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Bankruptcy and Class Actions: The Continuing Conflict over Class Proofs of Claim

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In re Charter Company[1]

I. INTRODUCTION

The continuing inconsistency among federal circuits about allowing class proofs of claim in bankruptcy proceedings[2] appears to originate from the dual and sometimes conflicting objectives of bankruptcy. The first of these objectives is to restore the debtor to a status of financial stability, or to give him a fresh start.[3] To protect the debtor's interest, the Bankruptcy Rules impose strict requirements on the creditor regarding eligibility for repayment or distribution.[4] One of these eligibility requirements is set out in section 501 of the Bankruptcy Code, which states that "a creditor or an indenture trustee may file a proof of claim."[5] Because section 501 only mentions filing by an individual creditor, a literal interpretation of this section has led some courts to reject class proofs of claim.[6] The second objective focuses on protection of creditors' financial interests in the debtor's estate.[7] This interest is protected by limiting which debts can be discharged and by providing priority for certain creditors' claims. In the typical liquidation case, these two goals rarely clash because the debtor has no expectation of sharing in the non-exempt assets of the estate. In many reorganization cases, however, the

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1. 876 F.2d 866 (11th Cir. 1989).

2. *See infra* notes 90 and 104 and accompanying text.

3. Wolmuth, *The Class Action and Bankruptcy: Tracking the Evolution of a Legal Principle*, 21 UCLA L. REV. 577, 579 (1973).

4. *See infra* note 5 and accompanying text. Specifically, section 501 of the Bankruptcy Code requires that each individual creditor file a proof of claim and makes no mention of allowing the filing of a class proof of claim.

5. 11 U.S.C.A. § 501(a) (West 1979 & Supp. 1991). Section 501, which addresses the filing of proofs of claim or interests, also states:

> (b) If a creditor does not timely file a proof of such creditor's claim, an entity that is liable to such creditor with the debtor, or that has secured such creditor, may file a proof of such claim.
>
> (c) If a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim.

Id.

6. *See infra* note 100 and accompanying text.

7. Wolmuth, *supra* note 3, at 579.

debtor's fresh start objective can directly conflict with allowing more creditors to be eligible for repayment through a class proof of claim.[8] Despite the potential opposing interests of the debtor and creditors, this conflict is overridden by the efficiencies of class actions. One of these efficiencies centers on the reality that small claims are less likely to be filed on an individual basis than they are if aggregated with other similar claims.[9]

Historically, courts have taken three positions regarding class actions in bankruptcy proceedings. They have either (i) allowed one proof of claim to be filed for a certified class, or (ii) allowed class actions but only after each creditor has filed an individual proof of claim, or (iii) disallowed both class actions and class proofs of claim.[10] The class proof of claim presents a possible conflict with the Code requirement of individual proofs of claim.[11] This issue, however, is irrelevant to class actions where every member has already filed an individual proof of claim.[12] Many courts have failed to recognize this distinction and have alleged that class actions, rather than merely class proofs of claim, conflict with the statutory requirement.[13] Beginning with the 1988 decision of *In re American Reserve Corporation*,[14] many courts have allowed the filing of class proofs of claim in bankruptcy proceedings.[15] *In re Charter*,[16] discussed in this Note, continues this trend of allowance and establishes several fundamental reasons in support of that allowance.

II. FACTS AND HOLDING

The appellants filed suit against the Charter Company (Charter) and its officers and directors in the United States District Court for the Middle

8. These objectives, however, do not collide in a Chapter 7 liquidation. The debtor's fresh start objective remains intact regardless if more creditors are allowed into the proceeding through a class proof of claim. The collision occurs between the creditors as more of them share in the distribution of a limited amount of proceeds from the liquidation of the debtor's estate. Even if these objectives do not conflict in a Chapter 7 proceeding, the disallowance of class proofs of claim still prevents some creditors with small claims from filing because of the lack of economic feasibility. As a result, the objective to protect creditors' financial interests is impaired.

9. Wolmuth, *supra* note 3, at 594.

10. *See infra* notes 90 and 104 and accompanying text.

11. Note, *Class Actions in Bankruptcy*, 64 TEX. L. REV. 791, 799 n.67 (1985).

12. *Id.*

13. *Id. See also infra* note 97 and accompanying text.

14. 840 F.2d 487 (7th Cir. 1988).

15. *Id.* at 414. *See also supra* note 104 and accompanying text.

16. 876 F.2d 866 (11th Cir. 1989).

District of Florida.[17] Based on violations of federal securities law, the action sought damages on behalf of the named plaintiffs and a class consisting of Charter stockholders.[18] The original complaint alleged that Charter misrepresented its financial condition to its stock purchasers during the prescribed period.[19] After the filing of the class action, Charter and a majority of its subsidiaries filed petitions for reorganization under Chapter 11 of the Bankruptcy Code.[20] Pursuant to automatic stay provisions of the Bankruptcy Code,[21] the class action "securities litigation was stayed with respect to Charter."[22] It continued, however, against the other named defendants. The named representatives in the securities class action filed a proof of claim in the reorganization case prior to the court-ordered due date for potential claimants to file their proofs of claim.[23] The proof, entitled "Proof of Claim on Behalf of Class of Claimants," purported to establish claims for the named plaintiffs and all the purchasers of Charter stock during the prescribed period.[24] The court later certified the class for the securities litigation in the federal district court.[25]

After two years of reorganization negotiations, Charter objected to the class proof of claim.[26] In response, the appellants filed a motion in the bankruptcy court for class certification of the claim.[27] The bankruptcy court

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17. *Id.* at 876.

