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MAY 28 2019

CLERK U.S. BANKRUPTCY COURT
Central District of California
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UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

LOS ANGELES DIVISION

In re: Verity Health System of California, Inc., *et al.*,

Debtors and Debtors in Possession.

☒Affects All Debtors

☐ Affects Verity Health System of California, Inc.
☐ Affects O'Connor Hospital
☐ Affects Saint Louise Regional Hospital
☐ Affects St. Francis Medical Center
☐ Affects St. Vincent Medical Center
☐ Affects Seton Medical Center
☐ Affects O'Connor Hospital Foundation
☐ Affects Saint Louise Regional Hospital Foundation
☐ Affects St. Francis Medical Center of Lynwood Medical Foundation
☐ Affects St. Vincent Foundation
☐ Affects St. Vincent Dialysis Center, Inc.
☐ Affects Seton Medical Center Foundation
☐ Affects Verity Business Services
☐ Affects Verity Medical Foundation
☐ Affects Verity Holdings, LLC
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures - San Jose Dialysis, LLC

Debtors and Debtors in Possession.,

Lead Case No.: 2:18-bk-20151-ER
Chapter: 11

Jointly Administered With:
Case No. 2:18-bk-20162-ER;
Case No. 2:18-bk-20163-ER;
Case No. 2:18-bk-20164-ER;
Case No. 2:18-bk-20165-ER;
Case No. 2:18-bk-20167-ER;
Case No. 2:18-bk-20168-ER;
Case No. 2:18-bk-20169-ER;
Case No. 2:18-bk-20171-ER;
Case No. 2:18-bk-20172-ER;
Case No. 2:18-bk-20173-ER;
Case No. 2:18-bk-20175-ER;
Case No. 2:18-bk-20176-ER;
Case No. 2:18-bk-20178-ER;
Case No. 2:18-bk-20179-ER;
Case No. 2:18-bk-20180-ER;
Case No. 2:18-bk-20181-ER;

Chapter 11 Cases.

MEMORANDUM OF DECISION DENYING MOTION OF LYNN C. MORRIS, HILDA L. DAILY, AND NOE GUZMAN FOR AUTHORIZATION TO FILE A CLASS PROOF OF CLAIM

Date: May 21, 2019

Time: 10:00 a.m.

Location: Ctrm. 1568
Roybal Federal Building
255 East Temple Street
Los Angeles, CA 90012

At the above-captioned date and time, the Court conducted a hearing on the *Motion of Plaintiffs Lynn C. Morris, Hilda L. Daily and Noe Guzman for Authorization to File a Class Proof of Claim on Behalf of Claimants Similarly Situated* [Doc. No. 1981] (the "Motion").[1] The Court took the Motion under submission at the conclusion of the hearing. For the reasons set forth below, the Motion is DENIED.[2]

I. Facts and Summary of Pleadings

On August 31, 2018 (the "Petition Date"), Verity Health Systems of California ("VHS") and certain of its subsidiaries (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. On August 31, 2018, the Court entered an order granting the Debtors' motion for joint administration of the Debtors' Chapter 11 cases. Doc. No. 17.

Lynn C. Morris, Hilda Daily, and Noe Guzman (collectively, the "Movants") seek authorization to file a class prepetition unsecured proof of claim on behalf of similarly situated creditors. Each Movant is employed at hospitals operated by the Debtors and is a participant in the Debtors' retirement plan. Movants intend to commence litigation against VHS, alleging that VHS diverted assets from Movants' underfunded retirement plan to create a new overfunded retirement plan, and that such actions constituted a breach of fiduciary duties imposed by the Employee Retirement Income Securities Act ("ERISA"). Debtors oppose the Motion, arguing that the Court should not permit the filing of a class proof of claim because Movants' allegations are completely devoid of merit.

A. The Debtors' Retirement Plans

Prior to 2015, the Debtors were operated by the Daughters of Charity under the name Daughters of Charity Health System ("DCHS"). Declaration of Richard G. Adcock in Support of Emergency First-Day Motions [Doc. No. 8] (the "First Day Decl.") at ¶¶ 82–88. In July 2015, DCHS entered into a recapitalization transaction with BlueMountain Capital Management LLC ("BlueMountain"), in which DCHS' name was changed to Verity Health System. *Id.* at ¶ 88. In connection with the BlueMountain transaction, the Debtors retained liabilities with respect to various DCHS pension plans, including a single employer defined benefit plan known as the "Church Plan." Declaration of Carlos De La Parra [Doc. No. 2225] (the "De La Parra Decl.") at ¶ 7. The Church Plan did not comply with ERISA, was not insured by the Pension Benefit Guaranty Corporation (the "PBGC"), and was significantly underfunded. *Id* at ¶¶ 7–8. The Debtors converted the Church Plan into the Verity Health System Retirement Plan (the "Verity Plan"), which did comply with ERISA and was partially insured by the PGBC. *Id* at ¶ 7.

