Supreme Court Decision on Tibble v Edison International - No One Should Be Surprised

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- The Supreme Court stated that fiduciary duty under the Employee Retirement Income Security Act of 1974 ("ERISA") is derived from the common trust law, and its decision affirms the fiduciary duty to provide ongoing monitoring of plan assets.
- The fiduciary duty to prudently select investment options is separate and distinct from the continuing duty to prudently monitor investment options.
  The duty to investigate as a part of continue monitoring requires a fiduciary to make informed and reasoned decisions regarding investment selected (to include share class) to be in the sole benefit of the plan participants and beneficiaries.
- Until revenue share is deemed illegal, controlling plan expenses in the sole interest of participants does not automatically mean the replacement of all funds with higher expense ratio which make revenue share distributions with institutional share class alternatives - selecting the "right" share class is a fiduciary act.
- A fiduciary should consider the investment management fee separately from the expense ratio of a fund since the expense ratio may contain revenue share payments that can be used to offset plan expenses or restore the participant's account in which the revenue has been derived.
- A part of the ERISA fiduciary responsibility is to administer the plan in accordance with the plan document. If the plan document states that the plan sponsor is fully responsible for all recordkeeping expenses, then plan fiduciaries should not make a deviating decision to use revenue share paying funds to offset such expenses.

The Supreme Court's May 18, 2015, decision regarding statute of limitations for claims alleging breach of fiduciary duty affirms the spirit and the practice of a plan fiduciary. An ERISA fiduciary is obligated to be vigilant in managing plan assets. The duty to make informed and reasoned decisions regarding each investment option, its share class, the disposition of any revenue share derived thereof, and the continuing responsibility for oversight of the suitability of the investment options are all parts of the overall fiduciary obligation.

FIDUCIARY OBLIGATION

The Supreme Court's opinion states that the Employee Retirement Income Security Act[1] (ERISA) requires plan fiduciaries to comply with fundamental obligations rooted in the of trust laws: duties of loyalty and due care. Specifically, plan fiduciaries must manage the plan prudently and with undivided loyalty to their participants and beneficiaries in meeting the plan purpose exclusively. [ERISA section 404(a)]

[1] A comprehensive statute created to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and welfare benefits. The broad public interest in ERISA-covered plans is expressed in its imposition of fiduciary responsibilities on parties engaging in important plan activities. ERISA

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Plan fiduciaries are expected to act prudently. This means to act

> "*with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims*." [ERISA section 404(a)(1)(B)]

BACKGROUND

In 2007, Glenn Tibble, William Bauer, and other (collectively, "Tibble") acting on behalf of Edison's past and present employees and participants in the 401(k), sued Edison International in the U.S. District Court for the Central District of California ("District Court") under ERISA alleged that their pension plan was managed imprudently and in a self-interested fashion. Tibble argued that Edison violated their fiduciary duties, among other things, with respect to three mutual funds added to the Plan in 1999 ("1999 Funds") and three mutual funds added to the Plan in 2002 ("2002 Funds"). Tibble argued that Edison acted imprudently by offering six higher priced retail-class mutual funds as plan investments when materially identical lower priced institutional-class mutual funds were available, among other issues.

Before the addition of the 1999 Funds, Edison paid the entire cost of recordkeeping services. With the addition of the retail mutual funds to the Plan, however, certain "revenue sharing[2]" was made available. The recordkeeper billed Edison for services after having deducted the amount received from the mutual funds from revenue sharing that paid for part of recordkeeping expenses. The use of revenue sharing to offset recordkeeping costs was discussed during the collective bargaining with the employee unions. Furthermore, this arrangement was disclosed to the Plan participants on approximately seventeen occasions after the practice began in 1999[3].

In short, Tibble's Motion for Partial Summary Judgment was denied and Edison's Motion for Summary Judgment was granted with regard to all claims except (1) Tibble's prohibited transaction claims arising out of the third party directed trustee retention of float and (2) whether Edison fiduciaries breached their duty of loyalty by choosing retail mutual funds in order to maximize the amount of revenue sharing at the expense of the Plan participants.

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[2] Revenue sharing is a general term that refers to the practice by which mutual funds collect fees from mutual fund assets and distribute them to service providers, such as recordkeepers and trustees—services that the mutual funds would otherwise provide themselves. Revenue sharing comes from so-called "12b-1" fees, which are fees that mutual fund investment managers charge to investors in order to pay for distribution expenses and shareholder service expenses. 12b-1 fees receive their name from SEC Rule 12b-1, which was promulgated pursuant to the Investment Company Act of 1940. Other fees included under the umbrella of revenue sharing are "sub-transfer agency" fees. These fees are similar in many respects to 12b-1 fees but are paid to third parties in order to track the accounts of individual participants.

[3] 639 F. Supp. 2d 1074 (2009) Glenn Tibble, et al., Plaintiffs, v. Edison International, et al., Defendants. No. CV 07-5359 SVW (AGRx) United States District Court, C.D. California. July 16, 2009.

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The District Court found that Edison had "not offered any credible explanation" for offering retail-class, and concluded that, with respect to the 2002 Funds, Edison had failed to exercise "the care, skill, prudence and diligence under the circumstances" that ERISA demands of fiduciaries. This is a violation of ERISA's prudence standard in failing to investigate the possibility of institutional-class alternatives.

