UNITED STATES DISTRICT COURT
DISTRICT OF RHODE ISLAND

STEPHEN DEL SESTO, AS RECEIVER AND ADMINISTRATOR OF THE ST. JOSEPH HEALTH SERVICES OF RHODE ISLAND RETIREMENT PLAN, et al. *Plaintiffs,* v. PROSPECT CHARTERCARE, LLC, et al. *Defendants*.	Case No. 1:18-cv-00328-WES-LDA

THE PROSPECT ENTITIES' POST-HEARING MEMORANDUM IN OPPOSITION TO SETTLEMENT MOTION (ECF No. 63)

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and PROSPECT EAST HOLDINGS, INC.

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INTRODUCTION

There is no requirement that, as part of the preliminary approval of a proposed class action settlement, a court make a finding that the settlement was made in "good faith" to satisfy the obligations of a Rhode Island statute. Rule 23 requires the Court to determine—at the *final* hearing—whether a settlement is "fair, reasonable, and adequate" after considering a series of enumerated elements. As part of this preliminary approval hearing, the Court's function is to simply determine that the proposed settlement is not so grossly offensive in some respect so as to lead the Court to pretermit the settlement process and reject it out of hand. Based on the Court's comments at the hearing on February 12, 2019, the settlement has passed that hurdle in the Court's view; nothing more is required.

Not only is a "good faith" finding not required at this juncture under Rule 23, but it is inadvisable to engage in that inquiry now for three reasons. First, there is no reason for the Court to make such a finding as part of the settlement process at all. Whether the settlement was made in good faith, and thus whether the Settling Defendants[1] gain the benefit of the Rhode Island statute, is irrelevant before there is a liability finding and a claim for contribution or indemnity. At this point, the question is not ripe. Second, even if the Court were inclined to address this question as part of the settlement process, the Prospect Entities[2] believe that limited discovery is required before the Court could make any such factual determination, and they have requested that the Court grant them leave to conduct such discovery. *See* ECF No. 103. Postponing the

[1] The Settling Defendants include Chartercare Community Board, Roger Williams Hospital, and St. Joseph Health Services of Rhode Island.

[2] The Prospect Entities include Prospect Medical Holdings, Inc.; Prospect East Holdings, Inc.; Prospect Chartercare, LLC; Prospect Chartercare SJHSRI, LLC; and Prospect Chartercare RWMC, LLC.

determination of "good faith" until the final settlement hearing would allow the mechanism of notice/objection of class members to begin while permitting such discovery to proceed at the same time, which would yield the most efficient use of time (and avoid concerns about undue delay). Finally, although the Court has not yet ruled on the question, Plaintiffs' claims are governed by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and their state-law claims are wholly pre-empted. If the Court so finds, then the question of whether the settlement was made in "good faith" sufficient to satisfy a Rhode Island statute is irrelevant. The cart should not be put before the horse: the Court should resolve the jurisdictional uncertainty underlying the case by deciding whether ERISA applies. If it does, the "good faith" determination is irrelevant, and if it does not, then this Court is without jurisdiction to hear this case.

While mindful of the fact that the Court has not yet determined whether ERISA applies, and the uncertain ground on which we are thus standing, the Prospect Entities support this Court taking jurisdiction over the Receiver through the appointment of a federal receiver on an interim basis, with this being more fully resolved once the ERISA threshold is crossed.

ARGUMENT

A. The Court Need Not Decide Good Faith in Preliminarily Approving the Settlement.

The Court need not, and should not, address questions of "good faith" at this initial stage of the settlement process. As explained in *Michaud v. Monro Muffler Brake, Inc.*, court approval of a Rule 23 class action settlement generally proceeds in two stages. *See* 2015 U.S. Dist. LEXIS 32526, at *24 (D. Me. Mar. 17, 2015) (citing Manual for Complex Litigation (Fourth) § 21.632 (2011)); *see also Hochstadt v. Boston Sci. Corp.*, 708 F. Supp. 2d 95, 97 n.1 (D. Mass. 2010) (describing two-step process of class settlement approval). "First, counsel submits the terms of the proposed settlement, and the court makes 'a preliminary determination on the fairness,

reasonableness, and adequacy of the settlement terms' and directs notice to class members on the certification, proposed settlement, and date of the final fairness hearing." *Michaud*, 2015 U.S. Dist. LEXIS 32526, at 23-24 (quoting Manual for Complex Litigation (Fourth) § 21.632).

