By Turner N. Falk

Playing "Gotcha" Games with Class Proofs of Claim

Outside of a bankruptcy proceeding, groups of persons may sue or be sued as the representative of a class if they meet the criteria of Rule 23(a) of the Federal Rules of Civil Procedure (numerosity, common questions of fact or law, typicality of the claims and defenses of the representative, fair and adequate protection of the interests of the class). If a court certifies a class — making findings that these and other applicable criteria are met under Rule 23(b) — the class representative may act on behalf of the class to bind its members to prosecute and settle the case, subject to certain circumstances that permit members to opt out.

Inside of a bankruptcy proceeding, a class will wish to make its claim on a class basis. The class representatives are more likely to prove a claim against a debtor than a previously disengaged class member acting alone. The class will have the additional negotiating power of a large dollar value claim, giving it room to maneuver to advance liquidation of the class claim.

In return, the class can offer its vote and support in favor of a proposed plan, bind its members to the settlement embodied in that plan, and take the issues of distribution to class members off the debtor's plate. The nonbankruptcy case law authorizing a class to bind nonparticipating class members is more developed than analogous bankruptcy law.

Most class claimants in traditional mass tort bankruptcies — such as asbestos, opioid or talc — fall neatly into the "known present claimant" or "future claimant" buckets. However, other major class actions exist where the class members have already suffered the requisite harm to become current creditors, but might not have any reason to know they have a claim.

For example, take individual customers whose drug prices were allegedly inflated by a price-fixing conspiracy.[1] Allegedly, hundreds of thousands of ordinary people paid the inflated prices and may have a present right to recover. Practically, they will not do so unless a class representative acts for them, since they have no reason to suspect a price-fixing conspiracy or to deeply question the price paid for a generic drug. Permitting a class representative to file a class claim and negotiate a plan-supporting settlement for its members can offer benefits to debtors and class creditors. Unfortunately, the existing case law is deeply unclear on exactly how and when a class claim may be submitted in bankruptcy.

The Simplicity of the Proof of Claim Clashes with the Complexity of Rule 7023

The Bankruptcy Code and Federal Rules of Bankruptcy Procedure make it simple to file a proof of claim. The submission of a form with a minimal amount of supporting information is sufficient.[2] Once submitted, a factually supported claim is deemed allowed until it has been challenged.[3]

Bankruptcy Rule 7023 states that Civil Rule 23 "applies in adversary proceedings." This single sentence has added layers of complexity to the claims-submission process where a class action is involved. Does this rule impact the filing of a claim or the objection to a claim? Does it address pre-petition certified classes? Does a pre-petition certified class need to be recertified during the bankruptcy? Does it permit a bankruptcy court to certify a class within the bankruptcy proceeding to permit it to file a claim?

One court held that Bankruptcy Rule 7023 should be employed as a sword, prohibiting class claims altogether: "The only provision in the Rules [that] deals with class actions is Bankruptcy Rule 7023. Obviously, filing a proof of claim is not an adversary proceeding. Therefore, the reliance on this Rule is misplaced."[4] This position is somewhat at odds with the very existence of Rule 7023: Why should a class of claimants be able to act collectively for most bankruptcy purposes except for filing a claim?

In disallowing class claims, the rationale followed by several early courts was twofold. First, the courts held that "a class representative cannot be considered the authorized agent of all of the creditors in a putative class."[5] Since a claim must be executed "by the creditor or the creditor's authorized agent," a claim filed by a person without proper agency authority is void.[6]

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1 *See In re Generic Pharms. Pricing Antitrust Litig.*, 368 F. Supp. 3d 814 (E.D. Pa. 2019).

2 *See* Fed. R. Bankr. P. 3001.
3 *See* 11 U.S.C. § 502(a).
4 *In re Black*, 95 B.R. 819, 823 (Bankr. M.D. Fla. 1989).
5 *In re Standard Metals Corp.*, 817 F.2d 625, 631 (10th Cir. 1987).
6 *Matter of Baldwin-United Corp.*, 52 B.R. 146, 148 (Bankr. S.D. Ohio 1985) (disallowing proof of claim filed by certified class representative because "we do not believe that being a class representative is the equivalent of being an authorized agent for purposes of filing a proof of claim").

Second, these courts felt that a "bankruptcy proceeding is equipped to resolve multiple claims against [an] estate. There is no need for the class to file as a class."[7]

A Split of Authority on Authority

It is now widely acknowledged that class claims and bankruptcy can coexist.[8] These two systems can and should work together to provide recovery for injured class members *pro rata* with the size of their claims while offering a comprehensible negotiating partner that can bind class members for the benefit of debtors.

