By Philip W. Allogramento III and Sydney J. Darling[1]

Want to Make a Stand? You May Not Have Standing

Philip W. Allogramento III
Connell Foley LLP
Newark, N.J.

Sydney J. Darling
Connell Foley LLP
Newark, N.J.

Philip Allogramento is Of Counsel and Sydney Darling is an associate in the Bankruptcy, Creditors' Rights and Commercial Law Practice Group of Connell Foley LLP in Newark, N.J.

Section 502(a) of the Bankruptcy Code plainly states that a claim is deemed allowed "unless a party in interest ... objects." Fed. R. Bankr. P. 3007 sets forth the manner in which an objection to a claim shall be filed and served, and no restrictions on a creditor's right to object to a claim are found in the Code. Armed with this crystal clear language of the Bankruptcy Code and Rules, practitioners may assume that their unsecured creditor clients have solid ground to file a claim objection in a chapter 7 case, but surprisingly, this is not so in most circuits. Instead, practitioners may find their clients without prudential standing to be heard on such matters because of a body of case law favoring orderly case administration above the rights of interested creditors.

A survey of bankruptcy-related decisions across the circuits reveals that courts generally take one of two approaches to this issue. The majority of courts defer claim-objection decisions to the chapter 7 trustee (primarily or exclusively). On the other hand, a minority of courts adhere to the Code's plain language and allow other parties in interest to object to claims without imposing any further restrictions on such parties' standing or ability to object. The majority approach reigns in the First,[2] Second,[3] Third[4] and Fourth Circuits.[5] Moreover, bankruptcy and district courts within the Ninth,[6] Tenth[7] and Eleventh Circuits[8] have also consistently applied the majority approach. As discussed herein, the state of the law is a bit less clear in the Fifth and Sixth Circuits, and courts within the Seventh and Eighth Circuits have applied the plain-meaning approach when addressing this issue.

The Majority Approach: Deference to the Chapter 7 Trustee

The majority approach confers standing to a "party in interest"[9] only after the chapter 7 trustee refuses to object, notwithstanding a request by the creditor, and the court grants leave to object to that party. Extending a body of case law that arose during the pre-Code era, the majority of courts regard the chapter 7 trustee as the proper party to lodge claims objections and, in consideration of efficient administration of the estate, are reluctant to grant leave to third-party objectors. The rationale of these courts is best summarized by the First Circuit as follows:

> As the chapter 7 trustee is charged with the fiduciary duty to administer the chapter 7 estate expeditiously in the best interests of the estate, the important policy favoring efficient bankruptcy administration normally will warrant judicial recognition that the chapter 7 trustee, as the duly appointed or elected representative of all unsecured creditors, rather than the chapter 7 debtor or an individual creditor, is the more appropriate arbiter of the "best interests" of the chapter 7 estate.
>
> Rather, a chapter 7 trustee is required to reach an informed judgment, after diligent investigation, as to whether it would be prudent to eliminate the inherent risks, delays and expense of prolonged litigation in an uncertain cause.[10]

The majority approach, while somewhat consistently applied, is subject to a number of tweaks. For example, some courts require the objecting creditor to establish that the trustee failed or refused to perform a fiduciary duty imposed by the Bankruptcy Code in order to satisfy the first prong.[11] In *Choquette*, the court stated that the trustee's failure or refusal to perform a fiduciary duty does not have to be improper, and in fact, noted that the trustee's decisions in that case were justified and a natural consequence of the court-approved settlement agreement.[12] However, a bankruptcy court within the Third Circuit imposed the requirement that the trustee must "unreasonably or unjustifiably" refuse to proceed with an objection prior to conferring

1 The authors thank Sara Cutuli, a summer associate with the firm, for her contributions to this article.

2 *Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136, 1145 (1st Cir. 1992).

3 *See Ross v. Drybrough*, 149 F.2d 676 (2d Cir. 1945).

4 *See Fred Reuping Leather Co. v. Fort Greene Nat'l Bank*, 102 F.2d 372 (3d Cir. 1939).

5 *See Rooke v. Reliable Home Equip. Co.*, 195 F.2d 667, 668-69 (4th Cir. 1952).

6 *See, e.g., In re Parker Montana Co.*, 47 B.R. 419, 421 (D. Mont. 1985); *In re Bakke*, 243 B.R. 753, 755-56 (Bankr. D. Ariz. 1999) (listing other relevant authority).

7 *See, e.g., In re Werth*, 54 B.R. 619, 622 (D. Colo. 1985); *but see In re Padget*, 119 B.R. 793, 798 (Bankr. D. Colo. 1990) (citing to majority rule as stated in *Werth* but comparing it to statute's plain language).

8 *See Trauner v. Huffman (In re Trusted Net Media Holdings LLC)*, 334 B.R. 470, 476 (Bankr. N.D. Ga. 2005); *In re Charter Co.*, 68 B.R. 225, 227 (Bankr. M.D. Fla. 1986) (acknowledging application of majority rule in chapter 7, but rejecting its application in chapter 11).

