No. 11-1310

IN THE
Supreme Court of the United States

CONTINENTAL INSURANCE COMPANY,
Petitioner,

v.

THORPE INSULATION COMPANY, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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The courts of appeals are deeply divided regarding when arbitration agreements are enforceable in bankruptcy. As the petition explained, the Third and Fifth Circuits hold that arbitration agreements must be enforced—even in core bankruptcy proceedings—unless the claim at issue arises under the Bankruptcy Code. *In re Mintze*, 434 F.3d 222 (3d Cir. 2006); *In re National Gypsum Co.*, 118 F.3d 1056 (5th Cir. 1997). The Second, Fourth, and now Ninth Circuits, by contrast, hold that bankruptcy courts have discretion to refuse to enforce arbitration agreements in core proceedings whenever arbitration would offend the purported

bankruptcy policy of "centralization." Pet. App. 20a; *In re White Mountain Mining Co.*, 403 F.3d 164 (4th Cir. 2005); *In re U.S. Lines, Inc.*, 197 F.3d 631 (2d Cir. 1999). The Ninth Circuit thus held below that the bankruptcy court did not abuse its discretion in refusing to enforce Thorpe's agreement to arbitrate disputes arising out of its pre-bankruptcy settlement agreement with Continental. Under the Third and Fifth Circuit's approach, such a dispute—which arises under state law, not the Bankruptcy Code—must be arbitrated.

Respondents claim that no such split of authority exists. But the split and its importance are plain from a review of the relevant cases and have been recognized repeatedly in scholarly commentary. To maintain their position, respondents are thus forced to distort the Fifth Circuit's reasoning and—strikingly—to ignore the Third Circuit's decisions altogether.

While respondents contend that all courts of appeals apply the same standard, under which it is "irrelevant" whether a claim arises under the Bankruptcy Code (Opp. 29-30), the Third and Fifth Circuit decisions are directly to the contrary. The Third Circuit could hardly have been clearer on this point: The enforceability of an arbitration clause turns on whether the claim at issue is one "that the Bankruptcy Code created." *Mintze*, 434 F.3d at 230. If not, there is no "inherent conflict between arbitration … and the underlying purposes of the Bankruptcy Code," *id.* at 231-232, and the claim must be arbitrated. And despite respondents' assertions, the Fifth Circuit employs that same standard. *National Gypsum*, 118 F.3d at 1069 ("[W]here the cause of action ... is derived entirely from the federal rights conferred by the Bankruptcy Code, a bankruptcy court retains significant discretion" to refuse to enforce an agreement to arbitrate). As multiple commentators

have recognized, the "uncertainty and confusion" among the courts of appeals on this significant issue requires this Court's guidance. Resnick, *The Enforceability of Arbitration Clauses in Bankruptcy*, 15 Am. Bankr. Inst. L. Rev. 183, 185 (2007).

On the merits, respondents offer no plausible defense of the Ninth Circuit's decision. Nothing in this Court's arbitration jurisprudence remotely supports the Ninth Circuit's cavalier conclusion that bankruptcy courts have broad discretion to ignore arbitration agreements whenever they deem that arbitration would somehow interfere with bankruptcy policy. And this Court's precedent directly refutes the notion that "centralization" of disputes is a reason for refusing to enforce pre-bankruptcy arbitration agreements. Indeed, the Ninth Circuit acknowledged that this Court had rejected such concerns as proper grounds for departing from the Federal Arbitration Act, but blithely asserted that this Court's jurisprudence "does not hold" in the bankruptcy context. Pet. App. 20a n.9. That view of the law would permit evisceration of the FAA's core guarantee in a broad range of bankruptcy-related disputes.

Rather than engage with this Court's precedent or the courts of appeals' conflicting attempts to apply it in the bankruptcy context, respondents devote most of their brief to a lengthy excursus on Section 524(g) of the Bankruptcy Code. That is nothing more than a smokescreen. Continental's claim is that Thorpe violated the parties' pre-bankruptcy settlement agreement, in which Thorpe released all claims to coverage from Continental, by encouraging tort plaintiffs to sue Continental directly and by purporting to assign claims against Continental to third parties (not, as respondents suggest, that Thorpe violated the settlement

agreement by creating a Section 524(g) trust). Thorpe agreed to arbitrate all disputes arising out of that settlement agreement. Thorpe now contends that Continental's action for breach of the agreement is impliedly preempted by Section 524(g), which, Thorpe argues, gave it the right to act as it did notwithstanding its contractual obligations. But whatever the merits of that defense, it has nothing to do with the question before this Court. If a claim is subject to arbitration, it is the arbitrator's responsibility to consider any defenses to that claim. *See, e.g.*, *Thomas James Assocs., Inc.* v. *Jameson*, 102 F.3d 60, 68 (2d Cir. 1996). And the fact that a claim or defense may be complicated—or may involve issues of federal law—has never been a justification for abrogating the parties' agreement to arbitrate.

