AMERICAN BANKRUPTCY INSTITUTE

2022 Annual Spring Meeting

Reevaluating Class Proofs of Claim

Hosted by the Bankruptcy Litigation & Commercial and Regulatory Law Committees

Hon. Kevin J. Carey (ret.)
Hogan Lovells; Philadelphia

Matthew Dundon
Dundon Advisers LLC; White Plains, N.Y.

Jeffrey K. Garfinkle
Buchalter, PC; Irvine, Calif.

René S. Roupinian
Raisner Roupinian LLP; New York

CONCURRENT SESSION

2022

AMERICAN BANKRUPTCY INSTITUTE

Annual Spring Meeting
April 28-30 | Washington, D.C.

REEVALUATING AND REVISITING CLASS CLAIMS

Presented by:

Hon. Kevin J. Carey (ret.)
Hogan Lovells; Philadelphia, PA

Matthew Dundon
Dundon Advisers LLC; White Plains, NY

Jeffrey K. Garfinkle
Buchalter, PC; Irvine, CA

René S. Roupinian
Raisner Roupinian LLP; New York City, NY

Saturday, April 30, 2022

Class Claims

The prevailing view is that the bankruptcy court may, in its discretion, permit class proofs of claim to be filed. A minority view is that they may not be filed at all.

Consumer, commercial, and employment class proofs of claim with recourse to the Plan recovery waterfall are regularly made and settled in large amounts.

Securities class action claims with recourse only to D&O insurance are also regularly settled.

When class claims are contested, bankruptcy courts deny right to file more often than they grant it. However, such denials often issue from the bankruptcy finding that the claimant hasn't demonstrated he/she/it has a certifiable class under FRCP 23 or its state analogs. Bankruptcy courts rarely exercise their discretion to prohibit claims they acknowledge a District Court would certify under FRCP.

Influential Southern District of Texas Bankruptcy Judges Isgur and Jones have taken something of a new direction – acknowledging (at least in general) the propriety of class proofs of claim but appearing to see trial courts as the appropriate venue for most issues concerning them.

Are They Legally Permissible?

Yes:

- *In re Hertz*, Case No. 20-11247, D. Del. Over 20 different class claim settlements approved for up to $20 million each. (*Hertz* being most prominent examples of scores of cases in this line.)
- *In re American Reserve Corp.*, 840 F.2d 487 (7th Cir. 1988)
- *Birting Fisheries v. Lane (In re Birting Fisheries)*, 92 F.3d 939 (9th Cir. 1996) Concurring with *American Reserve* that the Bankruptcy Code "should be construed to allow class claims"
- *Reid v. White Motor Corp.*, 886 F.2d 1462, 1469 (6th Cir. 1989). Allowing class proofs of claim is the more "equitable resolution"
- *The Certified Class in the Chartered Securities Litig. v. The Charter Co. (In re The Charter Co.)*, 876 F.2d 866 (11th Cir. 1989) "In light of Congress' inclusion of Rule 23 in bankruptcy proceedings [and] the clear congressional intent that the Bankruptcy Code encompass every type of claim . . . we conclude that class proofs of claim are allowable in bankruptcy"
- *In re TWL* Corp., 712 F.3d 886 (5th Cir. 2013) In an adversary proceeding, Rule 23 is automatically applicable.
- *In re Dewey & LeBeuef LLP*, 487 B.R. 169, 179 n.8 (Bankr. S.D. N.Y. 2013) Class treatment of WARN Act claims may be particularly appropriate in the bankruptcy context where equality of distribution is central to the bankruptcy process.

Are They Legally Permissible?

No:

- *In re Allegheny Int'l, Inc.*, 94 B.R. 877, 879-80 (Bankr. W.D. Pa. 1988). Holding that "on its face, section 501 does not provide for class proofs of claims," and collecting cases that have "interpreted section 501 as an exclusive list of who may file claims, thus barring class claims".
- *In re FIRSTPLUS Fin., Inc.*, 248 B.R. 60, 67 (Bankr. N.D. Tex. 2000). "A putative class representative is not, nor can he be transformed by the court into, an authorized agent within the purview of Bankruptcy Rule 3001(b)."
- *Sheftelman, v. Standard Metals Corp. (In re Standard Metals Corp.)*, 817 F.2d 625, 631 (10th Cir. 1987). "[A] class representative cannot be considered the authorized agent of all the creditors in a putative class."

Are They Legally Permissible?

