DEFENDANT CLASS ACTIONS IN BANKRUPTCY: A PRACTICE GUIDE

*AMENEH BORDI**

INTRODUCTION

The plaintiff class action has received extensive scholarly attention over the years, in contrast with the defendant class action, which has been relatively neglected by academics.[1] Yet even the sparse literature on defendant class actions is plentiful in compari-

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1. Francis X. Shen, *The Overlooked Utility of Defendant Class Actions*, 88 DENV. U. L. REV. 73, 73–74 (2010).

son with analysis of the defendant class action in the bankruptcy context. While some courts and authors have explored the use of the plaintiff class action device in bankruptcy,[2] the defendant class action has been employed in bankruptcy cases a mere handful of times, and studied even less.[3] This Note will begin to fill that void and advocate for more regular use of the device.

Parts I and II provide background on the current state of law regarding bankruptcy and class actions. While almost all jurisdictions now acknowledge that there is statutory authority for class actions to proceed in bankruptcy, courts have varying interpretations of the Bankruptcy Code's exact scope and the appropriate use of the class action in bankruptcy. Part II details the applicability of Rule 23 of the Federal Rules of Civil Procedure to the defendant class, drawing on case law and articles discussing the defendant class in non-bankruptcy contexts.

Part III will then explore In re *Integra Realty Resources, Inc.*,[4] a case in which the defendant class action was successfully employed. The case was appealed twice to the Tenth Circuit, providing many instructive and thorough opinions for analysis. Part III closely analyzes the reasoning of the various courts in this case and provides a basis for the argument that the defendant class is appropriate and helpful in certain bankruptcies. Finally, Part IV will build on the reasoning of In re *Integra* to argue that the defendant class action is uniquely suited to certain actions in bankruptcy, particularly actions resembling fraudulent conveyance actions against shareholders. Part IV also works through the requirements of Rule 23 and demonstrates how other courts have justified the use of the defendant class in bankruptcy.

This Note intends to be a comprehensive overview of the instances where defendant class actions in bankruptcy have been used and to be a "one-stop-shop" for practitioners and courts. Though there is very little case law on the topic, the defendant class action can be an extremely useful mechanism for a bankrupt estate. Thus, this paper can serve as a tool for trustees or debtors in possession in bankruptcy who would benefit from the certification of a defendant class and can thereby contribute to its increased use.

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2. *See, e.g.*, Leonard H. Gerson, *Another Look at Treatment and Use of Class Proofs of Claim and Class Actions in Bankruptcy*, AM. BANKR. INST. J., Sept. 2008, at 16; Luisa Kaye, *The Case Against Class Proofs of Claim in Bankruptcy*, 66 N.Y.U. L. REV. 897 (1991).

3. *See infra* Part II.

4. 354 F.3d 1246 (10th Cir. 2004).

I:
PLAINTIFF CLASS ACTIONS IN THE BANKRUPTCY COURTS

For many years, there was almost universal consensus that the class action proof of claim was not permitted in a bankruptcy proceeding.[5] Most courts followed the reasoning laid out in In re *Standard Metals Corp.*,[6] in which the Tenth Circuit held that proofs of claim must be filed individually, thereby eliminating the option for a class proof of claim. Over time, however, courts began to find statutory authority for the class proof of claim. Today the In re *Standard Metals Corp.* analysis is in disfavor, but it provides a useful starting point for the development of the class action device in bankruptcy.

A: Early Resistance to Class Proof of Claim in Bankruptcy

The bankruptcy court in In re *Standard Metals Corp.* had refused to let a plaintiff file a class proof of claim, reasoning that the Bankruptcy Reform Act of 1978 ("Bankruptcy Code") and the Bankruptcy Rules of 1983 did not allow it.[7] The Tenth Circuit affirmed this holding.[8] The Tenth Circuit looked for authority to 11 U.S.C. § 501,[9] which states that a creditor or "an entity that is liable to such creditor with the debtor[,] or that has secured such creditor, . . . [or] the debtor may file [the creditor's] proof of claim."[10] Although the Tenth Circuit determined that the Bankruptcy Act and Rules did not expressly deny or permit class proof of claim, it reasoned that Bankruptcy Rule 3001(b) requires that "[a] proof of claim shall be executed by the creditor or the creditor's authorized agent. . . ."[11] Thus, the court determined that "each *individual* claimant must file a proof of claim or expressly authorize an agent to act on his or her behalf."[12]

The plaintiffs in the case had argued to the bankruptcy court that the previous certification of the class in state court litigation could provide the necessary agent authorization. The Tenth Circuit rejected this argument, reasoning that consent to one piece of liti-

5. Alexander D. Bono, *Class Action Proofs of Claim in Bankruptcy*, 96 COM. L.J. 297, 298 (1991).
6. 817 F.2d 625 (10th Cir. 1987).
7. 48 B.R. 778, 784 (Bankr. D. Colo. 1985).
8. 817 F.2d 625 (10th Cir. 1987).
9. *Id.* at 630.
10. 11 U.S.C. § 501 (2012).
11. 817 F.2d at 631.
12. *Id.* (emphasis added).

gation is not blanket consent to an agency relationship.[13] Additionally the circuit court explained that class certification is unnecessary in bankruptcy because the bankruptcy adjudication process itself provides a way to avoid multiple or repetitious suits, and thus "[t]here is no need for the class to file as a class."[14] The court did note that class action procedures might be used in bankruptcy if individual creditors filed similar claims,[15] but it maintained that the requirement of individual filing would remain.[16] This strand of thinking has lived on, as some courts resist using two aggregating devices—the class action and bankruptcy—to adjudicate one dispute.

B: Applicability of Rule 23 in Bankruptcy

In the wake of In re *Standard*, however, some courts began to allow class proofs of claim in bankruptcy proceedings. Judge Easterbrook of the Seventh Circuit authored an influential opinion allowing a class action to be filed in bankruptcy court, affirming the bankruptcy court's approval of the class action and reversing the district court, which had overruled the bankruptcy court.[17]

Judge Easterbrook found authorization for class proofs of claim in bankruptcy, charting a trail through the Bankruptcy Rules. He began with BR Rule 7023, which states that Rule 23 of the Federal Rule of Civil Procedure (the rule governing class actions) applies in adversary proceedings.[18] He then observed that Bankruptcy Rule 9014 allows the court to apply any of the rules from Part VII, including Rule 7023, to "contested matters."[19] So, he concluded, "Rule 9014 thus allows bankruptcy judges to apply Rule 7023—and thereby Fed.R.Civ.P. 23, the class action rule—to 'any stage' in contested matters."[20] He acknowledged that there were potential policy

13. *Id.* (citing *In re* Baldwin-United Corp., 52 B.R. 146, 148–49 (Bankr. S.D. Ohio 1985)).

14. *Id.* at 632.

15. *Id.*

16. *Id.* ("The requirement of individual filing, however, does not disappear when a large number of similar claims are involved. A class action cannot be used to evade that requirement. Class action procedures can be employed in a bankruptcy proceeding only to consolidate claims that have already been properly filed.").

17. *In re* American Reserve Corp., 840 F.2d 487, 488 (7th Cir. 1988).

18. *Id.* at 488 (citing FED. R. BANKR. P. 7023); *see also* FED. R. BANKR. P. 7023 ("Rule 23 F. R. Civ. P. applies in adversary proceedings.").

19. 840 F.2d at 488 (citing FED. R. BANKR. P. 9014); *see also* FED. R. BANKR. P. 9014(c) ("The court may at any stage in a particular matter direct that one or more of the other rules in Part VII shall apply.").