Respondents cannot credibly contest the importance of this issue. This Court has never addressed the application of the FAA in bankruptcy, which is undoubtedly the single most significant area in which the enforceability of arbitration agreements remains unclear. And without this Court's guidance, the lower courts have created a confused and divided body of law that respondents' own authorities describe as a "morass." Sousa, *A Morass of Federal Policy: Enforcing Arbitration Agreements in Bankruptcy Proceedings*, 15 Norton J. Bankr. L. & Prac. 259 (2006). As a unanimous Court recently noted, the "Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law," making it critical for this Court to lay down "clear[] and predictable[]" rules. *RadLAX Gateway Hotel LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065, 2073 (2012). The question presented here is sorely in need of the clarity and predictability only this Court can provide.

I. THE NINTH CIRCUIT'S DECISION CONFLICTS WITH DECISIONS OF THE THIRD AND FIFTH CIRCUITS

The courts of appeals are split as to when bankruptcy courts have the discretion to refuse arbitration of a core proceeding. The Second, Fourth, and now Ninth Circuits hold that bankruptcy courts have such discretion whenever they believe arbitration would interfere with the "centralization" of bankruptcy-related disputes. Pet. App. 20a; *U.S. Lines*, 197 F.3d at 639-641; *White Mountain Mining*, 403 F.3d at 168-170. The Third and Fifth Circuits, by contrast, have held that a bankruptcy court may deny arbitration of a core proceeding *only* if the cause of action is created by the Bankruptcy Code—and may *not* refuse to enforce an arbitration clause when, as here, the claim at issue is a state-law claim of breach of a pre-bankruptcy contract. *Mintze*, 434 F.3d at 228-232; *National Gypsum*, 118 F.3d at 1067-1069; *see also* Kirgis, *Arbitration, Bankruptcy, and Public Policy: A Contractarian Analysis*, 17 Am. Bankr. Inst. L. Rev. 503, 518-520 (2009) (describing the split between the Second and Fourth Circuits on the one hand and the Third and Fifth Circuits on the other over the arbitration of core proceedings).[1]

Many scholars have recognized this split and highlighted the "uncertainty and confusion" in the lower courts "with respect to the interplay between arbitra-

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[1] As the petition noted (at 12-13 & n.7) and respondents emphasize (at 17), the Ninth Circuit purported to "join [its] sister circuits in holding that, even in a core proceeding, the *McMahon* standard must be met"—*i.e.*, that there must be an "inherent conflict" between arbitration and the Bankruptcy Code before a court may deny arbitration. Pet. App. 17a (citing *Shearson/Am. Express, Inc.* v. *McMahon*, 482 U.S. 220, 227 (1987)). But the division of authority is not over *whether* to apply *McMahon*, but *how* to do so.

tion and bankruptcy." Resnick, *supra*, at 185; *see also* Kirgis, *supra*, at 517 (the "significant circuit split" has caused "a great deal of confusion and disparity"); Culhane, *Limiting Litigation over Arbitration in Bankruptcy*, 17 Am. Bankr. Inst. L. Rev. 493, 493 (2009) (the lower courts have "struggled" to apply the Court's arbitration decisions in bankruptcy). Respondents' efforts to dispute the existence of this division of authority fail. Indeed, while respondents accuse Continental of "extravagant overstatement[]" for calling this area of the law a "morass of confusion" (Opp. 36), two sentences later respondents rely on an article titled "A Morass of Federal Policy," which describes arbitration in bankruptcy as a "quagmire" and a "thicket of thorny issues with no simple solution." Sousa, *supra*, at 260, 277.

Respondents cannot reconcile the conflicting decisions of the courts of appeals. Indeed, they do not even try to square the Ninth Circuit's approach with the Third Circuit's decision in *Mintze*—instead simply ignoring that decision. *Mintze* demonstrates that the Third and Ninth Circuit's approaches are irreconcilable. There, the Third Circuit held that bankruptcy courts have discretion to deny arbitration only in proceedings that "the Bankruptcy Code created for the benefit of the creditors of the estate." 434 F.3d at 230. Where the claim at issue arises under non-bankruptcy law—like the federal and state consumer-protection claims in *Mintze* or the breach-of-contract claim here—there is no "inherent conflict between arbitration … and the underlying purposes of the Bankruptcy Code." *Id.* at 231-232. Unlike the Ninth Circuit, the Third Circuit does not ask whether arbitration would implicate generalized concerns about "centralization."