Unfortunately, a split of authority on how class claims might be filed has complicated this happy picture. There are three general lines of cases on class claims. The largest group of cases requires a pending motion under Bankruptcy Rule 7023 at the time a class claim has been filed. Another line of cases requires that the class succeed upon a Rule 7023 motion before it may validly file a claim. A final line of cases does not require even a pending motion, on a variety of rationales.

Pending Motion Required

Acknowledging the short timeline to file claims in most bankruptcy cases, a plurality of reported opinions hold that a motion to apply Bankruptcy Rule 7023 must be pending either when a class claim is filed or before an objection to that claim is ruled upon.[9] Forward-thinking courts may make it clear that they expect a pending motion.[10] The courts embracing this line of reasoning note the contingent nature of the class representative's status, and that representative's role in acting for other disengaged parties. As the Seventh Circuit explained:

> The representative in a class action is an agent for the missing. Not every effort to represent a class will succeed; the representative is an agent only if the class is certified. Putative agents keep the case alive pending the decision on certification. If the bankruptcy judge denies the request to certify a class, then each creditor must file an individual proof of claim; the putative agent never obtains "authorized agent" status. If the court certifies the class, however, the self-appointed agent has become "authorized," and the original filing is effective for the whole class (the principals).[11]

If application of class principles is not warranted in a case, the bankruptcy court will not apply Civil Rule 23. Cases in this group flexibly address the result of such a denial. Some reopen the claim filing deadline for putative class members who relied on the class claim to safeguard their rights,[12] while others permit class members to file — even if they received notice of the bar date and have not shown reliance on the class claim.[13]

Successful Motion Required

A number of courts require the class to succeed on a motion to apply Bankruptcy Rule 7023 before it may file a class claim. These courts have held that any kind of conditional authority possessed by a representative of a purported or certified class is insufficient to support a representative proof of claim.[14] Since, per these courts, "a curative motion under Rule 9014(c) seeking to apply Rule 7023 is not a defense to an objection to a proof of claim purportedly filed on behalf of a class of creditors," a successful motion must come first.[15] These cases find the lack of authority so evident that, without prior authorization, a class claim is subject to "an obvious defect that will otherwise certainly result in disallowance of the claim."[16]

It is arguable that *In re Musicland Holding Corp*., possibly the key case regarding substantive application of Rule 7023, falls into this category.[17] In this case, a class proof of claim was filed before the bar date, and a motion to apply Civil Rule 23 was filed after the bar date. The court felt that application of class principles was not warranted, effectively invalidating the filed class claim. It did not generally reopen the claims-filing procedures for class members, only for those who might not have received notice of the bankruptcy. Class members who received notice and relied on their representatives to file as a class were unable to recover.

No Motion Required

Courts that do not require a pending or successful motion do so for several reasons. The simplest is that no provision of the Bankruptcy Code or Bankruptcy Rules restricts certification to a particular point in the lifecycle of a case.[18] Another straightforward rationale is that if a class is certified outside the bankruptcy, the certification decision is binding and authorizes the class to file claims for money as a class.[19]

Many courts in this group utilize a technical argument. They note that Rule 7023 applies only in adversary proceedings, and the filing of a claim is neither an adversary proceeding nor a contested matter. As a result, these courts conclude that no motion is necessary for a class claim;

> [H]owever, when an objection is made to a filed proof of claim, a contested matter arises ... [and] the first opportunity a claimant has to move under Bankruptcy Rule 9014, to request application of Bankruptcy Rule 7023, occurs when an objection is made to a proof of claim. Prior to that time, invocation of [Civil] Rule 23 procedures would not be ripe, because there is neither an adversary proceeding nor a contested matter.[20]

