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2012 Volume IV No. 29

Class Proofs of Claim and Class Certification in Bankruptcy

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Cite as: *Class Proofs of Claim and Class Certification in Bankruptcy*, 4 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 29 (2012)

Introduction

The Federal Rules of Bankruptcy Procedure (the "Rules") make class action procedures available to litigants in bankruptcy litigation.[1] However, the Bankruptcy Code (the "Code") and Rules leave open the question of whether a class representative may file a class proof of claim[2] on behalf of a putative class. Because the Code and Rules are silent, bankruptcy courts have to look to case law to "fill the gaps."[3] Different courts have adopted different interpretations, and a circuit split has emerged regarding the permissibility of class proofs of claim.

Initially, most bankruptcy courts and the first court of appeal that addressed the issue concluded that class proofs of claim were not permissible in bankruptcy.[4] These courts

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[1] Fed. R. Bankr. P. 7023 (providing that Fed. R. Civ. P. 23 applies in adversary proceedings); Fed. R. Bankr. P. 9014(c) (allowing a court to apply Rule 7023 at "any stage" in a contested matter).

[2] A class proof of claim is distinguishable from a group claim. A group claim is a single proof of claim filed on behalf of multiple creditors by an authorized agent of those creditors. In a group claim, no one creditor purports to be a representative of the others and every creditor's name is listed on the group claim. On the other hand, a class proof of claim would allow one class representative to file one proof of claim on behalf of a whole class of creditors. The members of the class would not be designated as parties for purposes of the class proof of claim. *See In re* Great Western Cities, Inc. of New Mexico, 107 B.R. 116, 118 (Bankr. N.D. Tex 1989).

[3] *In re* Motors Liquidation Co., 447 B.R. 150, 156 (Bankr. S.D.N.Y. 2011).

[4] *See, e.g.*, *In re* Standard Metals Corp., 817 F.2d 625, 630 (10th Cir. 1987); *In re* Black, 95 B.R. 819, 823 (Bankr. M.D. Fla. 1989); *In re* Great Western Cities, Inc. of New Mexico, 88 B.R. 109, 112 (Bankr. N.D. Tex. 1988), *vacated on other grounds*, 107 B.R. 116, 122 (Bankr. N.D. Tex

conceded that Rule 23 of the Federal Rules of Civil Procedure ("Rule 23") applies in bankruptcy litigation, but argued that § 501 of the Code provides an exhaustive list of entities that may file a proof of claim.[5] Since § 501 does not mention class representatives, these courts held that each class claimant has to file an individual proof of claim and then have their claims certified by moving the bankruptcy court to apply Rule 23 to their claims. Moreover, these courts noted that Rule 3001(b), requires that "[a] proof of claim shall be executed by the creditor or the creditor's authorized agent . . . ."[6] These courts also note that Rule 2019 requires any representative of more than one creditor to file a verified statement.[7] Since class representatives will most likely not have obtained the requisite authorization as the creditors' agents, they cannot file a class proof of claim.

The next three courts of appeal to decide the issue held that a class representative may file a class proof of claim on behalf of a putative class.[8] These courts relied on the Rules and the legislative history of the Code for support. The courts reasoned that Rule 23 can already be applied to bankruptcy litigation, and Congress did not expressly prohibit the filing of class proofs of claim. These courts further reasoned that even though § 501 of the Code dos not expressly mention class representatives, a narrow reading of it would render Rules 7023 and 3001(b) meaningless. Lastly, since Congress intended bankruptcy proceedings to be available to the "widest possible range of players," the right to file a class proof of claim is secure.[9] After the

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1989); *In re* Texaco, Inc., 81 B.R. 820, 825–826 (Bankr. S.D.N.Y. 1988); *In re* Allegheny Int'l, Inc., 94 B.R. 877, 881 (Bankr. W.D. Pa. 1988).

[5] 11 U.S.C. 501 (2006).

[6] FED. R. BANKR. P. 3001(b).

[7] FED. R. BANKR. P. 2019 (c)(4).

[8] Reid v. White Motor Corp., 886 F.2d 1462, 1472 (6th Cir. 1989); Certified Class in the Charter Securities Litigation v. Charter Co. (*In re* Charter Co.), 876 F.2d 866, 873 (11th Cir. 1989); *In re* American Reserve Corp., 840 F.2d 487, 493 (7th Cir. 1988).