20. 840 F.2d at 488.

issues in using a class action in bankruptcy, but concluded that they did not trump the fact that the Rules do authorize class actions.[21]

Judge Easterbrook also examined 11 U.S.C. § 501, which other courts had interpreted as an exclusive listing of the representatives who may file a claim and therefore an indication of Congressional intent to bar bankruptcy class action filings.[22] Contrary to other interpretations, Easterbrook thought that Congress intended an illustrative, rather than an exclusive, listing of representatives, because otherwise Bankruptcy Rules 3001(b) and 7023 would be without application.[23] Taking into consideration the "features . . . that may make class certification less desirable in bankruptcy than in ordinary civil litigation"[24] and the discretion granted under Rule 9014 to apply Rule 7023 and therefore Rule 23,[25] Easterbrook concluded that the bankruptcy judge on remand could decide whether to certify the class.

The Sixth Circuit subsequently agreed with Easterbrook's conclusion in *American Reserve*, finding that a class proof of claim could be filed in a bankruptcy proceeding.[26] The court provided the same dual rationales as Easterbrook: it agreed that the class action rule could be applied in bankruptcy through invocation of Rule 7023 under the authority of Rule 9014.[27] It also stated that § 501 is not "an exclusive list of situations where a person can file a proof of claim on behalf of a creditor."[28]

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21. *Id.* at 492 ("The problems we have discussed could lead people to conclude that the Bankruptcy Rules should not authorize class actions. But they do, and these considerations do not show that it is always such a bad idea to allow class actions in bankruptcy that courts should deny these Rules their ordinary meaning.").

22. *Id.* ("The district court, like the Tenth Circuit's first opinion in *Standard Metals*, concluded that this list is exclusive. It does not authorize one creditor to file on behalf of another; Q.E.D.").

23. *Id.* at 493 ("Bankruptcy Rule 3001(b) says that a 'proof of claim shall be executed by the creditor or the creditor's authorized agent.' If § 501 is exhaustive, filings by agents are ineffectual. Rule 3001(b), and the efficient administration it produces, would not be the only casualty of treating § 501 as exclusive. Rule 7023 would go with it. That rule expressly makes class actions available in adversary proceedings.").

24. *Id.*

25. *Id.* at 494.

26. Reid v. White Motor Corp., 886 F.2d 1462, 1470 (6th Cir. 1989).

27. *Id.*

28. *Id.*

A majority of circuits now permit the filing of class proofs of claim in bankruptcy proceedings.[29] However, there is still some disagreement among courts regarding the proper scope of authority of the bankruptcy court in the class action context. The Fifth Circuit in In re *Wilborn*[30] recently flagged disagreement among courts over whether bankruptcy judges can certify nationwide classes or only those within their districts,[31] and whether the Federal Bankruptcy Rules authorize certification of a debtor class.[32]

Additionally, many courts allow class claims to be filed but then decline to certify those classes due to the diminished need for class certification in light of the efficiency of the bankruptcy system. For example, the Fourth Circuit recently affirmed a bankruptcy court's decision not to certify a class, since the individual claims were proceeding efficiently through the district court. However, it noted that "[e]ach bankruptcy case must be assessed on a case-by-case basis to determine whether allowing a class action to proceed would be superior to using the bankruptcy claims process."[33] Nevertheless the use of the class proof of claim in bankruptcy has become relatively uncontroversial, and it is likely to continue to gain acceptance.

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29. *See, e.g.*, Gentry v. Siegel, 668 F.3d 83, 91 (4th Cir. 2012) ("In construing the Bankruptcy Rules to permit the filing of a class proofs of claim, we join the vast majority of other courts that have considered the issue."); *In re* Rodriguez, 695 F.3d 360 (5th Cir. 2012) (affirming the bankruptcy court's certification of a class); *In re* Birting Fisheries, Inc., 92 F.3d 939, 939 (9th Cir. 1996) ("[T]he bankruptcy code should be construed to allow class claims."); *In re* Charter Co., 876 F.2d 866, 873 (11th Cir. 1989) ("In light of Congress's inclusion of Rule 23 in bankruptcy proceedings, the clear congressional intent that the Bankruptcy Code encompass every type of claim, and the presumption established in *Yamasaki*, we conclude that class proofs of claim are allowable in bankruptcy."); Reid v. White Motor Corp., 886 F.2d 1462, 1469 (6th Cir. 1989) (following *In re* American Reserve).

30. 609 F.3d 748 (5th Cir. 2010).

31. *Id.* at 754 n.9. The court did not decide the issue since the bankruptcy court had certified only a district class. *Id.* at 754.

32. *Id.* The court held that the Rules do allow certification of a debtor class. *Id.*

33. *Gentry*, 668 F.3d at 94. *See also In re* Comput. Learning Ctrs. Inc., 344 B.R. 79, 92 (Bankr. E.D. Va. 2006) ("A bankruptcy case presents many of the same mechanisms to process large numbers of claims as a class action. There are established mechanisms for notice. Established procedures exist for managing a large number of claimants. All proceedings are centralized in a single court with nationwide service of process. There is no race to judgment since all the debtor's assets are under the control of the bankruptcy court. A class action in this case is not superior to the ordinary operation of this bankruptcy case.").

II:
THE DEFENDANT CLASS

In contrast to the plaintiff class action, the defendant class is infrequently used both outside and inside the bankruptcy context. Professor Francis X. Shen, in an article advocating for the use of the defendant class, noted that plaintiff class action were mentioned in LexisNexis over 4,000 times in recent years, while defendant class action mentions have never risen over 100.[34] Shen posits that one explanation may be the state of current jurisprudence on Rule 23's applicability to the defendant class, which is scarce and often in conflict across circuits.[35] This is likely because of the paucity of cases upon which judges can opine and create consistent case law. Although courts generally find Rule 23(a) applicable to and satisfied by the defendant class, there is conflict about the proper use and interpretation of Rule 23(b) in defendant class certification decisions.

A: Satisfaction of Rule 23(a) for the Defendant Class

Class actions are governed by Rule 23 of the Federal Rules of Civil Procedure. Rule 23(a) specifies that:

> [O]ne or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.[36]

These requirements apply to defendant classes as well as plaintiff classes.[37] As the court in *Thillens, Inc. v. Community Currency Exchange Ass'n of Illinois* explained:

> Rule 23 of the Federal Rules of Civil Procedure clearly contemplates both plaintiff *and* defendant class actions. For example, its very first clause provides "[o]ne or more members of a class may sue *or be sued* as representative parties on behalf of all." (emphasis added). Fed. R. Civ. P. 23(a). That Rule 23 was designed to permit both plaintiff classes and defendant classes is underscored by the appearance in the Rule of phrases such as

34. Shen, *supra* note 1, at 80–81.

35. *Id.* at 81.

36. Fed. R. Civ. P. 23(a).

37. *See* Consol. Rail Corp. v. Town of Hyde Park, 47 F.3d 473, 483 (2d Cir. 1995).

> "the claims *or defenses* of the representative parties" (emphasis added), Fed.R.Civ.P. 23(a)(3), and "the prosecution of separate action by *or against* individual members of the class." (emphasis added). Fed.R.Civ.P. 23(b)(1). Unquestionably, a defendant class *may* be certified.[38]

However, the court went on to note that the requirements of Rule 23 must still be satisfied.[39]

The numerosity requirement has been satisfied with as few as thirteen defendants;[40] as with the plaintiff class, the court must simply decide whether joinder of all potential class members is impracticable.[41] Courts have often applied this criterion more flexibly for defendant classes than for plaintiff classes,[42] and where the defendants are geographically dispersed, the impracticability test is met easily.[43]

The Rule 23(a)(2) requirement of commonality has similarly been satisfied for the defendant class.[44] It may even be easier to satisfy the requirement in a defendant class, as typical cases involve a class of local government officials acting under a state-wide governmental policy,[45] a class of shareholders or underwriters,[46] or a

38. Thillens, Inc. v. Cmty. Currency Exch. Ass'n of Illinois, 97 F.R.D. 668, 673 (N.D. Ill. 1983).

39. *Id.*

40. *See* Dale Elecs., Inc. v. R.C.L. Elecs., Inc., 53 F.R.D. 531, 534–36 (D.N.H. 1971) (certifying defendant class of only 13 members).