9 The Bankruptcy Code does not define "party in interest." However, courts generally consider creditors with a pecuniary interest that could be reasonably affected by the proceeding to be parties in interest. *See, e.g., Cult Awareness Network v. Martino (In re Cult Awareness Network)*, 151 F.3d 605 (7th Cir. 1998).

10 *Thompson*, 965 F.2d at 1145.

11 *See In re Choquette*, 290 B.R. 183, 189 (Bankr. D. Mass. 2003) (quoting *Thompson*, 965 F.2d at 1148); *see also Fred Reuping Leather Co.*, 102 F.2d at 373 ("[T]he trustee represents all [of] the creditors and may therefore be relied upon to press all proper objections to the claims of those whose standing is questionable. If he defaults in his duty, the court may upon application direct him in his duty or, if he be recalcitrant, remove him for disobedience, or permit a creditor to act in his name.").

12 290 B.R. at 189, n.10.

standing on a creditor to do so.[13] Another court held that the first prong of the test was not satisfied (*i.e.*, the trustee had not refused to object) where the trustee's stated intention was to examine all of the claims once the liquidation process was complete and object if appropriate.[14] Other courts impose the additional hurdle of requiring the objecting creditor to establish a benefit to the estate if the objection is sustained.[15]

Courts utilizing the majority approach have also carved out various exceptions. For example, one bankruptcy court in the Third Circuit allowed a case to proceed on its merits, even though "[b]y technical application of the law, the action could be dismissed and the Trustee requested to institute a new action."[16] In *Eastgate*, even though the objecting creditor had not requested the permission of the trustee or the court to proceed with the case on the trustee's behalf, the court found it persuasive that the objecting creditor "ha[d] voluntarily assumed the costs involved, which is a relevant factor in making a determination [of] whether to ... dismiss this action."[17] The court noted that dismissing the case on such a technicality "would serve to merely deplete the time, money, and effort of all parties concerned."[18]

The District of Hawaii recognized several exceptions to the rule that "a general creditor does not generally have standing to object to a claim when a trustee has been appointed," and added one of its own. For this court, standing could be conferred upon an unsecured creditor to object to the claim of another where

(i) there is no trustee;
(ii) the trustee refuses to object after formal notice is given by the debtor or creditor;
(iii) the unsecured creditor expends his own resources to object and the balance of equities weighs against dismissing the objection; and
(iv) the trustee's improper actions are a part of the reason for the objection.[19]

In that case, the court added a new exception, "where the trustee's improper actions are a part of the reason for the objection," and conferred standing upon an unsecured creditor to object to the claim of another. Similarly, in *Jones v. Clower*,[20] the court, while acknowledging that it had the power to raise the issue that the appellant lacked standing to appeal because such a standing belonged to the trustee, declined to do so because it was clear that "a mistake ha[d] been made [that] calls for investigation and correction."

The Minority Approach: Adhering to the Plain Meaning

Other courts have rejected the majority rule in favor of a plain reading of the statute. Under this approach, these courts generally allow any party with a pecuniary interest in the ultimate distribution of the bankruptcy estate to prosecute a claims objection. The minority approach eschews judicial meddling in an area of the Bankruptcy Code that is clear on its face, preferring to leave it to Congress to decide whether the claims-objection process needs to be amended to aid the orderly administration of chapter 7 cases. Acknowledging that application of the majority approach carries noble intentions, one bankruptcy court aptly observed:

> The problem is that this restriction on creditors' rights is a "judicial" one that does not appear in the Code itself. The right to object to claims that section 502(a) grants creditors ... is unqualified. Nowhere is it made subject to "the needs of orderly and expeditious administration." It may be that sound bankruptcy policy warrants limiting creditors' rights this way, and when it comes to objecting to claims, a chapter 7 trustee should be given first crack. But Congress, not the courts, decides what makes for sound bankruptcy policy. When Congress expresses its views in the Code, courts have no business rewriting the Code to suit themselves, turning it into something they consider more logical, sensible, or conducive to human enlightenment.[21]

Section 502(a) is clear ... yet courts applying the statute have imposed judicial restrictions upon an unsecured creditor's right to object to chapter 7 claims.

