

LEGAL

How Long Can You Hold Your Breath?

The risk of excessive fee litigation can be mitigated using ERISA's statute of limitations. Here's how.

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Excessive fees continue to be a hot topic for retirement plan committees to address, including:

- determining which share class to use;
- the amount of revenue sharing paid by each investment;
- how much of the plan expense should be allocated to plan assets versus paid by the plan sponsor;
- whether or not a covered service provider should be paid fees based on a percentage of assets; and
- how fees should be allocated among participants.

These are topics a TPA or advisor should bring to the committee's attention for purposes of establishing a documented process that can be used to defend their decisions.

Outside of the committee's documentation, the statute of limitation under ERISA §413 (29 USC §1113) provides another method built into ERISA that is often forgotten but which is very effective in mitigating litigation risk for a claim of excessive fees.

STATUTE OF LIMITATIONS: THE BASICS

ERISA §413 limits the time frame during which a plaintiff can bring a fiduciary breach claim for excessive and unreasonable fees to 6 years or an alternative 3 years if certain requirements are met. It is important to note that fraud, concealment, conflicts of interest and self-dealing can nullify the statute's protection or at least delay the start date of the limitations period until fraud, concealment, conflicts or self-dealing is discovered.

In addition, it has been argued before the Supreme Court, in *Tibble v. Edison*, that a fiduciary's obligations to monitor investment expenses resets the statute at each point in time expenses are evaluated, which arguably should occur on an annual basis. On May 18, 2015, the Supreme Court unanimously agreed to remand this case back to the 9th Circuit for rehearing.

Of particular importance in *Tibble* is that the Supreme Court's decision is aligned with current practices to conduct investment reviews at least annually, if not quarterly, thereby arguably restarting the clock after each meeting for the issues they deliberated — including, in many cases, the reasonableness and allocation of direct and indirect fees.

Since lawsuits can be filed by the Department of Labor, participants, beneficiaries and other fiduciaries, it is important that a fiduciary consider various strategies to mitigate litigation risk by leveraging the existing statute of limitations provisions.

'ACTUAL KNOWLEDGE' OF YOUR DECISIONS

As mentioned above, documentation goes a long way in establishing proof that a thoughtful, procedurally prudent process exists. However, if a fiduciary combines documentation with an action plan that complies with the 3-year statute of limitation requirements, the fiduciary has effectively reduced exposure to monetary damages by 50%. How is this possible, you might ask? Simply by providing those most likely to sue you with actual knowledge of your decisions.

According to ERISA §413, the 6-year statute of limitations provides a plaintiff 6 years to file a fiduciary breach claim. If a fiduciary engages in a breach that occurred more than 6 years ago, a plaintiff's claim will be dismissed assuming a claim of fraud, concealment, conflicts and/or self-dealing cannot be proved.

Of course, this is 6 years after the date of the last action that constituted a part of the breach. Therefore, if the breach is an ongoing event, a plaintiff has a rolling 6-year period to file the suit. In essence, an evergreen liability for the fiduciary assuming the fiduciary continues to engage in the same breach year after year.

The 6-year statute also applies to an omission but the start date of the 6-year statute is from the latest date on which the fiduciary could have cured the breach. For example, assume a fiduciary's omission resulted in a breach on April 1, but the fiduciary has until Dec. 31 of that year to fix the breach but fails to do so. In this case the plaintiff has 6 years from the last date (Dec. 31) the fiduciary could have cured the breach. Thus, in this case the plaintiff has 6 years and 9 months, although there is no reason for a plaintiff to file a suit during the time frame a fiduciary can cure the breach.

Finally, if the fiduciary is proactive and adopts a full disclosure approach, a fiduciary can limit the time frame during which a plaintiff can file suit to 3 years if the fiduciary can prove the plaintiff had actual knowledge of the breach. Herein lies the question, "How do the courts interpret 'actual knowledge'?"

Based on a cursory review of case law, it appears the courts are not completely aligned in their interpretation of "actual knowledge." This creates uncertainty for fiduciaries implementing risk mitigation strategies built around the 3-year statute. Some key cases that emphasize this concern include:

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- The court in *Edes v. Verizon Communications, Inc.* time-barred a participant's lawsuit for incorrect allocation of his 401(k) contributions to the wrong investments using the 3-year statute. Participant admitted he did not review his quarterly account statements because he treated the benefit statements as "junk mail." The court determined the participant's "willful blindness" was not reason enough to avoid "actual knowledge."
- In *Blanton v. Anzalone*, it was determined that knowledge required to trigger the 3-year statute is knowledge of the transaction, not knowledge of its legal effect.
- According to the court in *Meyer v. Berkshire Life Ins. Co.*, actual knowledge is a fact-specific determination that usually requires more than mere knowledge of the transaction.
- The 5th Circuit in *Reich v. Lancaster*

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determined that actual knowledge requires knowledge of all material facts necessary to understand that a claim exists.

- The 3rd Circuit in *International Union v. Murata Erie North America* determined that actual knowledge requires proof a plaintiff actually knew of the event(s) which constitute a fiduciary breach and that the event was a breach of fiduciary duty.
- Then again, the 7th, 9th and 11th Circuits all held that actual knowledge only requires knowledge of all relevant facts about the fiduciary breach not that the facts establish a valid fiduciary claim.

These different interpretations of "actual knowledge" should not persuade a fiduciary to ignore the obvious: If you have nothing to hide, don't hide anything — especially when it comes to fees deducted from plan assets directly or indirectly.

DISCLOSURES AND REPORT

To maximize the potential risk mitigation features of the 3-year statute, a fiduciary should consider distributing or making available to participants the 408(b)(2) disclosures, Form 5500, meeting minutes and a customized one-page report that includes the following information:

1. Plan sponsor and name of plan
2. Name of the responsible plan fiduciary, which is most likely the plan administrator
3. As-of date (issuing this report annually is recommended)
4. Breakdown of fees paid by the employer versus the plan in dollars per head, as a percentage of assets and annualized total dollars
5. Breakdown of fees by service category
6. Benchmarking of fees
7. Statement of reasonableness by the fiduciary

Expect the plan administrator named in the report to receive more calls and questions in the first year than in the following years, which is exactly what you want to accomplish by providing this level of disclosure. Every email or disclosure to participants provides additional documented proof the responsible plan fiduciaries provided participants actual knowledge to claim the 3-year statute thus minimizing litigation risk and monetary damages.

Again, this approach is only for the plan sponsor that has nothing to hide and is conscientiously seeking ways to mitigate litigation risk and any potential monetary damages. Since TPAs and record keepers are the gate keepers for the majority of this information, it seems logical they will become the go-to solution for this risk mitigation strategy. To improve efficiencies in delivery and the effectiveness of the strategy it will be important to link the record keeper's technology platform to an independent benchmarking database; otherwise, the analysis is based exclusively on a single record keeper's client base — which is hardly objective, especially if benchmarking statistics are incorporated into the report as suggested.

Of course, this strategy will come at a cost to the TPA or record keeper. However, it represents a value-added benefit that can justify higher fees. There is a cost associated with building and maintaining the link as well as automating the pushing and pulling of data to automate the report. However, by automating the process, the TPA or record keeper has increased its value proposition, created a unique differentiator and positioned itself to charge higher fees for the additional value at a time when the trend in fee compression is at its peak. PC



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