National Gypsum*, 118 F.3d at 1067. "Certainly not all core bankruptcy proceedings are premised on provisions of the Code that 'inherently conflict' with the Federal Arbitration Act; nor would arbitration of such proceedings necessarily jeopardize the objectives of the Bankruptcy Code." Id. The Second Circuit quoted this element of the *National Gypsum* opinion in support of its conclusion that "even a determination that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration." *U.S. Lines*, 197 F.3d at 640.

National Gypsum offers a structural framework for the analysis: does the underlying dispute concern non-Bankruptcy Code issues derivative of the debtor's pre-petition business activities or does it concern rights created by the Bankruptcy Code? See *National Gypsum*, 118 F.3d at 1068-70. *National Gypsum* holds that discretion is present in the latter situation and suggests that it would be lacking in the former, concluding that core issues centered on rights conferred by the Bankruptcy Code present sufficient tension to support discretion to determine whether arbitration of the issues would be consistent with the purpose of the Code:

We think that, at least where the cause of action at issue is not derivative of the pre-petition legal or equitable rights possessed by a debtor but rather is derived entirely from the federal rights conferred by the Bankruptcy Code, a bankruptcy court retains significant discretion to assess whether arbitration would be consistent with the purpose of the Code, including the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.

National Gypsum, 118 F.3d at 1069. "There can be little dispute that where a core proceeding involves adjudication of federal bankruptcy rights wholly divorced from inherited contractual claims [of the debtor], the importance of the federal bankruptcy forum provided by the [Bankruptcy] Code is at its zenith. . . . [T]he adjudication of [those types of] actions outside the federal bankruptcy forum could in many instances present the type of conflict with the purpose and provisions of the Bankruptcy Code alluded to in *McMahon*." Id. at 1068.

U.S. Lines and *National Gypsum* thus set as the court's first task discernment as to whether the Adversary Proceeding commenced by *Singer* presents issues premised on provisions of the Bankruptcy Code whose purposes conflict inherently with the arbitration policy. Only if there is such a conflict does the bankruptcy court have discretion to determine whether to preclude arbitration of the matter. Cf. *U.S. Lines*, 197 F.3d at 640.

In the instant case, the Bankruptcy Court found that it had such discretion. The Bankruptcy Court first concluded that the Adversary Proceeding is "essentially a counterclaim to Akai Electric's Proof of Claim" and is therefore a core proceeding. Rec. Item 6 (Transcript of August 10, 2000 Bankruptcy Court proceeding ("Tr.")) at 49.8 Turning to the question of the bankruptcy considerations at stake, the Bankruptcy Court stated that "[t]he underlying purpose of the Bankruptcy Code is to 'provide for centralized jurisdiction and administration of the Debtor, its estates [sic] and its reorganization in the Bankruptcy Court.'" Tr. at 50 (citation omitted). Quoting U.S. Lines, the Bankruptcy Court concluded that the "declaratory judgment proceedings are integral to the Bankruptcy Court's ability to preserve and equitably distribute the trust's assets" and held that it had discretion to refuse to refer the core proceedings to arbitration. Tr. at 52 (quoting U.S. Lines, 197 F.3d at 640).

8.

Neither party to this appeal challenges the Bankruptcy Court's finding of core jurisdiction.

The Bankruptcy Court's determination that it had such discretion was apparently based on three factors: the core nature of the adversary proceeding, the interrelationship between issues in that proceeding and ones raised by Akai's proof of claim, and the overall tension between the Bankruptcy Code's policy of centralization of the resolution of disputes concerning the debtor and the decentralization inherent in the enforcement of dispute-specific arbitral agreements. On appeal, this Court's review of the Bankruptcy Court's legal conclusion as to the existence of discretion to refuse to compel arbitration is de novo. See *National Gypsum*, 118 F.3d at 1064. The Court finds that the factors cited by the Bankruptcy Court are insufficient to support the existence of discretion to refuse arbitration of the issues raised in Singer's adversary proceeding.

As noted above, U.S. Lines and *National Gypsum* make it clear that not all core proceedings present inherent conflicts between the FAA and the Bankruptcy Code severe enough to support a finding under the *McMahon* standard that Congress intended to override the FAA's general policy of enforceability of arbitration agreements. See U.S. Lines, 197 F.3d at 640; *National Gypsum* 118 F.3d at 1067-68. Such an inherent conflict was clearly present in U.S. Lines because, in the absence of a bankruptcy court declaration as to the debtor's indemnity rights, the trust servicing the debtor's obligations to claimants would have had to disburse assets in a manner inconsistent with the Bankruptcy Code's distribution provisions in order to establish a predicate for claims under the policies:

[U]nder the pay-first provisions of the . . . policies, the [policy] proceeds will not be made available until the Trust has paid the claims. . . . If the Trust were initially to pay the claimants with assets earmarked for other creditors only to be informed afterward that the payments did not trigger the [insurers'] indemnification obligation, the result would be an inequitable distribution among the creditors. Therefore, in order to effectuate an equitable distribution of the bankruptcy estate, a comprehensive declaratory judgment is required to determine (1) whether a chosen payment plan will trigger the indemnification obligation and (2) the amounts payable under the insurance contracts. Thus, the declaratory proceedings brought by the Trust in this case directly affect the bankruptcy court's core administrative function of asset allocation among creditors. . . .