Preliminary settlement approval is different than final settlement approval, which occurs after certification of the class and notice to the class. *See In re M3 Power Razor Sys. Mktg. & Sales Practice Litig.*, 270 F.R.D. 45, 62 (D. Mass. 2010) ("Ultimately, the more fully informed examination required for final approval will occur in connection with the Final Fairness Hearing, where arguments for and against the proposed settlement will be presented after notice and an opportunity to consider any response provided by the potential class members"). The Court's inquiry at final settlement approval "'involves balancing the advantages and disadvantages of the proposed settlement as against the consequences of going to trial or other possible but perhaps unattainable variations on the proffered settlement.'" *Michaud*, 2015 U.S. Dist. LEXIS 32526, at 23-24 (quoting *Nat'l Ass'n of Chain Drug Stores v. New Eng. Carpenters Health Benefits Fund*, 582 F.3d 30, 44 (1st Cir. 2009)).

The difference between preliminary approval and final approval of a settlement is perhaps most aptly illustrated in *In re M3 Power Razor*, in which the Court stated that

> [t]he motion sought 'preliminary approval' of the settlement. I have declined to adopt the 'approval' nomenclature in order to emphasize, as a recent project of the American Law Institute has counseled, that the decision to permit class notice is not approval of the settlement. Approval must await 'definitive review at the time of the fairness hearing,' following notice and an opportunity for any objections.

270 F.R.D. at 49 n.1. Accordingly, preliminary approval of a settlement is only approval that the proposed settlement should be submitted to the class for consideration; it is not a determination as to whether the settlement is fair, reasonable, or adequate. *Nilsen v. York County*, 228 F.R.D. 60,

62 (D. Me. 2005) ("[at the preliminary stage] I am determining simply whether the proposed settlement agreement deserves consideration by the class and whether the notice is appropriate. I reserve all determinations of the proposed settlement's fairness, reasonableness and adequacy until [the final approval hearing]"); *see Hochstadt*, 708 F. Supp. 2d at 106 ("[f]irst, the judge reviews the proposal preliminarily to determine whether it is sufficient to warrant public notice and a hearing").

i. *No Good Faith Finding Is Required Even if the Court Preliminarily Approves the Settlement.*

At the preliminary stage, "the court's role is limited to deciding 'whether the proposed settlement appears to *fall within the range of possible final approval*.'" *Michaud*, 2015 U.S. Dist. LEXIS 32526, at 24 (quoting *Trombley v. Bank of Am. Corp.*, 2011 U.S. Dist. LEXIS 95140, at *4 (D.R.I. Aug. 24, 2011)); *see also In re Puerto Rican Cabotage Antitrust Litig.*, 269 F.R.D. 125, 140 (D.P.R. July 12, 2010) ("At the preliminary approval stage, the Court need not make a final determination regarding the fairness, reasonableness and adequateness of a proposed settlement; rather, the Court need only determine whether it falls within the range of possible approval"). While "Rule 23 does not itself provide for 'preliminary approval' of class action settlements," "it makes sense for a judge to say that a particular settlement has no chance of approval" before ordering class notice, but any determination as to a settlement's fairness, reasonableness, and adequacy "should be reserved for the fairness hearing." *Michaud*, 2015 U.S. Dist. LEXIS 32526, at 24 (citing *In re New Motor Vehicles Canadian Exp. Antitrust Litig.*, 236 F.R.D. 53, 55-56 (D. Me. 2006)); *see also In re M3 Power Razor*, 270 F.R.D. at 52 ("[w]hen asked to review a class action settlement preliminarily, I examine the proposed settlement for obvious deficiencies *before* determining whether it is in the range of fair, reasonable, and adequate"); *Canadian Exp. Antitrust*

Litig., 236 F.R.D. at 55-56 ("Before incurring the expense of widescale notice, it makes sense for a judge to say that a particular settlement has no chance of approval").