[9] *In re Charter Co.*, 876 F.2d at 870.

three courts of appeal held this way, lower courts generally followed suit, and a majority of courts now allow a class representative to file a class proof of claim on behalf of a putative class.

Part I of this memorandum discusses the relevant Rules concerning class actions and class proofs of claim. Part II discusses the split among the circuits as to whether class proofs of claim are allowed in bankruptcy and why the circuits disagree with each other. The memorandum concludes with the practical consequences of allowing or disallowing class proofs of claim and how either conclusion does not circumvent the stringent requirements of having a group of claimants certified as a class.

I. Class Action Procedures, the Bankruptcy Code, and Rules

As noted earlier, the Rules explicitly allow for class action treatment in bankruptcy litigation. Rule 7023, in Part VII of the Rules, which governs adversary proceedings,[10] expressly states that Rule 23 applies in adversary proceedings.[11] Although the Rules governing contested matters do not have a similar provision, they allow the court to apply any of the Part VII Rules governing adversary proceedings to a contested matter.[12] Rule 9014 thus allows bankruptcy judges to apply Rule 7023 to "any stage" in a contested matter. Since most disputes in bankruptcy are either adversary proceedings or contested matters, "Rule 23 may apply throughout a bankruptcy case at the bankruptcy judge's discretion."[13]

Despite the applicability of class action procedures in bankruptcy litigation, the question as to whether class proofs of claim should be allowed is left unanswered. For instance, § 501 of the Code provides a list of entities that may file a proof of claim, but does not mention class

[10] FED. R. BANKR. P. 7001 (providing an exclusive list of adversary proceedings).
[11] *See supra* note 1.
[12] FED. R. BANKR. P. 9014(c) (providing that a "court may at any stage in a particular matter direct that one or more of the other rules in Part VII shall apply."
[13] *In re American Reserve Corp.*, 840 F.2d at 488 (7th Cir. 1988).

representatives.[14] Similarly, Rule 3001(b) of the Federal Rules of Bankruptcy Procedure, which supplements section 501, does not mention a class representative.[15] For those reasons, a textual analysis of the Code is "of only of limited utility" when attempting to determine if class proofs of claim should be allowed because the Code and the Rules are silent in that regard.[16]

II. The Circuit Split

Because the Code leaves the question of whether a class representative may file a class proof of claim unanswered, courts are left with the task of interpreting the few provisions of the Code and Rules that were discussed above or look to case law in their respective jurisdictions for answers. The result is that a minority of courts disallow the filing of class proofs of claim.[17] Accordingly, a majority of courts allow class proofs of claim in bankruptcy, but leave the decision to allow a class proof of claim to the discretion of the bankruptcy judge.[18]

A. The Minority View

The Tenth Circuit was the first court of appeal to address the issue of whether class proofs of claim are permissible in bankruptcy. In *In re Standard Metals Corp,*[19] the court held that a class proof of claim was not permissible because class representatives were not the

[14] *See* 11 U.S.C. § 501 (a)–(c) (2006).
[15] FED. R. BANKR. P. 3001(b) (providing that a proof of claim shall be executed by the creditor or the creditor's authorized agent unless 11 U.S.C. §§ 501(b)–(c) apply).
[16] *In re* Motors Liquidation Co., 447 B.R. 150, 155–156 (Bankr. S.D.N.Y. 2011).
[17] *See, e.g.*, Sheftelman v. Standard Metals Corp. (*In re* Standard Metals Corp.), 817 F.2d 625 (10th Cir. 1987), *vacated and rev'd on other grounds*, 839 F.2d 1383 (10th Cir. 1987); *In re* FirstPlus Fin., Inc., 248 B.R. 60 (Bankr. N.D. Tex. 2000); *In re* Allegheny Int'l, Inc., 94 B.R. 877 (Bankr. W.D. Pa. 1989); *In re* Vestra Indus., Inc., 821 B.R. 21 (Bankr. D.S.C. 1987); *In re* Cont'l Airlines Corp., 64 B.R. 674 (Bankr. S.D. Tex. 1986); *In re* Computer Devices, Inc., 51 B.R. 471 (Bankr. D. Mass. 1985).
[18] *See, e.g.*, Reid v. White Motor Corp., 886 F.2d 1462, 1472 (6th Cir. 1989); Certified Class in the Charter Securities Litigation v. Charter Co. (*In re* Charter Co.), 876 F.2d 866, 875 (11th Cir. 1989); *In re American Reserve Corp.*, 840 F.2d at 492; *In re Motors Liquidation Co.*, 447 B.R. at 157.
[19] Sheftelman v. Standard Metals Corp. (*In re* Standard Metals Corp.), 817 F.2d 625 (10th Cir. 1987), *vacated and rev'd on other grounds*, 839 F.2d 1383 (10th Cir. 1987).

