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Class Warfare:
Class Litigation Proceedings and Structures in Bankruptcy

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I. INTRODUCTION[1]

"In the midst of chaos, there is also opportunity."[2]

- Sun Tzu, *The Art of War*.

To a practitioner whose battlefield is mainly class action litigation, the world of bankruptcy likely seems unfamiliar and strange, and the same would be expected for a typical bankruptcy practitioner facing class action litigation. However, for the practitioner who understands the intricacies and interplay of both concepts, there exists great opportunity for creative and impactful solutions.

There are considerable similarities in the players and procedures applicable to class action litigation and bankruptcy cases. Both class actions and bankruptcy involve court-appointed fiduciaries charged with acting on behalf of a larger whole in order to make distributions.[3] Each represents an established statutory scheme to govern certain prerequisites and other procedures to aggregate claims for relief into a single collective proceeding, while also providing certain assurances of due process.[4]

On the other hand, while these two schemes reflect common policies, principles and purposes, over time each has developed, and is intended to operate, independently of the other.[5] For example, bankruptcy law is designed to aggregate claims so that they can be resolved in an orderly fashion and as expeditiously as reasonably possible, whereas class action litigation rules aggregate claims in order to maximize the assertion and consistent adjudication of claims that practical considerations might otherwise prevent being asserted.[6] As

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[2] Sun Tzu, *The Art of War* (Ralph D. Sawyer trans., Westview Press 1994).

[3] *In re Craft*, 321 B.R. 189, 196 (Bankr. N.D. Tex. 2005); *In re Prime Dev., Inc.*, 2011 WL 4479529, at *3 (S.D. Ill. Sept. 26, 2011); *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 375 B.R. 719, 727 (S.D.N.Y. 2007); *In re Williams*, 152 B.R. 123, 127 (Bankr. N.D. Tex. 1992).

[4] *Matter of Am. Reserve Corp.*, 840 F.2d 487, 489 (7th Cir. 1988) ("The principal function of bankruptcy law is to determine and implement in a single collective proceeding the entitlements of all concerned… Class actions have procedural and substantive advantages. Procedurally, the class action concentrates litigation in a single forum, where it may be resolved more readily than a series of suits could be.") (citing *Butner v. United States*, 440 U.S. 48, 99 S. Ct. 914 (1979)); *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 553–54, 94 S. Ct. 756, 766 (1974); *In re Farah*, 141 B.R. 920, 928 n.7 (Bankr. W.D. Tex. 1992) (discussing how bankruptcy is closely analogous to a class action since it creates a common pool of assets for the benefit of all potential creditors/claimants); *In re CommonPoint Mortg. Co.*, 283 B.R. 469, 479 (Bankr. W.D. Mich. 2002).

[5] *See, e.g., Am. Reserve Corp.*, 840 F.2d at 489 ("The bankruptcy forum, as a mandatory collective proceeding, serves this purpose without the overlay of the class action."); Luisa Kaye, *The Case Against Class Proofs of Claim in Bankruptcy*, 66 N.Y.U. L. Rev. 897, 897–98 (1991) ("Federal Rule of Civil Procedure 23 (Rule 23), which governs class actions in civil proceedings, generally does not apply in bankruptcy case.").

[6] *See Am. Reserve Corp.*, 840 F.2d at 489; *CommonPoint Mortg. Co.*, 283 B.R. at 480; *In re First All. Mortg. Co.*, 269 B.R. 428, 445 (C.D. Cal. 2001); *In re Charter Co.*, 876 F.2d 866, 868 (11th Cir. 1989)

a result (and as further discussed below), courts have historically been reluctant to combine and effectuate the provisions of both where they have factually intersected due to concerns that applying class litigation rules and proceedings in bankruptcy cases can cause the bankruptcy to bog down and drag out.

There can be no doubt that when the two methods for relief are combined, impacted parties and their counsel are faced with legal complexity and practical challenges that they must wade through carefully. The advent of a class action adversary proceeding being instituted and/or the filing of a proof of claim in a bankruptcy case by a class representative or putative class representative requires special consideration and attention, both from the perspective of the debtor and the class counsel/representative.[7]

This paper touches on the history of how the class action process has melded with the bankruptcy process, and provides a relatively broad overview of the issues these proceedings present to practitioners in the heat of battle. This paper is divided into sections, each addressing a different issue in connection with class actions in a bankruptcy context. Section II provides an overview of the bankruptcy claims process and the applicability of Federal Rule of Civil Procedure 23 ("Rule 23") in bankruptcy. Section III discusses class proofs of claim in bankruptcy, including how courts' interpretations of the Federal Rules of Civil Procedure and the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") have evolved regarding allowing class proofs of claim. Section IV addresses class certification pre- and post-petition and the effect on putative class members' individual claims if a court denies class certification. Section V discusses how courts handle voting class proofs of claim in bankruptcy. Lastly, Section VI catalogues a few other issues of note for lawyers involved in bankruptcy/class warfare.

II. TWO INDEPENDENT SCHEMES FOR THE AGGREGATION OF CLAIMS

A. The Statutory Framework for Claims Submission in Bankruptcy

Those familiar with the basic structure of the Bankruptcy Code know that recovery in bankruptcy cases of amounts debtors owe on account of pre-petition obligations begins with notice of the filing of the case and the opening of the claims submission and allowance process.

As a simultaneous claims aggregation and resolution process, the Bankruptcy Code fundamentally relies upon notice to putative creditors of a bankruptcy case so that any and all known creditors whose claims are to be stayed, restructured, and/or potentially discharged, have a fair opportunity to assert their rights and claims against the debtor as permitted by the Bankruptcy Code.[8] Such a structure is mandated by established principles of due process,

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(discussing the use of claims bar dates to promote finality in bankruptcy cases, and the purpose of class action litigation to facilitate compensation of claims that might otherwise lie dormant).

[7] While a debtor may be a plaintiff in a class action, this paper focuses on issues that arise when a class claim is filed against a debtor. *See* Anthony Michael Sabino, *Going to the Head of the "Class" in Bankruptcy: The Continuing Evolution of Class Actions, the Class Proof, and Plaintiff and Defendant Classes in Bankruptcy Cases*, 2005 Ann. Surv. Bankr. L. 12, n.146 (2005) (providing extensive string cite of cases dealing with debtor as proposed class representative).

[8] *See Am. Reserve Corp.*, 840 F.2d at 489 ("The principal function of bankruptcy law is to determine and implement in a single collective proceeding the entitlements of all concerned.") (citations omitted); *In re Duarte*, 146 B.R. 958, 961–62 (Bankr. W.D. Tex. 1992) (explaining that claims filing deadlines serve the bankruptcy policy of ensuring prompt and efficient administration of the bankruptcy estate); 11 U.S.C. §

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