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Fiduciaries breached duty of prudence by investing in retail share classes

A recent federal District Court ruling should make fiduciaries of self-directed retirement plans think twice before offering retail share classes as investment options when less expensive institutional share classes are available.

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A recent court ruling should make fiduciaries of self-directed retirement plans think twice before offering retail share classes as investment options when less expensive institutional share classes are available. The case is *Tibble v. Edison International*, decided by the District Court for the Central District of California earlier this month. Although district court opinions have little precedential value, retirement plan committees and other plan fiduciaries would be wise to heed the lessons of this case.

The relevant (and somewhat oversimplified) facts are as follows. In July 2002, the Edison International Trust Investment Committee first made retail share classes of three mutual funds available to participants in the Edison 401(k) Savings Plan. In deciding which funds to offer, the committee itself did not consider, let alone evaluate, other share classes of the funds, although it did solicit and rely upon the advice of Hewitt Financial Services, an affiliate of the plan's third-party recordkeeper. In 2007, a class of plan participants sued the committee, Edison International, and others seeking damages under ERISA for alleged financial losses suffered by the plan, in addition to injunctive and other equitable relief on account of alleged breaches of fiduciary duty by the defendants.

In the decision filed on July 8, 2010, Judge Stephen V. Wilson set forth the oft-cited parameters of ERISA's duty of prudence. That duty requires a fiduciary to act with the care, skill, prudence, and diligence under the circumstances 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. In view of this standard, the question presented was whether the defendants acted appropriately before making the retail class funds available to plan participants.

Siding with the plaintiffs, the court held that because the defendants never considered or evaluated the different share classes of the three mutual funds at issue, they failed to conduct a proper investigation, thereby breaching their duty of prudence. Had the defendants thoroughly investigated different share classes of the three mutual funds, the court noted, they would have learned that both retail and institutional share classes were available, that the only difference between the retail share classes and the institutional share classes was that the retail share classes charged higher fees, and that in all other respects the investments were identical.

The defendants argued that because they solicited and relied on advice from Hewitt Financial Services, they had conducted a thorough investigation. The court, however, rejected the defendants' argument. Soliciting independent advice is some evidence of a thorough investigation, but in addition to showing that they solicited independent advice, the defendants needed to show that they were reasonably justified in relying upon that advice. Here, the defendants did not present any evidence that Hewitt Financial Services considered or evaluated the different share classes of the three mutual funds. In the absence of such evidence, the court determined that the defendants' reliance upon Hewitt Financial Services' advice was imprudent.

The defendants also argued that because the institutional share classes had mandatory minimums that the Plan could not meet, their investment in the retail share classes was prudent. Again, the court rejected the defendants' argument. According to the plaintiffs' expert witness, the mutual funds would have waived their mandatory minimums if the defendants had asked. However, the defendants never asked. The court concluded that a prudent fiduciary would have asked for and received a waiver of the mandatory minimums. Because the defendants failed to obtain a waiver of the mandatory minimum, they breached their duty of prudence.

Ultimately, the court directed the plaintiffs to submit damage calculations running from July 2002 to the present based on a prescribed methodology. Among other principles, the court held that "damages should account for the fact that had the Plan fiduciaries not invested in more expensive retail share classes, the Plan participants would have had more money invested and therefore would have earned more money over the course of time, so called 'lost investment opportunity.'"

Prior to the *Tibble* decision, plaintiffs in a number of other recent cases had argued unsuccessfully that plan fiduciaries breached their duties under ERISA by offering only retail share classes of mutual funds as investment options. In light of *Tibble*, retirement plan committees and other fiduciaries would be well-advised to revisit their retail class fund offerings to determine whether the investigations behind those offerings were prudent. Did the fiduciaries conduct the investigations themselves or did they rely upon third-party advice? If the latter, was that reliance reasonably justified? And notwithstanding that reliance and other perceived restrictions, did anyone approach the investment vendor and seek to secure institutional share classes? The answers to these and other questions should be well-documented in the fiduciary's meeting minutes. After all, questions of ERISA prudence rise and fall on the deliberative process undertaken by the plan fiduciaries, not the results of that process.
