Statute of Limitations

Is there a continuing duty to monitor prohibited transactions?

IN the tax-qualified plan area, even if an operational defect occurs in a closed plan year—generally within three years after the Form 5500 for the plan year is filed—so that the IRS could not disqualify the plan for that year, the agency's position is that the violation taints the plan until it is corrected. This is why plans that apply for relief under the IRS Employee Plans Compliance Resolution System (EPCRS) generally should correct for all plan years.

Under the Employee Retirement Income Security Act (ERISA), because a plan fiduciary has a duty both to prudently select and prudently monitor investments, it is frequently the case that a defendant's statute of limitations defense may successfully bar a plaintiff's claim that an investment was imprudently selected—but will not withstand one that the investment was improperly monitored.

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Courts have, however, reached different conclusions with respect to whether there is a continuing duty to monitor alleged prohibited transactions.

In *Re Northrop Grumman ERISA Litigation*, a 2015 California District Court case, the question was whether allowing a contract for administrative services that was first made outside of the limitations period to remain in effect during the limitations period constituted both a breach of fiduciary duty and a prohibited transaction, such that plaintiffs' claims were timely.

After the Supreme Court decision in *Tibble v. Edison*, it was clear that a fiduciary had a duty periodically to review the prudence of existing investments and to remove imprudent ones.

The open question for the District Court was whether an ERISA fiduciary had a similar continuing duty not to engage in prohibited transactions. The District Court concluded that there was such a duty.

The starting point for its analysis was that the duty not to engage in prohibited transactions derives from the general duty of loyalty recognized by the common law of trusts. Under trust law, the duty of loyalty continues throughout the administration of the trust. Thus, if a trustee learns of a third party's conflicting interest, his duty is therefore to remove it.

Consequently, the District Court concluded that, "given the fiduciaries' continuing duty to avoid transactions violating the duty of loyalty, plaintiffs can argue that each payment pursuant to an annual approved schedule during the limitations period constitutes a breach of fiduciary duty and a prohibited transaction."

However, the Northrop Grumman analysis is a minority view. For example, in *Cassell et al v. Vanderbilt University, a* case decided by the Middle District in Tennessee in January, plaintiffs alleged that the defendants had engaged in a prohibited transaction by locking the plan into the CREF Stock Account and the recordkeeping services of TIAA, which they contended was an unreasonable arrangement.

To the extent that the alleged prohibited transaction indeed locked the plan into an unreasonable arrangement, the action was time-barred, but plaintiffs also alleged claims based upon defendants' "continuing transactions with TIAA-CREF.

However, the court agreed with defendants that the continuing violation theory does not apply to prohibited transaction claims, which are based on discrete transactions obviously, if the prohibited transaction is a lease or a loan, or a guarantee of a loan, as in the U.S. Tax Court case of *Peek v. Commissioner,* there can be a continuing prohibited transaction.

The District Court agreed with those courts that hold that a decision to continue a certain investment or a defendant's failure to act cannot constitute a "transaction" for purposes of ERISA's prohibited transaction statutes. In *White v. Chevron*, the court explained that, "unlike a claim for breach of fiduciary duty, which turns on the prudence of the decisionmaking process, a violation of Section 1106 occurs when a fiduciary takes a particular action with respect to a plan. It makes no sense to assert a claim of duty to monitor a past occurrence, and the 9th Circuit has opined (*Wright v. Oregon Metallurgical Corp*) that there is no such thing as a "continuing" prohibited transaction, as the plain meaning of transaction is that it is a point-in-time event."

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