Maybe, but only with most of the work done elsewhere:

- *In re Gulfport Energy Corp*., Case No. 20- 35562-11 (S.D. Tex.), Hearing Transcript of February 24, 2021, Exhibit C at 43:2. Holding that a "motion to strike" a class proof of claim was appropriate recourse by a debtor where an underlying class had not been sought and certified, and the purported class counsel could not demonstrate he had contacted and secured engagement agreements with any of the purported class members.
- *In re Katerra, Inc.,* Case No. 21-31861 (S.D. Tex.) – permitting the liquidating trustee narrowly to allow the class proof of claim, but remanding the approval of the settlement terms (including certification of the class, approval of class counsel, and approval of service awards and fees) to the pre-Chapter 11 trial court.
- *In re TWM Merchants LLC (f/ka Tailored Brands, Inc.)* Case No. 20-33916 (S.D. Tex.) – refusing to approve a settlement between the liquidating trustee and private attorney general (analogous in some respect to class action) given discomfort with the Bankruptcy Court adjudicating core notice and fairness issues.

This line of SDTX decisions is suggestive that class claimants should immediately seek to lift the stay of bankruptcy and continue to establish procedural and substantive bona fides of claims in trial court.

Procedural Requirement of Obtaining Pre-Filing Approval

- The decision whether to permit a class claim is discretionary.
- Under reported decisions, a purported class claimant usually must move to apply Bankruptcy Rule 7023 before filing a class claim. (Rule 7023 by its terms applies only to adversary actions, but may be is made applicable to the purported class proof of claim by exercise of Rule 9014 authority.)
- *Reid v. White Motor Corp*., 886 F.2d 1462 (6th Cir. 1989). Holding that a claimant who did not move to apply Bankruptcy Rule 7023 before he filed a purported class proof of claim "failed to timely petition the bankruptcy court to apply the provisions of Rules 9014 and 7023," which is a "mandatory requirement essential to filing a class proof of claim."
- *In re Craft*, 321 B.R. 189 (Bankr. N.D. Tex. 2005). [I]t is the view of this court that it is the burden of the class representative to raise the issue of class certification."
- *In re Computer Learning Centers, Inc*., 344 B.R. 79 (Bankr. E.D. Va. 2006). The court denied as untimely the claimants' motion to apply Rule 7023, holding that failing to first file a motion to apply Rule 7023 before filing a class proof of claim is "an obvious defect that will . . . certainly result in disallowance of the claim."

Despite these precedents, many class claims are settled when leave is applied for after the filing, or even simultaneous with the settlement.

Factors for Determining Permissibility of Class Claim

- The easiest, and most common, way to deny a class proof of claim is to hold that it fails to satisfy *non-bankruptcy* standards for class certification (e.g., FRCP 23) or *non-class-action* merits considerations.
- Bankruptcy courts which recognize the potential validity of a claim both in FCRP 23 terms and *prima facie* potential underlying merit can and often do go on to apply *In re Musicland Holding Corp.,* 362 B.R. 644 (Bankr. S.D.N.Y. 2007) to decide whether to exercise their discretion to permit the claim to be or have been filed.
- The *Musicland* factors are:

  i) whether the class was certified pre-petition;

  ii) whether the members of the putative class received notice of the bar date;

  iii) whether class certification will adversely affect the administration of the estate.

Factors for Determining Permissibility of Class Claim

- But see, *American Pipe & Constr. Co v. Utah*, 414 U.S. 538, 554 (1974) Tolling of SOL; absent class members may rely on the class proof of claim or class action adversary proceeding.
- *In re Connaught Group, Ltd*, 491 B.R. 88 (Bankr. S.D. N.Y. 2013) If the court denies a motion to certify the class, it should set a reasonable bar date to allow the members of the putative class to filed individual claims. Also, claims that arise contemporaneous to the filing of the bankruptcy petition cannot be certified pre-petition, undercutting *Musicland* factors.
- *In re TWL Corp.*, 712 F.3d 886 (5th Cir. 2013) If defenses are to be asserted the need for attorneys both to assert the claims and defend against them weigh in favor of class certification.

Is Bankruptcy Rule 7023, or Portions of Rule 7023, Invalid?

- In 1964, Congress gave the Supreme Court rulemaking authority with respect to bankruptcy cases. ("Rules Enabling Act")
- 28 U.S.C. § 2075: The Rules Enabling Act provides that the Bankruptcy Rules, as well as the other federal procedural rules, "shall not abridge, enlarge, or modify any substantive right."
- Gatekeeping issue: Is the subject matter at issue a "substantive right"? See Resnick, *The Bankruptcy Rulemaking Process* , 70 Am. Bankr. L.J. 245 (1996).

Is Bankruptcy Rule 7023, or Portions of Rule 7023, Invalid?