41. *See* Robert E. Holo, *Defendant Class Actions: The Failure of Rule 23 and a Proposed Solution*, 38 UCLA L. REV. 223, 229 (1990).

42. *In re* Cardinal Indus., Inc., 105 B.R. 834, 843–44 (Bankr. S.D. Ohio 1989) (citing HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS § 4.55 (2d ed. 1985)).

43. *See In re* Dehon, Inc., 298 B.R. 206, 214 (Bankr. D. Mass. 2003) (finding certification appropriate where class members live "not only throughout the United States but in other countries" because "joinder here is 'not only impracticable, but impossible'") (internal citation omitted); Monaco v. Stone, 187 F.R.D. 50, 64 (E.D.N.Y. 1999) (observing that joinder of defendant state court judges is "impracticable since these judges are distributed over the entire area of New York State").

44. *See* Holo, *supra* note 41, at 275 (compiling cases).

45. *See, e.g.*, Consol. Rail Corp. v. Town of Hyde Park, 47 F.3d 473, 483 (2d Cir. 1995) (finding commonality satisfied in a defendant class of local government actors who adopted state assessments without individual evaluations); Mental Disability Law Clinic v. Hogan, No. 06-cv-6320, 2008 WL 4104460, at *3 (E.D.N.Y. Aug. 29, 2008) (certifying a defendant class of all individuals responsible for treatment programs under the Mental Hygiene Law). *But see* Brown v. Kelly, 609 F.3d 467, 471 (2d Cir. 2010) (overturning the district court's decision to certify a defendant class of New York City officials for lack of typicality).

46. *See, e.g.*, *In re* Itel Sec. Litig., 89 F.R.D. 104, 114 (N.D. Cal. 1981) (certifying defendant class of underwriters). *But see* Akerman v. Oryx Commc'ns, Inc., 609 F. Supp. 363, 376 (S.D.N.Y. 1984) (noting that no unified policy linked defendant

class of infringers against a patent or trademark[47]—all situations where the members of the class and their conduct is likely to be uniform.

Issues of typicality under Rule 23(a)(3) are particularly problematic in bilateral class actions, where a plaintiff class sues a defendant class.[48] The Rule requires that the claims or defenses of the representative class members be typical of the entire class, presenting a challenge to certification if some plaintiffs have claims against some, but not other, defendants.[49] The Ninth Circuit addressed this issue in *La Mar v. H&B Novelty Loan Co.*,[50] in which the named plaintiff had done business with one but not all the defendants in the class and found that typicality was not satisfied, even with an identical injury, if the injury was "at the hands of a party other than the defendant."[51]

However, the court in *La Mar* carved out exceptions where there was conspiracy or concerted schemes between defendants or where there were sufficient "juridical links between the defendants, such as uniform action of state officials.[52] Subsequent courts applying the "juridical links" exception have struggled to identify exactly what links will be sufficient, some finding that typicality is met and others that it is not.[53] Unilateral class actions, in which a single

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underwriters sufficient to support class certification), *aff'd*, 810 F.2d 336 (2d Cir. 1987).

47. *See, e.g.*, Tilley v. TJX Cos., 345 F.3d 34, 36 (1st Cir. 2003); Webcraft Techs., Inc. v. Alden Press, Inc., No. 85-cv-3369, 1985 WL 2270, at *2 (N.D. Ill. Aug. 9, 1985).

48. Holo, *supra* note 41, at 230–31.

49. Thillens, Inc. v. Cmty. Currency Exch. Ass'n of Illinois, 97 F.R.D. 668, 675 (N.D. Ill. 1983) ("The primary concern with bilateral actions, antitrust or other types, is a fear that each plaintiff member has not been injured by each defendant member.").

50. 489 F.2d 461, 466 (9th Cir. 1973).

51. *Id.* at 466. It should be noted that the focus was on the typicality of the *plaintiff* class, not the defendant class.

52. *Id.* at 470 (citing Broughton v. Brewer, 298 F.Supp. 260 (N.D. Ala. 1969)). In *Broughton*, the defendants were officials of a single state. *See also Thillens*, 97 F.R.D. at 676 ("A 'juridical link' is some legal relationship which relates all defendants in a way such that single resolution of the dispute is preferred to a multiplicity of similar actions.").

53. *See, e.g.*, *In re* Itel Sec. Litig., 89 F.R.D. 104, 121 (N.D. Cal. 1981) (finding sufficient juridical links among defendant underwriters); Alaniz v. Cal. Processors, Inc., 73 F.R.D. 269, 276 (N.D. Cal.1976) (finding a sufficient relationship among defendant employees and unions in a Title VII case). *But see* Thompson v. Bd. of Educ. of Romeo Cmty. Sch., 709 F.2d 1200, 1205 (6th Cir. 1983) (finding no juridical links between school boards in their adoption of maternity policies); Mudd v. Busse, 68 F.R.D. 522, 528 (N.D. Ind. 1975), *on reconsideration*, 437 F. Supp. 505

plaintiff sues a class of defendants, prove less troublesome,[54] and are the more likely model for the defendant class action in bankruptcy.[55]

The fourth requirement under 23(a), of adequacy of representation, has been the most worrying to courts in the defendant class context.[56] There are two primary concerns: first, that the named defendant is "unwilling" and therefore an inadequate representative;[57] and second, that the plaintiff can choose the class representative and therefore can choose an ineffective one.[58] However, these issues should not doom the defendant class. An unwilling representative may, in fact, be the most effective representative of the class.[59] And the court can ensure that the named defendant will be an adequate representative for the class by fully utilizing the structure of the adversary process and by allowing defendants to make motions opposing the selection of an inadequate class representative.[60] Additionally, these concerns may be of less consequence in the bankruptcy context, as this Note argues below.[61]

B: Satisfaction of Rule 23(b) for the Defendant Class

While most courts agree that defendant class actions can satisfy the four Rule 23(a) requirements of numerosity, commonality, typi-

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(N.D. Ind. 1977), *aff'd*, 582 F.2d 1283 (7th Cir. 1978) (finding no juridical links between judicial officers of the state charged with violating their discretion concerning bail).

54. *See, e.g.*, *Thillens*, 97 F.R.D. at 676 (noting that when a single plaintiff alleges that it has been injured by every member of a defendant class, certification is permissible).

55. *See infra* Part III.

56. *See Thillens*, 97 F.R.D. at 679 ("Because of the serious due process problems which attend the certification of a defendant class, the 23(a)(4) mandate for an adequate representative must be strictly observed.").

57. *See, e.g.*, Mudd v. Busse, 68 F.R.D. 522, 529–30 (N.D. Ind. 1975), *aff'd*, 582 F.2d 1283 (7th Cir. 1978) ("There is no showing in the record of ability or willingness on the part of the defendant Busse to bear the financial burden required to adequately litigate a complex class action lawsuit.").

58. *See, e.g.*, Richardson v. Kelly, 191 S.W.2d 857, 859–860 (1945) (defendant class members argued that plaintiffs had chosen a representative who had "neither incentive nor ability to defend the suit").

59. *In re* Gap Stores Sec. Litig., 79 F.R.D. 283, 290 (N.D. Cal. 1978) ("Ironically, the best defendant class representative may well be the one who most vigorously and persuasively opposes certification since he is the one most likely to guarantee an adversary presentation of the issues.").

60. Note, *Defendant Class Actions*, 91 HARV. L. REV. 630, 639–47 (1978) (noting the use of the adversary process, the structure of defendant classes themselves, and the requirement of notice as fail-safes against inadequate representation).