18. *Id.* The original class action was filed on April 15, 1984. *In re* Charter Securities Litigation, No. 84-448-CIV-J-12 (M.D. Fla. April 15, 1984).

19. *Charter*, 876 F.2d at 867.

20. 11 U.S.C.A. §§ 1101-1174 (West 1979 & Supp. 1991). *In re* Charter Company, Nos. 84-289-BK-J-GP through 84-332-BK-J-GP (Bankr. M.D. Fla. April 20, 1984).

21. 11 U.S.C.A. § 362(a) (West 1979 & Supp. 1991). Section 362(a) provides that a petition filed under title 11 operates as a stay of:

> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title.

Id.

22. *Charter*, 876 F.2d at 867.

23. *Id.* at 867. The bankruptcy court established the bar date, after which no claims could be filed, as November 19, 1984. The named representatives of the appellant class filed a proof of claim on September 14, 1984.

24. *Id.* at 867.

25. *Id.* at 868.

26. *Id.*

27. *Id.* The motion was under BANKR. R. 9014, applying to contested matters, to apply BANKR. R. 7023. Rule 7023, entitled "Class Proceedings," states FED. R. CIV.

upheld Charter's objection, citing for support its prior decision in *In re GAC Corporation*.[28] Additionally, the bankruptcy court stated that even if a class proof of claim was appropriate, the appellants failed to comply in a timely manner with the requirements for bankruptcy class certification.[29] The federal district court affirmed.[30] On appeal, the United States Court of Appeals for the Eleventh Circuit reversed. The court held that because of the clear congressional intent that the Bankruptcy Code encompass every type of claim, class proofs of claim are allowable in a bankruptcy proceeding.[31]

III. LEGAL BACKGROUND

Historically, bankruptcy courts have been split in their decisions regarding the use of class proofs of claim in a bankruptcy proceeding. Some circuits have adopted a literal interpretation of the Bankruptcy Code, holding that provisions requiring each creditor to file a proof of claim are incompatible with the purposes of class actions.[32] In contrast, other circuits have permitted a class representative to file a class proof of claim in a bankruptcy proceeding.[33] This Note will analyze these contrasting approaches and their effect on decisions of circuits that have not ruled on this issue.

A. Fundamentals of a Class Action

The class action allows many individuals or entities whose interests are sufficiently related to sue or be sued in a single action, making it more efficient to adjudicate their rights or liabilities than in numerous individual proceedings.[34] Federal Rule of Civil Procedure 23 prescribes the requirements for a class action.[35] Rule 23(a) sets forth four threshold requirements

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P. 23 applies in adversary proceedings.

28. 681 F.2d 1295 (11th Cir. 1982). In that case, the court held that proofs of claim on behalf of a class of claimants were not allowed in a bankruptcy proceeding. *Id.* at 1299.

29. *Charter*, 876 F.2d at 868.

30. *Id.*

31. *Id.* at 873.

32. *See In re* Society of the Divine Savior, 15 Fed. R. Serv. 2d (Callaghan) 294 (E.D. Wis. 1971). *See also In re* Woodmoor Corp., 4 Bankr. 186 (Bankr. D. Colo. 1980).

33. *See In re* American Reserve, 840 F.2d 487 (7th Cir. 1988).

34. J. FRIEDENTHAL, M. KANE, & A. MILLER, CIVIL PROCEDURE § 16.1 (1985) [hereinafter FRIEDENTHAL & KANE].

35. *Id.*

that must be met to maintain a class action.[36] Further, even if these four threshold requirements are met, the class action must meet one of the substantive requirements in Rule 23(b) before the action can proceed.[37] The burden rests on the movant to establish that the action satisfies each requirement of Rule 23.[38] The court, however, has discretionary power, based on the distinct facts of each case, to determine whether a class satisfies the requirements of Federal Rule 23.[39]

The first threshold requirement listed in Rule 23(a) requires that the class be "so numerous that joinder of all members is impracticable."[40] The number needed to make joinder of all members impracticable depends on the facts of each case.[41] The second threshold requirement is the presence of "questions of law or fact common to the class."[42] The third threshold requirement is typicality, which requires that "the claims or defense of the representative parties are typical of the claims or defenses of the class."[43] The final threshold requirement is that "the representative parties will fairly and adequately protect the interests of the class."[44] The last two requirements are closely related because there is no fair and adequate representation when the claims and defenses vary widely among the entire class.[45]

In addition to meeting these prerequisites, the class action must fall within one of the three categories listed in subdivision (b) of Rule 23.[46] The first category of Rule 23(b) allows a class action (1) when the litigation of separate actions might result in inconsistent or varying adjudications that would establish incompatible standards of conduct for the opposing party or

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36. *See* 9 COLLIER ON BANKRUPTCY § 7023.04 (18th ed. 1990).