U.S. Lines, 197 F.3d at 638-39. In light of the "conflict of near polar extremes" of statutory objectives thus presented, the Second Circuit upheld the bankruptcy court's finding of discretion to stay arbitration. *Id.* at 640 (citation omitted). The declaratory judgment proceedings at issue in *National Gypsum* concerned construction of Bankruptcy Code section 524's discharge injunction and the confirmed reorganization plan in the underlying bankruptcy case. *National Gypsum* 118 F.3d at 1070.

The issues in *Singer's Adversary Proceeding* center, by contrast, on pre-petition contractual rights, obligations and conduct. It is a core proceeding only because it is in effect a counterclaim to the claim Akai has asserted against the estate. Akai's claim, too, relates to prepetition events. Litigation regarding the allowance or disallowance of that claim constitutes a core proceeding. 28 U.S.C.A. § 157(b)(2)(B) (West 1993). Because the issues underlying the Adversary Proceeding — the parties' rights under the Agreement and whether Akai performed its obligations under the Agreement — do not arise from rights conferred or obligations imposed by the Bankruptcy Code, they do not, standing alone, present an inherent conflict between Code policy and the FAA's endorsement of the arbitral forum. Neither does the strong centralization policy of the Bankruptcy Code present such a conflict in this case. The resolution of the issues raised in the Adversary Proceeding will not affect the allocation of assets among creditors, nor is it essential to the debtor's ability to reorganize. Indeed, the plan of reorganization has already been confirmed. This case is thus quite different from *U.S. Lines* where failure to centralize the disputes regarding insurance coverage and eligibility therefor would not only have affected the amount of money available for a significant class of claimants but might also have resulted in the mis-allocation of estate assets.

Nor is the interrelationship of the Adversary Proceeding and Akai's claim against the estate sufficient to frame a significant conflict between the Bankruptcy Code and the FAA. Bankruptcy court jurisdiction of core proceedings is non-exclusive. 28 U.S.C.A. § 1334(b) (West 1993). While a creditor must generally file a proof of claim to be eligible to receive payment⁹ and the Bankruptcy Code imposes an automatic stay on creditors' collection efforts in non-bankruptcy fora,¹⁰ there is no Code requirement that all issues relating to a debtor's activities be adjudicated in the Bankruptcy Court. The risk of inconsistent adjudications is not unique to bankruptcy and does not frame an inherent conflict between Bankruptcy Code and FAA policy.¹¹

9.

See 11 U.S.C.A. §§ 501, 502 (West 1993 Supp. 2001); Fed.R.Bankr.P. 3021 (West Supp. 2001); and Bar Date Order.

10.

11 U.S.C.A. § 362 (West 1993 Supp. 2001).

11.

Singer argued strenuously in this Court that it is somehow disingenuous or unfair that Akai demanded arbitration only of the Adversary Proceeding, while asserting its claim against the estate in the bankruptcy forum. Assuming that *Singer* had not conceded the validity of Akai's claim by scheduling it as undisputed in its bankruptcy disclosures, Akai was required, as noted above, to file a proof of claim in the Bankruptcy Court to be eligible for any payment

in respect of its claim. Absent objection, Akai's claim would have been allowed without litigation of the underlying contract performance issues.11 U.S.C.A. § 502(a) (West 1993). Singer's Adversary Proceeding was commenced, and the demand for arbitration of that proceeding interposed, prior to the assertion of any objection to Akai's claim in the bankruptcy proceeding. Indeed, Singer's objection to Akai's claim was not filed until after Singer's opposition to the motion to compel arbitration was filed. Furthermore, the arbitration clause of the Agreement specifically permits "either party to prosecute, in any court having jurisdiction thereof, its rights under law . . . to recover payment of any amount due from the other party pursuant to the terms of this Agreement." Rec. Item 2, Exh. 1, Exh. 1, at § 7(a). Under these circumstances, Akai's failure to demand arbitration of its claim in the bankruptcy at the time it moved to compel arbitration of the Singer's Adversary Proceeding is not significant.

This Court thus finds that the Bankruptcy Court lacked discretion to deny the motion to compel arbitration of the contract and performance issues raised in the declaratory judgment proceeding commenced by Singer. Akai's motion should therefore have been granted to the extent it sought arbitration of issues relating to the parties' respective rights, obligations and performance under the Agreement. The decision of the Bankruptcy Court is reversed and the matter is remanded to the Bankruptcy Court for further proceedings consistent with this decision.

SO ORDERED.