In engaging in such narrow review of a proposed class settlement at the preliminary stage, "there is generally a presumption in favor of the settlement '[i]f the parties negotiated at arm's length and conducted sufficient discovery.'" *Hochstadt*, 708 F. Supp. 2d at 107 (quoting *In re Pharm. Indus. Average Wholesale Price Litig.*, 588 F.3d 24, 32-33 (1st Cir. 2009)). More specifically, courts in the First Circuit have found that a presumption of fairness attaches to the court's preliminary fairness determination when (1) the negotiations occurred at arm's length; (2) there was sufficient discovery; (3) the proponents of the settlement are experienced in similar litigation; and (4) only a small fraction of the class objected. *See id.*; *see also In re M3 Power Razor*, 270 F.R.D. at 63; *Cabotage*, 269 F.R.D. at 140. Any findings outside those outlined above, such as fairness and adequacy, are premature. *See Trombley*, 2011 U.S. Dist. LEXIS 95140, at 10 ("For that reason, the parties' request for a ruling that the claims administration and distribution plan in the Settlement Agreement are fair and adequate is premature").[3]

[3] Nevertheless, "[a]n illegal or collusive settlement agreement will not fall within the range of possible approval." *Cabotage*, 269 F.R.D. at 140. Accordingly, as set forth in the Prospect Entities' Opposition to the Motion for Settlement Approval, the settlement should be denied as collusive. "The storm warnings indicative of collusion are a lack of significant discovery and [an] extremely expedited settlement of questionable value accompanied by an enormous legal fee." *In re Lupron(R) Mktg. & Sales Practices Litig.*, 228 F.R.D. 75, 94 (D. Mass. 2005). The Prospect Entities have sought discovery on the issue of whether the settlement was collusive. In *In re Gen. Motors Corp. Engine Interchange Litig.*, 594 F.2d 1106, 1124 (7th Cir. 1979), objectors to a settlement challenged a district court's denial of their request to conduct discovery into the settlement negotiations to determine whether the proposed 23(e) settlement was fair, reasonable and adequate. The Seventh Circuit held that the conduct of the negotiations relevant to the fairness of the settlement and the trial court's refusal to permit discovery or examination of the negotiations constituted an abuse of discretion. *Id.*

For instance, in *Hochstadt*, class action plaintiffs, who were participants in an ERISA-covered retirement plan, sued their employer and plan fiduciaries alleging breach of fiduciary duty. 708 F. Supp. 2d at 98-99. Subsequently, the plaintiffs sought the court's preliminary approval of an $8.2 million settlement with the defendants. *Id.* at 100. The court conducted a "preliminary fairness determination"[4] and preliminarily approved the proposed settlement because it was negotiated at arm's-length over two months; sufficient discovery was conducted over a four-year period; the proponents of the settlement were experienced in litigation because they had been prosecuting ERISA actions over four years; and the number of objections was minimal. *Id.* at 107-08; *see also In re M3 Power Razor*, 270 F.R.D. at 62-63 (granting preliminary approval of settlement without finding of good faith because settlement was conducted at arm's length; there was sufficient discovery; proponents of the settlement were experienced in litigation; and only a small fraction of the class objection); *Cabotage*, 269 F.R.D. at 141 (same).

