AMERICAN BAR ASSOCIATION Section of Litigation

Settlement of Class Action Claims is Enforceable Against Debtor in Bankruptcy

By Emily M. Yinger and Michael M. Smith

The global financial crisis led to sharp increases in bankruptcy filings and class action lawsuits. With businesses and individuals turning to bankruptcy to protect their remaining assets, and filing class actions to recover their losses, more plaintiff-class members are likely to be debtors in bankruptcy as well.

In the past, it was simply assumed that debtors were no different than any other class members—their claims could be released by a settlement as long as they were given notice and an opportunity to opt out. But that assumption was virtually untested. Given that bankruptcy law prohibits any act to exercise control over a debtor's property—including any legal claims—can a court approve the release of the debtor's claims as part of a class settlement? Or does the settlement process itself, with its affirmative opt-out requirement, constitute an impermissible exercise of control over the debtor's property?

Eleventh Circuit First to Speak

The Eleventh Circuit recently became the first federal appellate court (and only the second federal court at any level) to address this question in *Thomas v. Blue Cross and Blue Shield Ass'n.* In *Thomas,* a nationwide class of physicians claimed that they had been systematically underpaid by the defendant health insurance companies for over nine years. The appeal arose from the class-wide settlement agreement involving more than 20 of the defendant health insurance companies.

Jemsek was a physician class member who operated a clinic in North Carolina specializing in the treatment of Lyme disease. His unorthodox treatments triggered an investigation by the state medical board that resulted in the restriction of his medical license. The sequence of events that followed is key to the issues addressed by the Eleventh Circuit.

While settlement negotiations were ongoing in the class action, one of the class action defendants, Blue Cross Blue Shield of North Carolina, sued Jemsek in state court seeking to recover payments it had made for Jemsek's questionable Lyme disease treatments. Jemsek then filed for Chapter 11 bankruptcy protection.

Settlement of "Underlying" Class Action

When BCBSNC's state-court case against Jemsek was removed to bankruptcy court, Jemsek asserted various counterclaims against BCBSNC similar to the claims asserted by the plaintiffs

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in *Thomas*. Several months after Jemsek sought bankruptcy court protection, the *Thomas* court preliminarily approved a class-wide settlement agreement. As part of the settlement, the physician class members agreed to release their claims against the health insurance companies, including BCBSNC.

Debtor Does Not Opt Out

Notices were mailed to all physician class members, including Jemsek, asking them whether they wanted to opt out of the class wide settlement agreement. Jemsek did not respond. A year later, the *Thomas* court gave its final approval to the settlement agreement. BCBSNC then moved to enjoin the claims asserted by Jemsek in the bankruptcy case on grounds that they were released by the *Thomas* settlement agreement.

Although Jemsek conceded that he did not opt out of the settlement agreement, he contended that the settlement agreement's release could not be enforced against his claims because he had filed for bankruptcy protection, and brought his claims in the bankruptcy action, before the *Thomas* settlement was approved.

Debtor's Section 362 Argument

Jemsek's poistion was grounded in Section 362 of the bankruptcy code. Section 362 stays any "action or proceeding against the debtor that was or could have been commenced before the commencement of the [bankruptcy] case . . . [or] any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."

Jemsek made two arguments based on this statute. First, he argued that his claims against Blue Cross were "cemented" within the bankruptcy court's jurisdiction before the *Thomas* settlement was approved, and thus the *Thomas* court had no jurisdiction to approve their release. The Eleventh Circuit dismissed that argument because Section 362 stays claims *against* the debtor, not claims *by* the debtor. Thus, under its plain terms, Section 362 had no effect on the claims asserted by Jemsek against Blue Cross.

Jemsek's second argument was more interesting. He asserted that the *Thomas* court ran afoul of Section 362 when it required him to make an election about whether to participate in the settlement or opt out, and thus his election to participate was invalid. Jemsek reasoned that his cause of action against Blue Cross became property of his estate when he filed for bankruptcy protection, and any attempt to "exercise control" over that cause of action would violate Section 362. Accordingly, Jemsek argued, when the *Thomas* court required him to either opt out of the settlement agreement or participate and release his claims against the defendants (including Blue Cross), the court improperly exercised control over his claims against Blue Cross.

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Class Settlement Upheld

The Eleventh Circuit rejected Jemsek's argument. It held that merely asking a debtor to make a decision about releasing his claims does not constitute an exercise of control of the property of the bankrupt estate. The court noted that, although Jemsek's claims were indeed property of the bankruptcy estate, the bankruptcy filing did not stay those claims. Because the claims were not stayed, Blue Cross was free to defend itself against them, and free to cause the claims to be settled. "It would not make sense under a plain reading of the [bankruptcy] statute," said the court, "to treat raising a defense against a non-stayed counterclaim as an 'exercise of control over property.'" Thus, a court administering a class action suit does not violate the automatic stay, or exercise any control over the debtor's claim, by requiring the debtor to make an election whether to opt out or participate in a class settlement. The court concluded "[d]ebtors holding claims as plaintiffs . . . must play by the same rules of procedure as any other plaintiff."

The Eleventh Circuit's interpretation of Section 362 forecloses an avenue of attack that could have affected the enforceability of existing class action settlements against some class members and made future settlements more difficult to achieve. The ruling confirms that a class member who petitions for bankruptcy protection before a class action is settled can be bound by a post-petition settlement agreement.

Editor's Note: Bankruptcy, class settlements, and related topics will be explored at the upcoming 13th Annual National Institute on Class Actions in San Francisco (October 30) and Washington, D.C. (November 20).

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