Proskauer

newsletter

# ERISA Litigation

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**in this issue**

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A report to clients and friends of the firm

**Edited by Stacey C.S. Cerrone and Russell L. Hirschhorn**

## Editor's Overview

In this month's newsletter, Anthony Cacace analyzes the heavily anticipated Supreme Court ruling in *Tibble v. Edison Intl.*, 135 S. Ct. 1823 (2015), where the Court held that ERISA's fiduciary duty of prudence includes a regular review of investments. The article also discusses proactive measures that plan fiduciaries can take regarding monitoring plan investment options and what future claims may be brought by the ERISA plaintiffs' bar as a result of the decision.

As always, be sure to review the section on Rulings, Filings, and Settlements of Interest including: changes to the IRS determination letter program; an IRS Chief Counsel Memorandum clarifying the impact of correction of Section 409A failures; and recent case law on benefit claim exhaustion, ERISA stock drop claims in the Second Circuit, and the Third Circuit's decision that the catalyst theory of recovery applies to ERISA fee awards.

## U.S. Supreme Court Says "Regular Review" of ERISA Investments Required[*]

By Anthony S. Cacace[1]

ERISA plan fiduciaries charged with responsibility for selecting, monitoring or removing plan investment options should pay close attention to the U.S. Supreme Court's recent ruling in *Tibble v. Edison Intl.*, 135 S. Ct. 1823 (2015). In that decision, the Court ruled that ERISA's duty of prudence involves "a continuing duty to monitor investments and remove imprudent ones." Although the Court did not elaborate on what it viewed to be the scope of an ERISA plan fiduciary's duty to monitor, the plaintiffs' bar is already seizing on the ruling as a potential basis for asserting new claims based on a failure to monitor prudently plan investments and other plan functions. Thus, plan fiduciaries are advised to establish a thoughtful and appropriate procedure for monitoring plan investment options, to diligently follow that procedure when monitoring plan investment options, and to make

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and preserve a written record reflecting that they followed their procedure in every regard. Taking these steps will put fiduciaries in a favorable position should emboldened plan participants file lawsuits challenging whether fiduciaries fulfilled their duty to monitor plan investment options based on the perceived plaintiff-friendly *Tibble* ruling.

**Background**

In 2007, plaintiff Glenn Tibble on behalf of himself and a putative class of participants and beneficiaries in the Edison 401(k) Savings Plan (Plan) filed a lawsuit asserting a variety of fiduciary breach claims associated with the selection, monitoring and removal of certain investment options in the Plan that had been available since as early as 1999. The claims included assertions that the investment funds selected were: (i) "retail mutual funds" and, as such, allegedly charged higher fees than institutional funds that were available instead; (ii) in the wrong economic sector; and (iii) money market as opposed to "stable value" funds. Plaintiffs also claimed, among other things, that the Plan's company stock fund was imprudently managed because it was a "unitized" fund, rather than a direct ownership fund.

The district court ruled that plaintiffs' claims related to the investment options that were added to the Plan's menu of investment options in 1999 were untimely because they had been added more than six years prior to the filing of the complaint.

The Ninth Circuit affirmed and held that the statute of limitations for a fiduciary breach claim alleging that the Plan's investment menu was designed "imprudently" begins to run from the "act of designating an investment for inclusion" in the Plan, not from the date fiduciaries of the Plan failed to remove the investment option or the date that the alleged imprudent option remained in the Plan. In so holding, the Ninth Circuit concluded that plaintiffs could not establish that there were "changed circumstances engendering a new breach," such that a new duty to act prudently with respect to the challenged investment options, and thereby a new statute of limitations period, had arisen. The Court further explained that if the continued offering of a plan investment option, without more, started a new statute of limitations period, it would render the statute of limitations "meaningless" and potentially expose current fiduciaries to claims based on actions that occurred many years ago by their predecessors.

**The Supreme Court's Decision**

The Supreme Court vacated the Ninth Circuit's decision. First, it held that the Ninth Circuit failed to recognize that under trust law a fiduciary is required to conduct a "regular review of its investments with the nature and timing of the review contingent on the circumstances." The Court explained that this duty exists separate and apart from a fiduciary's duty to exercise prudence in selecting investments options in the first place.

Second, the Court ruled that a participant may timely allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones, provided that this alleged breach occurred within six years of suit.

Notably, the Court remanded the issue of the scope of the continued duty to monitor plan investments to the lower court to consider whether the Plan fiduciaries breached their duties, "recognizing the importance of analogous trust law." While the Court did not specify the scope of the duty to monitor, some inferences may be drawn from the Court's observations about trust law required. The Court, citing trust law, commented that a fiduciary must “systematic[ally] condside[r] all the investments of the trust at regular intervals” to ensure their continued appropriateness for the trust. The trust law authorities cited by the Court further suggest that the level of diligence required must be “reasonable” and “appropriate” to the particular investments.

