AMERICAN BANKRUPTCY INSTITUTE

2019 Southeast Bankruptcy Workshop

Bankruptcy & Class Action Convergence

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Hon. Keith L. Phillips
U.S. Bankruptcy Court (E.D. Va.); Richmond

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CONCURRENT SESSION

2019

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Agenda

- Introductions
- Overview of Class Actions
- Arbitration
- Class Proofs of Claim
- Jurisdictional Issues

Overview of Class Actions

René S. Roupinian

Outten & Golden LLP; New York, NY

Overview of Class Actions

- Proposed class action must meet Rule 23(a) *and* (b) requirements

Rule 23[1](a):

- Numerosity
- Commonality
- Typicality
- Adequacy of representation

Plaintiffs must establish each for the case to proceed.

[1] Rule 7023. Class Proceedings; Rule 23 F.R.Civ.P. applies in adversary proceedings.

Overview of Class Actions

Rule 23(b)(2):

- "The party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making it appropriate to award final injunctive relief or corresponding declaratory relief with respect to the class as a whole."
- Notice to opt out is not required.
- Individualized monetary relief is not available.

Rule 23(b)(3):

- "The court finds that questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."
- Notice of opt-out rights is required.
- Predominance and manageability are far more significant concerns.

Arbitration

Brad C. Knapp

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Arbitration

- Clashes between the FAA and other statutes
  - *Shearson/Am. Exp. v. McMahon*, 482 U.S. 220 (1987) and its progeny
  - *Epic Systems Corp. v. Lewis*, 138 S.Ct. 1612 (2018)
- But Bankruptcy is special (maybe?)
  - Bankruptcy Courts have discretion to deny arbitration in core proceedings
  - Bankruptcy Courts do not have discretion to deny arbitration in core proceedings
  - *Lamps Plus, Inc. v. Varela*, 138 S.Ct. 1407 (2019) means this matters a whole lot
- Stay Tuned

Class Proofs of Claim

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Class Proofs of Claim

- Rule 3003. Filing Proof of Claim
  - (c) Filing Proof of Claim.
  - (1) Who May File. Any creditor or indenture trustee may file a proof of claim within the time prescribed by subdivision (c)(3) of this rule.
- Bankruptcy Rule 9014
- Objection to CPOC
- Contested matter
- Bankruptcy 2019
  - *In re American Reserve,* 840 F.2d 487 (7th Cir. 1988)
  - Class action adversary proceedings (Bankruptcy Rule 7001)

Jurisdictional Issues

Karen Elizabeth Sieg

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Jurisdictional Issues

- Scope of court's ability to enforce a discharge order from another district is a central issue in class-actions alleging discharge violations
  - Which court may enter a contempt order for a discharge violation?
    - Only the issuing court?
    - Any bankruptcy court?
  - What is the jurisdictional reach of a court enforcing a discharge order?
    - District-wide?
    - Nationwide?

Jurisdictional Issues

- Bankruptcy Code specifies that a discharge "operates as an injunction" against any action to collect any debt for which the debtor received a discharge.
  - Bankruptcy Code sec. 524 (a)(2).
- When bankruptcy court enters a discharge order, it effects an injunction.
  - No private right of action exists for debtors to claim a creditor has violated the bankruptcy discharge.
  - Such claims take the form of actions seeking to hold creditors in contempt of court.

Jurisdictional Issues

- Authority is settled in the non-bankruptcy context that only issuing courts may use the contempt power to enforce their own injunctions.
  - *Gunn v. Univ. Comm. to End the War in Viet Nam*, 399 U.S. 383 (1970).
- A majority of courts have recognized similar limitations in the enforcement of discharge orders
  - *Anderson v. Credit One Bank, N.A.*, 884 F.3d 382 (2d Cir. 2018)
  - *Galaz v. Katona*, 841 F.3d 316, 322 (5th Cir. 2016)
  - *Jones v. CitiMortgage, Inc.*, 666 F. App'x 766, 774–75 (11th Cir. 2016)
  - *Green Pt. Credit, LLC v. McLean*, 794 F.3d 1313, 1319–20 (11th Cir. 2015)
  - *Alderwoods Grp., Inc. v. Garcia*, 682 F.3d 958 (11th Cir. 2012)

Jurisdictional Issues

- Arguments have been raised that discharge orders have a unique posture enabling enforcement by any bankruptcy court.
- At least one bankruptcy court has accepted these arguments.
- *In re Crocker*, 585 B.R. 830 (Bankr. S.D. Tex. 2018) (presently on appeal)
  - A discharge order is not itself a court-ordered injunction
  - The discharge order operates as an injunction only through statute
  - In this context, the court is not enforcing another court's discharge order, but rather is enforcing a bankruptcy statute

Jurisdictional Issues

- Debtors argue that foreign court jurisdiction over discharge orders would:
  - Permit a debtor who moves post-discharge to enforce from a local court rather than travelling to a distant forum
  - Permit adjudication of nationwide class-actions for discharge violations, rather than case-by-case enforcement

Jurisdictional Issues

- Creditors argue that divorcing enforcement of discharge orders from the issuing court implicates important policy considerations.
  - Permits enforcement by a court that may have lacked authority to enter a discharge order in the first instance
  - Denies issuing court ability interpret its own discharge order
  - Would allow enforcing court to apply precedent different from issuing court
  - Lead to forum shopping

Class Arbitration and Bankruptcy

Brad Knapp

The arbitrability of bankruptcy-related disputes has become a hotly contested legal issue following recent Supreme Court decisions favoring arbitration. The stakes for such disputes have risen in light of further Supreme Court precedent curtailing the availability of classwide arbitrations absent express provision for class arbitrations in an arbitration clause. This section of the paper will address both aspects of this evolving issues.