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[1] The Court considered the following papers in adjudicating the Motion:

1) Notice of Motion and Motion of Plaintiffs Lynn C. Morris, Hilda L. Daily and Noe Guzman for Authorization to File a Class Proof of Claim on Behalf of Claimants Similarly Situated [Doc. No. 1981] (the "Motion");
    a) Declaration of Adam Thomas in Support of [Motion] [Doc. No. 1982];
2) Debtors' Objection to the Motion of Lynn C. Morris, Hilda Daily and Noe Guzman for Authorization to File a Class Proof of Claim on Behalf of Claimants Allegedly Similarly Situated [Doc. No. 2225] (the "Opposition");
3) Response of Claimants Lynn C. Morris, Hilda L. Daily, and Noe Guzman to Debtors' Objection to Motion for Authorization to File Class Claim [Doc. No. 2289] (the "Reply"); and
    a) Declaration of Emily P. Rich in Support of [Reply] [Doc. No. 2290].

[2] This disposition is not appropriate for publication.

Effective December 31, 2016, the Board of Directors of VHS (the "Board") converted the Verity Plan into Plan A and created Plan B. *Id.* at ¶ 9. Plan B was funded with approximately $7,996,440 from the corpus of the Verity Plan. *Id.* Prior to the creation of Plan B, the Verity Plan had assets of $274,549,560. *Id.*

The Board conducted a special session on December 28, 2016, to consider the creation of Plan B. According to the minutes of the Board's meeting, Plan B was created "to reduce current and future premium costs from [the PBGC]." Telephonic Meeting Minutes [Doc. No. 2255 at pp. 43–44] (the "Minutes"). The Minutes explain the purpose and structure of the transaction as follows:

> Specifically, the assets spun off to the new de minimis plan [Plan B] must be no more than 3% of the total assets of the Plan before the spin-off per IRS regulations, which is approximately $8 million. In order to qualify as a de minimis spin-off, a plan sponsor must transfer assets equal to the benefit obligations being spun-off to the new plan. As a result, the spun-off plan is fully funded and does not have a variable-rate premium ("VRP"). The goal of the spin-off is to have as many participants transferred to the spinoff plan as possible because the savings is based on the number of participants in the spinoff plan [Plan B]. Once the headcount is reduced in the original plan [the Verity Plan, which was converted to Plan A] while maintaining the same unfunded obligation, the VRP for the original plan is reduced due to the $500 per participant cap being applied to a lower headcount. As a result of the spin-off, PBGC premiums paid by the Plan is estimated to decrease by $300,000 to $800,000 in 2017. The annual savings will continue for each subsequent year. The actual savings will be determined by the final number of members who can be moved to the new spinoff plan. Management is still finalizing the appropriate categories of employees to transition to the de minimis spinoff plan.

Minutes at ¶ 2.

According to filings with the United States Secretary of Labor, as of December 31, 2015 (prior to the creation of Plan B), the Verity Plan was underfunded, having assets sufficient to cover only 66.36% of the Verity Plan's liabilities. Schedule SB (Form 5500) for Verity Plan, Plan Year 2015, at Part II, § 14 [Doc. No. 1980, Ex. A]. As of December 31, 2016 (subsequent to the creation of Plan B), the newly-created Plan A (the successor to the Verity Plan) had assets sufficient to cover only 65.41% of Plan A's liabilities. Schedule SB (Form 5500) for Plan A, Plan Year 2016, at Part II, § 14 [Doc. No. 1980, Ex. B]. That is, subsequent to the creation of Plan B, Plan A's ability to satisfy its liabilities was reduced by approximately one percentage point, from 66.36% to 65.41%. As of December 31, 2016, Plan B was overfunded, having assets sufficient to cover 128.79% of Plan B's liabilities. Schedule SB (Form 5500) for Plan B, Plan Year 2016, at Part II, § 14 [Doc. No. 1980, Ex. C].

No member of the Board or of the BAC is a beneficiary of Plan B. Declaration of Steven C. Sharrer [Doc. No. 2255] (the "Sharrer Decl.") at ¶ 8. No member of the Debtors' management is a beneficiary of Plan B. *Id.* at ¶ 9.

