ALERT - Supreme Court Expands Liability for 401(k) Plan Fiduciaries

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Long-standing legal protections against a participant's ability to sue 401(k) plan fiduciaries were eliminated when the United States Supreme Court issued its opinion on February 20, 2008 in the case of *LaRue v. DeWolff, Boberg & Associates, Inc.* The *LaRue* decision opens the federal courts to claims by
401(k) plan participants who allege that plan administrators committed errors resulting in losses to their individual account balances. But the majority and concurring opinions leave open certain issues for resolution by lower courts. Later decisions on those issues may lessen the liability risk for plan fiduciaries. Time will tell whether *LaRue* is more bark than bite.

Overview

Unlike a traditional "defined benefit" pension plan, participants in a defined contribution plan (e.g., 401(k) plan) exercise individual discretion and control over investments in their plan accounts. For that reason, it has been commonly accepted that ERISA Section 404(c) exempts defined contribution plan fiduciaries from breach of fiduciary duty liability for alleged losses in individual accounts. Additionally, most courts have concluded that no claim exists under ERISA Section 502(a)(2) for "appropriate relief" to remedy losses suffered by an individual 401(k) plan participant (as opposed to losses incurred by the "entire plan"), or under ERISA Section 502(a)(3) for "equitable relief" where the remedy sought is a compensatory payment of money (a "legal" not "equitable" remedy). But *LaRue* ostensibly opened the courthouse doors to 401(k) plan participants seeking individual monetary relief.

The Case

James LaRue participated in a 401(k) plan administered by his former employer, a management consulting firm. LaRue alleged that his former employer failed to carry out his instructions to change certain investments in his 401(k) plan account. As a result, LaRue claimed that his plan account decreased by about $150,000. LaRue sued his former employer and the plan in the United States District Court in South Carolina. That court dismissed LaRue's case, holding that monetary relief was not available to an individual 401(k) plan account holder as "equitable relief" under ERISA Section 502(a)(3), the provision of ERISA

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under which LaRue had brought suit. The District Court determined that LaRue was seeking compensatory damages, a "legal" not "equitable" remedy. LaRue appealed that judgment. The United States Court of Appeals for the Fourth Circuit affirmed. The Court of Appeals held that allowing monetary relief to an individual 401(k) plan participant for losses in his account was neither "appropriate relief" for breach of fiduciary duty under ERISA Section 502(a)(2) nor "equitable relief" under ERISA Section 502(a)(3), and ERISA afforded LaRue no claim.

According to the Supreme Court, the Fourth Circuit got it wrong, at least with respect to ERISA Section 502 (a)(2). The Court held that ERISA Section
502(a)(2) authorizes a 401(k) plan participant to sue a plan fiduciary to recover losses caused by the fiduciary's breach, e.g., fiduciary acts which impair the value of the participant's plan account. The majority opinion distinguished its prior precedent, which had limited Section 502(a)(2) relief to claimants asserting remedies for the "entire plan." The Court noted that its prior precedent worked in the context of defined benefit plans, which paid fixed benefits. The Court explained that benefits in a defined benefit plan are jeopardized only if the "entire plan" itself is jeopardized. But the Court noted that the retirement plan landscape has changed from one dominated by defined benefit plans to one dominated by defined contribution plans. In the context of defined contribution plans, the Court held that a fiduciary breach need not threaten the solvency of the "entire plan" for a participant's benefits to be reduced. Hence, the Court reasoned that Section 502(a)(2) afforded an individual participant a remedy in the defined contribution plan context. The Supreme Court remanded the case to the lower courts for further proceedings consistent with its opinion.

Implications

The *LaRue* case leaves open several issues, resolution of which by lower federal courts will determine whether the ERISA litigation floodgates have been opened wide, or perhaps just a crack. The majority made clear, in a footnote to its opinion, that it had not decided whether Section 502(a)(2) claimants are required to exhaust administrative plan remedies before seeking relief in federal court. Administrative exhaustion typically is applicable only in the context of claims for benefits brought under ERISA Section 502(a)(1)(B). But the *LaRue* majority suggested that an administrative exhaustion requirement may be applicable to a fiduciary breach claim brought under Section 502(a)(2), as well. If a plan participant is required to prosecute claims and appeals before the plan administrator, as opposed to gaining immediate entry into federal court alleging fiduciary breach, the administrator is potentially given the opportunity to correct errors and to build an administrative record which could prevent liability in a subsequent court case.

Moreover, Chief Justice Roberts wrote a concurring opinion suggesting that concepts which have developed in ERISA benefit claim cases brought under Section 502(a)(1)(B), such as the administrative exhaustion requirement and discretionary review of eligibility determinations, may be applied to participant fiduciary breach claims brought under Section 502(a)(2). The Chief Justice, joined by Justice Kennedy, concurred that LaRue had a claim against the administrator, but expressed his opinion that LaRue's claim was cognizable as a benefit claim under Section 502(a)(1)(B) not a fiduciary breach claim under Section 502(a)(2). If the lower courts adopt the Roberts-Kennedy suggestion, and treat *LaRue*-type claims as Section 502(a)(1)(B) benefit claims, or the lower courts simply import concepts that have developed under Section 502(a)(1)(B) when construing *LaRue*-type claims under Section 502(a)(2), then potential fiduciary liability would be significantly dampened, principally because a heightened standard of court review might be applied to plan administrator decisions.

First, *LaRue*-type claims would be subject to the administrative exhaustion requirement, discussed above. Even the majority in *LaRue* suggested that administrative exhaustion might be required for such claims. More importantly,*LaRue*-type claims would be subject to deferential judicial review pursuant to the Supreme Court's holding in Firestone Tire & Rubber Co. v. Bruch, as long as the plan contained a grant of discretion. Under Bruch, if a plan grants its administrators discretion to determine benefit eligibility and to construe plan terms, then the administrators' decisions can be reversed by a court only if found to be an "abuse of discretion" or "arbitrary and capricious." That is a very high standard of judicial review, which often leads to summary judgment against ERISA plaintiffs when applied by courts. The suggestion by Chief Justice Roberts and Justice Kennedy, that discretionary review may apply to *LaRue*-type claims if the plan calls for discretionary review, may be embraced by the lower federal courts. That is perhaps a very significant "saving grace" for 401(k) plan administrators and fiduciaries, despite the recognition of a new plaintiff claim in *LaRue*.

Recommendations

As with all ERISA pension and welfare plans, *LaRue* points out that it is critically important for ERISA plans to contain a broad grant of discretionary authority to their administrators and fiduciaries. To the extent courts in the future will apply Bruch discretionary review to *LaRue*-type claims, heightened review will only be available if the plan contains a grant of discretion which encompasses such claims. *LaRue* also suggests that 401(k) plan administration be designed, as much as is feasible, to permit plan participants to physically make their own investment selections, and to complete other plan administrative tasks on their own without plan administrator involvement (e.g., through a computer website).*LaRue* shows that, where the administrator acts as an intermediary between the participant and the plan trustee, the administrator potentially may be liable to the participant if it fails to carry out the participant's instructions properly.

If you would like to discuss the impact of the Larue decision, please contact one of our ERISA Practice Group attorneys:

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