37. *Id.*

38. *In re* Grocerland Cooperative, Inc., 32 Bankr. 427, 435 (Bankr. N.D. Ill. 1983).

39. *Id.*

40. FED. R. CIV. P. 23(a)(1).

41. *In re* Sclater, 40 Bankr. 594, 599 (Bankr. E.D. Mich. 1984) (potential class of 390 held as sufficient because "joinder of so many small claims would be clearly impractical"). *See In re* Wholesale Furniture Mart, 24 Bankr. 240, 241 (Bankr. W.D. Mo. 1982) (court observed that no hard and fast rule can be given since "'numerosity' is tied to 'impracticability' of joinder under the specific circumstances"); *In re* Woodmoor Corp., 4 Bankr. 186, 189 (Bankr. D. Col. 1980) (despite that as many as 900 class members existed, class action treatment was denied because claims involved could "be conveniently and expeditiously managed by following normal bankruptcy procedures").

42. FED. R. CIV. P. 23(a)(2).

43. FED. R. CIV. P. 23(a)(3).

44. FED. R. CIV. P. 23(a)(4).

45. 9 COLLIER, *supra* note 36, at § 7023.04.

46. FED. R. CIV. P. 23(b).

(2) when individual prosecution might result in judgments that would not be dispositive of the interests of other class members who are not parties to those individual suits.[47] This type of class action focuses on the element of prejudice. A class action is allowed if individual suits would result in prejudice to either the class opponent or to the class members.[48]

The second type of class action under Rule 23(b) is allowed when (1) the party opposing the class has acted or refused to act on grounds generally applicable to the whole class and (2) the class is seeking appropriate final injunctive relief or corresponding declaratory relief.[49] These requirements are satisfied if the class opponent has either acted in a consistent manner toward the class members amounting to a "pattern of activity," or "imposed a regulatory scheme" that affects all the class members.[50] This type of class action is not meant to apply to an action where the primary relief sought is monetary damages.[51] It is used most frequently in civil rights actions and in other suits relating to constitutional issues.[52]

A third type of class action arises under Rule 23(b) when a court finds that common questions about law or facts predominate over questions involving only individual members.[53] Additionally, the court in this type of class action must determine that "the class action is superior to other available methods for the fair and efficient adjudication of the controversy."[54] This category of class actions contains those cases in which a class action would save time, effort, and expense, and promote uniform decisions for similarly situated persons without excluding procedural fairness.[55] In comparison, the first two types of class suits deal with the effect of the relief, whereas the latter type focuses on the nature of the issues.[56]

In conclusion, a class action provides the means for numerous people to save both time and money by having a single adjudication of their similar claims. If class actions were not allowed, many class members would not be able to litigate their claims individually for lack of economic feasibility.

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47. FRIEDENTHAL & KANE, *supra* note 34, at § 16.2.
48. *Id.*
49. *Id.*
50. *Id.*
51. 9 Collier, *supra* note 36, at § 7023.05[2]. *See also* FED. R. CIV. P. 23(b)(2).
52. FRIEDENTHAL & KANE, *supra* note 34, at § 16.2.
53. FED. R. CIV. P. 23(b)(3).
54. *Id.*
55. FED. R. CIV. P. 23 advisory committee's note.
56. 9 COLLIER, *supra* note 36, at § 7023.04.

B. Bankruptcy and the Class Action

The two fundamental objectives in bankruptcy are to restore the debtor to a condition of financial stability, thereby providing a fresh start, and to protect the creditors' financial interests in the insolvent estate.[57] These objectives should combine with the objectives of class actions to reach both goals of debtor assistance and creditor relief. A class action where numerous similar claims and objections have been filed will benefit the estate by saving time and expenses. It will also benefit the class members by providing them with a more cost-effective method of representation.[58]

Although the objectives and policies of bankruptcies and class actions appear compatible, the issue of class proofs of claim in bankruptcy proceedings has divided the federal circuits.[59] Before the 1978 Bankruptcy Code was enacted, the Second Circuit held in *In re Stirling Homex Corporation*,[60] that there was no provision in the Bankruptcy Act for the filing of claims on behalf of a class in a reorganization proceeding.[61] In *In re Standard Metals Corporation*,[62] the Tenth Circuit also disallowed class proofs of claim.[63] The *Standard* court stated that class proofs of claim are not necessary in bankruptcy proceedings because there is minimal reason to fear multiple or repetitious litigation, which are the historical reasons for filing bankruptcy, and because the bankruptcy court has complete control over the debtor's estate.[64] The Seventh Circuit reached the opposite result in *American Reserve* by allowing the filing of class proofs of claim in a bankruptcy proceeding.[65] The court reasoned that the proof of claim procedure was a contested matter that, under the Bankruptcy Rules, allows the bankruptcy judge to apply Federal Rule of Civil Procedure 23 to the proceeding.[66] The court further rejected the proposition that section 501, which deals with the filing of proofs of claim, was exclusive and therefore precluded a class representative from filing one claim on behalf of the class.[67] The Eleventh Circuit's decision in *Charter* followed and expanded the reasoning of *American Reserve*. The *Charter* court similarly rejected a "restrictive" reading