In *C.P. Hall*, the issue of standing to object to a claim arose when creditor A objected to creditor B's claim, and the trustee thereafter sought approval of a settlement with creditor B, essentially disposing of creditor A's objection.[22] The court ruled that the Bankruptcy Code not only confers an unqualified right upon creditors to object to the claims of other creditors, but also mandates that the court rule on a claims objection.[23] "Nothing in the Code subordinates that right to the trustee's duty to administer the estate, let alone his agreement with a creditor that the creditor's claim will be allowed."[24]

Also applying the minority approach, the Eighth Circuit Bankruptcy Appellate Panel held that § 502(a) "expressly authorizes objections to claims by any 'party in interest.' As the largest creditor of the Debtor's bankruptcy estate, the Plaintiff is clearly a party in interest with standing to object to the Defendants' claims and their priority status.... Consequently, the Plaintiff does not need permission from the court to request such relief."[25]

Although its interpretation has not been consistent, the Fifth Circuit held that by virtue of its status as a creditor of a debtor, the creditor is directly interested in the judgment complained of and therefore has a right to appeal allowance

13 *In re Morrison*, 69 B.R. 586, 592 (Bankr. E.D. Pa. 1987).
14 *See Pascazi v. Fiber Consultants Inc.*, 445 B.R. 124, 129 (S.D.N.Y. 2011).
15 *See In re Simon*, 179 B.R. 1, 7 (Bankr. D. Mass. 1995); *Trusted Net Media Holdings LLC*, 334 B.R. 470 at 476; *In re Sinclair's Suncoast Seafood Inc.*, 140 B.R. 588, 591 (Bankr. M.D. Fla. 1992) ("Section 502(a) ... is designed to maximize the estate for the benefit of all general creditors; it is not designed to enable a lone creditor to act solely in his own self-interest.").
16 *See Eastgate Enters. Inc. v. Funk (In re Meade Land & Dev. Co.)*, 1 B.R. 279, 282 (Bankr. E.D. Pa. 1979).
17 *Id.*
18 *Id.*
19 *In re Sun Ok Kim*, 89 B.R. 116, 118 (D. Haw. 1987).
20 22 F.2d 104, 106 (5th Cir. 1927).
21 *In re C.P. Hall Co.*, 513 B.R. 540, 544 (Bankr. N.D. Ill. 2014) (citations and internal quotation marks omitted); *but see In re Drive-in Dev. Corp.*, 371 F.2d 215 (7th Cir. 1966), *cert. denied*, 387 U.S. 909 (1967) (pre-Code case wherein Seventh Circuit gave credence to majority approach in *dicta* when analyzing issue in context of chapter 11 case).
22 *Id.* at 542-43.
23 *Id.* at 544.
24 *Id.*
25 *PW Enters. Inc. v. State of North Dakota (In re Racing Servs. Inc.)*, 363 B.R. 911, 917 (B.A.P. 8th Cir. 2007).

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of a claim of another creditor.[26] Finally, some bankruptcy courts within the Sixth Circuit have also taken a strict plain-meaning approach to the issue.[27]

While the plain-meaning approach has not yet been widely embraced, Hon. **A. Benjamin Goldgar** in *C.P. Hall* made a compelling argument for its consideration. The majority approach has its genesis in pre-Code case law and has been applied by most courts without analysis simply because it is touted by *Colliers* as the majority rule and with little or no acknowledgment of the principle that a court's "role is to interpret the language of the statute enacted by Congress."[28] As the U.S. Supreme Court noted in *Barnhart*, where a "statute does not contain conflicting provisions or ambiguous language [or] ... require a narrowing construction or application of any other canon or interpretative tool," a court "must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'"[29]

26 *In re Roche*, 101 F. 956 (5th Cir. 1900); *see also, e.g., In re Heritage Org. LLC*, 375 B.R. 230, 283 (Bankr. N.D. Tex. 2007). *But see, e.g., In re Curry*, 409 B.R. 831, 837-38 (Bankr. N.D. Tex. 2009) (adopting majority approach).

27 *See, e.g., In re Bozman*, 403 B.R. 494, 496 (Bankr. S.D. Ohio 2006) (holding that as long as objecting creditor qualifies as party in interest (*i.e.*, person with pecuniary interest in outcome), that creditor has standing to object to another's claim); *but see, e.g., In re Dow Corning Corp.*, 244 B.R. 721, 750-51 (Bankr. E.D. Mich. 1999) (applying majority approach); *In re Mobile Air Drilling Co.*, 53 B.R. 605, 608 (Bankr. N.D. Ohio 1985) (same).

28 *See Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 461-62 (2002).

29 *Id.*

Chapter 7 Claim Objections: Where We Go from Here

Section 502(a) is clear on its face, yet courts applying the statute have imposed judicial restrictions upon an unsecured creditor's right to object to chapter 7 claims. These differing interpretations have produced a disconnect that practitioners must unfortunately learn to live with until a harmonious judicial or legislative solution is found. Creditors are typically provided with a right to be heard throughout the bankruptcy process in return for being dispossessed of their individual rights to pursue the debtor. In the case of creditor objections to claims, however, many courts have placed limitations on creditors' rights to be heard by way of precedent-driven procedural hurdles intended that give deference to the trustee's administration of the chapter 7 estate. As explained in *C.P. Hall*, bankruptcy courts in most circuits have interpreted § 502 with the best interests of case administration at heart, but have likely overstepped their roles and actually worked to rewrite the meaning of the Code itself. Absent Congress unexpectedly revisiting the Bankruptcy Code to clarify its intentions, practitioners should take careful note of the requirements in their respective jurisdictions. abi