**The View from Proskauer**

The Court’s ruling that ERISA plan fiduciaries have a continuing duty to monitor plan investments is unremarkable it its own right. However, while the Court declined to expressly state how this duty is satisfied, it did provide some clues on where to find some guidance. For starters, the Court stated that “the nature and timing of the review [is] contingent on the circumstances.” It also stated that the Ninth Circuit, in evaluating whether the Plan fiduciaries satisfied their duty of prudence, should recognize the “importance of analogous trust law.” In doing so, the Court signaled that the monitoring of plan investments must be regular, systematic and reasonable based on the particular investments at issue.

Plan fiduciaries should take proactive measures to ensure that the monitoring of plan investment options is regular, systematic and reasonable. “Best practices” militate in favor of plan fiduciaries adopting a procedure for the regular monitoring of plan investment options, closely following that procedure, and making a written record of the implementation of and the adherence to that procedure. While the results of investment decisions on behalf of the plan do not have to be “correct,” the process in place must be prudent and diligently followed. As long as fiduciaries have engaged in prudent process with respect to monitoring investment options (that was clearly regular, systematic and reasonable based on the plan’s written record), they ought to have a meritorious defense to a breach of fiduciary duty claim.

Also, a good rule of thumb for plan fiduciaries to determine what is “reasonable” is to compare their plan’s practices to what other plans of similar size and nature are doing by way of monitoring plan investment options. By doing this, one can gauge the “industry standard,” which will aid in a legal defense in the event there is future litigation concerning the monitoring fiduciaries have undertaken.

Will *Tibble* cause the ERISA plaintiffs’ bar to initiate widespread class action lawsuits challenging plan fiduciaries’ alleged lack of continuous monitoring of plan investments? Some have already opined that the Court’s decision has paved the way for increased class litigation and called the decision a “game-changer” for the plaintiffs’ bar. That is not necessarily the case. Plaintiffs will have to do more than simply plead that the plan fiduciaries failed, within six years of filing suit, to prudently monitor an investment option. Rather, as the Supreme Court articulated many years ago, a plaintiff must be able to plead a plausible claim. That is, plaintiffs will have to plead “enough factual matter” to “nudge their claims across the line from conceivable to plausible.” To withstand a motion to dismiss, plaintiffs will not only have to allege that plan fiduciaries had a continuous duty to monitor, but also plead enough facts to suggest that there was in fact a failure to monitor and that plaintiffs (or the plan) suffered actual harm as a result of the alleged failure to monitor. However, if plan fiduciaries do find themselves as defendants in a lawsuit for allegedly failing to prudently monitor plan investment options, they will be well-served to have remembered the *Tibble* ruling and taken the measures discussed above.

## Rulings, Filings, and Settlements of Interest

### Changes to the IRS Determination Letter Program

By Roberta Chevlowe and Paul M. Hamburger

> The IRS has informally stated that it is intending to make some significant changes to the Determination Letter program, and is even considering eliminating the program for individually designed retirement plans (other than perhaps initial and final determination letters). The agency apparently is looking to streamline its operations and focus its resources on other areas. Guidance is expected later this summer, along with a request for comments.

### Second Circuit Affirms Dismissal of ERISA Stock Drop Claims

By Joseph Clark

> The Second Circuit recently affirmed the dismissal of an ERISA stock drop class action because, like the district court, it held that Named Plaintiff Debra Taveras lacked constitutional standing to pursue her claims. Taveras alleged that defendants, which included UBS and a number of individuals, breached their fiduciary duties by maintaining the company stock fund as an investment option in the UBS Savings and Investment Plan. As relevant here, Taveras's complaint alleged that "[a]s a direct and proximate result of the breaches of fiduciary duties alleged [in the complaint], the Plans, and indirectly Plaintiffs and the Plans' other Participants and beneficiaries, lost a significant portion of their investments." The Court determined that this was nothing more than an attempt to demonstrate injury-in-fact by showing diminution in the value of the Plan's assets generally, and that it was possible that the Plan lost value while Taveras's individual account did not. Furthermore, even if Taveras's account suffered a loss in value after she purchased shares of company stock, the district court correctly concluded that the complaint failed to allege any facts connecting her losses to the fiduciaries' alleged breaches. Taveras therefore lacked constitutional standing to bring her claims. The case is *Taveras v. UBS AG*, 2015 WL 1934576 (2d Cir. Apr. 30, 2015) (unpublished).

### IRS Chief Counsel Memorandum Clarifies that Correction of Section 409A Failures in Year of Vesting Will Not Shield Income Inclusion Under 409A

By Joshua Miller

> Earlier this month, the Office of Chief Counsel of the Internal Revenue Service released a Memorandum clarifying the impact of a correction of a Code Section 409A operational failure before the date of vesting of nonqualified deferred compensation but during the year of vesting. In the Chief Counsel Memorandum, the IRS clarified that such a correction, under such circumstances, would not avoid income inclusion under Code Section 409A.