57. Wolmuth, *supra* note 3, at 579.
58. 9 COLLIER, *supra* note 36, at § 7023.03.
59. *See infra* notes 90 and 104 and accompanying text.
60. 579 F.2d 206 (2d Cir. 1978).
61. *Id.* at 210.
62. 817 F.2d 625 (10th Cir. 1987).
63. *Id.* at 631.
64. *Id.* at 632.
65. *See infra* notes 94 to 102 and accompanying text.
66. *See infra* notes 95 to 98 and accompanying text.
67. *See infra* note 99 and accompanying text.

of section 501, and commented on the absence of an express stipulation in the Code prohibiting class proofs of claim.[68] The court asserted the policy argument that class proofs of claim ensured the litigation of small claims that would probably not be litigated otherwise due to cost and time considerations.[69] The most recent decision on this issue was handed down by the Second Circuit in *Reid v. White Motor Corporation*.[70] The court held that nothing in the Bankruptcy Code or Rules deprives the court of discretion to permit filing of class proofs of claim.[71] The last three decisions represent a trend in courts to allow class proofs of claim.

The United States District Court for Wisconsin in *In re Society of the Divine Savior*[72] was the first court to consider whether Rule 23 applied to bankruptcy proceedings.[73] The court stated that the real issue was not whether Rule 23 applied in a bankruptcy proceeding, but "whether the specific application sought by the petitioner [putative class representative] is inconsistent with the Act."[74] After discussing some of the purposes behind the class action rule,[75] the court prevented the case from continuing as a class action for two reasons. First, the usual problems that justify the maintenance of a class action were not present in the case.[76] Second, if permission was granted to the petitioner to proceed by class action, it would be in direct conflict with the Bankruptcy Act.[77] The court stated that the essence of class actions was that the final judgment included all those persons whom the court found as members of the class, regardless of whether they

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68. *See infra* notes 114 and 136 and accompanying text.
69. *See infra* note 124 and accompanying text.
70. 886 F.2d 1462 (6th Cir. 1989).
71. *Id.* at 1470.
72. 15 Fed. R. Serv. 2d (Callaghan) 294 (E.D. Wis. 1971).
73. Note, *supra* note 11, at 793.
74. *Divine Savior*, 15 Fed. R. Serv. 2d (Callaghan) at 297.
75. The court stated class actions served the following policies:
> [T]hat a multiplicity of suits should be avoided and litigation of the same issues should wherever possible be centered in a single forum; avoiding the possibility of inconsistent results arising from multiple lawsuits; providing small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation; and freeing a defendant from the harassment of repetitious litigation on the same issues.

Id. at 298.

76. *Id.* The court noted that no suits had been filed elsewhere, and since creditors must present their claims in this court, no claims would arise in the future. *Id.* at 298-99. Therefore, inconsistent results from a multiplicity of actions in different forums was not possible. *Id.* The court also found that there was little or no danger of repetitious litigation causing harassment to the debtor. *Id.*

77. *Id.* at 298.

actually participated in the suit.[78] This characteristic of class actions directly conflicted with section 57 of the Bankruptcy Act, which stringently required that "each and every creditor shall file his proof of claim in order to participate."[79] The court reasoned that allowing a class representative to file a single proof of claim for the class would later allow each of those creditors to participate in the proceedings and to share in the distributions, even though they did not comply with the requirements of the Bankruptcy Act.[80] Even though the court prevented the filing of one proof of claim on behalf of the class, it indirectly stated that, under appropriate circumstances, a class action could be maintained in a bankruptcy case.[81] The court, however, did not discuss under what "appropriate circumstances" a class action could be maintained. By reasoning that the purposes of class actions and the Bankruptcy Act provisions conflicted, the court provided an authoritative basis for the proposition that "class action principles are antithetical to those of bankruptcy proceedings."[82]

The United States Bankruptcy Court for Colorado in *In re Woodmoor Corporation*,[83] adopted the "antithetical" proposition and disallowed creditors from maintaining a class action.[84] The court, however, introduced a different argument in support of that proposition. The court stated that "claims against a bankrupt estate may not be treated *en masse* but instead each must be treated on its own merits .... Thus, the requirement of individual determinations of the permissibility of claims precludes a class action."[85] The court reasoned that to permit a class representative to proceed on behalf of a class would "deprive class members of their interest in 'individually controlling the prosecution' of their own claims which interest is inherent in the scheme of the Bankruptcy Act."[86] The court failed, however, to explain why creditors do not have the choice, assuming their claims are similar, to combine their resources and respond as a class to any objections by the trustee.[87] Typically, creditors have adverse interests because allowing another creditor's claim will result in a reduction of other creditors' shares under a pro rata distribution. Rule 23(b)(3) addresses these adverse interests by requiring the court to consider the interests of class members in "individually controlling the

78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.* at 297.
82. Note, *supra* note 11, at 809.
83. 4 Bankr. 186 (Bankr. D. Colo. 1980).
84. *Id.* at 194.
85. *Id.* at 192.
86. *Id.* at 194.
87. Note, *supra* note 11, at 809.

prosecution or defense of separate actions."[88] Since the option to apply for class certification still rests with the creditors, courts should assume that members of the class have each considered their individual interests in making a decision to seek class certification.[89] Even though *Society of the Divine Savior* and *Woodmoor* did not provide an adequate reason for refusing to apply Rule 23, later decisions of other courts have upheld these earlier cases' disallowance of class actions and class proofs of claim in bankruptcy proceedings.[90]

In *In re REA Express, Inc.*,[91] the United States Bankruptcy Court for the Southern District of New York rejected the premise that class actions and bankruptcy proceedings are antithetical. The court granted class certification to representatives of non-union employee creditors who opposed the corporation trustee's objection to their wage claims.[92] After its determination that the Rule 23(a) prerequisites were satisfied, the court made an important observation:

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88. FED. R. CIV. P. 23(b)(3)(A).

