NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

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In re:

ANTHONY and NANCY M. TRIMBLE,

Debtors.

Chapter 7
Case No. 06-22616 (RTL)

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THEODORE LISCINSKI, JR., Trustee,

Plaintiff,

v.

CAMBRIDGE MANAGEMENT GROUP,

Defendant.

Adversary Proceeding
Case No. 07-2115 (RTL)

- -X

OPINION

APPEARANCES:

Theodore Liscinski, Jr., Esq.
Theodore Liscinski, Jr. LLC
(Attorneys for Chapter 7 Trustee, Theodore Liscinski, Jr.)

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RAYMOND T. LYONS, U.S.B.J.

INTRODUCTION

In this case, the court is considering the limited issue of whether to grant the Defendant's motion to stay proceedings pending arbitration. The court declines to do so, finding the

Trustee's preference action is not subject to arbitration. The Trustee's claim requires the court to examine the contract between the Debtor and the Defendant, and the arbitration clause at issue is part of that contract. However, the preference cause of action belongs to the Trustee, and the Trustee was not a party to that contract. Therefore, the Trustee cannot be bound by the arbitration clause.

JURISDICTION

This court has jurisdiction under 28 U.S.C. § 1334(b), 28 U.S.C. § 157(a), and the Standing Order of Reference by the United States District Court for the District of New Jersey dated July 23, 1984, referring all proceedings arising under title 11 of the United States Code to the bankruptcy court. This is a core proceeding under 28 U.S.C. § 157(b)(2)(F) since the adversary proceeding brought by the Trustee was initiated to recover a preference.[1]

FINDINGS OF FACT AND PROCEDURAL HISTORY

Anthony Trimble, one of the debtors in this case, filed a personal injury lawsuit in the Superior Court of New Jersey. His suit stemmed from an accident that occurred on or about

[1] The Defendant's argument that this is not a core proceeding is incorrect. A core proceeding must be "arising under" or "arising in" title 11. *See* 28 U.S.C. §157(b)(1) (2000). To be "arising under" or "arising in" title 11, a proceeding must substantively invoke title 11 or have no existence independent of the bankruptcy case. *See Stoe v. Flaherty*, 436 F.3d 209, 216 (3d Cir. 2006). Proceedings only "related to" a case under title 11 cannot be classified as core. *Id.* at 217. The Defendant argues that the contract between the Debtor and the Defendant exists independent of the bankruptcy, and the Debtor could have pursued an action outside of bankruptcy to invalidate the contract. While these statements are accurate, this does not change the fact that this is a preference action, which is a cause of action created by title 11. Additionally, the motion to stay the preference action pending arbitration would not exist but for the bankruptcy case since a preference action is unique to bankruptcy. *See OHC Liquidation Trust v. Am. Bankers Ins. Co. (In re Oakwood Homes Corp.),* Adv. No. 04-56928, 2005 Bankr. LEXIS 429, at *4 (Bankr. D. Del. Mar. 18, 2005).

October 14, 2002. After filing suit, Mr. Trimble sought a cash advance on his claim from Cambridge Management Group ("CMG"), the defendant in this case.

CMG is a legal finance company, based in New Jersey, that specializes in non-recourse pre-settlement funding.[2] CMG is a company organized to advance money to individuals involved in various types of litigation, including personal injury cases. In exchange for advancing money, CMG is assigned a portion of the potential proceeds of the litigation. Thus, CMG is paid when a successful settlement, judgment, or verdict is obtained by a plaintiff. If no settlement is reached and the plaintiff is unsuccessful in litigation, the plaintiff is not obligated to repay CMG.

Mr. Trimble and CMG entered into an agreement on January 1, 2006. The agreement provided that Mr. Trimble would receive $15,000 from CMG. It was agreed that the money would be repaid to CMG from proceeds of the personal injury case if Mr. Trimble was successful. The total amount owed to CMG, including fees and interest, was outlined in a sliding scale agreement. This agreement also contained a mandatory arbitration clause.[3]

Mr. Trimble eventually settled his personal injury case. On October 21, 2006, a check was issued to CMG in the amount of $24,000. A second check was issued to CMG on December 1, 2006, in the amount of $7,650.86.

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[2] All information relating to the operations of CMG was obtained from a certification of CMG's attorney.