A. Older circuit court decisions regarding the arbitrability of bankruptcy-related disputes remains in doubt following the Supreme Court's decision in *Epic Systems*.

The Supreme Court has long decided disputes regarding arbitration to further the strong policy in favor of arbitration supporting the Federal Arbitration Act ("FAA").[1] The strong presumptions in favor of arbitration can be overridden, but only "by a contrary congressional command."[2] As the Supreme Court expressed in the *McMahon* opinion, this conflict must be "'deducible from [the statute's] text or legislative history,' or from an inherent conflict between arbitration and the statute's underlying purposes."[3]

In 2018, the Supreme Court clarified the long-running standards in favor of arbitration in *Epic Systems Corp. v. Lewis*, 138 S.Ct. 1612 (2018). The Court held that other federal statutes do not displace the FAA absent a "clear and manifest" statement of congressional intent to displace arbitration.[4] A "party seeking to suggest that two statutes cannot be harmonized, and that one displaces the other, bears the heavy burden of showing a clearly expressed congressional intention that such a result should follow."[5] The Court further noted that "over many years, this Court has

[1] *See, e.g.*, 9 U.S.C. § 2; *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 224 (1987).
[2] *McMahon*, 482 U.S. at 226; *see also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985).
[3] *McMahon*, 482 U.S. at 226-27 (citing *Mitsubishi Motors Corp.*, 473 U.S. at 628).
[4] *Epic Systems*, 138 S.Ct. at 1624.
[5] *Epic Systems*, 138 S.Ct. at 1624.

heard and rejected efforts to conjure conflicts between the Arbitration Act and other federal statutes. In fact, this Court has rejected every such effort to date . . . with statutes ranging from the Sherman and Clayton Acts to the Age Discrimination in Employment Act, the Credit Repair Organizations Act, the Securities Act of 1933, the Securities Exchange Act of 1934, and the Racketeer Influenced and Corrupt Organizations Act."[6] The *Epic Systems* opinion therefore makes clear that courts must focus on the language Congress used, rather than any unexpressed intentions or policies.[7]

Significantly, *Epic Systems* does not mention the Bankruptcy Code in any way. Pre-*Epic Systems* decisions, relying largely on the "inherent conflict" language from the *McMahon* opinion, provided bankruptcy courts with some discretion in determining whether bankruptcy-related disputes are arbitrable. The Fifth Circuit's decision in *National Gypsum* is typical of these lines of cases.[8] In *National Gypsum*, the Fifth Circuit held that non-core bankruptcy matters are subject to arbitration, but for core matters the analysis is not so simple.[9] The court applied a two-step analysis for core bankruptcy proceedings: (1) to apply the standard from *McMahon* to determine whether there was a conflict between the Bankruptcy Code and the FAA that would give the bankruptcy court discretion to decline arbitration, and (2) to determine whether the bankruptcy court abused that discretion.[10] The court then applied that analysis to find that a bankruptcy court had discretion to decline to compel arbitration of a dispute challenging whether a creditor's efforts to collect a pre-petition debt violated the Bankruptcy Code's discharge injunction or the terms of the applicable confirmed Chapter 11 plan.[11] The Fifth Circuit explained: "[t]here can be little

[6] *Epic Systems*, 138 S.Ct. at 1627; *see also Green Tree Fin. Corp.-Ala. V. Randolf*, 531 U.S. 79, 90-91 (2000) (declining to find a conflict between the FAA and the Truth in Lending Act).
[7] *Gaffers v. Kelly Services, Inc.*, 900 F.3d 293, 296 (7th Cir. 2018).
[8] *In re National Gypsum Co.*, 118 F.3d 1056 (5th Cir. 1997).
[9] *Id.* At 1066.
[10] *Id.* At 1067-70.
[11] *Id.* At 1058, 1069.

dispute that where a core proceeding involves adjudication of federal bankruptcy rights wholly divorced from inherited contractual claims, the importance of the federal bankruptcy forum provided by the Code is at its zenith."[12] The resulting "rule" from the case is as follows:

> We think that, at least where a cause of action at issue is not derivative of the pre-petition legal or equitable rights possessed by a debtor but rather is derived entirely from the federal rights conferred by the Bankruptcy Code, a bankruptcy court retains significant discretion to assess whether arbitration would be consistent with the purpose of the Code, including the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.[13]