89. Note, *supra* note 11, at 809.

90. *See In re* Standard Metals Corp., 817 F.2d 625, 632 (10th Cir. 1987) (class proofs of claim are not necessary in a bankruptcy proceeding because there is minimal reason to fear multiple litigation or repetitious litigation, the historic reason for filing of bankruptcy, because the bankruptcy court has complete control over the debtor's estate); *In re* GAC Corp., 681 F.2d 1295, 1299 (11th Cir. 1982) ("[N]o provision of the Bankruptcy Act or the Bankruptcy Rules specifically authorizes the filing of a class proof of claim."); *In re* Stirling Homex Corp., 579 F.2d 206, 210 (2d Cir. 1978) ("[T]here is no provision in the Bankruptcy Act for the filing of claims . . . on behalf of a class."); *In re* Great Western Cities, Inc., 88 Bankr. 109 (Bankr. N.D. Tex. 1988) (the appropriateness of trying claims as a class does not vitiate the requirement that individual proofs of claim be filed), *rev'd*, 107 Bankr. 116 (Bankr. N.D. Tex. 1990) (trend was to allow class proofs of claim); *In re* Allegheny Int'l, Inc., 94 Bankr. 877 (Bankr. W.D. Pa. 1988) (bankruptcy court lacks authority to allow class proofs of claim); *In re* U.S. Truck Co., Inc., 89 Bankr. 618 (Bankr. E.D. Mich. 1988); *In re* Computer Devices, Inc., 51 Bankr. 471 (Bankr. D. Mass. 1985) (to allow a class representative to file a claim on behalf of the members of a class would be inconsistent with the requirement that the creditor file his own claim in a Chapter 11 bankruptcy); *In re* Johns-Manville Corp., 53 Bankr. 346 (Bankr. S.D.N.Y. 1985); *In re* Grocerland Corp., Inc., 32 Bankr. 427, 434-36 (Bankr. N.D. Ind. 1983) ("Class actions are antithetical to those of bankruptcy."); *In re* Shulman Transport Enterprises, Inc., 21 Bankr. 548, 551 (Bankr. S.D.N.Y. 1982), *aff'd*, 33 Bankr. 383 (Bankr. S.D.N.Y. 1983) (Code's requirement that each creditor must file individual proof of claim should be strictly enforced).

91. 10 Bankr. 812 (Bankr. S.D.N.Y. 1981).

92. *Id.* at 815.

> Since the trustee filed broad objections to the employees' claims on grounds generally applicable to them as a class, and since, if the trustee prevailed, all claims would be disallowed without reference to individual circumstances, it is clear that general issues predominate in this action .... Furthermore, if class action status is not granted, each individual plaintiff would be forced to appear and comment on the manner in which the trustee's general objections touch upon his or her claim. Other than through the use of class action there is no means for the employees to present a single coherent voice with impact equal to the trustee's general objection to their claims.[93]

In making this observation, the court clearly realized that the objectives of bankruptcy and class actions could all be attained in reaching a fair result.

The *American Reserve* court proceeded one step further and allowed a putative class representative to file a class proof of claim, subject to certification of the class by the bankruptcy court.[94] This approach differs from the decision in *REA Express,* which allowed the filing of a class action after all the potential class members had filed individual proofs of claim. The premise of the *American Reserve* holding was that the proof of claim procedure was a contested matter under Bankruptcy Rule 9014,[95] which subsequently allows the bankruptcy judge to apply Bankruptcy Rule 7023.[96] Rule 7023, by definition, applies Federal Rule of Civil Procedure 23 to bankruptcy proceedings.[97] The court stated that a court may apply Rule

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93. *Id.* at 814.

94. *American Reserve,* 840 F.2d at 494.

95. *See* BANKR. R. 9014 advisory committee's note:

> Whenever there is an actual dispute, other than an adversary proceeding, before the bankruptcy court, the litigation to resolve that dispute is a contested matter. For example, the *filing of an objection to a proof of claim,* to a claim of exemption, or to a disclosure statement creates a dispute which is a contested matter. Even when an objection is not formally required, there may be a dispute.

Id. (emphasis added).

96. *American Reserve,* 840 F.2d at 493.