[3] The arbitration clause stated:

> Plaintiff acknowledges and agrees that any and all disputes that arise concerning the terms, conditions, interpretation or enforcement of this Agreement shall be determined through arbitration pursuant to the Rules and methods outlined by the American Arbitration Association in New Jersey, or in a Court of competent jurisdiction, at the election of CMG.

Trimble-CMG Contract, Exhibit B at § 10(b), Docket No. 07-2115, Doc. 6-4, Oct. 23, 2007.

On December 15, 2006, approximately eleven months after entering into the contract, Mr. Trimble filed a voluntary chapter 7 bankruptcy petition. He obtained a discharge on March 20, 2007. Subsequent to this, the Trustee filed an adversary proceeding against CMG claiming the payments to CMG, made within 90 days prior to the bankruptcy petition, were preferences. CMG moved to stay the proceeding pending arbitration, which the Trustee opposed.

DISCUSSION

The Federal Arbitration Act (FAA), 9 U.S.C. §§ 1–307 (2000), mandates that an arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.* § 2. Section 3 of the FAA empowers the court to stay a proceeding "upon being satisfied that the issue involved . . . is referable to arbitration", *Id.* § 3, while § 4 outlines the procedure by which a party may seek the enforcement of such an agreement. *Id.* § 4.

Both the United States Supreme Court and the Third Circuit Court of Appeals have noted the strong policy favoring arbitration. *See Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006); *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 226 (1987); *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *Mintze v. Am. Gen. Fin. Servs., Inc. (In re Mintze*), 434 F.3d 222, 229 (3d Cir. 2006). "[T]he FAA mandates enforcement of applicable arbitration agreements even for federal statutory claims." *Mintze*, 434 F.3d at 229.

The rationale behind favoring arbitration is rooted in contract theory. The Supreme Court has described the FAA by saying it "is at bottom a policy guaranteeing the enforcement of private contractual arrangements". *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 626 (1985). Thus, " '[the] preeminent concern of Congress in passing the Act was to

enforce private agreements into which parties had entered,' a concern which 'requires that we rigorously enforce agreements to arbitrate.' " *Id.* (quoting *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985)). By recognizing the importance of a party's freedom to contract, the FAA seeks to enforce arbitration agreements as to the parties who entered into them.

This policy favoring arbitration has its limitations. For example, a trustee in bankruptcy is not always bound to arbitrate a claim based on a pre-petition arbitration agreement signed by a debtor. In bankruptcy, a trustee may pursue two different types of claims, which result in opposite outcomes on the issue of arbitrarily. First, a trustee may pursue a debtor-derivative cause of action in which the trustee acts "as successor to the debtor's interest under section 541".[4] *Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1154 (3d Cir. 1989). Thus, "the trustee stands in the shoes of the debtor and can only assert those causes of action possessed by the debtor." *Id.* (internal citations omitted). In such circumstances, "the trustee is bound to arbitrate all of its claims that are derived from the rights of the debtor under section 541". *Id.*

A trustee may also pursue non-debtor-derivative claims such as § 544 lien avoidance actions, § 547 preference actions, and § 548 fraudulent transfer claims. These claims are unique because they are statutorily created causes of action under the Bankruptcy Code and "are creditor claims that the Code authorizes the trustee to assert on their behalf." *Id.* at 1155. *Accord Allegaert v. Perot*, 548 F.2d 432, 436 (2d Cir. 1977) ("These are statutory causes of action belonging to the trustee, not to the bankrupt, and the trustee asserts them for the benefit of the bankrupt's creditors, whose rights the trustee enforces.").

[4] Section 541 defines property of the estate. *See* 11 U.S.C. § 541 (Supp. 2005).

The United States Bankruptcy Court for the District of Delaware discussed the distinctive nature of preference and fraudulent transfer actions in *OHC Liquidation Trust v. American Bankers Insurance Co. (In re Oakwood Homes Corp.)*, Adv. No. 04-56928, 2005 Bankr. LEXIS 429 (Bankr. D. Del. Mar. 18, 2005). The court explained:

> Neither of these [actions] may be brought by a debtor, and under no interpretation could any such action be described or construed as having been derived from the debtor. They are creatures of statute, available in bankruptcy solely for the benefit of creditors of the debtor, whose rights the trustee enforces.