Additionally, this Court has previously preliminarily approved a settlement without making any finding as to good faith. *See Div. 618, Amalgamated Transit Union v. R.I. Pub. Transit Auth.*, 2018 U.S. Dist. LEXIS 174000, at *7 (D.R.I. Oct. 10, 2018). In *Amalgamated Transit*, this Court, in preliminarily approving a settlement, held that "the proposed settlement, as set forth in the parties' Settlement Agreement[], appears to be fair, reasonable, and adequate. The settlement

[4] As noted by several courts a "preliminary fairness determination" is somewhat of a misnomer inasmuch as fairness is not determined until the final fairness hearing. For instance, in granting preliminary approval of a class settlement, one district court replaced the word "approval" with the term "review" as *approval* of the settlement only occurs after a final fairness hearing has taken place. *Hochstadt*, 708 F. Supp. 2d at 97 ("It is only after the second step, a fairness hearing has taken place, however, that the court may 'approve' the settlement agreement. Accordingly, I have replaced the term 'approval' with the term 'review' for this step in the process"); *see Nilsen*, 228 F.R.D. at 62 ("I do not characterize this order as a preliminary fairness determination. Because a judicial declaration of 'preliminary fairness' unjustifiably suggests a built-in headwind against objections to the settlement, I am determining simply whether the proposed settlement agreement deserves consideration by the class and whether the notice is appropriate").

appears to have been entered into at arm's-length by highly experienced and informed counsel." *Id.* at 6. The Court notably made no finding as to whether the settlement was actually made in good faith; instead, the Court determined there was nothing glaringly inappropriate that would demand rejection prior to the final hearing after notice and the opportunity for objection. *See id.*

Accordingly, a finding of good faith is not a required determination at the preliminary approval stage of this settlement proceeding; the Court can conduct a preliminary review and approval of the settlement without making any finding as to good faith. As in *Amalgamated Transit*, *Hochstadt*, *In re M3 Power Razor*, and *Cabotage*, the Court could, should it be inclined, approve the preliminary settlement without any regard to a "good faith" analysis or inquiry. Plaintiffs' reliance on out-of-circuit precedent to claim that good-faith is a required finding at the preliminary stage is misplaced given that district courts in the First Circuit—and this Court—have preliminarily approved settlements without any finding as to good faith.[5]

B. The Court Should Appoint Del Sesto As an Independent Fiduciary for the Plan, or at Least as Its Receiver.

Plaintiffs and the Settling Defendants already have stated in their submission that they have no objection to appointing Del Sesto to serve as the Plan's temporary receiver, and causing him to report directly to this Court and be made subject to its supervision:

> . . . Plaintiffs have no objection to the Court converting the state court Receivership into a federal equity receivership and appointing Attorney Del Sesto as Receiver to continue to assert claims on behalf of the Plan, and ratifying all prior actions of the Receiver, provided the Defendants agree not to seek further delay and provided the Superior Court relinquishes jurisdiction over the Plan and the Plan assets.

[5] While some in-circuit district courts *may* have made a finding of good faith, there is simply nothing to suggest that such finding is *required* at the preliminary stage. And since, if ERISA applies—a question that the Court has not yet decided—a "good faith" determination would be irrelevant, the Court should on prudential grounds refrain from engaging in such an analysis at this point, given that it is not necessary for the decision of the matter at hand.

ECF No. 109 at 15.

The Prospect Entities also have no objection to the Court taking control over the Plan and, indirectly, its assets[6] and appointing Del Sesto—at least, on a temporary basis—to serve as the Plan's receiver in accordance with Rule 66 and 28 U.S.C. §§ 754 and 959(a) (as applicable), provided the requisite statutory conditions are timely met. As the Prospect Entities noted in their Surreply (ECF No. 101), the federal court appointment of a receiver is a longstanding and well-settled remedy to a finding of a fiduciary breach, *see* ECF No. 101 at 8-9 (*citing and discussing Marshall v. Snyder*, 572 F.2d 894, 901 (2d Cir. 1978); *and Donovan v. Bierwirth*, 689 F.2d 263, 276-77 (2d Cir. 1982)), and such an appointment indisputably qualifies as "appropriate equitable relief" within the meaning of Section 502(a)(3) of ERISA. The fact that some or all of the Settling Defendants have now acknowledged and admitted that they were in breach of their fiduciary duties to the Plan, incident to settling the Plaintiffs' claims against them (however one views the process that produced such a result), makes the ordering of such equitable relief an uncontroversial process.