<u>B. The Proposed Class Proof of Claim</u>

Movants initially sought authorization to file a class proof of claim which would allege that "the BAC decided to transfer assets out of Plan A, and into Plan B, in order to protect their personal retirement benefits from any negative consequences associated with Plan A's underfunded status." Motion at 12. The proposed class claim would further allege that:

1) "Each of the BAC members, and approximately 1,000 of their fellow executives, were participants in [the Verity Plan] when the BAC decided to take this action, which included spinning $7,996,440.00 worth of assets out of the 'under-funded' Plan A and into Plan B." Motion at 12.
2) "Each BAC member personally benefited from this spin-off by virtue of Plan B immediately being overfunded by 128.79% (thereby providing each member of the BAC with a much greater degree of retirement security). This constitutes a self-interested benefit obtained by each member of the BAC, in violation of ERISA §§ 406(a)(1)(D), and 406(b)(1)." *Id.* at 12–13.
3) "[T]he Debtor, by and through the BAC, breached a fiduciary duty of loyalty owed to [Movants] … when it made the decision to spin assets off from Plan A, and into Plan B. In so doing, the Debtor and the BAC … failed to act solely in the interest of all participants and beneficiaries … [in violation of] ERISA §§ 404(a)(1)(A)(I)–(ii)." *Id.* at 13.
4) "[T]he Debtor, by and through the BAC, breached a fiduciary duty of prudence owed to [Movants under] … ERISA § 404(a)(1)(B) …. The BAC breached this duty … when it transferred … assets out of Plan A … for the exclusive benefit of Plan B participants." *Id.*

After the Debtors presented evidence showing that (1) it was the VHS Board, not the BAC, that executed the spinoff and that (2) no members of the Board are beneficiaries of Plan B, Movants modified the theory underlying their proposed class proof of claim. Movants now seek authorization to file a class proof of claim alleging that:

1) "[T]he Board exercised discretion to dispose of plan assets in the [Verity Plan], by moving them into Plan B and in doing so, it breached ERISA's fiduciary duties by failing to act in the best interest of all participants and beneficiaries in the [Verity Plan], and by using the assets of the [Verity Plan] to reduce the Debtors' operating costs." Reply at 7–8.
2) "[T]he spin-off of Plan B used plan assets and hurt Plan A participants by increasing the underfunding of Plan A, and this decision was made in order to reduce PBGC premiums paid by the employer…. Thus, while acting as a plan sponsor and party-in-interest, VHS made a decision to use plan assets at the expense of Plan A participants in order to benefit itself, the employer…. This is a violation of ERISA § 403 where the $7.9 million in assets 'inured' to the benefit of the Debtors, and violates ERISA § 406(a)(1)(D) … because it involved a 'transfer of assets' out of the [Verity Plan] for the use and benefit of the Debtors." *Id.* at 13.

The proposed class would consist of the approximately 6,924 beneficiaries who remained in Plan A subsequent to the spinoff transaction. Movants seek a monetary remedy payable by VHS, as well as attorneys' fees.

C. Summary of Papers Filed in Connection with the Motion

As described above, Movants modified the legal theory underlying their proposed class proof of claim after the Debtors presented evidence showing that certain of Movants' claims were predicated upon a demonstrably false factual predicate. The shift in Movants' legal theory has mooted some of the factual disputes initially placed at issue by the Motion. Specifically, Movants have abandoned their theory that the spinoff was a self-interested transaction by the BAC, and now argue that in executing the spinoff transaction, the Board violated its fiduciary duties to beneficiaries of the Verity Plan (which was subsequently renamed Plan A).

The primary issues that remain in dispute are as follows. First, Debtors assert that Movants' claim for breach of the fiduciary duties imposed by ERISA fails as a matter of law. According to Debtors, the ERISA allegations do not state a claim because the Board was not acting in its fiduciary capacity when it executed the spinoff transaction. Movants contend that the Board was acting in its fiduciary capacity, on the ground that the Board exercised discretionary authority to transfer assets in the Verity Plan into the newly created Plan B.

Second, Debtors contend that class certification would be wasteful and would interfere with the administration of the estate. Debtors note that the PBGC is already pursuing proofs of claim on account of the underfunded status of Plan A. Debtors argue that Movants' proposed class proof of claim is effectively duplicative of the claims being pursued by the PBGC. Movants dispute that their proposed class proof of claim is duplicative. Movants argue that unlike the PBGC, they are seeking relief for violations of Title I of ERISA, and that the PBGC lacks standing to pursue such claims.

II. Findings and Conclusions

Class certification is governed by Civil Rule 23. Bankruptcy Rule 7023 provides that Civil Rule 23 "applies in adversary proceedings." Under Bankruptcy Rule 9014(c), the Court has discretion to apply Bankruptcy Rule 7023 to the claims administration process. Courts have developed a three-factor framework to guide the exercise of this discretion:

1) whether the class was certified pre-petition;
2) whether the members of the putative class received notice of the bar date; and
3) whether class certification will adversely affect the administration of the estate.