7 *Standard Metals*, 817 F.2d at 632.
8 *See, e.g., In re Birting Fisheries*, 92 F.3d 939, 939 (9th Cir. 1996) ("[W]e conclude that the [B]ankruptcy [C]ode should be construed to allow class claims.").
9 *See In re Tarragon Corp.*, 2010 WL 3842409, at *6 (No. 09-10555 DHS) (Bankr. D.N.J. Sept. 24, 2010) (motion must be filed contemporaneously with proof of claim).
10 *See In re W.R. Grace & Co.*, 389 B.R. 373, 376 n.5 (Bankr. D. Del. 2008) ("[T]his court directed that before any class proofs of claim were filed a motion to certify a class had to be filed.").
11 *In re Am. Reserve Corp.*, 840 F.2d 487, 493 (7th Cir. 1988) (citations omitted).
12 *See In re TWL Corp.*, 712 F.3d 886, 899 (5th Cir. 2013); *see Gentry v. Siegel*, 668 F.3d 83, 91 (4th Cir. 2012).
13 *See In re Connaught Grp. Ltd.*, 491 B.R. 88, 97 (Bankr. S.D.N.Y. 2013); *see In re Vanguard Nat. Res. LLC*, 2017 WL 5573967, at *5 (Case No. 17-30560) (Bankr. S.D. Tex. Nov. 20, 2017).
14 *See In re Circuit City Stores Inc.*, 2010 WL 2208014, at *11-12 (No. 08-35653) (Bankr. E.D. Va. May 28, 2010). *Reid v. White Motor Corp.*, 886 F.2d 1462, 1470-71 (6th Cir. 1989).
15 *In re Associated Cmty. Servs. Inc.*, 520 B.R. 650, 655 (Bankr. E.D. Mich. 2014).
16 *In re Comput. Learning Ctrs. Inc.*, 344 B.R. 79, 88-89 (Bankr. E.D. Va. 2006).
17 *See In re Musicland Holding Corp.*, 362 B.R. 644 (Bankr. S.D.N.Y. 2007).
18 *See In re F-Squared Inv. Mgmt. LLC*, 546 B.R. 538, 547 (Bankr. D. Del. 2016) (objection to class claim denied because there is no "*per se* bar against certifying a class claim after the confirmation of a plan").
19 *See In re Trebol Motors Dist. Corp.*, 211 B.R. 785 (Bankr. D.P.R. 1997) (representative of certified class had authority to file class claim without motion).
20 *In re Charter Co.*, 876 F.2d 866, 874 (11th Cir. 1989).

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This rationale has been employed by several courts, which have relied on the idea that a claim is allowed until a party objects.[21] Even courts that reject this rationale have called it an "ingenious use of Rules 9014 and 7023 [to] allow the court to bootstrap the permissibility of the class proof of claim."[22]

As appealing as this principle is — it would permit unobjectionable class claims to stand while requiring in-bankruptcy certification of objectionable claims — it is inconsistent with the rules. A claims objection is a contested matter. While many Part VII Rules apply to contested matters, Bankruptcy Rule 7023 is not one of them.[23]

This leaves supporters and detractors of the "allowed until objection" school in a strange spot, as the rules do not permit Rule 7023 to be applied in the face of an objection. They also do not permit Rule 7023 to be applied in any other contested matter, like a motion for application of Rule 7023. How can authority to file a class claim be reconciled with the existing cases and rules? It cannot, absent changes to the rules.

Solution: Amend the Rule to Clearly Permit Certified Classes to File Claims, Require Authority for Uncertified Classes

Bankruptcy Rule 7023 permits class treatment in theory, and it is sensible to permit class proofs of claim. Courts have applied wildly differing analyses for how to obtain class treatment, who may obtain this treatment and when the treatment must be sought.

The benefits to debtors of allowing class claims are real and tangible. It is impractical to force a class certified pre-petition to seek that same certification in the bankruptcy case, driving up expenses for the class and estate.[24] To solve this problem, Rule 7023 should be amended to allow classes certified pre-petition to file and defend a class claim without a motion.

A putative class has provisional authority to act for its members, but provisional authority is not enough to provide the mutual binding benefits of a class claim in bankruptcy. Bankruptcy Rule 7023 should also clearly state that a putative class does not have authority to file a proof of claim unless it does so after requesting or receiving court authorization to act in the bankruptcy for the putative class. abi

21 *United Cos. Fin. Corp.*, 276 B.R. 368 (Bankr. D. Del. 2002) (no request for class treatment until objection was filed).

22 *In re FIRSTPLUS Fin. Inc.*, 248 B.R. 60, 70 (Bankr. N.D. Tex. 2000) (stating in *dicta* that claim subject to no objection must be supported by immediate motion for class certification).

23 *See* Fed. R. Bankr. P. 9014(c) (providing that Rules 7009, 7017, 7021, 7025, 7026, 7028-7037, 7041, 7042, 7052, 7054-7056, 7064, 7069 and 7071 apply in contested matters).

24 The author does not suggest giving a certified class a complete pass on invoking Bankruptcy Rule 7023. For any action aside from filing a proof of claim, the court should be able to address whether class treatment is warranted under the facts and circumstances in play. Since class claimants are often unsecured creditors in cases where a committee is appointed, they commonly have an existing fiduciary that may moot the need to do anything other than file a claim.