Nevertheless, should the Court decide to take the above-described step, it should proceed post-haste to find that the Plan is subject to ERISA, as Plaintiffs have twice alleged (ECF Nos. 1 and 60) and as the Prospect Entities have repeatedly agreed. Since the Court's jurisdiction over this matter hinges on this question, the appointment of a federal receiver should compel the quick assurance of a jurisdictional basis for that step and for any actions that the Receiver then takes going forward. Moreover, should the Court also reach the conclusion that the Plan is subject to ERISA, it should formally recognize and confirm Del Sesto as an independent ERISA fiduciary

[6] While not much attention appears to have been paid by the Receiver to the physical location of the Plan assets, they appear to be in the custody of Bank of America, N.A., which serves as trustee of and for the Plan. The actual situs of those assets is reasonably believed to be New York, New York, USA.

of and for the Plan, which should obviate the need to rely on Rule 66 and on an ongoing basis comply with 28 U.S.C. §§ 754 and 959. It also would put to rest (hopefully, with some finality) the further issuance of advisory opinions, which we pointed out in our most recent brief is judicially problematic. *See* ECF No. 113 at 6.

The Prospect Entities are mindful that simply converting the state court receivership into a federal equity receivership and appointing Del Sesto as Receiver leaves potentially important business unfinished, such as the extent to which federal law preempts virtually all state laws under ERISA § 514(a). Such a result would eliminate the need to deal—on an ongoing basis—with 28 U.S.C. § 959(b) (pertaining to complying with relevant state law(s)), as and when administrative and other matters get brought to the Court's attention by Del Sesto, or by Bank of America, N.A., the Plan's trustee.

While it normally would go without saying, the continued drumbeat from Plaintiffs accusing the Prospect Entities of litigating in bad faith requires this assurance: the Prospect Entities have not in the past, nor will they in the future, file any motion or pleading for the purpose of causing a delay in the proceedings. The Prospect Entities remain convinced that this lawsuit was brought against them with no basis in fact or law and look forward to resolving it expeditiously.

For all of the reasons stated by the Prospect Entities in its prior memoranda regarding the exclusive jurisdiction of the federal court with respect to pension plans governed by ERISA, including this one, a federal court receiver is necessary and appropriate. That said, if the Court was inclined to appoint Del Sesto and conduct a "joint receivership" with the state court until such time as the Court rules on whether the Plan is governed by ERISA, the Prospect Entities would

have no objection to such an arrangement.[7] As the Court is aware, there is Rhode Island precedent for our federal district court and state superior court working together and/or holding joint hearings, and the Prospect Entities are confident that the courts could do so successfully here as well.

CONCLUSION

For the above reasons, the Court need not make a finding of good faith in preliminarily considering the proposed settlement. Furthermore, the Court should initiate a federal equity receivership, at least on a preliminary basis pending its determination as to whether the Plan is subject to ERISA, and appoint Del Sesto as temporary receiver of the Plan.

CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of March 2019, I have caused the within document to be filed with the Court via the ECF filing system. As such, this document will be electronically sent to the registered participants as identified on the Notice of Electronic Filing (NEF) and paper copies will be sent to those indicated as non-registered participants.

/s/ Christopher J. Fragomeni, Esq.

[7] Plaintiffs contend that the Court should ratify all prior actions of the Receiver should it appoint Del Sesto as a federal equity receiver. However, the Prospect Entities respectfully suggest that the Court should not accept or ratify the Receiver's prior actions wholesale. To the extent a joint receivership is established, it is likely unnecessary; if an exclusively federal receivership is established, absent any challenge to a prior action of the Receiver, it also seems unnecessary to effect a sweeping "nunc pro tunc" ratification. If needed, prior to ratifying specific actions of the Receiver, the Court should conduct its own review of the Receiver's previous actions.