Fiduciary Commentary

Summer 2015

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By: Brant Griffin - August 4, 2015

Introduction

On February 24, 2015, the US Supreme Court began hearing arguments in a highly anticipated ERISA plan case. As the first excessive 401(k) fee case heard by the Supreme Court, Tibble vs. Edison International has been closely followed by ERISA practitioners and sponsors. The case went well beyond the frequently discussed topic of plan fees, which many believe was the focal point of this case.

The Court's findings have significant ramifications to plan fiduciaries and how they monitor plan investments. The central issue under consideration was whether a claim for failing to monitor an investment could proceed even though the fiduciary breach in the selection of the investment occurred outside of ERISA's six-year statute of limitations period.

Background

Edison International is a holding company for electric utilities and other energy interests. Edison sponsored a 401(k) plan for its 20,000 employees with a value of $3.8 billion during the litigation. The case involves six mutual fund investments that were added to Edison's 401(k) plan from 1999 to 2002; three funds in 1999 and another three in 2002. These investments were higher cost retail classes of the mutual funds when lower cost, institutional alternatives could have been utilized to reduce participants' investment expenses.

The Tibble plaintiffs, representing current and former 401(k) plan participants and beneficiaries, claimed that Edison and its plan fiduciaries violated ERISA's fiduciary duty of prudence by investing in the retail fund alternatives when identical, less expensive alternatives were available. In 2010, the U.S. District Court for the Central District of California heard the case. The court ruled with the plaintiffs and found that Edison breached its fiduciary duty of prudence by selecting the pricier retail funds over the lower cost options (noting there was no evidence to support the selection of the more expensive investments). The court granted the plaintiffs a judgment of $370,732 for the damages related to the higher fees in the three retail funds added to the plan in 2002. However, it did not grant damages related to the three funds added in 1999. The court's decision limited the applicable findings to the investments that had been offered to plan participants within ERISA's six year limitation period.

In rendering its decision, the district court maintained that Edison's decisions to add the 1999 funds occurred more than six years before the complaint was filed, and was not eligible to be included in the suit. The decision to deny the claim was based on ERISA law that requires a breach of fiduciary duty claim to be filed no more than six years after "the date of the last action which constitutes a part of the breach or violation" or "in the case of an omission the latest date on which the fiduciary could have cured the breach or violation." This six year period is considered a statue of repose that, distinct from a statute of limitations, sets an absolute time limitation to seek a lawsuit.

The plaintiffs argued that despite the time period since the 1999 investments were added to the plan, Edison's fiduciaries had an ongoing duty to prudently monitor the investments, and that evaluation process should have resulted in the removal of the imprudent investments. Therefore, the plaintiff's charged that there was a continuous violation by the fiduciaries by maintaining imprudent, more costly investments. The district court rejected the plaintiff's claim, citing their failure to identify new facts and circumstances that would have necessitated a re-evaluation of the investments (thus causing a new, distinct fiduciary breach).

In response to the district court's ruling, Tibble appealed the decision to the Ninth Circuit. The plaintiff arguments were again met with rejection, as the appellate court upheld the district court's decision to limit the settlement to the investments added to the plan within the ERISA limitations period. The Ninth Circuit stated that initially choosing the investment for inclusion in the plan triggers the limitations period, unless evidence showed that "changed circumstances" obliged plan fiduciaries to conduct a "full diligence review" of existing funds. The Ninth Circuit supported its decision, saying that the "changed circumstances" requirement gave meaning to ERISA's six-year limitations period, despite the ongoing fiduciary duty to monitor investments.

The appellate court ruling prompted a U.S. Solicitor General's brief, where Tibble's argument finally found support. The brief supported the notion that the claim should not be subject to ERISA's time limitation, and a fiduciary's ongoing duty to review plan investments was a potential additional breach in the case. The plaintiffs received further support when the Department of Labor argued in favor of the "continuing violation" exception to the six-year period noting that otherwise, ERISA fiduciaries would have no incentive to remove ill-advised investments.

Supreme Court Decision And Opinion

In October 2014, the Supreme Court agreed to review the closely followed 401(k) fee case. The Court opposed the appellate court's finding that only new, significant "changed circumstances" could initiate a separate fiduciary breach within the repose period. The Court found that there can be a claim of fiduciary breach for the failure to "properly monitor investments and remove imprudent ones" as long as the breach occurred within the six years before filing suit. On May 18, 2015, the U.S. Supreme Court announced its 9-0 decision. In rendering its opinion, the Court found that ERISA, like trust law, imposes upon a plan fiduciary a "continuing duty to monitor trust investments and remove imprudent ones." The Supreme Court remanded the decision saying that the Ninth Circuit failed to consider the "role of the fiduciary's duty or prudence under trust law." Further, it found the duty to continually monitor investments to be distinct from the fiduciary's duty to prudently select an investment.

In rendering its opinion, the Supreme Court fell short of defining what constitutes a prudent evaluation regiment for the ongoing duties of fiduciaries. However, the Court did mention that "changed circumstances" were not the only scenario wherein there might be a fiduciary failure to monitor and review investments.

Some have argued that the Tibble vs. Edison case is about the duty of plan sponsors to select inexpensive plan investments. Clearly, it is not. ERISA does not require fiduciaries to select the cheapest fund available; rather they must prudently select plan investments. The case is about the thoughtful, ongoing duty to monitor plan investments, including evaluating the multitude of share classes available.

The outcome of the Supreme Court's decision provides important guidance to fiduciaries. Among them, the common understanding that the duty to monitor plan investments is a fundamental and continuous obligation. Further, there are no separate levels of prudence under ERISA. Prudence is evaluated based on the facts and circumstances of the situation. When monitoring plan investments, the same level of prudence is required as when making the initial investment selection. Fiduciaries have long been reminded that the best way to demonstrate conformity with a prudent investment process is to document their initial and ongoing analysis of investments.