61. *See infra* Part III.

cality, and adequacy of representation, the circuits are split as to which type of class action, under Rule 23(b), is most appropriate for the defendant class.[62]

Rule 23(b) provides three categories of class actions. Under Rule 23(b)(1)(A), class certification is appropriate if the prosecution of separate actions would create a risk of inconsistent adjudications "that would establish incompatible standards of conduct for the party opposing the class."[63] Certification under Rule 23(b)(1)(B) is appropriate where separate prosecutions would be dispositive of or substantially impair the ability to protect the interests of other members of the putative class.[64] The majority of courts have held that *stare decisis* alone cannot form the basis of a certification decision,[65] but some courts have found *stare decisis* effects to be a compelling and sufficient reason for 23(b)(1)(B) certification.[66]

These two subsections of 23(b)(1) create mandatory classes;[67] since every class member is bound by the judgment, certification under this prong is attractive to defendants and potentially troubling to courts. Nonetheless, defendant classes have been certified under both subparts of 23(b)(1),[68] though many courts are cautious of due process concerns.[69]

Like 23(b)(1), the second prong of 23(b) also creates a mandatory class.[70] 23(b)(2) allows certification of a class if the class representatives are seeking injunctive or declaratory relief and the party opposing the class has "acted or refused to act on grounds

62. Shen, *supra* note 1, at 81.

63. FED. R. CIV. P. 23(b)(1)(A).

64. FED. R. CIV. P. 23(b)(1)(B).

65. *See, e.g.*, Tilley v. TJX Cos., 345 F.3d 34, 42 (1st Cir. 2003); *see also* La Mar v. H & B Novelty & Loan Co., 489 F.2d 461, 467 (9th Cir. 1973) ("If the individual action inescapably will alter the substance of the rights of others having similar claims, as would an action attacking the reorganization of a fraternal benefit society, the situation falls within Rule 23(b)(1)(B).").

66. *See, e.g.*, *In re* Alexander Grant & Co. Litig., 110 F.R.D. 528, 538 (S.D. Fla. 1986) ("Application of the *La Mar* position that mere *stare decisis* effects of separate adjudications is insufficient for certification would render Rule 23(b)(1)(B) wholly ineffective and reduce it to mere surplussage. Quite clearly that was not the intent of the drafters.").

67. FED. R. CIV. P. 23(b)(1). *See also* Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 131 (2011) (explaining that Rule 23(b)(1) and (b)(2) classes are mandatory because there is no opportunity for class members to opt out).

68. Nelson Rodrigues Netto, *The Optimal Law Enforcement with Mandatory Defendant Class Action*, 33 U. DAYTON L. REV. 59, 93 (2007).

69. *See* Matthew K. K. Sumida, *Defendant Class Actions and Patent Infringement Litigation*, 58 UCLA L. REV. 843, 872 (2011).

70. FED. R. CIV. P. 23(b)(2). *See also* note 69, *supra*.

generally applicable to the class."[71] However, the circuits are split as to whether defendant class actions can ever be certified under the language of Rule 23(b)(2). The rule in the Fourth and Seventh Circuits is that injunctive relief must be against the party that has taken the action or inaction—so, if a defendant class were certified, there would be the anomalous result that the plaintiff's actions or inactions result in injunctive relief against the defendants.[72] The other circuits seem to allow certification of a defendant class under 23(b)(2),[73] although the issue has not been squarely addressed or uniformly considered.

The third prong of Rule 23(b) allows for class certification if "questions of law or fact common to class members predominate over any questions affecting only individual members" and if the class is a superior method for adjudication.[74] If a class satisfied the commonality requirement of 23(a), predominance can likely be found where a judge is inclined to certify the class.[75] However, the second requirement, superiority, has been a sticking point for some bankruptcy judges in certifying plaintiff classes.[76] And it is all the more likely that defendants will opt out of a class. Doing so, they gain the potential advantage of *stare decisis* from litigation favoring the class without running the risk of being bound by an unfavorable result.[77] If a court anticipates every defendant opting out of the class, it would be difficult to conclude that the class action is a superior method for adjudication.[78]

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71. *Id.*

72. *See* Paxman v. Campbell, 612 F.2d 848, 854 (4th Cir. 1980); *see also* Henson v. E. Lincoln Twp., 814 F.2d 410, 414 (7th Cir. 1987).

73. *See* David E. Rigney, *Permissibility of Action Against a Class of Defendants Under Rule 23(b)(2) of Federal Rules of Civil Procedure*, 85 A.L.R. FED. 263 (originally published in 1987) (cataloguing cases).

74. FED. R. CIV. P. 23(b)(3).

75. *See* Holo, *supra* note 41, at 240 (noting that courts have discretion to bifurcate a trial to try common issues as a class and other issues separately under Rule 23(d)).

76. See *supra* Part I.B.

77. Holo, *supra* note 41, at 241 ("[T]he incentive to opt out of a defendant class is much stronger. If the defendant class loses the action, the defendant who opted out is free from liability and will still have the opportunity to defend himself in later actions. But if the defendant class is ultimately successful, the opting-out defendant will at least have *stare decisis* on his side if the plaintiff then sues him individually. Therefore, courts must determine whether the ability, and assumed propensity, of defendants to opt out of a class defeats the superiority requirement of 23(b)(3).").

78. *Id. But see* Thillens, Inc. v. Cmty. Currency Exch. Ass'n of Illinois, 97 F.R.D. 668, 681–82 (N.D. Ill. 1983) (finding superiority in an antitrust action against The Community Currency Exchange Association of Illinois).

Thus, there seems to be a tension between the mandatory and opt-out options for a defendant class: while the mandatory class forces defendants, who may be inadequately represented, into a class that will have preclusive effects, the opt-out class may not be a superior method of adjudication, especially in the bankruptcy context where the class action is already somewhat suspect. The subsequent parts of this Note further explore the use of the defendant class in bankruptcy and propose that the mandatory class may be more appropriate in the bankruptcy context than in ordinary civil litigation.

III: BANKRUPTCY AND DEFENDANT CLASS ACTIONS

When considering whether to use a defendant class action in the bankruptcy context, courts and commentators express two primary concerns—one with the use of the class action in bankruptcy and the other with the use of the defendant class. However, these concerns may be uniquely addressed by the bankruptcy system itself. The first common objection to the use of the class action in bankruptcy is that the system of bankruptcy is itself an aggregating device; the bankruptcy judge is already well situated to handle large classes of claimants, and there is no need to utilize a second aggregating device such as the class action in the bankruptcy context.[79] The second concern applies to all defendant class actions and focuses on the defendants themselves; the fear is that they are unwillingly and thus unfairly bound, especially by non-opt-out classes.[80]

Yet both of these concerns are diminished when the certification is of a defendant class in bankruptcy. The second concern is mitigated because the defendant in a bankruptcy proceeding is already a mandatory defendant and is likely to be engaged in vigorous litigation to protect its interest. And, though the first concern is well-founded, in certain types of defendant class actions in bankruptcy there is a commonality among defendants such that the class action device is useful in addition to the aggregation already provided by Bankruptcy. For example, many of the cases that have certified a defendant class involved a class of shareholders, or otherwise uniform recipients of property, where the trustee in bankruptcy or debtor in possession was attempting to bring an action to reclaim property for the bankruptcy estate.[81] Litigating indi-

79. *See supra* Part I.
80. *See infra* Part III.B.ii.
81. *See infra* Part III.A.

vidually against the defendants would diminish the estate at the expense of some creditors, which is exactly what the bankruptcy process is meant to avoid. Thus in the circumstances discussed above, the two typical concerns with defendant class actions in bankruptcy are fully addressed, and the class action device should be a welcome addition in the bankruptcy context.

This part will focus in depth on In re *Integra Realty Resources, Inc.*[82] as an elucidating case study of the specific issues that arise when certifying a defendant class in a bankruptcy proceeding. The opinions in In re *Integra* thoroughly address the key issues of a defendant class action in bankruptcy due to the case wending its way through the courts for over ten years.[83] Using the In re *Integra* litigation as a guide, this part will attempt to show how the concerns expressed by critics of the class action in bankruptcy and the defendant class action can be addressed when the defendant class action is used in the bankruptcy context. Working through the issues presented by In re *Integra* and the answers provided by the In re *Integra* courts and others demonstrates how the defendant class action is particularly well suited for use in bankruptcy.