If a claim arises under non-bankruptcy law, it must be arbitrated.

Respondents attempt to explain away the Fifth Circuit's decision in *National Gypsum*, but they seriously distort that decision's reasoning. That case, like this one, involved a dispute between a debtor with asbestos liability and its insurer, but its analysis cannot be squared with the Ninth Circuit's and would mandate a different result in this case. In *National Gypsum*, after the debtor emerged from bankruptcy, one of its insurers tried to collect on a prior debt. The reorganized debtor returned to bankruptcy court, arguing that the debt had been discharged in the bankruptcy case. The bankruptcy court denied the insurer's motion for arbitration. The Fifth Circuit affirmed, but rejected the debtor's argument that "arbitration of core bankruptcy proceedings is inherently irreconcilable with the Bankruptcy Code." 118 F.3d at 1067. Instead, it held that a bankruptcy court's discretion to deny arbitration of a core proceeding "turns on the underlying nature of the proceeding." *Id.* A court may deny arbitration only where "the proceeding derives *exclusively* from the provisions of the Bankruptcy Code," rather than state law, and "arbitration ... would conflict with the purposes of the Code." *Id.* (emphasis added); *see also id.* at 1069. The debtor's motion to enforce the discharge injunction was thus not required to be arbitrated because it "assert[ed] a statutory right under the Bankruptcy Code," raised no "state law contract issue[]," and "involve[d] adjudication of federal bankruptcy rights wholly divorced from ... contractual claims." *Id.* at 1064, 1068.

By contrast, Continental's action did not derive in any way, let alone "exclusively," from the Bankruptcy Code. It is a state-law contract claim arising from a

pre-bankruptcy contract. Under the Third and Fifth Circuits' approach, enforcing the parties' agreement to arbitrate would thus pose no "irreconcilable conflict" with the Bankruptcy Code. *See Mintze*, 434 F.3d at 230-231; *National Gypsum*, 118 F.3d at 1067-1069. In short, had Thorpe's bankruptcy occurred in the Third or Fifth Circuits, Continental's claim would have been arbitrated. The Ninth Circuit's contrary decision squarely conflicts with *Mintze* and *National Gypsum*.

II. THE NINTH CIRCUIT'S DECISION CANNOT BE RECONCILED WITH THIS COURT'S PRECEDENT

Respondents hardly mention this Court's precedent, which fatally undermines the Ninth Circuit's analysis. This Court has never found a federal statute that poses an "inherent conflict" with the Federal Arbitration Act, and the Bankruptcy Code—at least with respect to a creditor's state-law claim against the estate—is an exceedingly poor candidate to become the first.

As this Court recently held in *CompuCredit Corp.* v. *Greenwood*, 132 S. Ct. 665 (2012), when a statute is "silent" regarding arbitration, there is a strong presumption that Congress did not intend to override the Federal Arbitration Act. *Id.* at 673. As everyone agrees, the text and legislative history of the Bankruptcy Code say nothing about arbitration. *E.g.*, Pet. App. 15a. The Ninth Circuit's failure to acknowledge or address the presumption in favor of arbitration recognized in *Greenwood* by itself demonstrates the flaws in the Ninth Circuit's analysis.

Even setting *Greenwood* aside, however, this case involves no "inherent conflict" between the Bankruptcy Code and arbitration. *McMahon*, 482 U.S. at 226-227.

In finding such a conflict, the Ninth Circuit focused on the need for "centralization" of disputes related to Thorpe's bankruptcy. Pet. App. 20a-21a. This Court has repeatedly rejected that rationale for refusing to enforce arbitration. The FAA "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement," *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983), "even where the result would be the possibly inefficient maintenance of separate proceedings in different forums," *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213, 217 (1985). Indeed, the Ninth Circuit itself recognized that "centralization of disputes" is not a valid reason under this Court's precedent for "nonenforcement of an otherwise applicable arbitration clause." Pet. App. 20a n.9. But it baldly announced that this principle "does not hold in the bankruptcy context." *Id.* There is no basis for a "bankruptcy exception" to the enforcement of arbitration agreements.

