The Seamless Web of Records Retention

Records retention represents the intersection of many disparate legal principles and issues, including the scope of a fiduciary's duty and the statute of limitations.

BY JOHN J. NESTICO

Clichés are interesting because they present something of a paradox: They are statements of some fundamental truth or something that is universally understood, but are so shopworn and tiresome that the very expression of it undermines its truthfulness.

One of my favorites has to be: "the Law is a seamless web."[1] The Supreme Court has applied that same characterization to ERISA, though perhaps in a less elegant way, saying that ERISA was a "complex and reticulated statute."[2] "Reticulated" means forming a network. I had to look it up. But the truth of the statement about the law, and ERISA, is evident even in the most mundane of issues, such as records retention.

I do not mean to belittle records retention. In fact, records retention represents the practical and necessary intersection of a multitude of widely disparate legal principles and issues, including the scope of a fiduciary's duty and the statute of limitations, which was recently addressed by the U.S. Supreme Court, as well as the attorney-client relationship.

DEMONSTRATING COMPLIANCE

One of the fundamental obligations of the administrator (usually the sponsor) of a qualified retirement plan is to administer the plan in accordance with its terms.[3] Therefore, the first point of keeping good records is to be able to prove that you have complied with the terms of the plan (and, it goes without saying, the law). The most obvious case is whether benefits have been calculated and distributed correctly, so the plan's records should be able to demonstrate every step in the process.

A plan fiduciary is required to perform his or her duties with the care, skill, prudence and diligence then prevailing that would be used by a reasonable person familiar with such matters — the "reasonable expert." This is the ERISA proposition: If a fiduciary engages in a thorough analysis of an issue, hiring experts when necessary to fill in knowledge gaps, to arrive at reasonable alternative courses of action, the fiduciary will never be held liable for the exercise of his or her judgment in choosing from among those alternatives, regardless of the outcome.

> "The issue about the statute of limitations is inextricably tied to the examination of the scope of a fiduciary's responsibility to correct a breach once the fiduciary becomes aware that a breach has occurred."

In legal parlance, a plan fiduciary is entitled to an arbitrary and capricious standard of review.[4] As stated by the 2nd U.S. Circuit Court of Appeals,[5] a court should overturn a plan administrator's decision only if it was without reason, was unsupported by substantial evidence, or was erroneous as a matter of law. As long as there is some rational basis for the decision, it will not be overturned by a court. Therefore, the records to be maintained by a fiduciary should be able to demonstrate the analytical process employed that provided a rational basis for the decision.

HOW LONG SHOULD RECORDS BE PRESERVED?

The time period prescribed for keeping records is a direct function of the statute of limitations. Absent fraud or concealment, no claim for a breach or violation of ERISA can be brought *after the earlier of:*

- six years after "the date of the last action which constituted a part of the breach or violation," or
- three years after the earliest date on which the plaintiff had actual knowledge of the breach.

In some instances, the meaning of this language is pretty clear. For example, if an individual receives a benefit from a plan, it's pretty safe to assume that he or she is on notice of what that benefit is, and has only three years to bring a claim that the benefit was calculated incorrectly.

Suppose, however, that a fiduciary for a 401(k) plan selects the retail share class of certain investment funds when the institutional share class of the same funds was available for a significantly lower fee, suggesting a breach of fiduciary duty. To further complicate the issue, three years after the selection of those original funds, the plan fiduciaries selected additional funds and were careful to

1 The expression has been attributed to the legal historian F.W. Maitland, but likely derived from his statement: "Such is the unity of all history that any one who endeavors to tell a piece of it must feel that his first sentence tears a seamless web." From *A Prologue to a History of English Law*, 14 L. Qtrly Rev. 13 (1898).

2 *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146 (1985).

3 ERISA §404(a)(1)(D).

4 *See Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 115 (1989).

5 *Celardo v. GNY Auto. Dealers Health & Welfare Trust*, 318 F.3d 142, 146 (2d Cir.2003).

acquire the institutional share class. If the original funds were initially selected more than six years prior to the date participants bring suit, are they foreclosed from bringing a claim as a result of the six-year statute of limitations?

That was the question recently addressed by the U.S. Supreme Court in *Tibble v. Edison*. In that case, 401(k) plan fiduciaries initially selected the retail share class of certain funds that had significantly higher investment management fees than the institutional share class that was available to the plan. A portion of the excess investment management fee was then paid as revenue sharing payments that reduced the obligation of the plan sponsor to pay recordkeeping fees.

The district court dismissed the claims since more than six years had passed since the initial selection of the funds. The 9th U.S. Circuit Court of Appeals affirmed the district court's decision, stating that only a significant change in circumstances would require the performance of some additional duty, the failure of which would constitute a new fiduciary breach.