creditors' authorized agents as required by Rule 3001(b).[20] The court reasoned that a class representative could not be considered an authorized agent of all the creditors in a putative class because consent to being a class representative "is not tantamount to a blanket consent to any litigation the class counsel may wish to pursue."[21] This argument was strengthened by the court's interpretation of section 501 of the Bankruptcy Code, which the court though to be an exclusive list of who may file a proof of claim.[22] The court further held that class proofs of claim are unnecessary in a bankruptcy proceeding. Class actions help prevent a multiplicity of suits in a variety of forums, but since a bankruptcy court has full control over a bankrupt's estate, the Tenth Circuit thought that same concerns were not present in bankruptcy.[23]

More recently, in *In re FirstPlus Fin., Inc.*,[24] adopted the view set forth in *In re Standard Metals Corp.*, further addressed the argument that disallowing class proofs of claim eviscerates the effects of Rules 7023 and 9014.[25] The *FirstPlus* court responded to those concerns by concluding that, to the contrary, allowing class proofs of claim would eviscerate the effect of Rule 3001(b)'s agency requirements. The court stated that "[a] putative class representative is not nor can he be transformed by the court into, [sic] an authorized agent within the purview of Rule 3001(b)." [26] That was in response to the Seventh Circuit's holding that a class representative may file a class proof of claim on behalf of a putative class without having obtained the requisite authorization under Rule 2019(a)[27] discussed *infra*. The court noted that an

[20] *Id* at 631.
[21] *Id.* (quoting *In re* Baldwin-United Corp., 52 B.R. 146, 148–149 (Bankr. S.D. Ohio 1985)).
[22] *Id.* at 630; *see supra* text accompanying notes 13–17.
[23] *Id.*
[24] 248 B.R. 60 (Bankr. N.D. Tex. 2000).
[25] Reid v. White Motor Corp., 886 F.2d 1462, 1470 (6th Cir. 1989).
[26] *In re FirstPlus Fin., Inc.*, 248 B.R. at 67.
[27] Fed. R. Bankr. P. 2019(b)(1) (supplementing Rule 3001(b) and requiring "every entity that represents multiple creditors . . . ." to file a verified statement).

agency relationship exists only if the principal manifests to the agent that it may act on the principal's behalf. In other words, the agency requirement does not eviscerate Rules 7023 and 9014; it simply limits their applicability. In not allowing class proofs of claim, Rules 7023, 9014, and 3001(b) all work in harmony.[28] The court also noted that if no one objects to the proof of claim, it is automatically allowed, and it will never be a contested matter.[29] In that scenario, an unauthorized agent will have filed a proof of claim on behalf of similarly situated creditors but Rule 23 would never come into play. Since only an objection to the class proof of claim would create a contested matter, absent an objection, that agent would remain unauthorized and the court would never be able to address Rules 7023, 9014 and the appropriateness of the class proof of claim.[30] The Court envisioned the proper application of Rules 7023 and 9014 in contested matters with the following hypothetical: "[S]imilarly situated claimants who have filed individual proofs of claim may petition the court under Rule 9014 for class treatment of their claims via Rule 7023."[31]

B. The Majority View

Less than a year after the Tenth Circuit's decision in *In re Standard Metals Corp.*, the Seventh Circuit, in *In re American Reserve Corp.*, held that class proofs of claim were allowed in Bankruptcy.[32] First, the Court found support for its holding from the statutory text of the Code

[28] *Id.* at 69.
[29] *Id.*
[30] *Id.*; *see also* Certified Class in the Charter Securities Litigation v. Charter Co. (*In re* Charter Co.), 876 F.2d 866, 874 (11th Cir. 1989) (allowing class proofs of claim, but noting that the "invocation of Rule 23 procedures" would not be ripe until an objection to the class proof of claim is made).
[31] *In re FirstPlus Fin., Inc.*, 248 B.R. at 69.
[32] 840 F.2d 487, 493 (7th Cir. 1988).

and Rules.[33] Second, the court took the opportunity to entertain some of the counter arguments in *In re Standard Metals Corp.* and other district courts that had ruled on the issue since.