A: In Re *Integra Background*

The debtor at the center of In re *Integra* was a hotel business with multiple subsidiaries in the restaurant business.[84] One of those subsidiaries, ShowBiz Pizza Time, Inc., was very successful and eventually came to own all of Integra's restaurant operations.[85] In 1987, Integra (then named Brock Hotel Corporation) bought most of the assets of Monterey House, Inc., a restaurant services provider, leading to a negative cash flow and financial difficulties.[86] As part of a plan of corporate and financial restructuring, Integra spun off its ninety percent stake in Show Biz Pizza Time, Inc. to Integra shareholders, who received a prospectus informing them that the distribution may be subject to future surrender due to bankruptcy.[87]

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82. 354 F.3d 1246 (10th Cir. 2004).

83. For clarity, the first appeal to the Tenth Circuit, *In re* Integra Realty Resources, Inc., 262 F.3d 1089 (10th Cir. 2001), will be cited as *Integra I*, and the second appeal, *In re* Integra Realty Resources, Inc., 354 F.3d 1246 (10th Cir. 2004), as *Integra II*. All other iterations of the case will be cited in full.

84. *Integra II*, 354 F.3d at 1252.

85. *Id.*

86. *Id.*

87. *Id.* The prospectus and registration statement filed with the SEC contained the following language: "If . . . Integra is unable to satisfy its future cash requirements, a recipient of the [ShowBiz] Common Stock in the Integra Distribution might be required to surrender to a trustee in bankruptcy, or creditors, of

Integra's stock plummeted after distribution of the ShowBiz common stock to its shareholders, from $4.88 per share on January 3, 1989, to $0.125 per share on December 6, 1991.[88] In contrast, the ShowBiz stock, which had traded at $5.50 the day after the spin off, had risen to $51.75 by July 14, 1992, the date Integra filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code.[89]

The bankruptcy court approved a plan of reorganization, creating a trust to act on behalf of Integra's unsecured creditors.[90] Subsequently, the trustee for the unsecured creditors filed an adversary proceeding against all beneficial recipients of the Show Biz shares distributed in the 1988 spin off on the theory that the distribution was a fraudulent transfer under Texas law or an unlawful dividend under the Delaware Code.[91] The Trustee eventually named approximately 6,000 defendants in the suit and requested certification of a defendant class pursuant to Bankruptcy Rule 7023, which incorporates Federal Rule of Civil Procedure 23.[92] The bankruptcy court certified a defendant class under Rule 23(b)(1), limiting the class representatives to seven members, including Fidelity, the largest recipient of the shares, and designated Fidelity's counsel as sole class counsel.[93]

The facts of In re *Integra* provide both an example of the kind of case that is particularly well suited to defendant class certification and an explanation for why the device can be particularly useful: the defendant class action can supply the necessary protection for the defendants while providing a value-adding tool for the bankruptcy estate that is not otherwise available in the proceeding.

B: Protection of the Defendant

As explored in Part II, commentators and courts often express concern that the certification of a defendant class may not adequately protect the defendant class members as required by Rule 23. However, some unique features of bankruptcy adjudication may mitigate these concerns. First, nationwide service of process can satisfy the due process requirement that a court give adequate notice

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Integra the shares of the [ShowBiz] Common Stock received in the Integra Distribution, or the value thereof." *Id.* (internal citations omitted).

88. *Id.* at 1253.
89. *Integra II*, 354 F.3d at 1253.
90. *Id.*
91. *Id.* at 1253–54.
92. *Id.* at 1254.
93. *Id.*

to, and have personal jurisdiction over, each member of the class. The bankruptcy process itself can also help ensure adequate representation by the named representatives. For example, the defendant class members will be involved in litigation by virtue of the bankruptcy proceeding, the named representatives will have an interest in litigating for the class vigorously and may even be able to receive compensation from the bankruptcy estate, and the bankruptcy judge is uniquely situated to ensure fairness in the proceeding.

i: Due Process Concerns

One of the issues raised on appeal in In re *Integra* was whether the bankruptcy court had jurisdiction over foreign defendants who did not have substantial contacts with the State of Colorado.[94] One of the shareholders bound by the adverse judgment against the defendant class, a Mr. Mollison,[95] argued that *Phillips Petroleum Company v. Shutts*[96] required an out-of-state class member to affirmatively consent to jurisdiction in order for the court to exercise personal jurisdiction over him or her.[97]

The Court in *Shutts* held that to bind an absent plaintiff on a claim for money damages, a state must ensure minimum procedural due process protections including notice and an opportunity to be heard, an opt-out option for the plaintiff, and adequate representation of the interests of the absent class members by the named representative.[98] Though the case concerned a plaintiff class, the Court was particularly concerned that out of state defendants be protected, noting that the burdens on the defendant are much greater than on the plaintiff and that "the minimum contacts requirement of the Due Process Clause prevents the forum State from unfairly imposing them upon the defendant."[99]

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94. Weinman v. Fidelity Capital Appreciation Fund, No. 04-C 5721, 2008 WL 753958, at *2 (N.D. Ill. Mar. 18, 2008).

95. Mr. Mollison had a judgment of $3752.00 plus post-judgment interest entered against him by the district court. *Id.* at *1.

96. 472 U.S. 797 (1985).

97. *Weinman*, 2008 WL 753958, at *3.

98. *Shutts*, 472 U.S. at 811–12.

99. *Id.* at 808. The Court explained:

> An out-of-state defendant summoned by a plaintiff is faced with the full powers of the forum State to render judgment against it. The defendant must generally hire counsel and travel to the forum to defend itself from the plaintiff's claim, or suffer a default judgment. The defendant may be forced to participate in extended and often costly discovery, and will be forced to respond in damages or to comply with some other form of remedy imposed by

The court in *Weinman* first distinguished the *Shutts* case as dealing with a state court and a plaintiff class, and thus reasoned that the holding would not apply to a federal defendant class action.[100] Even if *Shutts* did apply, however, the district court agreed with the bankruptcy court's holding that nationwide service of process provides sufficient due process protection of the right to notice and the opportunity to be heard.[101] Bankruptcy Rule 7004 provides for service of process "anywhere in the United States."[102] So a bankruptcy court exercising its federal question jurisdiction has personal jurisdiction over out-of-state defendants as long as they have sufficient minimum contacts with the United States. The court concluded that the minimum contacts requirement, and thus personal jurisdiction, was satisfied for Mr. Weiman (and all other defendants) by virtue of his United States citizenship.[103]

ii: Mandatory Class Concerns

The Tenth Circuit in *Integra II* addressed the appellant's argument that *Shutts* mandated that money damages class actions be certified under Rule 23(b)(3) as an opt-out class rather than as a 23(b)(1) mandatory class as had been certified.[104] The court again noted that *Shutts* may not apply in federal defendant class actions, but found that regardless it would not apply where the trustee is attempting to recover property in a fraudulent transfer action, rather than seeking money damages.[105] Once the determination of fraudulent transfer was made, the culpability of defendants would be of no consequence, and the judgment against each defendant

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the court should it lose the suit. The defendant may also face liability for court costs and attorney's fees.

Id.

100. *Weinman*, 2008 WL 753958, at *3.

101. *Id.* at *5 (*citing* United States v. Trucking Emp., Inc., 72 F.R.D. 98, 99 (D.D.C. 1976)). This holding was affirmed by the Tenth Circuit. *Integra II*, 354 F.3d 1246, 1260–61 (10th Cir. 2004).

102. FED. R. BANKR. P. 7004(d).

103. *Weinman*, 2008 WL 753958, at *4; *see also* Lisak v. Mercantile Bancorp, Inc., 834 F.2d 668, 671 (7th Cir. 1987) (federal court in federal-question case implements national, not state, policy); Fitzsimmons v. Barton, 589 F.2d 330, 333 (7th Cir. 1979) ("Here the sovereign is the United States, and there can be no question but that the defendant, a resident citizen of the United States, has sufficient contacts with the United States to support the fairness of the exercise of jurisdiction over him by a United States court.").

104. *Integra II*, 354 F.3d at 1264–65.