In re Chaparral Energy, Inc., 571 B.R. 642, 646 (Bankr. D. Del. 2017).

These factors were first articulated in *In re Musicland Holding Corp.*, 362 B.R. 644, 654 (Bankr. S.D.N.Y. 2007) and are commonly referred to as the "*Musicland* factors." "No one factor is dispositive; a factor may take on more or less importance in any given case." *Chaparral Energy,* 571 B.R. at 646.

Only if the Court determines that it is appropriate to apply Bankruptcy Rule 7023 to the claims administration process does the Court proceed to determine whether the requirements of Civil Rule 23 have been satisfied. As explained by the *Chapparal Energy* court:

> Whether to permit a class action proof of claim is a matter of discretion. In exercising that discretion, a two-step analysis is performed. First, the court must decide whether it is beneficial to apply Bankruptcy Rule 7023, via Bankruptcy Rule 9014(c), to the claims administration process. Second, the court must determine whether the requirements of Federal Rule 23 have been satisfied, such that a class proof of claim may properly be

filed.

Id. (internal citations omitted); *see also Gentry v. Siegel*, 668 F.3d 83, 93 (4th Cir. 2012) ("Civil Rule 23 factors do not become an issue until the bankruptcy court determines that Rule 7023 applies by granting a Rule 9014 motion. The issue on such a motion centers more directly on whether the benefits of applying Rule 7023 (and Civil Rule 23) are superior to the benefits of the standard bankruptcy claims procedures.").

Careful consideration of the *Musicland* factors is necessary because "class certification may be 'less desirable in bankruptcy than in ordinary civil litigation.'" *In re Ephedra Prod. Liab. Litig.*, 329 B.R. 1, 5 (S.D.N.Y. 2005). Consequently, "[e]ven class actions that were certified prior to the filing for bankruptcy may … be disallowed." *Id.*

In *In re First Alliance Mortgage Co.*, the District Court for the Central District of California stated that "class action devices … are particularly appropriate" in bankruptcy proceedings, and that "the party opposing the use of class devices [bears] the burden." *First All. Mortg. Co.*, 269 B.R. 428, 445 (C.D. Cal. 2001). In the eighteen years since it was published, no decision—either published or unpublished—has cited *First Alliance* for this proposition.[3] More recent decisions within the Ninth Circuit have approached class proofs of claim in a manner inconsistent with the standard set forth in *First Alliance*.

For example, in *In re Aughney*, the court expunged a class proof of claim, reasoning that the "essential problem with a class proof of claim is that class action procedures often conflict with established bankruptcy procedures." *Aughney*, No. 10-12666, 2011 WL 479010, at *1 (Bankr. N.D. Cal. Feb. 4, 2011). The court held that "class claims can be allowed, especially where a class was certified before bankruptcy or principles of equity and simple justice militate in favor of a claim being pursued on behalf of a class," but emphasized that a "prerequisite for allowance … is that the proponent must seek and obtain a determination of the Bankruptcy Court that Rule 7023 of the Federal Rules of Bankruptcy Procedure be made applicable to the claims process." *Id.* In *Westfall v. MII Liquidation Inc.*, the District Court upheld the Bankruptcy Court's denial of class certification, explaining that "bankruptcy courts have broad discretion to allow or disallow such class claims." *Westfall*, No. 06-CV-02343-BENNLS, 2007 WL 2700951, at *4 (S.D. Cal. Sept. 11, 2007).

Courts outside the Ninth Circuit have also declined to follow *First Alliance*. In *Gentry v. Siegel*, the court "weighed the benefits and costs of class litigation against the efficiencies created by the bankruptcy claims resolution process." *Gentry*, 668 F.3d 83, 92 (4th Cir. 2012). The court "looked at the issue both on a systemic level and in light of the facts specific to [the] case." *Id.*

First Alliance's holding that class actions are particularly appropriate in bankruptcy proceedings, and that the party opposing a class proof of claim bears the burden of proof, is also inconsistent with the *Musicland* factors. The *Musicland* factors—which have been widely adopted—do not contain a presumption in favor of a class proof of claim. To the contrary, application of the *Musicland* factors requires an "exercise of … discretion" and "a fact and case specific analysis." *Chaparral Energy,* 571 B.R. at 646. The Court declines to follow *First Alliance* for the propositions that class actions are particularly appropriate in bankruptcy or that the party opposing class certification bears the burden of proof. Instead, the Court applies the

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[3] Five published and six unpublished decisions have cited *First Alliance*. None of these eleven decisions cite *First Alliance* for the proposition that class actions are particularly appropriate in bankruptcy proceedings or that the party opposing a class proof of claim bears the burden of proof.