In concluding that class proofs of claim were permissible, the court went through the same analysis in Part I *supra*.[34] The court also addressed the statutory argument that § 501 of the Code provides an exclusive list of entities that may file a proof of claim. The court looked at the legislative history and structure of the then 1978 Code[35] and held that section 501 could not possibly be an exclusive list because it omits "the most common representative filing of all:" claims by an authorized agent on behalf of a creditor, which is governed by Rule 3001(b).[36] If section 501 were an exclusive list, Rule 3001(b) would lose its full force and effect.[37] It would also nullify Rule 7023, which expressly allows for Rule 23's application in adversary proceedings.[38] The court noted that if section 501 prevents class proofs of claim, "there will never be a *Rule 23* class action; there will only be a spurious class action . . . ."[39]

Citing to the seminal United States Supreme Court case *Butner v. United States*,[40] the court began its analysis with the following basic tenet of bankruptcy law: "[t]he principal function of bankruptcy law is to determine and implement in a single proceeding the entitlements of all concerned."[41] With that basic principal in mind, the Court addressed the argument about class actions being unnecessary in bankruptcy because bankruptcy inherently avoids duplicative litigation and contains proceedings in one forum. Admitting that the bankruptcy forum, as a

[33] *Id.* at 488.
[34] *See* text accompanying notes 9–13
[35] *Id.* at 492.
[36] *Id.* at 493.
[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] 440 U.S. 48 (1979).
[41] *In re American Reserve Corp.*, 840 F.2d at 489.

mandatory collective proceeding, does achieve those goals to some degree, the Court noted that there are other advantages to class actions.[42] Although the costs of litigation may "consume much of the benefit, the [class action] still serves a deterrent function by ensuring that wrongdoers bear the cost of their activities."[43] The only way a similarly situated class of creditors could reap all of the benefits of a class action would be if it were allowed to file a class proof of claim[44] because there may be many claims of uncertain value, and holders of contingent claims "may not recognize their entitlement to file unless some champion appears."[45] That champion is the class representative who, presumably, will have identified and shaped the claim for the class.[46] Furthermore, because Rule 9011(b)[47] requires every claimant to investigate, reasonably under the circumstances, the facts and perform the necessary legal research before filing a proof of claim, for many small claims "it is class actions or nothing."[48]

In addressing the concerns about the agency requirement in Rules 3001(b) and 2019, the Court states that the representative in a class action is an agent, but that the representative is an agent only if the class is certified.[49] On the other hand, if the bankruptcy judge denies the request to certify a class, then each creditor must file an individual proof of claim, and the agent would never achieve "authorized agent" status. Once the class is certified, however, the self appointed agent becomes the "authorized agent," and the filing of the class proof of claim becomes effective for the whole class.

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[42] *Id.*
[43] *Id.*
[44] *See id.* at 489–90 ("The class proof of claim may be essential to discover what the bankrupt's entire debts are, and therefore who should be paid what.").
[45] *Id.* at 489
[46] *Id.*
[47] FED. R. BANKR. P. 9011(b).
[48] *In re American Reserve Corp.*, 840 F.2d at 489.
[49] *Id.*

III. Implications

Whether or not a particular jurisdiction allows class proofs of claim in bankruptcy may dictate the logistics of the proof of claim, but the benefits of allowing them do end there. A class proof of claim is in no way a golden ticket to getting a putative class certified. Rule 23's stringent requirements may deny certification all together regardless of a class proof of claim or individual proofs of claim.

When class action procedures are applied in a bankruptcy case, there are special considerations that are "superimposed" on those that apply in the run-of-the-mill class certifications.[50] The primary consideration is to avoid undue delay in the administration of the bankruptcy case.[51] Accordingly, to certify a class claim, the proponent "must (1) make a motion to extend the application of Rule 23; (2) satisfy the requirements of Rule 23;[52] and (3) show that the benefits derived from the use of the class claim are consistent with the goals of bankruptcy."[53] This is not the hardest hurdle, however, since typically what happens is the bankruptcy judge will assume, without deciding, that the requirements of Rule 23(a) have been satisfied.[54] Judges will do that because Rule 23(b)(3)'s requirements are much more stringent