In general, the 2008 proposed rules on income inclusion under Section 409A (available here) provide that if there is a Section 409A violation in a taxable year, all compensation deferred under the applicable nonqualified deferred compensation arrangement for that taxable year and all preceding years is includible in the service provider's gross income to the extent not subject to a substantial risk of forfeiture (i.e., vested) and not previously included in the service provider's gross income in a prior taxable year. Whether or not deferred compensation must be included in income under Section 409A is determined as of the last day of the taxable year.

Consistent with the proposed rules, the IRS guidance clarifies that Section 409A requires income inclusion if there is a compliance failure at any time during the taxable year in which the applicable substantial risk of forfeiture lapses, even if the noncompliant provisions are corrected prior to the lapse of the substantial risk of forfeiture. Accordingly, a “same-year” correction of an operational failure under Section 409A is not effective in fixing noncompliant deferred compensation in time to escape the corresponding adverse tax consequences to the extent that the deferred compensation becomes vested at any time during that tax year.

Perhaps more interesting, however, is that the Chief Counsel Memorandum guidance does not preclude correction of noncompliant nonqualified deferred compensation in a taxable year prior to the taxable year in which the compensation vests. Under the 2008 proposed income inclusion rules, Section 409A income inclusion does not appear to be required for the year that nonqualified deferred compensation ceases to be subject to a substantial risk of forfeiture (or any later years) to the extent that the applicable plan is amended to comply with Section 409A prior to the taxable year in which the compensation vests. By not providing any indications to the contrary with regards to such a “prior year” correction, it appears the IRS has tacitly blessed the correction of unvested amounts in years prior to the year of vesting. Of course, the IRS retains the authority under the Proposed Rules to nonetheless disregard such a correction as part of the general “anti-abuse” provisions under Section 409A to the extent it finds a “pattern or practice” of permitting impermissible changes in the time and form of payment of unvested deferred compensation.

**Third Circuit: Catalyst Theory of Recovery Applies to ERISA Fee Award**

By Madeline Chimento Rea

> The Third Circuit held that the catalyst theory of recovery applies to ERISA cases when determining whether to award attorneys’ fees. In this case, Plaintiffs (two individuals and two pharmacies) filed suit against Defendant insurance companies for denial of benefits under ERISA. After their motion to dismiss was denied, Defendants paid the claims in full. Both parties then sought attorneys’ fees and costs, which the district court denied. The Third Circuit affirmed the district court’s decision to deny fees, but remanded on the issue of whether Plaintiffs were entitled to interest on the delayed payment of benefits. Ultimately, the Defendants agreed to pay $68,000 in interest to Plaintiffs and the case settled.

Plaintiffs then filed a motion for attorneys’ fees and costs. The district court denied the motion. In so ruling, the court explained that under the catalyst theory of recovery, which applies when the lawsuit brings about a voluntary change in the defendants’ conduct, judicial action must serve as the catalyst for change. The Third Circuit agreed that the catalyst theory applied, but it disagreed with the district court’s ruling and held that all that was necessary was that litigation activity pressed Defendants to settle or give Plaintiffs the requested relief. It explained that the victory must be voluntary, non-trivial, and more than a procedural victory that is apparent to the court without the need to conduct a lengthy inquiry into whether that success was substantial or occurred on a central issue. The Court held that Plaintiffs were eligible for an award under this standard and remanded to the district court to determine whether to award attorneys' fees. The case is *Templin v. Independence Blue Cross*, No. 13-4493, 2015 WL 2151778 (3d Cir. May 8, 2015).

### ERISA Participant's Supplemental Submission Doesn't Restart Exhaustion Clock

By Madeline Chimento Rea

> A federal district court in New Jersey held that supplemental documentation submitted by a participant in connection with the claims review process did not restart the clock for a claims administrator to decide the participant's appeal. Plaintiff Tracee Lewis-Burroughs timely appealed Prudential Insurance Company of America's decision to stop paying her long-term disability benefits. Shortly after she filed her appeal, Plaintiff submitted additional documentation to support her claim that had not been requested by Prudential. Plaintiff filed suit when she did not receive a response from Prudential within 90 days after submitting her initial appeal. Prudential moved to dismiss on the ground that Plaintiff failed to exhaust her administrative remedies; Prudential argued that it had 90 days from the date Plaintiff submitted her supplemental documentation, not 90 days from the date her appeal was initially submitted. According to the court, the 90-day clock did not restart upon the submission of the additional documentation. The case is *Lewis-Burroughs v. The Prudential Ins. Co. of Am.*, No. 14-1632, 2015 WL 1969299 (D.N.J. Apr. 30, 2015).

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Our ERISA Litigation practice is a significant component of Proskauer's Employee Benefits, Executive Compensation & ERISA Litigation Practice Center. Led by Howard Shapiro and Myron Rumeld, the ERISA Litigation practice defends complex and class action employee benefits litigation.

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