Id. at *13. *See also Pardo v. Pacificare of Tex., Inc. (In re APF Co.)*, 264 B.R. 344, 363 (Bankr. D. Del. 2001) ("[W]here the trustee brings a cause of action on behalf of creditors which the Bankruptcy Code itself authorizes the trustee to assert on the creditors' behalf, the cause of action derives from the Bankruptcy Code, not from the debtor.").

The Third Circuit case *Hays & Co.* is particularly instructive on this matter. In that case, the Trustee was pursuing both debtor-derivative and non-debtor-derivative claims. *Hays & Co.*, 885 F.2d at 1154-57. The court found the trustee was bound to arbitrate the debtor-derivative causes of action, which included securities law violations. *Id.* However, the trustee was not bound to arbitrate the § 544(b) claims, which were not debtor-derivative. *Id.* at 1155. Thus, the court determined that a trustee is not bound by an agreement to arbitrate when neither he nor the creditors he represents were parties to the agreement. *Id.* "[I]t is the *parties* to an arbitration agreement who are bound by it and whose intentions must be carried out." *Id.* ("[T]here is no justification for binding creditors to an arbitration clause with respect to claims that are not derivative from one who was a party. . . . It follows that the trustee cannot be required to arbitration. . . .").

The court in *Oakwood Homes* reached a similar conclusion. In that case, the court found a trustee's § 547 cause of action was not derivative of the debtor; therefore, the trustee was not bound to arbitrate the claim. *Oakwood Homes*, 2005 Bankr. LEXIS 429, at *13-14. The court held:

> The arbitration agreement was entered into by Debtor, pre-petition, and as the courts have made clear, it is the parties to such an agreement who are bound by it and whose intentions must be carried out. Thus, . . . this Court may not require . . . preference actions under § 547, to be submitted to arbitration."[5]

Id. The court reached its conclusion about preference actions by way of analogy, equating § 547 with § 544(b) and § 548 claims. *Id.* at *13. This court agrees that such equation is appropriate because all three of these sections deal with causes of action belonging to the trustee.

The Third Circuit decision, *Mintze*, does not affect the analysis of these non-debtor-derivative causes of action. In *Mintze*, the Third Circuit undertook the task of analyzing the breadth of its prior decision in *Hays & Co. Mintze*, 434 F.3d at 228-32. *Mintze*, which dealt with a debtor-derivative cause of action, held that a determination of whether a cause of action is core or non-core does not "affect whether a bankruptcy court has the discretion to deny enforcement of an arbitration agreement." *Id.* at 229. The core versus non-core distinction was important in *Mintze* because one party was arguing *Hays & Co.* only applied to non-core

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[5] *See also Astropower Liquidating Trust v. Xantrex Tech., Inc.*, 335 B.R. 309, 326 (Bankr. D. Del. 2005) ("[C]reditors may not be compelled indirectly through their representative to arbitrate fraudulent transfer claims pursuant to a pre-petition contract to which they were not a party."); *EXDS, Inc. v. Ernst & Young LLP (In re EXDS, Inc.)*, 316 B.R. 817, 826 (Bankr. D. Del. 2004) ("Since EXDS's § 548 (a) (1) cause of action, like § 544 (b), is Bankruptcy Code created (i.e., not derivative of the bankrupt) I cannot require EXDS to submit [its claim] to binding arbitration."); *APF Co.*, 264 B.R. at 363 ("[T]hese claims are not subject to mandatory arbitration because the parties on whose behalf the trustee is acting, i.e., the creditors, are not a party to the arbitration agreement and are thus not bound by its terms.").

proceedings. *Id.* at 230-31. Such a distinction is beyond the scope of the court's decision in this case because the analysis and conclusion here are based on the type of claim at issue and not whether the action is core or non-core.

In this case, the Trustee's complaint seeks to recover preference payments pursuant to § 547[6] and § 550 based on transfers of money from Mr. Trimble to CMG in late 2006. CMG's defense challenges the cause of action as to the elements of a preference. CMG claims the agreement between the parties was not a loan agreement but an assignment to CMG of Mr. Trimble's interest in the potential proceeds of his personal injury case. Thus, CMG argues it was not a creditor of Mr. Trimble but rather the owner of an interest in his settlement. Additionally, CMG asserts the transaction was not on account of an antecedent debt because Mr. Trimble and CMG were not in a loan or credit transaction relationship. Finally, CMG claims the relevant time period for determining a preferential transfer was not the date the money was transferred from Mr. Trimble to CMG but the time of the assignment of the interest. CMG argues that since the assignment took place in January 2006, and the bankruptcy was not filed until December 2006, the assignment was beyond the 90 day preference period.