[50] *In re* Motors Liquidation Co., 447 B.R. 150, 157 (Bankr. S.D.N.Y. 2011).
[51] *Id.*
[52] Fed. R. Civ. P. 23(a) (allowing "[O]ne or more members of a class to sue or be sued as representative parties on behalf of all members only if: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class.").
[53] *Id.*
[54] *In re Motors Liquidation Co.*, 447 B.R. at 157; *In re* Genesisintermedia, Inc. Sec. Litig., 2007 WL 1953475 n.5 (C.D. Cal. 2007).

and it is the subsection under which most parties' motion for class certification is denied.[55] Rule 23(b)(3) provides that a class action may be maintained if Rule 23(a) is satisfied and if the "court finds that the questions of law or fact common to the class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."[56] Courts considering whether Rule 23(b) has been satisfied thus consider two separate requirements: (1) predominance of common issues, and (2) superiority of class action treatment.[57]

To illustrate the difficulty of having a class certified, in *In re Motors Liquidation Co.*, a case with an unusual set of facts, 26 claimants in two separate groups (the "Botha Claimants" and the "Balintulo Claimants") filed two proofs of claim, one for each group, against General Motors Corporation ("Old GM").[58] The claimants alleged that Old GM "aided and abetted South Africa's apartheid regime." [59] More than 8 months after filing their proofs of claim against Old GM, the claimants sought class treatment of their claims. Old GM then sought to disallow the claims, on a class basis or otherwise. The bankruptcy court for the Southern District of New York denied the motion because the claimants failed to satisfy the requirements of Rule 23.[60]

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[55] *In re Motors Liquidation Co.*, 447 B.R. at 157; *In re* Genesisintermedia, Inc. Sec. Litig., 2007 WL 1953475 n.5 (C.D. Cal. 2007); Adelstein v. Unicare Life and Health Ins. Co., 2000 WL 35808378, at *2 (M.D. Fl. 2000).

[56] Fed. R. Civ. P. 23(b)(3) ("The matters pertinent to this finding include: (A) the class members' interests in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already begun by or against class members; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and (D) the likely difficulties in managing a class action.").

[57] *In re Motors Liquidation Co.*, 447 B.R. at 158.

[58] *Id.* at 153. The former General Motors Corporation is now Motors Liquidation Company. Since the proofs of claim in this case were filed against Old GM, the distinction is noteworthy.

[59] *Id.*

[60] *Id.* at 153, 168; *see also* Fed. R. Civ. P. 23 (providing requirements for class certification).

The court in *In re Motors Liquidation Co.* denied class certification because it found that the common issues presented in this case did not predominate over the individual issues. Because the claimants sought relief on behalf of thousands of South Africans who suffered distinct injuries over the course of several decades, the court determined that it would be difficult to establish causation and the requisite intent on the part of Old GM.[61] The court found that the simpler alternative would be to have individual claimants "tell" their story to the court and the court then ascertain Old GM's liability, if any.[62] To proceed on a class action basis, the court would have to choose between holding one or more trials of "extraordinary complexity," or take inappropriate shortcuts to make class action treatment superior, thereby threatening the parties' due process rights.[63]

The foregoing example helps demonstrate that class actions are usually inferior to individual claims because the creditors of a debtor can file proofs of claim without counsel and at virtually no cost.[64] Similarly, the deterrent effect of class actions may not be present when a class moves for certification in a bankruptcy proceeding. Class actions will be less likely to deter other companies from committing the same harm when the punishment for any wrongful conduct is being borne by innocent creditors.[65] Lastly, class certification will usually be less desirable in bankruptcy because class-based claims have the potential of "adding layers of procedural and factual complexity" to a bankruptcy proceeding. In other words, as the Southern District of New

[61] *Id.* at 159.
[62] *Id.* at 163.
[63] *Id.*
[64] *In re* Ephedra Products Liability Litigation, 329 B.R. 1, 9 (S.D.N.Y. 2005).
[65] *Id.*

York noted, a class action "may gum up the works, because until it is complete, the court cannot determine the entitlement of the other creditors."[66]

IV. Conclusion

With most jurisdictions generally allowing class proofs of claim, the circuit split may be resolved in the near future either through a Supreme Court decision or by the minority jurisdictions overruling existing precedent. What will remain constant, however, is the twofold difficulty of having classes of similarly situated creditors certified in a bankruptcy proceeding.

[66] *In re* Woodward & Lothrop Holdings, Inc., 205 B.R. 365, 376 (Bankr. S.D.N.Y. 1997).