STATUTE OF LIMITATION

For the 1999 Funds, the District Court held that Tibble's claims were untimely because these mutual funds were included in the plan more than six years before the complaint was filed in 2007. As a result, the 6-year statutory period had run. According to 29 U.S. Code § 1113 regarding statute of limitations, for claims alleging breach of fiduciary duty, ERISA provides:

> No action may be commenced under this subchapter with respect to a fiduciary's breach of any responsibility, duty, or obligation under this part, or with respect to a violation of this part, after the earlier of six years after (A) the date of the last action which constituted a part of the breach or violation, or (B) in the case of an omission, the latest date on which the fiduciary could have cured the breach or violation[4]

Under this framework, in order to extend the statute of limitations beyond six years, Tibble must prove that Edison "made knowingly false misrepresentations with the intent to defraud the plaintiffs," or took "affirmative steps" to conceal its own alleged breaches. The District Court found that Tibble failed to present undisputed evidence that Edison had actual knowledge of the alleged breaches of fiduciary duty. As a result, for the most part, Tibble's claims would be limited to those that accrued within six years of the filing of this suit, which was August 16, 2001. In the context of prohibited transactions, the statute of limitations typically begins when the "transaction" takes place. There is no "continuing violation" theory to claims subject to ERISA's statute of limitations. The District Court said that although the trustee's conduct could be viewed as a series of breaches, the statute of limitations did not begin anew because each breach was "of the same character."

On March 21, 2013, an appeal from the District Court was filed with the U.S. Court of Appeals for the Ninth Circuit. The Ninth Circuit also rejected the continuing violation theory and held that under ERISA's six-year statute of limitations, the District Court correctly measured the timeliness of claims alleging imprudence in plan design from when the decision to include those investments in the plan was initially made.

Further, the Ninth Circuit affirmed the District Court's grant of summary judgment to Edison on the beneficiaries' claim that revenue sharing between mutual funds and the administrative service provider violated the pension plan's governing document and was a conflict of interest. The Ninth Circuit agreed that an abuse of "discretion standard of

[4] or three years after the earliest date on which the plaintiff had actual knowledge of a breach or violation; except that in the case of fraud or concealment, such action may be commenced no later than six years after the date of discovery for such breach or violation.

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review" applied in this "fiduciary duty and conflict-of-interest suit" because the plan granted interpretive authority to the administrator.
The Ninth Circuit affirmed the district court's holding that Edison was imprudent in deciding to include retail-class shares of 2002 Funds in the plan menu because they failed to investigate the possibility of institutional-share class alternatives.

SUPREME COURT DECISION

On May 18, 2015, the Supreme Court[5] vacated the Circuit Court ruling applying the 6 year statute of limitation and remanded for the Ninth Circuit to consider Tibble's claims that Edison breached its duties within the relevant 6-year statutory period under §1113, recognizing the importance of analogous trust law. The Supreme Court unanimously found that Edison has an ongoing fiduciary duty under ERISA to monitor plan investments.

The Supreme Court stated that ERISA fiduciary duty is derived from the common trust law which provides that a trustee has a continuing duty - separate and apart from the duty to exercise prudence in selecting investments at the outset - to monitor, and remove imprudent, trust investments. The opinion of the Court cites the Uniform Prudent Investor Act that "[m]anaging embraces monitoring" and that a trustee has "continuing responsibility for oversight of the suitability of the investments already made." Thus, so long as the alleged breach of the continuing duty occurred within six years of suit, the claim is timely.

CONCLUSION

The Supreme Court's decision to vacate the Circuit Court ruling that affirmed the District Court's earlier finding should not be a surprise to any fiduciary. ERISA is very clear about the duty of a plan fiduciary and the functional fiduciary standard to which a fiduciary must adhere. A fiduciary is like a parent, and a parent's role to watch out for the sole interest of sons and daughters is continual. In this case, the statute of limitation does not apply since there is no limitation to fulfilling the fiduciary duties of loyalty and due care.

[5] http://www.supremecourt.gov/opinions/14pdf/13-550_97be.pdf

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FOOD FOR THOUGHT

From a practice standpoint, ERISA plan fiduciaries and those who advise them should consider the following steps as a part of demonstrating procedural prudence:

1. Review the plan's Investment Policy Statement (IPS) regarding investment selection and monitoring factors periodically. Moreover, the investment options should not be selected and reviewed in isolation of fees and expenses.

2. Understanding and controlling investment and plan expenses are basic fiduciary functions. However, the decision to pay all or a part of a retirement plan's recordkeeping and other reasonable plan expenses is a function of the employer and not the plan fiduciaries. Once a decision is made by the employer as to the amount and methodology of payment, it is the plan fiduciary's role to determine and select the most suitable investment share class or alternatives. Develop a clear plan expense statement.

3. Selecting investments that offer revenue share is a fiduciary decision[6]. Directing the revenue share to offset plan expenses or to restore participant accounts where such payments were derived should be based on a well thought out fiduciary process. Lowest expense share class funds without revenue share should be considered along with other share classes with revenue share within the context of who are responsible for plan expenses and how such plan expenses should be paid. Develop a clear revenue sharing policy.

4. Following the plan documents (unless inconsistent with ERISA) - "Say what you do and do what you say" - ERISA Section 404

About Chao & Company, Ltd.

Chao & Company is a Securities & Exchange Commission Registered Investment Advisor and serves as an ERISA Section 3(21) investment co-fiduciary or ERISA Section 3(38) investment management fiduciary to qualified retirement plans such as 401(k), 403(b), and 401(a) plans.

Philip Chao, founder, principal and chief investment officer, is a strong advocate for upholding the fiduciary standard and insists on a fiduciary culture throughout his practice.

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[6] January 25, 2014, Chao & Company publication; "Whack-A-Mole": Catch Me If You Can - Fiduciary Considerations in Controlling and Accounting for Plan Administration Fees

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