The Supreme Court disagreed, and remanded the case to the 9th Circuit to reconsider its decision in light of the fiduciary's obligation under trust law to "conduct a regular review of its investment with the nature and timing of the review contingent on the circumstances."[6]

The Supreme Court has now left it to the lower courts to determine what the scope of that review should have been under the circumstances, whether plan fiduciaries satisfied that review process, and if so, whether the fiduciaries appropriately responded to the results of that review. The Court emphasized the proposition, however, quoting from multiple sources, that when an investment is determined to be inappropriate or imprudent, a trustee is obligated to dispose of it within a reasonable time.

Keep in mind that the plan fiduciaries in *Tibble* apparently made a determination three years after the initial selection of retail shares for the three funds in question (and within six years of the date suit was filed), that acquiring retail shares was inappropriate when institutional shares were available.

The question also remains whether a breach of the duty to monitor will be considered "the last action which constituted a part of the breach or violation," or a separate breach. That may seem like a distinction without a difference, since a claim may be brought within six years of the failure to monitor, whether it is considered the "last action" or an entirely new breach. It could affect, however, how a plan fiduciary designs its records retention policy. If the failure to properly monitor is treated as the last action that constitutes part of a breach, then effectively there is a single breach that has multiple parts, and the statute of limitations for the first part (initial selection of the fund) will not run until six years after the date the fund is no longer an investment option in the plan.

If, however, the failure to monitor constitutes a new and separate breach, then each action — the initial fund selection and each subsequent periodic review — has its own six-year statute of limitations. The ultimate effect this ruling will have on cases claiming a breach of fiduciary duty will take some time to play out. Until then, the safest course for retaining records related to any fiduciary decision that may require periodic review, such as the selection of an investment choice or plan service provider, is to retain such records for a period of at least six years after the removal of the fund or the termination of the service contract.

> "A fiduciary cannot hide behind the attorney-client privilege in order to conceal a breach of duty to the beneficiaries."

PRESERVING THE CONFIDENTIALITY OF POTENTIALLY DAMAGING RECORDS

Everybody knows about the attorney-client privilege. A client must be able to communicate openly with his or her attorney in order to obtain effective and comprehensive legal advice, just like a patient must be able to communicate freely with his or her doctor. One's ability to obtain competent legal or medical advice would be severely impaired if one's confessions to a doctor or lawyer could be readily discovered upon request.

When acting in a fiduciary capacity, however, the attorney-client relationship becomes complicated, and a series of cases have firmly established that a fiduciary seeking the advice of counsel in the performance of his or her fiduciary duties cannot claim the privilege.[7] There are two theories supporting this position. The first is that a fiduciary is acting solely in a representative capacity on behalf of plan participants. Therefore, it is the plan participants who are the actual clients who "own" the

6 *Tibble v. Edison*, 575 U.S.__(2015); Slip Opinion at p. 5.

7 The seminal case is *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), a shareholder derivative case seeking recovery on behalf of a corporation against officers and directors who violated their fiduciary duty to the corporation. The principles of that case have been extended to other fiduciary relationships, including fiduciaries to employee benefit plans. *See, e.g., Petz v, Ethan Allen, Inc.*, 113 F.R.D. 494 (D. Conn. 1985).

privilege. A participant suing for breach of fiduciary duty is not very likely to invoke the privilege to prevent disclosure.

The second theory involves a balancing of conflicting public policy interests: protecting attorney-client communications on the one hand, and protecting the rights of the beneficiaries in a fiduciary relationship on the other. Since a fiduciary owes the beneficiaries the highest duty known to the law, it is understandable that beneficiary's interests win over the interest in protecting client communications. Another expression of that theory is that a fiduciary cannot hide behind the attorney-client privilege in order to conceal a breach of duty to the beneficiaries.

To be clear, the exception to the attorney-client privilege applies only to advice obtained in connection with the performance of a fiduciary's duties. Once a claim has been asserted, a fiduciary does have the benefit of the privilege when seeking legal advice at his or her expense in the defense of that claim.

There is at least one mechanism for preserving the confidentiality of communications with counsel suggested by the nature of the fiduciary exception: Ensure that communications with the attorney take place at a staff level below the level of the actual fiduciary. Activity that is preliminary to consideration by the fiduciary is arguably not the activity of the fiduciary and not subject to disclosure.[8]

CONNECTING RECORDS RETENTION TO THE SCOPE OF FIDUCIARY RESPONSIBILITY

At the end of the day, records retention policies are driven by considerations of the statute of limitations, which is generally measured from the date of some action. The ruling from the Supreme Court in *Tibble* offers the possibility that the ERISA statute of limitations may be a lot longer than anyone anticipated. PC

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8 *See, e.g., Cheney v. United States Dist. Court*, 542 U.S. 367 (2004)