Musicland factors to determine whether Civil Rule 23 should be made applicable to the claims administration process.

A. Factors 1 and 2: Prepetition Certification and Notice of the Bar Date

The first *Musicland* factor is whether the putative class was certified prepetition. The second factor is whether putative class members received notice of the bar date. The first two factors "are critical" and are often evaluated concurrently. *Musicland*, 362 B.R. at 655. "[Putative members of an uncertified class members who received actual notice of the bar date but did not file timely claims are the least favored candidates for class action treatment." *Id.* Allowing class certification for such creditors would effectively extend "the bar date for the benefit of those who sat on their rights … at the expense of vigilant creditors who observed the bar date." *Id.*

1. Prepetition Certification

The putative class has not been certified prepetition. In fact, no litigation has been commenced at all. The allegedly wrongful conducted occurred on December 31, 2016. The publicly available forms reporting the funding status of Plans A and B which supply the basis for Movants' allegations were filed with the Department of Labor on October 10, 2017. *See* Schedule SB (Form 5500) for Plan A, Plan Year 2016 [Doc. No. 1980, Ex. B] and Schedule SB (Form 5500) for Plan B, Plan Year 2016 [Doc. No. 1980, Ex. C]. The Debtors sought bankruptcy protection on August 31, 2018. Movants' claims arose and could have reasonably been discovered sufficiently far in advance of the Petition Date to permit prepetition class certification. At the very least, litigation could have been commenced prepetition.[4] Yet even after expiration of the bar date and the filing of the motion seeking class certification, Movants still had not finalized the legal theory underlying their proposed class complaint.

The changes in Movants' legal theory are not minor. Movants initially alleged that members of the BAC engaged in a self-interest transaction by creating the overfunded Plan B for their own benefit. After the Debtors presented evidence showing that BAC members are not beneficiaries of Plan B, Movants alleged that in creating Plan B, the VHS Board violated its fiduciary duties to beneficiaries of the Verity Plan and Plan A (the successor to the Verity Plan). According to this new theory, the insurance savings resulting from Plan B's creation inured to VHS' benefit, but the harm resulting from the concomitant reduction in Plan A's assets was born by the Debtors' employees.[5]

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[4] Movants dispute that they could have commenced the litigation prepetition. Movants contend that a review of the plans' publicly available forms—commonly referred to as the "Forms 5500"—would not have been sufficient to put them on notice of the alleged fiduciary breach. In support of this contention, Movants cite *Fink v. Nat'l Sav. & Tr. Co.*, 772 F.2d 951, 957 (D.C. Cir. 1985), in which the court held that the filing of Form 5500 would not provide constructive knowledge of certain types of fiduciary breaches.

Fink is distinguishable. The *Fink* court held that a review of Form 5500 would not have provided plaintiffs notice of their claims because the fiduciary breach was one of omission—specifically, the fiduciary had allegedly failed to conduct an independent evaluation of the prudence of the plan's investments. *Fink*, 772 F.2d at 958. The *Fink* court reasoned that the absence of an independent evaluation would not have been apparent from a review of Form 5500. *Id.*

By contrast, here the alleged fiduciary breach was the decision to spin off 3% of the assets of the Verity Plan into Plan B. Unlike the alleged breach in *Fink*, the existence of the spinoff decision would have been readily apparent from a review of the Forms 5500 filed by the plans.

[5] In an attempt to salvage their initial theory that the BAC wrongfully executed the spinoff to protect the retirement benefits of BAC members, Movants argue that the evidence presented by the Debtors shows only that no *current*

Movants' approach to the proposed class proof of claim is not well taken. Movants' initial legal theory was based upon a false factual assumption—that the BAC created Plan B for its own benefit—that could have easily been discovered. The Debtors sought bankruptcy protection on August 31, 2018. At any time after this date, Movants could have sought information from the Debtors in support of their class proof of claim under Bankruptcy Rule 2004. An examination under Rule 2004 may relate "to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate …." In Chapter 11 cases, the examination "may also relate to … any … matter relevant to the case or to the formulation of a plan." "The scope of a Rule 2004 examination is exceptionally broad," and Rule 2004 examinations "have been compared to a 'fishing expedition.'" *In re Duratech Indus., Inc.*, 241 B.R. 283, 289 (E.D.N.Y. 1999). Rule 2004 contains a mechanism for compelling the production of documents. *See* Bankruptcy Rule 2004(c). At least one court has recognized that Rule 2004 is an appropriate means of obtaining discovery in support of a proposed class proof of claim. *See In re Associated Cmty. Servs., Inc.*, 520 B.R. 650, 655–56 (Bankr. E.D. Mich. 2014) ("If Pepper [the claimant] needed to conduct discovery before filing a motion to apply Rule 7023, he had ample time to do so under Fed. R. Bankr. P. 2004. Rule 2004 examinations are routinely granted, and are one of the few instances where the Federal Rules of Civil Procedure permit discovery to be taken before filing a motion or commencing an action. Pepper offers no explanation as to why he has not taken a Rule 2004 examination or sought any other discovery to date that could assist him in assembling whatever facts he believes are necessary before filing a motion to apply Rule 7023.").