Other circuits have followed a similar approach in finding that bankruptcy courts retain discretion to deny arbitration.[14] Other circuits have focused less on the primacy of the bankruptcy forum and taken a closer look at the substantive claims asserted.[15]

The common thread between *National Gypsum* and its progeny is a reliance on a conflict between the FAA and the Bankruptcy Code divined from a policy perspective. As various circuit courts have recognized, there is "no evidence within the text or in the legislative history that Congress intended to create an exception to the FAA in the Bankruptcy Code."[16] The *Epic Systems* decision makes clear that courts should focus on articulated expressions of Congressional intent and not resort to policy concerns. Since *Epic Systems*, courts have split on whether core bankruptcy proceedings may be arbitrated or whether some discretion remains.[17]

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[12] *Id.* At 1068.
[13] *Id.* At 1069.
[14] *See In re Anderson*, 884 F.3d 382 (2d Cir. 2018), *cert. denied*. (decided pre-*Epic Systems*)
[15] *See Mintze v. Am. Gen. Fin. Servs., Inc. (In re Mintze)*, 434 F.3d 222, 231-32 (3d Cir. 2006); *Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1157 (3d Cir. 1989).
[16] *Whiting-Turner Contracting Co. v. Elec. Mach. Enters., Inc. (In re Elec. Mach. Enters., Inc.)*, 479 F.3d 791, 796 (11th Circ. 2007); *see also Mintze*, 434 F.3d at 231.
[17] *See In re Trevino*, 2019 WL 1090165 (Bankr. S.D. Tex. Mar. 7, 2019) (holding that bankruptcy claims remain subject to arbitration following *Epic Systems*), *contra In re Belton*, 2019 WL 1017293 (S.D.N.Y. March 4, 2019), *In re Roth*, 594 B.R. 672 (Bankr. S.D. Ind. 2019); *In re Golden*, 587 B.R. 414 (Bankr. E.D.N.Y. 2018) (all holding that bankruptcy courts retain discretion to deny arbitration of core proceedings).

Fortunately, practitioners may get some additional clarity regarding these issues in the near future. The Fifth Circuit has the opportunity to address directly whether *National Gypsum* remains good authority after *Epic Systems* in a putative class action case involving the dischargeability of certain student loan debt. In *Stephanie Marie Henry v. Educational Financial Services, a Division of Wells Fargo Bank, N.A.*[18], Henry asserts her student loan debt to a for-profit ultrasound diagnostic school was discharged in her bankruptcy case. She seeks certification of a class of similarly-situated borrowers and requests injunctive relief and damages related to allegations that such debt has been subject to collection efforts notwithstanding the discharge. Education Financial Services moved to compel arbitration before the United States Bankruptcy Court for the Southern District of Houston, and that request was denied based on *National Gypsum*. The bankruptcy judge certified the issue for direct appeal based on the importance of the issue raised. The Fifth Circuit took the appeal. It is now fully briefed and may result in a decision clarifying how the Bankruptcy Code and claims based on the Bankruptcy Code interact with the FAA going forward.

B. The Supreme Court's *Lamps Plus* decision limits the arbitrability of class actions.

The issue of whether bankruptcy disputes are subject to arbitration has serious implications in the context of bankruptcy class action litigation. The Supreme Court has long held that consent to arbitrate on a class wide basis may not be implied solely from the agreement to arbitrate:

> An implicit agreement to authorize class-action arbitration, however, is not a term that the arbitrator may infer solely from the fact of the parties' agreement to arbitrate. This is so because class-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator. In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes. . . . But the relative benefits of class-action arbitration are much

[18] *Stephanie Marie Henry v. Educational Financial Service, a Division of Wells Fargo Bank, N.A.*, Case No. 18-20809 (5th Cir.).

> less assured, giving reason to doubt the parties' mutual consent to resolve disputes through class-wide arbitration.[19]

This authority was bolstered within the last month with the Supreme Court stating definitively that "[c]ourts may not infer from an ambiguous agreement that parties have consented to arbitrate on a classwide basis."[20] Instead, parties must now expressly authorize class arbitrations because "[l]ike silence, ambiguity does not provide a sufficient basis to conclude that parties to an arbitration agreement agreed to 'sacrifice[] the principal advantage of arbitration.'"[21]

In light of this authority, the scope of disputes subject to arbitration could have significant implications regarding whether bankruptcy class actions may move forward at all. If plaintiffs are subject to binding arbitration clauses that do not provide for class action arbitration, those cases may be subject to individual arbitrations instead. If cases remain in bankruptcy court, those matters will likely proceed subject to the split in authority regarding the scope of bankruptcy class jurisdiction discussed below.

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[19] *Stotl-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 686-87 (2010) (further noting that "it follows that a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so" and "[w]e think that the differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings.").

[20] *Lamps Plus, Inc. v. Varela*, 587 U.S. __ (2019).

[21] *Lamps Plus, Inc.*, 587 U.S. __ (*quoting AT&T Mobility LLC v. Concepcion*, 563 U. S. 333, 348 (2011)).