105. *Id.* at 1265.

would be calculated by reference to the amount of stock held by each shareholder.[106]

The court acknowledged the limited defenses available to shareholders, such as the claim that the shareholder only acted as a conduit for the actual recipients of the stock, or that she had a smaller number of shares than alleged, but noted that these defenses would not be waived as a result of class certification.[107] Thus, the classification did not deprive any class members of defenses that would have benefited them in the litigation of the fraudulent transfer, and an opt-out class was not necessary.[108]

Similarly in *Guy v. Abdulla*,[109] the Trustee in Bankruptcy for D. Don Lowers, who had been engaged in a Ponzi scheme, sought to certify a class of defendants who were transferred property by the bankrupt.[110] The court noted that the trustee would be able to recover from all defendants if he could prove the requisite elements of voidable preference and fraudulent conveyance, and so the same allegations and defenses would be used for all the defendants.[111]

And in In re *Broadhollow Funding Corp.*,[112] which certified a class of investors in a portfolio of mortgages held by the debtor, the court found that the conduct of the bankrupt towards all class members was the same: "[a]ll funds collected by Broadhollow were commingled; all agreements between investors and Broadhollow are substantially the same; all investors were subject to the same written inducements to invest."[113] Nonetheless the court did find reason to subdivide the class to provide an opportunity for different legal strategies.[114] This option to create a subclass provides a further guarantee that the class representative will protect the interests of the class members adequately.[115]

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106. *Id.*

107. *Id.* at 1264–65.

108. *Id.* at 1265.

109. 57 F.R.D. 14 (N.D. Ohio 1972).

110. *Id.* at 15.

111. *Id.* The court noted that proof of the common issues of law and fact would not be sufficient to insure recovery against every defendant, but found that there were sufficient common questions and typical defenses to certify the class. *Id.* at 17.

112. 66 B.R. 1005, 1009–10 (Bankr. E.D.N.Y. 1986).

113. *Id.*

114. *Id.* at 1010. ("Judicial awareness of intraclass conflict prompts this court to certify a subclass comprised of the 574 defendant/investors named on mortgages.").

115. *Id.*

Certifying a defendant class in certain bankruptcy proceedings seems to address two of the due process requirements of *Shutts*,[116] leaving perhaps the most important concern: the adequacy of the named representative. This issue was litigated in In re *Integra* and several other defendant class action cases, and also seems to be uniquely addressed by the bankruptcy process itself.

iii: Adequate Representation Concerns

The requirement of adequate representation under Rule 23(a)(4) was challenged on appeal in In re *Integra*; the appellant shareholders argued that Fidelity was not an adequate representative because it had sold its shares of ShowBiz stock at a higher price than almost all other class members, it had conflicting duties to its shareholders, and there was a conflict since attorney's fees would be paid out of the settlement fund.[117] The court decided that Fidelity was an adequate representative. Fidelity's interests were perfectly aligned with the class since, as the largest shareholder, it had an incentive to bring the per-share costs of settlement down as much as possible, and its duty to its own shareholders overlapped with its duty to the class to "vigorously litigate the class issues and to reduce the class liability as much as possible."[118]

Other courts have made this kind of adequate representation argument in similar contexts. For example, the court in *Guy v. Abdulla* noted that the named representatives accounted for nearly one-third of the total transfers sought to be invalidated.[119] Thus, the court argued, "[t]his group would certainly appear to have a sufficient interest to adequately defend the class."[120]

The court in In re *Integra* did not directly address the issue that *Fidelity* would receive payment from the settlement agreement to offset litigation costs, besides noting that this did not create a conflict sufficient to undermine adequate representation.[121] But the

116. Even if the Tenth Circuit is not convinced the *Shutts* requirements apply to a defendant class action, the requirements can serve as useful guideposts for protections that might be required were the Supreme Court to address the issue.

117. *Integra II*, 354 F.3d 1246, 1259. Fidelity had intervened in the appeals to argue that it *was* an adequate representative. *See Integra I*, 262 F.3d 1089, 1096 n.1 (10th Cir. 2001).

118. *Integra II*, 354 F.3d at 1260.

119. Guy v. Abdulla, 57 F.R.D. 14, 16 (N.D. Ohio 1972).

120. *Id. Contra* O'Connell v. David, 35 B.R. 146, 148 (Bankr. E.D. Pa. 1983) (overturning class certification by the bankruptcy code because there was nothing in the record "to support a finding that the representative parties would fairly and adequately protect the interests of the other class members").

121. *Integra I*, 262 F.3d at 1112.

fact that there is a fund from which to compensate the named representative for expenses incurred substantially reduces the burden on the named defendant. The bankruptcy court in In re *Integra* noted that "[t]he real concern with a reluctant representative is for his ability to carry the expense and other practical burdens of a class defense."[122] Where there are funds available from the bankruptcy estate to assist the defense, it is more likely that the named representatives will be able to adequately represent the interests of the class without undue financial strain.[123]

In addition to the availability of this fund, the bankruptcy process also differs from civil litigation in that it assumes some litigation by the defendant. The Court in *Shutts* was concerned about defendants facing default judgment if they did not travel to the forum to defend.[124] But the bankruptcy code is unforgiving towards absent defendants—if a creditor fails to file a proof of claim against the bankrupt, they will forfeit their claim against the reorganized debtor.[125] To the point, the court in In re *Broadhollow Funding Corp.*[126] noted: "[i]n the case at bar, named defendants have indicated their willingness to defend the action through participation on the Creditors Committee. In addition, two defendants are litigants in the 11 U.S.C. § 541(d) proceeding [to preclude equitable interests held by third parties from becoming part of the bankruptcy estate] before this court. These actions indicate their tacit acceptance of the financial responsibilities commensurate with the cost of litigation."[127]

The bankruptcy judge also has a certain degree of flexibility and familiarity with creating equitable remedies, so she may be

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122. *In re* Integra Realty Res., Inc., 179 B.R. 264, 271 (Bankr. D. Colo. 1995).

123. *See In re* Braniff Airways, Inc. 22 B.R. 1005, 1009 (Bankr. N.D. Tex. 1982) (finding that Rule 23(a)(4) was satisfied, relying partly on the availability of funds for the defendant class representatives and the agreement of the Debtor to pay defense costs as an administrative expense). See also *Bell v. Disner*, No. 3:14CV91, 2015 WL 540552, at *5 (W.D.N.C. Feb. 10, 2015), in which a receiver was appointed to recover money distributed in a Ponzi scheme. The court found that a defendant class was justified, and noted that even though the defendants were well funded and likely to litigate vigorously, "the Court has repeatedly made it clear that the receiver will be required to help fund the defense of the class." *Id.*

124. *See supra* note 98 and accompanying text.

125. *See* 11 U.S.C. § 501 (2012). *See also* Gierbolini Rosa v. Banco Popular de Puerto Rico, 930 F. Supp. 712, 716 (D.P.R. 1996) aff'd sub nom. Gierbolini-Rosa v. Banco Popular De Puerto Rico, 121 F.3d 695 (1st Cir. 1997) ("The proof of claim procedure [in Section 501] compels a creditor to participate in the bankruptcy distribution or forfeit its claim.").

126. 66 B.R. 1005, 1011 (Bankr. E.D.N.Y. 1986).

127. *Id.*

more attuned to the needs of a class of defendants. For instance in In re *Cardinal Indus., Inc.*,[128] the Bankruptcy Court of the Southern District of Ohio certified a defendant class of creditors at the request of the debtor. The court found that the requirements of Rule 23(a) were satisfied and certified one class under 23(b)(1)(B), to provide declaratory relief regarding the applicability of the automatic stay under §362(a)(3) of the Bankruptcy code.[129] However, the debtor also requested that a class be certified under §105(a) of the Bankruptcy Code, enjoining all members of the defendant class from pursuing any claims against the debtor.[130] The court denied certification of this class, reasoning that injunctive relief required a balancing of harms on an individual basis, and thus finding that the typicality requirement was not met.[131] This kind of equitable balancing may be more natural to a bankruptcy judge, who sits in equity and is accustomed to constantly weighing competing concerns and interests in the goal of reaching the fairest outcome for all.