In addition to the fact that the putative class was not certified prepetition, Movants' proposed claims are wholly without merit. The Court recognizes that in determining whether to apply Civil Rule 23 to the claims administration process, the focus is typically not upon the merits of the underlying claims. Nonetheless, application of the *Musicland* factors requires "a fact and case specific analysis." *Chaparral Energy,* 571 B.R. at 646. In conducting that case specific analysis, the Court has an obligation to screen out nonmeritorious class proofs of claim in order to conserve estate resources. That is particularly the case where, as here, Movants have abused the litigation process by first filing a class proof of claim containing allegations which Movants should have known lacked evidentiary support, and then by dramatically modifying their legal theory after the Debtors pointed out the claims' fundamental defects.

Movants allege that by executing the spinoff transaction, the Board violated its fiduciary duties to those participants in the Verity Plan that were subsequently transferred to Plan A.

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member of the BAC is a beneficiary of Plan B. Movants contend that the Debtors' evidence does not rule out the possibility that *former* members of the BAC may be beneficiaries of Plan B.

The declaration of Steven C. Sharrer, the Debtors' Chief Human Resource Officer, provides that "[n]either I nor any other member of the BAC is a beneficiary of Plan B." Sharrer Decl. at ¶ 8. The Sharrer Declaration further provides that "[n]o member of management of the Debtors or the Board of Directors of VHS is a Plan B beneficiary." *Id.* at ¶ 9. The Sharrer Declaration does not specify the time frame to which these statements apply. However, when reading the statements in context, it is clear that they are intended to refer to the time period during which the spinoff transaction was executed. The Court finds that the Sharrer Declaration sufficiently establishes that no members of the BAC, the Board, or the Debtors' management were beneficiaries of Plan B at the time the Board voted to execute the spinoff transaction.

At the hearing, Movants' counsel alleged, on information and belief, that senior executives of VHS who voted in favor of the spinoff transactions were and are beneficiaries of Plan B. Movants offered no evidence in support of this allegation. As set forth above, the only evidence in the record shows that the VHS Board members who voted for the spinoff transaction are not, and were not, beneficiaries of Plan B. Movants' unsubstantiated allegations to the contrary do not warrant granting the Motion.

Movants' theory is that the spinoff harmed participants in Plan A by reducing the assets available to satisfy Plan A's obligations.

Movants' allegations that the Board violated the fiduciary duties imposed by ERISA fail as a matter of law. The "threshold question" in an action charging breach of fiduciary duty under ERISA is "not whether the actions of some person … adversely affected a plan beneficiary's interest, but whether that person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to complaint." *Pegram v. Herdrich*, 530 U.S. 211, 226 (2000). Here, the Board was not acting in a fiduciary capacity when it executed the spinoff transaction.

Through the spinoff transaction, the Board amended the Verity Plan "by spinning off to a new and separate plan maintained by Verity [Plan B] the liability attributable to certain participants in the Plan and assets equal to such liability." Resolution 2016-12-28-1 of the Board of Directors of Verity Health System of California, Inc. Re: Approval of Spinoff Retirement Plan [Doc. No. 2255 at pp. 46–47] (the "Spinoff Resolution"). In so amending the Verity Plan, the Board was not acting in its fiduciary capacity within the meaning of ERISA because "[p]lan sponsors who alter the terms of a plan do not fall into the category of fiduciaries." *Lockheed Corp. v. Spink*, 517 U.S. 882, 890, 116 S. Ct. 1783, 1789, 135 L. Ed. 2d 153 (1996). As the Supreme Court has held, "employers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans. When employers undertake those actions, they do not act as fiduciaries, but are analogous to the settlors of a trust." *Id.* (internal citations and quotation marks omitted). Applying *Lockheed*, the Ninth Circuit has held that "a decision to spin a plan off … is not a fiduciary act." *Paulsen v. CNF Inc.*, 559 F.3d 1061, 1076 (9th Cir. 2009).

