SANDBERG PHOENIX

CLASS ACTION BLOG

Bankruptcy Court Properly Denied Class-wide Arbitration

AUTHOR: ANTHONY MARTIN

Summary: Credit One Bank (Credit One) issued a credit card to Anderson who failed to make timely payments. The debt was charged off, then sold to a third party, and reported to the major credit reporting agencies. Thereafter, Anderson filed Chapter 7 bankruptcy and was discharged, but Credit One failed to honor Anderson's request to correct his credit report. After the Bankruptcy Court permitted Anderson to reopen the bankruptcy proceeding, he filed a putative class action complaint against Credit One. Credit One moved to stay the proceedings and initiate arbitration, which the Bankruptcy Court refused to do "because it was a core bankruptcy proceeding that went to the heart of the 'fresh start' guaranty to debtors under the Bankruptcy Code." The District Court affirmed the Bankruptcy Court as did the 2nd Circuit. The issue before each Court was how to reconcile the Federal Arbitration Act's public policy favoring arbitration with the Bankruptcy Code's strong public policy to ensure that discharged debtors receive a "fresh start." That was the key issue the 2nd Circuit resolved against arbitration and in favor of a fresh start.

In re Anderson v. Credit One Bank, N.A.

Many written consumer agreements contain mandatory arbitration clauses. Credit One's agreement with Anderson was no different. Once Anderson fell in arrears, his debt was charged off, sold, and reported to the major consumer credit reporting agencies – Equifax, Experian, and Transunion. After Anderson filed a voluntary Chapter 7 bankruptcy petition, his debts were discharged and his Chapter 7 case was closed. Thereafter, Anderson contacted Credit One and asked it to correct his credit reports, which it refused to do. Shortly thereafter, he moved to have his bankruptcy case reopened in order to pursue Credit One for allegedly violating the injunction which is part of every discharge under Bankruptcy Code § 524. Anderson thereafter amended his complaint to pursue the matter on a class-wide basis. Credit One responded by moving to compel arbitration which the Bankruptcy Court denied. Credit One stipulated that it would update the credit reports, but only after the Bankruptcy Court's refusal to send the matter to arbitration had been affirmed by the District Court and after oral argument in the 2nd Circuit. The 2nd Circuit first held that despite the stipulation, there remained an Article III case or controversy allowing the 2nd Circuit to rule on the substantive issues before it.

Second Circuit precedent required bankruptcy courts to send non-core proceedings to arbitration when requested, but if the Bankruptcy Court determines that "arbitration would create a 'severe conflict' with purposes of the Bankruptcy Code, it has discretion to conclude that 'Congress intended to override the Arbitration Act's general policy favoring the enforcement of arbitration agreements.'" *MBNA American Bank, N.A. v. Hill*, 436 F.3d 104, 108 (2nd Cir. 2006). Proceedings in Bankruptcy Court are "core" if they "involve 'more pressing bankruptcy concerns.'" The 2nd Circuit held in *Hill* that "[b]ankruptcy courts are more likely to have discretion to refuse to compel arbitration of core bankruptcy matters." *Hill*, 436 F.3d at 108. The parties before the Court in *Anderson* agreed that his claim was a core proceeding.

The Court recognized the Supreme Court had declared in *Shearson/American Ex., Inc. v. McMahon*, 482 U.S. 220, 226 (1987) that the Federal Arbitration Act "establishes a federal policy favoring arbitration." The Supreme Court also stated the burden was "on the party opposing arbitration…to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." *McMahon*, 482 U.S. at 227. The Court noted that a Chapter 7 bankruptcy discharge "is the foundation upon which all other portions of the Bankruptcy Code are built." The Bankruptcy Code was established to allow "honest, but unfortunate debtors an opportunity to reorder their financial affairs and get a fresh start. This is accomplished through the statutory discharge of pre-existing debts." *In re DeTrano*, 326 F.3d 319, 322 (2nd Cir. 2003). The Court had concluded earlier that the "'fresh start' procured by discharge [was] the 'central purpose of the Bankruptcy Code' as shaped by Congress, permitting debtors to obtain a 'fresh start in life and a clear field unburdened by the existence of old debts.'" *In re Bogdanovich*, 292 F.3d 104, 107 (2nd Cir. 2002). For those reasons, the 2nd Circuit held in *Anderson* that "arbitration of a claim based on an alleged violation of § 524(a)(2) would 'seriously jeopardize a particular core bankruptcy proceeding.'" *In re U.S. Lines, Inc.*, 108 F.3d 631, 641 (2nd Cir. 1999). "We come to this conclusion because 1) the discharge injunction is integral to the bankruptcy court's ability to provide debtors with a fresh start that is the very purpose of the Code; 2) the claim regards an ongoing bankruptcy matter that requires continuing court supervision; and 3) the equitable powers of the bankruptcy court to enforce its own injunctions are central to the structure of the Code. The fact that Anderson's claim comes in the form of a putative class action does not undermine this conclusion."

Only the Bankruptcy Court "has the power to enforce the discharge injunction in § 524." It was entitled to do so based upon its statutory contempt powers provided under §105(a) which complement the "inherent powers of the federal court" to enforce its own orders. The Court reiterated that there was nothing about "the class action nature of this case [which would] alter our analysis." The Court further noted that "arbitration of the claim would thus present an inherent conflict with the Bankruptcy Code." In a case "where the putative class members are all allegedly victims of willful violations of the discharge injunction issued by the Bankruptcy Court, there is a continuing disruption of the debtors' ability to obtain their fresh starts." For those reasons, the Court concluded that the Bankruptcy Court had properly balanced and considered the conflicting policies and had done so in accordance with the law. The 2nd Circuit held "that the bankruptcy court did not abuse its discretion by denying Credit One's motion to compel arbitration."

The issue whether to allow arbitration in a putative class action is a matter which comes up before the courts with frequency. The 2nd Circuit's holding in *Anderson* found that the Bankruptcy Court had properly weighed the conflicting public policies between the Bankruptcy Code's fresh start goal and the desire of Congress to send matters to arbitration whenever possible when it denied Credit One's motion to compel arbitration. Although there are instances in Bankruptcy Court non-core proceedings where the denial of a motion to compel arbitration in a putative class action case would be an abuse of discretion, this was not the case; ensuring a fresh start for a discharged debtor is central to the purpose of the United States Bankruptcy Code. *In re Anderson* is another case which helps define the limits of arbitration clauses in class action litigation.