Thus, the defendant class action is likely to be more adequately represented in a bankruptcy proceeding than in civil litigation. Since one concern about defendant class actions is that their representative will be reluctant to carry the costs of the litigation, the fact that there is a fund available from the estate to pay the representative, in conjunction with the fact that the representative would have to litigate individually to preserve its rights in bankruptcy, provides some guarantee that the representative will be able to vigorously litigate the class issues. And since the bankruptcy court is already monitoring the bankruptcy estate to ensure it is treating creditors fairly, it can police the appointment and representation of the class representative as well.

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128. 105 B.R. 834, 847 (Bankr. S.D. Ohio 1989).

129. *Id.* at 845–46.

130. *Id.*

131. *Id.* at 847. The court explained:

> [T]hroughout this proceeding numerous named and non-named defendants indicated a plethora of factors which differentiate each lender. Such factors range from the type and size of the lending institution, to the type and maturity of the Partnership Property securing each loan. Recognizing the existence of such a diverse set of circumstances, it is impossible for this Court to find that the defenses of the named representatives to the imposition of an injunction are typical of all the defenses of the class. And, where the injunctive relief sought would be imposed upon the Defendants prior to any subsequent hearing where individual defenses might be raised, the Court finds that the prerequisite of typicality required by Rule 23(a) cannot be satisfied and that certification of the proposed defendant class would be inappropriate." Id.

iv: Availability of Settlement Opt-Outs and Review

Finally, the bankruptcy judge may allow opt-outs when the class reaches the point of settlement—even in a class that has been certified as a mandatory class—allowing opportunities for dissenters to be heard once more. Under Federal Rule of Civil Procedure 23(e), a proposed settlement can be approved only after the court ascertains that it is fair, reasonable, and accurate, and the court must take into account any objections by members of the class.[132] At this point the court may condition approval of the settlement on the ability of class members to opt out, as occurred in the *Integra* litigation.[133] After negotiations Fidelity and the Trustee reached a settlement, which was reviewed by the district court under Rule 23(e) for fairness and approved with the opt-out provision. Only 250 members of the class opted out of the settlement; the rest had final judgments entered against them, and some appealed that final judgment.[134]

The Tenth Circuit initially received the appeals, but dismissed them for lack of standing.[135] The court reasoned that appellants who had opted out of the settlement lacked standing to contest the settlement on appeal because they did not have any legally protected interest that could support the "injury in fact" element necessary to demonstrate standing.[136] The court rejected the appellees' argument that the settlement gave a "war chest" to the trustee for arguing its case.[137] It also rejected appeals from non-named parties who did not opt out and who did not move to intervene in the class action.[138]

However, the Supreme Court's subsequent decision in *Devlin v. Scardelletti*[139] undercut this ruling. In *Devlin*, the Court held that an

132. FED. R. CIV. P. 23(e). *See also In re* Prudential Ins. Co. Am. Sales Practice Litig. Agent Actions, 148 F.3d 283, 318 (3d Cir. 1998) (analyzing the factors a court must use to determine whether a settlement is fair, including objections by class members).

133. *Integra II*, 354 F.3d 1246, 1255. *See also In re* Salem Mortg. Co., 783 F.2d 626, 630–31 (6th Cir. 1986) (approving temporary classes in a bilateral class action for the purpose of considering a settlement, and allowing opt out for members of both the plaintiff and defendant classes).

134. *Integra II*, 354 F.3d at 1256.

135. *Id.*

136. *Integra I*, 262 F.3d 1089, 1102–03 (10th Cir. 2001).

137. *Id.* at 1102.

138. *Id.* at 1103, 1105 ("[F]ormal intervention is a prerequisite to an unnamed class member's standing to appeal, at least in the absence of any violations of the Rule 23 procedures intended to protect the rights of those unnamed class members.") (quoting Gottlieb v. Wiles, 11 F.3d 1004, 1009 (10th Cir. 1993)).

139. 536 U.S. 1 (2005).

unnamed class member may appeal a settlement as long as she objected during the fairness hearing.[140] It also clarified that the issue was not one of standing, but rather one of definition: the nonnamed class members are "parties" to the litigation and thus may appeal a settlement decision.[141] The Court explained that the nonnamed class member would be appealing the court's decision to disregard her objections to the Rule 23(e) settlement; this appeal could not effectively be accomplished through the named class representative, whose interests "by definition diverge" when it agrees to the settlement.[142]

After the Supreme Court's decision in *Devlin*, In re *Integra* made its way back to the Tenth Circuit on appeal. The Tenth Circuit confirmed that even after *Devlin*, an unnamed class member must at least object to the settlement in the district court or appear at a fairness hearing to preserve their right to appeal.[143] However, the court rejected the argument of the trustee that an opt-out provision in the settlement forecloses the right to appeal a settlement. It noted that although "*Devlin* involved a non-opt out class, the Court's reasoning also suggests that the right of an objecting class member to appeal must be recognized," and thus held that *Devlin* allows appeal by a class member who does not opt out but objects at a fairness hearing and has a final judgment entered against her.[144] Ultimately, the court allowed appeal by two class members, one an unnamed class member and one a named representative, and found that the district court had not abused its discretion in finding that the settlement was fair, reasonable, and adequate after considering all prior proceedings and evidence and all objections, which matched the objections of the appellants.[145]

Thus, even in a mandatory defendant class, if the class reaches a settlement, members of the class may object to the settlement whether they opted in to the settlement or not, and their objections must be heard and taken into consideration by the judge before she decides to approve the settlement. And although the In re *Integra* court did not address Bankruptcy Rule 9019,[146] this rule can add an additional layer of protection at the settlement stage. Rule 9019(a)

140. *Id.* at 14. ("We hold that nonnamed class members like petitioner who have objected in a timely manner to approval of the settlement at the fairness hearing have the power to bring an appeal without first intervening.").

141. *Id.* at 10.

142. *Id.* at 9.

143. *Integra II*, 354 F.3d 1246, 1257.

144. *Id.*

145. *Id.* at 1266–69.

146. FED. R. BANKR. P. 9019.

allows a court to approve a settlement after a hearing. While the analysis under Rule 9019 is similar to that under Rule 23, in that the court must decide whether the settlement is fair and equitable,[147] the court should also be judging whether the settlement is in the best interests of the estate and its creditors.[148] Thus, the bankruptcy judge is instructed to ensure fairness for all parties,[149] and is well situated to do so.[150] The rule also contains a procedural protection in that notice must be given to creditors and other parties the court may designate,[151] further ensuring that defendants will have an opportunity to object.[152]

The concerns of critics of the defendant class may be assuaged, therefore, by the various protections and particularities of the bankruptcy process. But these safeguards may further convince critics of the class action in bankruptcy that the bankruptcy process itself can handle the adjudication without the need for the class device. These critics are wrong however, because the advantages of single-stroke adjudication outweigh the downsides (as they did in In re *Integra*), making defendant certification in bankruptcy the best course of action in situations involving litigation by the estate against many identical defendants.

C: Utility of Certification

The purpose of bankruptcy is to preserve as much value in the bankruptcy estate as possible, either to distribute the assets to creditors or to rehabilitate the business.[153] In some situations allowing individual litigation would deplete the bankruptcy estate with repetitious litigation on essentially the same issue. In these cases the cer-

147. *See In re* Drexel Burnham Lambert Grp., Inc., 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991) (citing Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968)).

148. *In re* Worldcom, Inc., 347 B.R. 123, 149 (Bankr. S.D.N.Y. 2006).

149. *See* Nellis v. Shugrue, 165 B.R. 115, 122 (S.D.N.Y. 1994) (discussing several factors to be considered in a fairness determination); *see also In re* Worldcom, Inc., 347 B.R. at 137 (listing as one factor to be considered "the degree to which the settlement is supported by other parties in interest").