- As to class claims, there may be substantive rights conflicts– *i.e.*, abridgement, enlargement or modification—between Bankruptcy Rule 7023 and the numerous provisions of the Bankruptcy Code:
  i. § 501(a). "A creditor … may file a proof of claim." Allowing a putative class representative to file a class proof of claim may enlarge and modify § 501(a) and abridge the rights of class members.
  ii. § 1126(a). "The holder of a claim … may accept or reject a plan." Allowing a putative class representative to vote on a plan, on behalf of class members, may abridge and modify § 1126(a).
  iii. Rule 23(e) addresses settlement of class claims and the procedures related to those settlements. An argument exists that this portion of Rule 23 conflicts with the plan confirmation requirements set forth in § 1123(a)(3) (plan shall specify the treatment of any impaired class of claims) and § 1123(b)(5) (plan may modify the rights of creditors.
  iv. Rule 23(g): "A court that certifies a class must appoint class counsel." An argument exists that the appointment of class counsel to represent a group of creditors conflicts with §§ 327 and 1103, as the rule potentially enlarges and modifies estate professionals.
  v. Rule 23(h): The certifying court "may award reasonable attorney's fees and costs" to class counsel. In bankruptcy, if class counsel is paid from either estate assets or creditor distributions, this may enlarge and modify the universe of compensated professionals and may conflict with §§ 328 and 503(b)(4).
  vi. There is no statutory basis in the Bankruptcy Code for class counsel to surcharge distributions to class members. Arguably, class members have a right to receive their distributions without deduction for payment to class counsel. To the extent class members' distributions are surcharged to pay class counsel, this may abridge the rights of class members.

Opt-In or Opt-Out

- Starting Point: Bankruptcy, as a whole, is the quintessential class action, structured as opt-in. Participation is voluntary. If a creditor with a disputed claim does not want to participate in receiving distributions from the case, it simply does not file a proof of claim.
- In contrast, Rule 23 is structured as opt-out. *See* Rules 23(c)(2), 23(e)(4) —Class action must allow class members to elect to be excluded.
- If a class proof of claim is permitted, should inclusion by class members be on an opt-in or opt-out basis?
- How should courts deal with potential class members that file proofs of claim? Is the filing of such a proof of claim by potential class members de facto opt-out?
- Courts addressing class proofs of claims in bankruptcy have not substantively focused on the opt-in/opt-out dichotomy.

Opt-In or Opt-Out

- **In practice, most class proof of claim settlements are structured to provide an opt-out opportunity**, often with notice making clear to absent class members that by operation of the Chapter 11 bar date, opting out will leave them with no chance at recovery.
- **Limited fund cases which are not opt out**: Rule 23(b)(1)(B); *In re Toys R Us;* Insufficient funds to pay administrative expenses in full; a class was certified for settlement purposes comprising 30k+ former TRU employees who were owed severance under TRU's severance policy. The class settled for an allowed $10M claim, with an expected distribution of 20 cents. Class members received notice of the settlement with right to object, but no right to opt-out.

Common claims that resemble, but aren't, class claims

- **Mass tort claims**: each individual alleged victim has to file their own proof of claim. *Resolution* of mass torts can be very similar to the resolution of class claims. Individual claims can be in the tens or hundreds of thousands.
- **US Fair Labor Standards collective actions**. A representative claimant receives preliminary certification, after which employees and former employees are solicited to join the action. Only the employees who elect to join the action are members of the collective class, and their posture is as individual claimants. Collective counsel will file individual proofs of claims – usually in the hundreds or thousands.
- **California Private Attorney General Act claims.** Present in many bankruptcies, these claims have a lead plaintiff and lead counsel, and are asserted in right of the California State Labor and Workforce Development Agency, and as such are treated as individual, and not class, claims.

FLSA and PAGA claims regularly have parallel state law class claims.

Faculty

Hon. Kevin J. Carey is senior counsel in Hogan Lovells US LLP's Business Restructuring and Insolvency practice in Philadelphia and is a retired bankruptcy judge. He also is ABI's President-Elect. Judge Carey was first appointed to the U.S. Bankruptcy Court for the Eastern District of Pennsylvania in 2001, then in 2005 began service on the U.S. Bankruptcy Court for the District of Delaware (serving as chief judge from 2008-11). He is a past global chairman of the Turnaround Management Association and is an honorary member of the Turnaround, Restructuring and Distressed Investing Hall of Fame and a Distinguished Fellow of the Association of Insolvency & Restructuring Advisors. Judge Carey is a Fellow of the American College of Bankruptcy and a member of the International Insolvency Institute. He also is a contributing author to *Collier on Bankruptcy* and a member of the National Conference of Bankruptcy Judges. Judge Carey began his legal career in 1979 clerking for Bankruptcy Judge Thomas M. Twardowski, then served as clerk of court of the U.S. Bankruptcy Court for the Eastern District of Pennsylvania. He received his B.A. in 1976 from Pennsylvania State University and his J.D. in 1979 from Villanova University School of Law.

