

SEVENTH CIRCUIT AFFIRMS “CLASS CERTIFICATION BY ESTOPPEL” THEORY; SUPREME COURT DENIES REVIEW

The Supreme Court in January declined to review a Seventh Circuit decision holding that a defendant’s support of a proposed class settlement estops the defendant from later opposing certification of a litigation class in the event the proposed settlement is not approved. The defendants had argued that such a result—handed down in *Carnegie v. Household Int’l, Inc.*¹—would “discourage the settlement of class actions.” Rejecting that suggestion, the Seventh Circuit (Posner, J.) noted that “[t]he pressures for settlement of class actions are enormous and will be not be lessened significantly by our upholding the class certification.”

Carnegie involved two consolidated challenges to an income tax refund anticipation loan program offered by Household International and H&R Block. On behalf of a nationwide class, the plaintiffs alleged that Household and H&R Block failed to disclose that, under the programs, the tax preparer defendants received referral fees from the bank defendants that originated the refund anticipation loans. This nondisclosure was said to constitute mail and wire fraud, and thus to create liability under RICO, the federal racketeering statute.

After nine years of litigation, the defendants and one of the named plaintiffs entered into a “global settlement” intended to resolve all pending class actions on a classwide basis in exchange for a \$25 million settlement payment. As part of the proposed settlement, the defendants joined with the named plaintiff in representing to the district court that the settlement class was certifiable under Fed. R. Civ. P. 23, and the district court duly approved the settlement. The Seventh Circuit reversed, however, finding that the settlement was collusive. On

remand, the district court followed the Seventh Circuit’s directive, refused to approve the settlement, and appointed new counsel for the plaintiffs. “[R]ather than require the new plaintiff to move for certification[,] the [district] judge asked the defendants for their objections to certification, and they responded.” After considering the defendants’ class certification objections, the district court then certified a class for litigation—“the same class that had been contemplated by the rejected settlement.”

On appeal, the defendants attacked the class certification procedure followed by the district court, arguing that the district court had improperly shifted the burden of persuasion to the defendants by requiring them to show cause why class certification should *not* be granted, and that the district court failed to address the significant manageability issues involved in trying the claims of a multimillion member class. The Seventh Circuit held that the defendants’ previous support for a class settlement barred them from challenging certain aspects of class certification. Said the court:

In the previous round of this protracted litigation the defendants had urged the district court to accept the giant class as appropriate for a global settlement, had prevailed in their urging, and so are precluded by the doctrine of judicial estoppel . . . from challenging its adequacy, at least as a settlement class (the significance of this qualification will appear in due course). It is true that we reversed the district court’s approval of the settlement, but a reversal need not affect the application of judicial estoppel [T]he

defendants benefited from the temporary approval of the settlement, which they used to enjoin other [refund anticipation loan] litigation against them; and having reaped a benefit from their pertinacious defense of the class treatment of the case for purposes of settlement they cannot now be permitted to seek a further benefit from reversing their position.²

The Seventh Circuit further noted that while the defendants were entitled to challenge two aspects of class certification (manageability and adequacy of representation) notwithstanding their previous support for a certified settlement class, the defendants had failed to proffer a sufficient evidentiary basis for their arguments on those points.

Depending on how it is received in other circuits, *Carnegie* could prove to be a watershed in class action settlement strategy. The immediate significance of *Carnegie* is that, in the Seventh Circuit, defendants that support class certification in the settlement context will need to be particularly careful about ensuring that the requisites of settlement certification under Fed. R. Civ. P. 23(e) are satisfied, since a failure to obtain settlement approval will preclude many objections to later certification of a litigation class. More broadly, *Carnegie* suggests that defendants should be chary of entering into class settlement negotiations before the plaintiff’s motion for certification of a litigation class has been decided.

Footnotes

¹ 376 F.3d 656 (7th Cir. 2004), *cert. denied sub nom.* H&R Block, Inc. v. Carnegie, 2005 U.S. LEXIS 465 (Jan. 10, 2005).

² *Id.* at 660 (citations omitted).