The Trustee counters CMG's position by arguing the assignment of a personal injury

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[6] Section 547(b) permits the trustee to avoid a transfer of the debtor's property if a number of requirements are established:

> (1) an interest of the Debtors was transferred;
> (2) the transfer was made to or for the benefit of [a creditor];
> (3) the transfer was because of an antecedent debt owed by the Debtors before the transfer was made;
> (4) the Debtors were insolvent at the time of the transfer;
> (5) the transfer occurred within ninety days before the bankruptcy petition was filed; and
> (6) the transfer permitted [a creditor] to receive more than it would have received upon liquidation of the Debtors under the Code.

APF Co., 264 B.R. at 357; 11 U.S.C. § 547(b) (Supp. 2005).

claim is invalid under New Jersey law, *In re Fontaine*, 23 B.R. 1, 4-5 (D.N.J. 1999), thereby voiding the contract between the parties. Thus, the Trustee asserts that there is a basis for finding a preferential transfer of funds between the parties.

Regardless of the merits of these arguments, CMG claims the arbitration clause in the agreement requires the Trustee to submit his claim to arbitration. Thus, CMG seeks to stay all proceedings pending such mandatory arbitration as required by the contract.

In this case, the Trustee's cause of action calls into question the validity of the contract, and CMG's defense hinges on its existence. For the court to determine if all the elements of a preference have been established, the court will have to determine the validity of the contract. Outside of bankruptcy, a challenge to the validity of a contract is an arbitrable issue. *Buckeye Check Cashing, Inc.*, 546 U.S. at 444-45. However, the fact that the validity of the contract is in question does not change the essential nature of the suit. This is a preference cause of action initiated by the Trustee on behalf of the creditors of the bankruptcy. It is a non-debtor-derivative suit and is not subject to arbitration because the cause of action to avoid the transfers does not belong to Mr. Trimble, a party to the contract, but to the Trustee.

Policy concerns further bolster the argument for allowing the bankruptcy court to disregard an arbitration clause and maintain jurisdiction over a preference action. In *Oakwood Homes*, the court stated that "the interests, policies and objectives of the Bankruptcy Code would be seriously jeopardized by requiring arbitration of such claims." *Oakwood Homes*, 2005 Bankr. LEXIS 429, at *14. The court went on to explain this conclusion stating:

> Many, if not most substantial bankruptcy cases involve numerous preference and fraudulent conveyance claims. The law, and the lore surrounding the adjudication of such claims is extensive, and has been developed over significant periods of time. The result is, that certain fact

> situations may be expected to bring about fairly consistent results, wherever they are tried. To subject these matters to arbitration, before individuals or tribunals with little or no experience in bankruptcy law or practice, and with little or no concern for the rights and interests of the body of creditors, of which the particular defendant is only one, would introduce variables into the equation which could potentially bring about totally inconsistent results. Such a result would be contrary to the primary policy of the Bankruptcy Code, which is that all classes of creditors of a debtor are entitled to be treated as equitably as possible, and that the remaining assets of a liquidating debtor are to be distributed on a pro rata basis to all creditors of a given class.

Id. at *14-15. The court concluded that even if § 547 were debtor-derivative, policy would justify the bankruptcy court denying enforcement of the agreement "as contrary to the objectives of the Bankruptcy Code". *Id.* at *15. *See also APF Co.*, 264 B.R. at 364 (explaining why staying the adversary proceeding in the case would "seriously jeopardize Bankruptcy Code objectives").

CONCLUSION

While the validity of the contract between Mr. Trimble and CMG is at issue, and the arbitration clause is part of that contract, the Trustee's preference claim is not subject to arbitration. The preference cause of action belongs to the Trustee, not Mr. Trimble, and the Trustee was not a party to the contract containing the arbitration clause. Therefore, the Trustee's claim is not subject to arbitration and remains within the jurisdiction of the bankruptcy court. Thus, CMG's motion to stay proceedings pending arbitration is denied.

Dated: January 17, 2008

/S/Raymond T. Lyons
United States Bankruptcy Judge