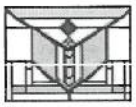

Comment to Proposed Amendment to Bankruptcy Rule 3007
Judge Eric Frank (Bankr Judge) to: Rules_Comments 01/05/2012 05:48 PM
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January 5, 2012

To: The Advisory Committee on Bankruptcy Rules
From: Judge Eric L. Frank (Bankr. E.D. Pa.)
Re: Comment on Proposed Revision to Rule 3007(a)

I wish to comment on the Advisory Committee's proposed amendment to Rule 3007(a).

The focus of my concern is what I perceive to be the tension between one of the purposes of the proposed amendment to Rule 3007 (i.e., to clarify that hearings need not be scheduled on every claims objection filed under Rule 3007) and the provisions of Rule 3001(f). If Rule 3001(f) continues to manifest sound public policy in the administration of the claims allowance system, the Committee may wish to reconsider the promulgation of the proposed amendment to Rule 3007(a), or at least consider expanding the Advisory Committee Note to clarify that the amendment to Rule 3007(f) is not intended to sanction the creation, by local rule, of an unbridled, "negative notice" system for the adjudication of objections to proofs of claim.

1.

Rule 3001(f) allows for a proof of claim, in some circumstances, to be prima facie evidence of the allowability of the claim. The most salient purpose of this provision, which has no analogue in ordinary civil litigation, is that it establishes a less formal and, presumably less costly and burdensome, system for determining the validity of creditor claims against the bankruptcy estate. In that respect, Rule 3001 and the Proof of Claim Official Form, in general, and Rule 3001(f), in particular, facilitate the filing and allowance of claims by parties who may

be geographically remote from the bankruptcy forum and the allowance of claims in favor of artificial entity-creditors who might otherwise have to retain counsel in order to appear in a federal court proceeding (perhaps for a claim whose size does not warrant that expense). The major legal consequence of the filing of a properly filed proof of claim that satisfies the requirements of Rule 3001(f) is that the initial burden of production of evidence in the contested matter shifts to the objector (usually, the debtor or the trustee).

Consistent with these purposes, the national Bankruptcy Rules impose no obligation on a claimant to file a written response to a claims objection. The absence of a response requirement may be why the current text of Rule 3007(a) appears to contemplate that the filing of a claims objection always triggers a hearing. Perhaps it is not too much of a stretch to suggest that at such a hearing (by analogy to ordinary civil litigation) the proof of claim serves as "the complaint" and the objection serves as "the answer to the complaint." If the proof of claim makes out a prima facie case for allowance pursuant to Rule 3001(f), the proof of claim serves both as pleading and evidence and the objector must present some contrary evidence to overcome the prima facie case, but at all times the burden of proof rests with the claimant.

The proposed Committee Note observes that the amendment will permit local rules to require a response to a claims objection in which the claimant must request a hearing or file a response in order to obtain a hearing. While the Note does not go this far, Judge Wedoff's Memorandum to the Standing Committee (revised June 6, 2011) describes the rule as being amended "to allow the use of a negative notice procedure for objections to claims." Without intending to be pejorative, it is well-known in the bankruptcy community that negative notice is sometimes referred to colloquially as "scream or die."

2.

I have difficulty reconciling a comprehensive negative notice system for resolving objections to proofs of claim with Rule 3001(f). Unless the court has already ruled that a proof of claim does not fall within Rule 3001(f) (a decision itself which I would think requires a hearing or at least some additional process), I do not understand how, consistent with Rule 3001(f), a proof of claim that complies with Rule 3001 can be disallowed without a hearing. At the very least, an objector must submit contrary evidence, perhaps through the verification of the written claims objection and exhibits thereto, before such a claim can be disallowed. The only mechanism I can conceive for sustaining a claims objection without a hearing is to require the claimant to respond to a claims objection in which: (1) the objector disputes the validity of the claim **and** (2) asserts that the claim is not self-sustaining (i.e., it does not satisfy Rule 3001(f) or otherwise set forth information sufficient to make out prima facie case for its validity). Of course, limiting "negative notice" disallowance of claims to objections of that type would require a somewhat complicated rule on the subject (which I would not want to have the task of drafting).

3.

Putting all of this abstraction aside, as a sitting bankruptcy judge, I am well aware that very, very few claims objections ripen into true contested matters in which both parties appear and present evidence. Thus, it is understandable why some courts wish to avoid what appears to be the needless expenditure of court resources in scheduling hearings and, perhaps, bar resources

in attending them.

My sense is that the problem that the proposed amendment to Rule 3007 is intended to address involves objections to unsecured claims because, in my experience, secured claimants (most commonly, residential mortgage lenders or servicers) usually respond or appear to contest objections to their proofs of claim. In my experience, the most common bases for the objections to unsecured claims are: (1) the claim lacks sufficient documentation to establish that the claimant is a truly the assignee of the original creditor; (2) the claim more generally lacks sufficient documentation to permit the objector to assess its validity (and the objector, in good faith, disputes the validity or amount of the claim); (3) the claim is barred by the statute of limitations; and (4) for some other expressed reason, the objector disputes the validity or amount of the claim.