The Ninth Circuit's opinion in *Paulsen v. CNF Inc.* relied upon *Systems Council EM-3 v. AT&T Corp.*, 159 F.3d 1376 (D.C. Cir. 1998). *Systems Council* is instructive, as its facts are similar to the instant matter. In *Systems Council*, AT&T decided to reorganize its corporate structure by spinning off operations into separate businesses, one of which was Lucent. *Id.* at 1378. Pursuant to the reorganization, AT&T executed an agreement with Lucent, under which AT&T would spinoff assets in its employee benefit plan to a plan established for the benefit of Lucent. *Id.* The plaintiffs alleged that AT&T violated fiduciary duties imposed by ERISA by favoring itself in the allocation of plan assets. *Id.* The court dismissed the complaint, concluding that AT&T was not acting in its fiduciary capacity when it amended the plan to allocate assets and liabilities between AT&T and Lucent. *Id.* at 1379–80.

As in *Systems Council*, here the Board amended the Verity Plan to allocate assets and liabilities between Plan A and Plan B. As was the case in *Systems Council*, the amendment to accomplish the allocation does not constitute a fiduciary act.

Movants contend that *Paulsen* and *Systems Council* do not apply because the spinoff transactions in those cases were undertaken in connection with divestitures of business units, whereas in the present case no such divestiture occurred. The distinction Movants highlight is immaterial. The holdings of *Paulsen* and *Systems Council* did not depend upon *why* the plan sponsors decided to spin off plan assets. Instead, those cases reasoned that the decision to spin off plan assets constituted an amendment to the plan, and that an amendment to the plan was not a fiduciary act. *See Systems Council*, 159 F.3d at 1379–80; *Paulsen*, 559 F.3d at 1076.[6]

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[6] Movants contend that the spinoff transaction was not an amendment to the plan, because VHS did not alter the plan's substantive terms or eligibility requirements. *Systems Council* makes clear that a spinoff transaction qualifies as an amendment. The *Systems Council* court stated that "AT&T amended its pension and welfare plans to divide

Movants further allege that the spinoff transaction violated ERISA § 403(c). ERISA § 403(c) provides in relevant part:

> [T]he assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

Movants' theory is that in spinning off 3% of the Verity Plan's assets to create Plan B, VHS caused such assets to inure to its benefit, because the purpose of the spinoff transaction was to reduce the amount of premiums VHS was obligated to pay to the PBGC.

This allegation is without merit. First, the allegation fails because the Board was not acting in its fiduciary capacity when executing the spinoff transaction, for the reasons set forth above. Second, ERISA § 403(c)'s anti-inurement provision "demands only that plan assets be held for supplying benefits to plan participants." *Raymond B. Yates, M.D., P.C. Profit Sharing Plan v. Hendon*, 541 U.S. 1, 22, 124 S. Ct. 1330, 1344, 158 L. Ed. 2d 40 (2004). The purpose of the provision "is to apply the law of trusts to discourage abuses such as self-dealing, imprudent investment, and misappropriation of plan assets, by employers and others." *Id.* at 23. Movants' claims fail because Movants do not allege that the assets transferred to Plan B were used for any purpose other than supplying benefits to plan participants.

In *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 435, 119 S. Ct. 755, 759, 142 L. Ed. 2d 881 (1999), the Supreme Court held that allegations similar to those made here failed to state a claim for violation of ERISA's anti-inurement provision. In *Hughes*, plaintiffs alleged that Hughes violated its fiduciary duties by amending its retirement plan. *Id.* at 435. The amendments prevented new participants from contributing to the plan, thereby ensuring that new participants would receive fewer benefits. *Id.* at 436. The court held that even if the amendments benefitted Hughes by reducing its labor costs, the receipt of such benefits would not constitute improper inurement. *Id.* at 441–42.

Similar to the situation in *Hughes*, Verity's amendment to its plan benefitted Verity by reducing its PBGC premiums. The benefit of reduced PBGC premiums, like the benefit of reduced labor costs in *Hughes*, does not constitute improper inurement.

2. Notice of the Bar Date

The Debtors provided notice of the bar date to Plan A participants who were current employees of the Debtors on the Petition Date. All Plan A participants who were former employees were kept apprised of important dates in the cases by the Plan A administrator. Adcock Decl. at ¶ 6. It is not clear from the record whether the Plan A administrator provided notice of the bar date to former employees.

