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corpcounsel.com | February 8, 2016

## Class Actions and Class Claims in Bankruptcy Proceedings

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A bankruptcy proceeding is, at its heart, a collective collection action. Bankruptcy cases often benefit not only the debtors, but also the creditors of the debtors' estates. A class action also is a collective proceeding, but it generally is meant to benefit a class of plaintiffs against a single defendant or in some instances a class of defendants.

These two forms of proceedings can merge through the use of Bankruptcy Rule 7023, which makes Federal Rule of Civil Procedure (FRCP) 23, governing class actions, applicable in bankruptcy cases. This article highlights some issues that may arise when Rule 7023 is invoked, either by a class of debtors against a creditor defendant or by multiple creditors in a class proof of claim against the estate of a single debtor.

Recently class actions have been used in individual consumer bankruptcy cases against a single creditor, such as a mortgage lender or servicer, asserting violations of the consumer protection laws, the bankruptcy automatic stay or the discharge injunction. Contested issues in such a class action may involve the geographic scope of the proposed class and the nature of the remedies sought. Courts are almost always open to allowing class actions to proceed in appropriate cases, but they vary on such things as the scope of the classes they will approve and the nature of the remedies they will permit to be asserted.

Bankruptcy is a federal, not a state, creation. It is one of the subjects dealt



with expressly in the U.S. Constitution and is governed by the comprehensive Bankruptcy Code created by Congress. Plenary bankruptcy jurisdiction is vested in the U.S. district courts. However, the power to exercise that jurisdiction is delegated by the district courts to the bankruptcy judges for each federal court district. Bankruptcy judges are Article I appointees, for limited terms, unlike the Article III district judges, who enjoy lifetime appointments. As such, bankruptcy judges may issue final orders and judgments only in "core" bankruptcy matters; in "non-core" matters, a bankruptcy judge may issue reports and recommendations which are subject to de novo review by the district court. This dual court system, and the nature

of bankruptcy proceedings themselves, causes many of the issues courts face with class proceedings.

All bankruptcy class actions must comply with the elements of FRCP 23. In short, every such action must meet the numerosity, commonality, typicality and adequate representation prongs of Rule 23(a). The case also must meet one of three elements of Rule 23(b): (1) there is a risk of inconsistent adjudications; (2) declaratory or injunctive relief is appropriate to the class as a whole; or (3) common questions predominate over any individual issues. Compliance with these elements often present some issues unique to bankruptcy cases, and the courts vary on their resolution of those issues.

For example, the courts differ on the geographic scope of proposed classes of debtor-plaintiffs permitted in bankruptcy class actions. Some courts allow a nationwide class of debtor-plaintiffs while others restrict the scope of the class to debtors whose cases are pending in their judicial district. These divergent opinions stem from the debtor-centric nature of a bankruptcy proceeding, the *res* of a bankruptcy estate and the referral of bankruptcy jurisdictional powers by the district courts to the bankruptcy judges of each individual district.

Some decisions restrict contempt claims, which are based on a violation of court order, only to the court that issued the order. This effectively precludes a nationwide classes for things such as discharge injunction violations because those claims are based on the alleged disregard of the discharge order or confirmation order entered in virtually every bankruptcy case. The cases vary on that point, with the majority against nationwide classes. Counsel are advised to be aware of which rule is followed in the circuit, and in the district, at issue in an individual case.

Certification standards also vary by judicial circuit and district, as do the defenses available to class defendants. Some courts invoke a "rigorous analysis" standard for compliance with the certification requirements, while others are more permissive in their application of Rule 23. Additionally, the typical defenses asserted in class actions also vary from court-to-court and by circuit. Examples: the failure to meet the predominance of superiority elements; issues with standing, conflict of interest and adequacy of representation elements; individual defenses applicable to certain class action members—e.g. arbitration, waiver and consent that destroy the typicality element; and "fail safe" classes, whose membership can only be ascertained by a determination of the merits of the case because the class is defined in terms of

the ultimate question of liability. Such a class, by definition, shields the plaintiff from an adverse decision because the class members either win or are not in the class. Again, counsel are advised to know the case law applicable in the jurisdiction at issue, and to know the predilections of the judge assigned to hear the case.

The class remedies allowed by courts fall typically into two broad categories: declaratory/injunctive relief and damages. The majority of cases appear to permit the former while a minority also allow the latter, generally because a class damages case requires proof that common issues predominate over individual issues. The reason for the distinction is summed up in two decisions issued by the U.S. Court of Appeals for the Fifth Circuit: *Matter of Wilborn* (2010) and *Matter of Rodriguez* (2012). In *Wilborn*, the individual circumstances affecting each class member, with respect both to damages and to declaratory/injunctive relief, overrode class concerns, so certification was denied. Stated another way, the monetary relief sought by each class member varies depending on the individual circumstances applicable in each debtor's bankruptcy case and those damages do not follow directly or automatically from a determination of liability on the part of the defendant. Two years later, however, in *Rodriguez*, the court affirmed the districtwide, fail safe class for declaratory/injunctive relief that was certified by the bankruptcy court.

Finally, class proofs of claim are a useful tool for asserting uniform damage claims based upon a single action by a debtor company. WARN Act claims are a typical example of easily quantifiable damages suffered by each member of the class. As illustrated by the Fifth Circuit in *Matter of TWL Corp.* (2013), most courts are open to allowing class proofs of claim. However, the class typically must comply with the Rule 23

certification requirements. That means the class represented in the proof of claim either must have been certified prior to the bankruptcy case or it must be certified in the bankruptcy proceedings themselves. Additionally, in chapter 11 cases, counsel may need to comply with Bankruptcy Rule 2019 regarding disclosure requirements when representing a group of creditors.

In sum, while class actions and class proofs of claim may be allowed in bankruptcy proceedings, the wide variance among the circuits and the various judicial districts require counsel to be aware of the case law applicable in the jurisdiction in which the action is brought. The old adage, "know your judge," is especially pertinent when prosecuting or defending bankruptcy class actions and class proofs of claim.

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