Respondents claim (at 24) that the Bankruptcy Code "differs" from other federal statutes because "it is a procedure that requires centralization, and individual arbitrations may therefore more often lead to an inherent conflict with federal bankruptcy policy." This mischaracterizes bankruptcy practice. The confirmation of a debtor's plan of reorganization or a motion to approve an asset sale—the kinds of matters that arise under the Bankruptcy Code—may not be amenable to arbitration. But as the petition explained (at 31-32), disputes over the allowance of individual claims are routinely divided among several courts in the same case—the bankruptcy court may handle some, but others may be resolved by

the district court or by state courts.[2] In fact, all circuits agree that a bankruptcy court *must* refer to arbitration any "non-core" proceedings—such as a debtor's claim against a creditor—notwithstanding concerns about "centralization." There is no reason, as a matter of bankruptcy law or policy, why a creditor's state-law claim against a debtor should be treated differently.

As this Court has long recognized, the starting point for ascertaining parties' rights in bankruptcy is the parties' rights outside bankruptcy. Thus, a creditor's claim against the debtor must be decided by the underlying non-bankruptcy law that created it—usually state contract, property, or tort law. *See* 11 U.S.C. § 502; *Raleigh* v. *Illinois Dep't of Revenue*, 530 U.S. 15, 20 (2000); *Butner* v. *United States*, 440 U.S. 48, 54-55 (1979); *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 161 (1946). Arbitrators are fully capable of resolving such matters.

The Ninth Circuit's (and respondents') focus on "centralization" also fails to provide any meaningful or principled standard for determining when an arbitration agreement should be enforced. In the absence of any clear rule, the matter is left to the unguided discretion of individual judges. *See* Kirgis, *supra*, at 520 (the approach is "so vague and malleable that [it] give[s] courts license to do almost anything they want"); *Sunbeam Prods., Inc.* v. *Chicago Am. Mfg., LLC*, 2012 WL 2687939 (7th Cir. July 9, 2012) ("There are hundreds of

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[2] *See generally In re Quigley Co.*, 361 B.R. 723, 745 (Bankr. S.D.N.Y. 2007) (granting stay relief to permit arbitration of an insurance dispute in an asbestos bankruptcy case because the "coverage dispute can move at its own pace without disturbing the administration of the [bankruptcy] case").

bankruptcy judges, who have many different ideas about what is equitable in any given situation."). That approach cannot be squared with this Court's admonition that the FAA "leaves no place for discretion" for a court presented with a valid arbitration clause. *Dean Witter*, 470 U.S. at 218. To the contrary, the Ninth Circuit's approach reflects "exactly the judicial approach to arbitration that [this] Court has repeatedly repudiated for the last three decades." Kirgis, *supra*, at 540.

Respondents, like the Ninth Circuit, also dwell at length on Section 524(g) and their contention that it precludes Continental's claim for breach of the parties' settlement agreement. Those issues are wholly irrelevant. As the petition explained (at 28-29), arbitrability turns on the nature of the *claim*. If a claim is arbitrable, all affirmative defenses must also be referred to arbitration. *See, e.g.*, *Thomas James Assocs.*, 102 F.3d at 68 ("Once a court determines that the parties agreed to arbitrate a dispute, then that dispute must be submitted to the arbitrator. This includes questions of affirmative defenses to the claim." (citations omitted)). Here, Continental's claim is an ordinary state-law contract action. Respondents' affirmative defense (that Section 524(g) of the Bankruptcy Code impliedly preempts state contract law) must be heard by the arbitrator. Respondents' contention that only a bankruptcy court is fit to consider that issue reflects exactly the hostility to arbitration that this Court has sought for decades to eradicate from federal law. *McMahon*, 482 U.S. at 232.

III. THIS CASE PRESENTS AN IMPORTANT ISSUE WARRANTING THE COURT'S INTERVENTION

The issue presented in this case has broad importance. Indeed, it is likely the most important arbi-

tration question unresolved by this Court. The conflict among the courts of appeals and the widespread confusion among lower courts are a significant problem because "the variety of cases in which arbitration and bankruptcy can collide is nearly limitless." Kirgis, *supra*, at 514. A national solution to this problem is essential, and only this Court can provide it.

This case is an excellent vehicle for doing so. Respondents' contention (at 31) that this case affects only the "arcane subworld of § 524(g)" is baseless. This case, like every case this Court considers, arises on specific facts. Sometimes those facts are arcane. But the principle of federal law at issue is of general applicability and enormous importance. This case squarely and cleanly presents the question whether an otherwise valid arbitration agreement reflected in a pre-bankruptcy contract should be enforced when that contract is the basis for a creditor's claim in bankruptcy. This Court should take this opportunity to resolve that question.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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