Resolution of the first and, likely, the second type of objections described above does not necessarily require a hearing, although such objections do require the court to assess the merits of the contentions in the objection that the proof of claim is legally insufficient on its face. For such objections, a procedure could be employed that advises the claimant that unless the claimant responds or requests a hearing, the court will decide the matter "on the papers." The third type of objection may or may not be amenable to resolution in the same manner. It depends on whether the facts needed to decide the statute of limitations issue can be determined from the information in the proof of claim; if not (and particularly, if the proof of claim satisfies Rule 3001(f)), the objector must present some evidence to the court. The fourth type of objection to be sustained, a hearing or some other mechanism for the submission of evidence if the proof of claim is prima facie valid pursuant to Rule 3001(f) is necessary and, in my view, it would be incorrect to

disallow without one so long as Rule 3001(f) is in place.

In short, I believe that negative notice procedures may be appropriate for certain types of claims objections, but that a comprehensive negative notice system for claims objections is overinclusive. In light of Rule 3001(f), such a true negative notice system would result in courts improperly sustaining claims objections and disallowing valid claims by default and without a hearing.

All of that said, on its face, the proposed amendment to Rule 3007(a) does not sanction a comprehensive, negative notice system. It says only that the notice of objection to proof of claim must be served at least 30 days before "any" scheduled hearing or "any deadline to request a hearing." The "any deadline to request a hearing" is problematic to the extent it may be interpreted to mean that the failure to make such a request can, by itself, be grounds for disallowance. I know the proposed amended rule does not say that expressly, but it might be read to imply it, particularly in light of the statement in the Committee Note that authorizes local rules to "require" a claimant to request a hearing or file a response.

In any event, at a minimum, I suggest that the Committee Note state unequivocally that although local rules may impose the obligation on a claimant to respond to a proof of claim, there may matters in which a proof of claim is valid and allowable notwithstanding the failure to file a response to claims objection or request a hearing and that, notwithstanding the failure to respond or request a hearing, the court has the duty to independently determine whether Rule 3001(f) mandates allowance of the claim.

While I have not surveyed how the all the districts address negative notice issues in the claims allowance process, I suspect that there is considerable variation and that some districts have already done what the proposed amendment is intended to expressly authorize – promulgated local rules that require responses to objections to proofs of claim and permit objections to be sustained by default. I have my doubts about the propriety of such a system, but my point here is not to challenge those courts that may be applying existing Rules 3001 and 3007 in a manner that differs from my interpretation of the rules, but rather to comment on the Committee's proposed change to Rule 3007.

Assuming that I am correct regarding the national variation in the application of Rules 3001 and 3007, I am unaware that there has been any litigation that has created a "problem" that necessarily requires action by the Rules Committee. It appears that the proposed amendment was generated by a general sense of unease in certain districts that have negative notice procedures in place or, perhaps, are contemplated enacting such procedures. I do not feel strongly about this next point, because there is some benefit to clarifying the rules if the Committee believes that in some circumstances negative notice procedures are appropriate and may be established by local rule, but I do suggest that the Committee consider whether there is a problem of sufficient national magnitude to warrant the amendment to Rule 3007. The status quo is one in which different districts are handling these matters in different ways – hardly an unusual situation in the bankruptcy system. Does the Rules Committee really need to weigh in on these issues?

5.

I have one final observation.

Based on the modest length of my tenure on the bench, I have concluded that the claims allowance process involves a very delicate balancing of interests. Both objectors (usually debtors, but sometimes trustees) and creditor-claimants often operate in an environment where there are scare resources (i.e., small estates, small claims, small distributions). As a result, there is a great potential and temptation for one side to use whatever leverage that may be available to its advantage. Stereotypical examples of this are: (1) debtors who file marginal claims objections because they do not expect the creditors to respond, either because the creditors are from out-of-town or the amount does not warrant a response, particularly if the creditors have to hire a lawyer; and (2) creditors who file small claims without supporting material to enable the debtor's counsel to assess its validity or claims that clearly are time-barred, on the assumption that the debtor will not object because benefit of objecting to the claim is outweighed by the costs.

My point is not to demonize either side, but simply to emphasize that it is difficult to be confident that the system can be structured in a way that fairly balances the interests of both constituencies and avoids creating incentives for either side to take advantage of the other. In light of these dynamics, I believe the Committee needs to tread carefully when modifying the existing rules governing claims allowance.

Thank you for your consideration of these comments.

From my past service on the Committee, I know that the Committee has great expertise, experience and collective judgment and will ably employ its resources to fashion a rules "product" that will improve the administration of the bankruptcy system.