150. *In re* Walsh Constr., Inc., 669 F.2d 1325, 1328 (9th Cir. 1982) ("[T]he bankruptcy judge is uniquely situated to consider the equities and reasonableness of a particular compromise.").

151. FED. R. BANKR. P. 9019(a).

152. *See, e.g.*, *In re* Neuman, 103 B.R. 491, 500 (Bankr. S.D.N.Y. 1989) *rev'd on other grounds*, 124 B.R. 155 (S.D.N.Y. 1991) ("The purpose of providing notice to creditors is to afford creditors the opportunity to review the compromise and settlement and to object to it if they find it unsatisfactory.").

153. *See, e.g.*, *In re* Colortex Indus., Inc., 19 F.3d 1371, 1377 (11th Cir. 1994); *In re* Dant & Russell, Inc., 853 F.2d 700, 707 (9th Cir. 1988).

tification of a mandatory class can be value-adding to the estate; it preserves judicial and litigation resources, and can reduce unfairness that may result from independent adjudications.

This issue was, perhaps unsurprisingly, addressed in the In re *Integra* litigation. The shareholder appellants in In re *Integra* challenged certification under 23(b)(1), and argued that the class should have been certified under 23(b)(3) as an opt-out class.[154] Had this been the decision, they argued, Fidelity would have been in a stronger bargaining position when negotiating with the Trustee.[155] However, the bankruptcy court had certified the class under 23(b)(1) because it was concerned about the judicial resources that would be consumed by individually litigating rather basic questions.[156] Additionally, the court was worried about the "very high risk of varying adjudications with respect to individual members of the class."[157] It felt that mandatory class certification would better protect absent class members than deciding their cases by application of *stare decisis*.[158]

Although the bankruptcy court had not specified which prong of 23(b)(1) it was applying, the court of appeals concluded that it had certified under both prongs.[159] The appellate court made clear, however, that it was upholding the certification under subsection (B), reasoning that subsection (A) would not be met if the Trustee recovered some but not other shares.[160] The court distinguished the requirement articulated by many courts[161] that a 23(b)(1)(B) class not be certified solely on an anticipated *stare decisis* effect by noting that in an action for fraudulent transfer, the defenses available to a defendant are not intertwined with the determination of whether there had actually been a fraudulent transfer.[162] The defendant could argue that it acted merely as a conduit for actual recipients of the stock or had fewer shares than alleged, but the legal and factual issues of whether there had been a fraudulent transfer would be the same for every defendant.[163] Thus, the first determination would not merely "form the basis for application of *stare decisis* in subsequent cases; [it] would almost inevitably

154. *Integra II*, 354 F.3d 1246, 1263 (10th Cir. 2004).
155. *Id.*
156. *In re* Integra Realty Res., Inc., 179 B.R. 264, 272 (Bankr. D. Colo. 1995).
157. *Id.*
158. *Id.*
159. *Integra II*, 354 F.3d at 1263.
160. *Id.* at 1264.
161. *See supra* Part II.B.
162. *Integra II*, 354 F.3d at 1264.
163. *Id.*

prove dispositive in those cases," especially since all the cases would be litigated in the same forum pursuant to the court's bankruptcy jurisdiction.[164]

The Eastern District of New York, in In re *Broadhollow Funding Corp.*,[165] provided a similar explanation for its decision to certify a defendant class of investors in the debtor's mortgage brokering service under Rule 23(b)(1)(B). The court noted that the issue of equitable ownership of the mortgages would decide the outcome of each case.[166] This alone would not provide a reason to certify, but the court noted that "the cost of the litigation would deplete the assets of the bankruptcy estate, thereby rendering reorganization doubtful, if not impossible."[167]

Similarly, the Sixth Circuit affirmed the certification of a defendant class by the bankruptcy court in *First Fed. of Michigan v. Barrow*.[168] Echoing the reasoning employed by the Eastern District of New York in *Broadhollow*, the court explained that the "multiplicity of separate actions" would have established incompatible standards of conduct for the trustee in seeking satisfaction of individual claims, and that class certification "provided an efficient vehicle for achieving unitary adjudication as to all class members."[169]

The rationales used by these courts are similar to the idea of certification under Rule 23(b)(1)(B) for limited fund class action cases, where there are limited assets that, if distributed on a "first come, first served" basis, would unfairly disadvantage later claimants.[170] The Second Circuit in In re *Drexel*[171] certified a 23(b)(1)(B) plaintiff class in bankruptcy, even though it was not the typical "first come, first served" case, noting that some members

164. *Id.*

165. 66 B.R. 1005 (Bankr. E.D.N.Y. 1986).

166. *Id.* at 1007.

167. *Id.*

168. 878 F.2d 912, 919 (6th Cir. 1989).

169. *Id. See also* Bell v. Disner, No. 3:14CV91, 2015 WL 540552, at *5 (W.D.N.C. Feb. 10, 2015), in which the court certified a mandatory class of recipients of awards in a Ponzi-type scheme, explaining that the receiver would have difficulty recovering from defendants if they anticipated or knew of inconsistent results for the same conduct.

170. A full exploration of the limited fund doctrine is beyond the scope of this paper. For a thorough explanation of the limited fund doctrine and the Supreme Court's recent case cabining the use of the doctrine, see *The "Fair" Is The Enemy of The Good*: Ortiz v. Fibreboard Corporation *and Class Action Settlements*, 8 SUP. CT. ECON. REV. 23, 62–67 (2000); see also Ortiz v. Fibreboard Corp., 527 U.S. 815, 860 (1999) which leaves open the possibility of the limited fund doctrine 23(b)(1)(B) class in bankruptcy.

171. 960 F.2d 285 (2d Cir. 1992).

of the class might otherwise litigate their claims more vigorously, thereby "unfairly diminishing" the eventual recovery of other class members.[172]

A recent amendment to the bankruptcy rules provides another situation in which a mandatory defendant class would add value to the bankruptcy proceeding and prove a superior method of adjudication. According to Bankruptcy Rule 3007, an adversary proceeding must be brought to challenge the validity, priority, or extent of a lien.[173] So if the bankruptcy estate were to attempt to subordinate multiple, perhaps even thousands, of identical liens it would have to bring an adversary proceeding against each one.[174] This is obviously inefficient for both the parties and the court system.

Thus, the use of the defendant class action is the most appropriate and efficient device to resolve certain bankruptcies. The conditions under which a defendant class action should be used in bankruptcy are when there are virtually identical defendants, whose liability or culpability turns on a limited factual and legal determination, with limited defenses unrelated to the underlying claim, and against whom individual litigation would be time consuming and potentially inconsistent. Litigation against the defendant class preserves the efficiency of the bankruptcy system, the bankruptcy estate itself, and provides a fair resolution to potentially absent members in a way the bankruptcy process itself may not.

CONCLUSION

The bankruptcy process is designed to aid the bankrupt estate in swift and equitable resolution of its claims. In certain cases, especially where there are numerous recipients of potentially voidable property transfers, the defendant class action can be particularly helpful. As noted in the previous parts, class actions are rare in bankruptcy, and defendant classes are scarce overall, so it should be no surprise that the defendant class appears only a few times in bankruptcy cases. If the practice becomes more common, courts and debtors will become more comfortable with the reasoning used by judges to justify the defendant class and build a more robust body of case law to draw upon. This Note has attempted to fill the gap in the literature on this topic by providing an overview of the

172. *Id.* at 292.

173. FED. R. BANKR. P. 3007.

174. *See In re* Eads, 417 B.R. 728, 739 (Bankr. E.D. Tex. 2009); *see also* Leonard H. Gerson, *Another Look at Treatment and Use of Class Proofs of Claim and Class Actions in Bankruptcy*, 27 AM. BANKR. INST. J., 16, 59 (Sept. 2008).

current state of the law as well as arguing for the use of defendant class actions in bankruptcy proceedings when certain conditions are present. These justifications and the supporting case law could be used by a trustee or debtor in possession seeking to employ the defendant class action in practice.