97. *See supra* note 27 and accompanying text. *See also* Note, *Class Actions, supra* note 11, at 799 n.67 which states:

> The issue of whether class proofs of claim are possible under the Code and the Rules is really a separate issue from whether Rule 7023 should be applied in a contested matter. The class proof of claim raises the issue of a conflict with the apparent statutory requirement of individual proofs of claim, this issue is not raised by the consideration of a class action in a contested matter where all members have filed individual proofs of claim. Many courts have failed to make this distinction, however, asserting that class actions, rather than merely class proofs of claim, conflict with the

9014 at any stage in a contested matter and concluded that filing a proof of claim was a "stage" in a contested matter.[98] The court rejected the argument that section 501 of the Bankruptcy Code, which deals with the filing of proofs of claim, was exclusive and therefore precluded a class representative from filing a class proof of claim.[99] To support its rejection, the court reasoned that if section 501 was exclusive, then Bankruptcy Rule 3001(b), which permits a creditor's authorized agent to file a proof of claim for the creditor, is essentially "ineffectual."[100] The court further reasoned that the class representative is an agent for the missing creditors, but only if the class is certified.[101] If the class is not certified by the bankruptcy judge, however, the putative class representative never becomes an "authorized agent" and each creditor must then file an individual proof of claim.[102]

American Reserve represents a departure from the majority of cases that have disallowed the filing of a class proof of claim in a bankruptcy proceeding.[103] Several subsequent decisions, however, have followed its lead in

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statutory scheme.

Id. *See also* Wolmuth, *supra* note 3, at 577 (assumes throughout that each individual must file a proof of claim to participate in any class action to defend their claim against objections by the trustee).

98. *American Reserve*, 840 F.2d at 480. *See* Annotation, *Validity of Class Proofs of Claim Under Bankruptcy Code of 1978*, 99 A.L.R. FED. 858 (1990).

99. *American Reserve*, 840 F.2d at 493. *See also supra* note 5 and accompanying text.

100. *American Reserve*, 840 F.2d at 493. *But see In re* Allegheny Int'l, Inc., 94 Bankr. 877, 879 (Bankr. W.D. Pa. 1988) ("We respectfully disagree with the conclusion of *In re American Reserve* that 11 U.S.C. § 501 is only illustrative-and not exhaustive-as to who may file a proof of claim . . . . On its face, section 501 does not provide for class proofs of claims.").

101. *American Reserve* 840 F.2d at 493.

102. *Id.*

103. *See supra* note 90 and accompanying text.

allowing class proofs of claim.[104] *In re Charter* which is discussed below, is among these cases.

IV. THE INSTANT DECISION

In *In re Charter Company*, the court referred to the decision in *American Reserve* as one of the few cases that has directly dealt with the issue of whether the Bankruptcy Code permits class proofs of claim.[105] The court began its discussion by stating that normally, creditors file individual proofs of claim under 11 U.S.C. section 501.[106] The court explained that section 501 does not operate by itself, but is supplemented by other provisions pertaining to who may file proofs of claim and the procedures by which reorganization will be conducted.[107] The parties in this case did not dispute that according to these provisions, individually filed claims may be certified and treated as a class if the requirements are met. They did dispute, however, whether a class proof of claim could be filed on behalf of a class of claimants that have not filed individual claims.[108]

The court responded to this dispute by noting that the Bankruptcy Code contains no explicit provision permitting class proofs of claim.[109] The court asserted that the legislative history of the Code, although silent on the exact issue, does support the proposition that class proofs of claim are allow-

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104. *See* Reid v. White Motor Corp., 886 F.2d 1462, 1470 (6th Cir. 1989) (nothing in the Code nor Rules deprives the court of discretion to permit filing of class proofs of claim); *In re* Chateaugay Corp., 104 Bankr. 626, 634 (Bankr. S.D.N.Y. 1989) (filing of proof of claim on behalf of class persons who have not filed individual proofs of claim is permissible); *In re* Zenith Laboratories, Inc., 104 Bankr. 659, 633 (Bankr. D.N.J. 1989) (although split of authority as to whether class proofs of claim are permissible, decisions in *In re American Reserve* and *In re Charter* set forth the better rule); *In re* Retirement Builders, Inc., 96 Bankr. 390, 392 (Bankr. S.D. Fla. 1988) (Bankruptcy Court has discretion to permit a class proof of claim); *In re* Texaco, Inc., 81 Bankr. 820, 826 (Bankr. S.D.N.Y. 1988) (order certifying class proof of claim).

105. *Charter*, 876 F.2d at 869. Before deciding *Charter*, the Eleventh Circuit was previously confronted with a class proof of claim issue in *GAC Corp.* Because the court held that the petitioner had not followed the proper filing procedures, it stated that "[we] need not and do not decide the issue whether a class proof of claim is ever allowable in a [bankruptcy] proceeding." *In re* GAC Corp., 681 F.2d 1295, 1299 (11th Cir. 1982).

106. *Charter*, 876 F.2d at 868. *See supra* note 5 and accompanying text.

107. *Charter*, 876 F.2d at 868.