Matthew Dundon is the principal of Dundon Advisers LLC in White Plains, N.Y., and founded the firm in 2016. He has been a global credit, litigation and distressed investment leader for more than 13 years, having served as research head at Miller Tabak Roberts Securities from 2006-10 and portfolio manager at Pine River Capital and Advent Capital from 2010-16, and has been involved in dozens of litigation-intensive investments and trading opportunities. Mr. Dundon was a corporate finance lawyer and analyst from 1998-2006. He received his B.A. from the University of California at Berkeley and his J.D. from the University of Chicago.

Jeffrey K. Garfinkle is a shareholder with Buchalter, PC in Irvine, Calif., and Seattle. His primary practice involves the representation of secured and unsecured creditors, creditors' committees, trustees, equity receivers, debtors, and other parties in interest in a variety of bankruptcy, restructuring cases and collection matters, including out-of-court workouts. He also specializes in matters pertaining to Articles 2 and 9 of the Uniform Commercial Code and in representing purchasers of assets from bankrupt companies and financially troubled companies. Mr. Garfinkle is regarded as one of the nation's leading health care and pharmaceutical insolvency attorneys. For more than 20 years, he has served as primary U.S. insolvency, bankruptcy and collections counsel to McKesson, the world's largest health care corporation. He currently represents McKesson in several opiate-related bankruptcy and restructuring cases, including Purdue Pharma and Mallinckrodt, and he has represented committees, debtors, creditors and other parties in dozens of other health care bankruptcy cases. Mr. Garfinkle has been recognized *The Best Lawyers in America* for 2021 and 2022 in the areas of Bankruptcy and Creditor/Debtor Rights and Insolvency and Reorganization Law. He is a member of the Board of Governors of the Financial Lawyers Conference and co-chairs ABI's Commercial and Regulatory Law Committee. Mr. Garfinkle worked *pro bono* on the successful chapter 11 reorganization of the San Diego Symphony, during which he devoted 1,000 hours and was awarded an honorary lifetime membership in the American Federation of Musicians. For the last decade, he has served as an advisor to the law student-run *Emory Bankruptcy Developments Journal*. Mr. Buchalter previously spent 12 years with an international law firm and a one-year clerkship with Hon. Louise DeCarl Adler in the U.S. Bankruptcy Court for the Southern District of California. In addition to

practicing before the U.S. Supreme Court, he has argued appeals in five Federal Courts of Appeals and handled bankruptcy matters in dozens of districts throughout the U.S. Mr. Garfinkle received his B.A. in 1987 from the University of Florida and his J.D. in 1990 from Emory University School of Law.

René S. Roupinian is a founding partner of Raisner Roupinian LLP in New York, which also has offices in California. For nearly two decades, she has devoted her practice to the litigation of federal and state Worker Adjustment and Retraining Notification (WARN) Act cases and related employment claims on behalf of tens of thousands of terminated employees. Her practice is national, with most cases initiated as class action adversary proceedings. Her class action clients often hold seats on unsecured creditors' committees. Ms. Roupinian has litigated hundreds of WARN Act cases and recovered more than $100 million in settlements and judgments on behalf of employees let go without adequate notice. Her firm's class actions have been adjudicated by the U.S. Supreme Court and Appeals Courts for the Second, Third, Fourth and Fifth Circuits, and none have been decertified. Her notable class action bankruptcy cases include *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017); *Conn v. Dewey & LeBoeuf LLP (In re Dewey & LeBoeuf LLP)*, 487 B.R. 169 (Bankr. S.D.N.Y. 2013); *In re MF Glob. Inc.*, 512 B.R. 757 (Bankr. S.D.N.Y. 2014); *Etzelsberger v. Fisker Automotive Holdings Inc.*, 13-13087-KG, 2019 WL 8269114 (Bankr. D. Del. Dec. 27, 2019); *In re Shopko*, Case No.19-80064 (Bankr. D. Neb.); *In re Transcare Corp.*, 614 B.R. 187 (Bankr. S.D.N.Y. 2020); and *Federman v. ITT Educational Services Inc.*, Case No. 16-50296 (Bankr. S.D. Ind.). Ms. Roupinian received her B.A. in 1989 from the University of Michigan and her J.D. in 1994 from Michigan State University College of Law, where she was a member of the Moot Court Executive Board.