However, whether plan participants received notice of the bar date is not relevant for purposes of determining the appropriateness of class certification, because individual plan participants lack standing to pursue claims on behalf of Plan A. The PBGC has advised the Debtors that it will shortly initiate the process of terminating Plans A and B. Sharrer Decl. at ¶ 12–13. "Upon distress termination, employers are liable to PBGC for any unfunded benefit

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the assets and liabilities of AT&T's defined plans" between AT&T and Lucent. *Systems Council*, 159 F.3d at 1377. The court further stated that the "issue in this case is whether AT&T acted in a fiduciary capacity when it amended its pension and welfare plans and allocated the assets and liabilities of those plans between AT&T and Lucent." *Id.* at 1378.

liabilities. After recovery from the employer, PBGC must pay plan participants all guaranteed benefits and a portion of non-guaranteed benefits based on a statutory formula." *Paulsen v. CNF Inc.*, 559 F.3d 1061, 1074 (9th Cir. 2009). The Ninth Circuit has held that where a plan is subject to a distress termination, plan participants lack standing to assert claims against the plan sponsor for breach of ERISA fiduciary duties. *Id.* at 1073. Recovery for a breach of fiduciary duties inures to the benefit of the plan as a whole, and not to an individual beneficiary. *Id.* Since upon distress termination the plan is under the control of the PBGC, any recovery would go to the PGBC, which is already required to distribute benefits in accordance with a detailed statutory formula. *Id.* at 1073–74. Therefore, courts lack the ability to redress the plan participants' injury through a favorable decision. *Id.* at 1074. *See also In re Adams Hard Facing Co.*, 129 B.R. 662, 663 (W.D. Okla. 1991) (holding that if plan participants "make claims directly against the bankruptcy estate, the purposes of ERISA § 4022(c) will be defeated"); *United Steelworkers of America, AFL-CIO, CLC v. United Eng'g, Inc.*, 52 F.3d 1386, 1392 (6th Cir. 1995) ("Several courts that have addressed the issue that confronts us today have held that ERISA now preempts direct against the employer").

Because Plan A participants lack standing to assert their claims, the fact that certain Plan A participants may not have received actual notice of the bar date is immaterial.

B. Factor 3: Whether Class Certification Will Adversely Affect the Administration of the Estate

Class certification will adversely affect the administration of the estate. As discussed above, class certification would be pointless because the claims are wholly without merit and the Plan A participants lack standing to assert their claims. But even if that were not the case, class certification would be adverse to the administration of the estate because the PBGC has filed proofs of claims that are effectively duplicative of the proposed class proof of claim.

In Proof of Claim No. 4318 ("Claim 4318"), the PBGC asserts a claim in the amount of $310.3 million for the unfunded benefit liabilities of Plan A. In Proof of Claim No. 4325 ("Claim 4325"), the PBGC asserts a claim in the amount of approximately $30.6 million for unpaid minimum funding contributions to Plan A. In Proof of Claim No. 4327 ("Claim 4327"), the PBGC asserts a claim in the approximate amount of $27 million for insurance premiums, interest, and penalties in connection with Plan A.

The gravamen of Movants' claim is that through the creation of Plan B, VHS increased the unfunded benefit liabilities of Plan A. The PBGC's proofs of claim seek recovery on account of Plan A's unfunded benefit liabilities. Movants assert that their proposed class proof of claim differs from the PBGC's claims. Movants note that they seek recovery for breaches of fiduciary duty under Title I of ERISA, a form of relief that the PBGC lacks standing to pursue.

It is true that the statutory predicate for Movants' claims differs from that of the PBGC's claims. However, both sets of claims exist only because Plan A is underfunded. The PBGC's proofs of claim seek relief on account of Plan A's underfunded status for the purpose of redressing the injury suffered by Plan A participants. The ultimate relief sought by the PBGC—recovering assets for the underfunded Plan A—is the same as that sought by Movants. In this sense, the relief sought by Movants is duplicative of that sought by the PBGC. In determining whether to apply Civil Rule 23 to the claims administration process, it is appropriate for the Court to be cognizant of this reality. In *In Re Mirant Corporation*, the court declined to permit class certification because the interests of the proposed class members were being pursued "by various arms of local and state governments and [the Federal Energy Regulatory Commission]."

Mirant, 321 B.R. 189, 199 (Bankr. N.D. Tex. 2005). Denial of class certification is likewise appropriate here given that the interests of the proposed class members are being pursued by the PBGC. Certifying the class proposed by Movants would mean that two separate entities, Movants and the PBGC, would be competing for assets that will go to the same place.

C. The *Musicland* Factors Weigh Against Applying Civil Rule 23 to the Claims Administration Process

As set forth above, all three *Musicland* factors weigh against applying Civil Rule 23 to the claims administration process. Accordingly, the Court declines to apply Civil Rule 23 and declines to authorize Movants to proceed with the proposed class proof of claim. Because the Court will not apply Civil Rule 23, it is not necessary for the Court to address whether Movants have met the class certification requirements of numerosity, commonality, typicality, and adequacy.

III. Conclusion

Based upon the foregoing, the Motion is DENIED. The Court will enter an order consistent with this Memorandum of Decision.

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Date: May 28, 2019

Ernest M. Robles
United States Bankruptcy Judge