108. *Id.*

109. *Id.* at 869. *See also GAC Corp.*, 681 F.2d at 1299.

able.[110] The 1978 revisions broadened the definition of a claim under section 101(4), which states:

> claim means -
>
> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured; . . . .[111]

Based on the broadening revisions, the court asserted that the congressional goal was clear.[112] As stated in the revision notes to section 101, the new definition "[p]ermits the broadest possible relief in the bankruptcy court."[113] If the congressional goal was to provide broad relief, a "restrictive" reading of section 501, the filing provision, would frustrate that goal.[114] "[A] reading of section 501 that permitted class proofs of claim," concluded the court, "would be consistent with the goals of the bankruptcy statutory scheme."[115] The court further rejected Charter's exclusive reading of section 501, stating that other Code provisions indicate the section's nonexclusivity.[116] The filing by a creditor's agent, which is allowed under Bankruptcy Rule 3001(b), is not included in section 501, thereby making section 501 nonexclusive.[117] Therefore, the court concluded that the maxim of statutory construction of *expressio unius est exclusio alterius*, or "specifica-

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110. *Charter*, 876 F.2d at 870.

111. 11 U.S.C.A. § 101(4) (West 1979 & Supp. 1991).

112. *Charter*, 876 F.2d at 870.

113. *Id. See also* 11 U.S.C.A. § 101 (West 1979 & Supp. 1991) and the state historical and revision notes to that section. The selected notes on paragraph (4) state:

> The effect of the definition is a significant departure from present law . . . . By this broadest possible definition and by the use of the term throughout the title 11 . . . the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.

Id.

114. *Charter*, 876 F.2d at 876.

115. *Id.*

116. *Id.* at 871.

117. *Id.*

tion of certain things implies an intention to exclude all others," did not apply to this section.[118]

After the court construed the filing provision, it analyzed the framework and objectives of the Code. Because it found Congress' incorporation of Rule 23 into the Code persuasive,[119] the court reasoned there was a "strong indication" that the procedures that accompany the initiation of a class action should be available.[120] The majority rejected the position of other courts that allow bankruptcy proceedings to continue under Rule 23 but only after each potential class member files an individual claim.[121] The court labeled this position as "illogical and contrary to important class action policy considerations," and determined that the position ignored the goal of permitting the economical prosecution of small claims.[122] The court found that, "[t]he class action permits the aggregation and litigation of many small claims that would otherwise lie dormant,"[123] and that the cost and time of researching and filing a claim may exceed most creditors' own claims, thus discouraging them from prosecuting their claims absent a class action procedure.[124] In conclusion, the court reasoned that this policy of ensuring the litigation of these small claims is consistent with the goals of the bankruptcy statutes.[125] Bankruptcy not only seeks to promote creditor reimbursement, but also seeks to attain an equitable distribution of the debtor's estate.[126] The court determined that persons holding small claims, who might not be able to collect absent class procedures, are no less creditors under the Code than a creditor with a large claim that is easily filed.[127]

The court also explained that even if there were not any indications in the Code, the presumption declared by the United States Supreme Court in *Califano v. Yamasaki*[128] would influence its interpretation of the statute. In *Yamasaki*, the Supreme Court interpreted section 205(g) of the Social Security Act, which spoke in terms of actions filed by "any individual," to permit class action prosecutions.[129] The Supreme Court relied on the fact that the statute

118. *Id.*
119. *See supra* note 27 and accompanying text.
120. *Charter*, 876 F.2d at 870.
121. *Id.* at 871. *See also In re* Standard Metals Corp., 817 F.2d 625 (10th Cir. 1987).
122. *Charter*, 876 F.2d at 871.
123. *Id.* at 871 (quoting *American Reserve*, 840 F.2d at 489).
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*
128. 442 U.S. 682 (1979).
129. *Id.* at 700.

permitted judicial review of the type of civil actions normally brought in district courts, which apply the federal rules.[130] Since Rule 23 would ordinarily apply, the Supreme Court stated that "[i]n the absence of a direct expression by Congress of its intent to depart from the usual course of trying 'all suits of a civil nature' under the Rules established for that purpose, class relief is appropriate in civil actions brought in federal court."[131] Based on this presumption, the *Charter* court held that, as in *Yamasaki*, the filing provision does not explicitly provide for filing by a class.[132] As with the section of the Social Security Act at issue in *Yamasaki*, the bankruptcy statute incorporates many of the Federal Rules, including Rule 23.[133] Additionally, the court in *Yamasaki* noted that application of a class filing procedure would be appropriate for the claims presented.[134] Also, it would be suitable for the purposes of the bankruptcy statute.[135] Based on these common reasons, and the absence of an express stipulation in the Code prohibiting class proofs of claim, the court decided that the statute must be "presumed to incorporate class action procedures, including those related to initiating suit."[136]

The court's final argument rebutted Charter's assertion that Bankruptcy Rule 3001(b) conflicts with allowing class proofs of claim.[137] Rule 3001(b) provides that, "[a] proof of claim shall be executed by the creditor or the creditor's authorized agent."[138] In addressing this rule, the court stated that the class representative is an agent for the class members, contrary to Charter's view.[139] The court further explained that the lack of consent from potential class members before filing is inherent in the nature of a class action.[140] The subsequent application of class action procedures, including notice, "representativeness" of the named class members, and opt-out

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130. *Id.*

131. *Id.*

132. *Charter*, 876 F.2d at 872.

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.* The court noted that in *In re* Standard Metals Corp., 817 F.2d 625, 631 n.8 (10th Cir. 1987) the Tenth Circuit distinguished *Yamasaki* on the basis that in a contested matter the Federal Rules are not generally applicable, but are applicable only at the court's discretion. The *Charter* court, however, explained that the discretion applied to Bankruptcy Rule 7023 relates to the same discretion exercised by any district court judge in determining whether to allow class certification under Rule 23. Therefore, the distinction did not affect the *Yamasaki* presumption. *Charter*, 876 F.2d at 872 n.10.

137. *Charter*, 876 F.2d at 873.

138. BANKR. R. 3001(b).

139. *Charter*, 876 F.2d at 873.

140. *Id.*

provisions, would serve as protection against the possible prejudice that would result to potential class members not included in the action.[141] As a result, the court determined that the interests of putative class members would not be prejudiced.[142] Therefore, the filing status of the putative representative is "at least minimally sufficient to authorize his agency for class filing purposes, and there is no apparent reason to prohibit him from acting in that capacity."[143] Additionally, the majority stated that the court and Rule 23 will supervise any other functions performed by the class representative, preventing any other prejudice to the other claimants.[144]

In conclusion, the *Charter* court reiterated the three main reasons supporting its holding allowing the filing of class proofs of claim in a bankruptcy proceeding.[145] The court stated that because Congress included Rule 23 in bankruptcy proceedings, the apparent congressional intent that the Code embrace every type of claim, and the presumption sanctioned in *Yamasaki*, class proofs of claim are allowed in bankruptcy.[146]

V. COMMENT

By adopting the reasoning of *American Reserve*, the instant decision continues the trend of allowing the filing of class proofs of claim in bankruptcy proceedings. The objectives of class actions can be compatible with the objectives of bankruptcy. As mentioned previously, a class action comprised of numerous similar claims or objections benefits both the debtor's estate, by saving time and expenses, and the class members, by providing effective representation at a cost that is significantly less than the cost of individual filing.[147]

Several public policies are served by allowing class actions in bankruptcy proceedings. First, the class action permits aggregation and adjudication of many small claims that otherwise would not be heard.[148] This not only satisfies the bankruptcy objective of providing the "broadest possible relief in the bankruptcy court,"[149] but also accomplishes the class action objective of efficiently adjudicating the rights of individuals with similar interests and

141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.*
147. *See supra* note 58 and accompanying text.
148. *In re* American Reserve Corp., 840 F.2d 487, 489 (7th Cir. 1988).
149. *See supra* note 113 and accompanying text.

claims.[150] Because the costs of individual litigation would prevent many small claim holders from filing a claim, the class action allows each creditor to "have their day in court" through adequate representation. Second, the permissive use of class actions in bankruptcies furthers the policy of efficient use of judicial resources. If Rule 23 is applied with both fairness and efficiency, it should prevent bankruptcy courts from becoming overburdened with complicated and prolonged litigation.[151] It would alleviate some of the court's time constraints by consolidating claims that otherwise would have been heard individually.[152] Third, class actions reduce discovery costs by consolidating the discovery requirements for a group of related claims. The potential for abuse in discovery is minimal because most claims are for the debtor's unpaid contractual obligations, which require more simplistic proof.[153] Finally, the class actions help promote the central element of bankruptcy--the pro rata distribution of a limited fund to creditors. The trustee, as the party opposing the class, would not face the pressure to settle unmeritorious claims to avoid potentially significant liability.[154] The threat of significant liability, a major criticism of class actions, is eliminated because of pro rata distribution of a limited fund. Therefore, class actions and bankruptcy proceedings can be compatible.

Despite the public policies served by allowing class actions in bankruptcy proceedings, the issue of class proofs of claim continues to divide the federal circuits.[155] As previously discussed, however, a trend is developing. Beginning with the Seventh Circuit's decision in *American Reserve*, the Eleventh and Sixth Circuits have followed its lead in allowing class proofs of claim.[156] Whether this trend will continue depends on the decisions of the other circuits and the United States Supreme Court. The Eighth Circuit has not yet determined its position on this issue. The common objectives and policies achieved by allowing class proofs of claim lead to only one equitable solution. The Eighth Circuit, along with the other undecided circuits, must allow class proofs of claim to achieve a fair and just result. Otherwise, the courts will face many potential abuses.

If class proofs of claim are not allowed in bankruptcy proceedings, the bankruptcy court will serve as a haven of reprieve for debtors evading pending class action suits. These potential debtors will view the bankruptcy forum as an easy way out. Even though some class members will be financially able

150. *See supra* note 34 and accompanying text.
151. Note, *supra* note 11, at 815.
152. *Id.* at 804.
153. *Id.*
154. *Id.*
155. *See supra* notes 90 and 104 and accompanying text.
156. *See supra* notes 65 to 71 and accompanying text.

to file an individual claim, many class members that have joined the class action because of cost considerations will be unable to participate in the debtor's bankruptcy proceeding. Finally, an objective of bankruptcy, to protect creditors' interests, will not be achieved if class proofs of claim are disallowed. In view of the policies and objectives of both class actions and bankruptcy, allowing class proofs of claim in bankruptcy proceedings is the only just result.

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