Legal Backgrounder

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HIGH COURT UNDERMINES PRECEDENT IN EXPANDING PRIVATE SUITS UNDER ERISA

by

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Earlier this year, in *LaRue v. DeWolff, Boberg & Associates*,[1] the U.S. Supreme Court held that an individual plan participant may seek damages for his or her own account when those damages result from a defendant's breach of fiduciary duty under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001-1491 (West 2008).[2] *LaRue* represents a victory for participants and beneficiaries of individual account plans, which most commonly (but by no means exclusively) take the form of 401(k) plans. Plan fiduciaries must, therefore, be more vigilant than ever.

In *LaRue*, the Court backtracked significantly from its decision in *Massachusetts Mut. Life Ins. Co. v. Russell*,[3] in which it strongly suggested that individuals may not sue for money damages for breach of fiduciary duty when they cannot show harm to the plan as a whole, as opposed to solely the plaintiffs or a subset of plan participants. Plaintiffs in individual account plans have alleged – particularly in stock-drop cases where the plans allowed plan participants to invest in their employer's securities – that the defendants breached their fiduciary duties by either failing to make the necessary disclosures to participants regarding adverse material information concerning the employer and the value of its securities, or negligently allowed the plan to continue to offer the employer securities to participants at times when the stock was no longer a prudent investment option. Since 401(k) plans by their terms allow participants to select investments for their accounts, rarely will such a plan as a whole be damaged by a breach of fiduciary duty, but, more

[1] 2008 U.S. LEXIS 2014 (U.S. Feb. 20, 2008).

[2] ERISA's fiduciary duties are codified at 29 U.S.C. §§ 1101 to 1114. Fiduciaries must, for example, act solely in the interest of plan participants and beneficiaries, using the "care, skill, prudence, and diligence under the circumstances then prevailing 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[.]" 29 U.S.C. § 1104(a)(1)(B). They must also diversify a plan's investments "to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so[.]" 29 U.S.C. § 1104(a)(1)(C). A person whose breach of duty harms a plan may be held personally liable for all resulting damages. *See* 29 U.S.C. § 1109(a).

[3] 473 U.S. 134 (1985).

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commonly, only some of the plan's participants will be affected. Prior to *LaRue*, courts had split over whether *Russell* meant that plaintiffs had standing to bring actions seeking relief for less than the entire plan.[4] *LaRue* resolved this split of authority in favor of standing.

Fundamental ERISA Principles

Defined Benefit Versus Defined Contribution Plans. ERISA recognizes only two forms of pension plans: defined contribution plans (also known as individual account plans) and defined benefit plans.[5] A defined contribution plan "provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account."[6] With a defined contribution plan, employees, employers, or both, may contribute to the plan, and "the employer's contribution is fixed and the employee receives whatever level of benefits the amount contributed on his behalf will provide."[7] "'Under such plans, by definition, there can never be an insufficiency of funds in the plan to cover promised benefits". . . since each beneficiary is entitled to whatever assets are dedicated to his individual account.'"[8]

A defined benefit plan, however, consists of a general pool of assets rather than individual accounts. "Such a plan, 'as its name implies, is one where the employee, upon retirement, is entitled to a fixed periodic payment.'. . .The asset pool may be funded by employer or employee contributions, or a combination of both."[9] The employer, moreover, "typically bears the entire investment risk and – short of the consequences of plan termination – must cover any underfunding as the result of a shortfall that may occur from the plan's investments."[10]

Thus, actions for relief on behalf of the plan as a whole would theoretically involve only defined benefit plans, since participants do not have individual accounts and the plan's assets are held for the benefit of its constituents. In recent years, however, the trend in private pension plans has clearly been away from the traditional defined benefit plan model and toward individual account plans, which often include profit sharing, employee stock ownership, and 401(k) plans. In *LaRue*, the Court implied that this trend warrants a different interpretation of the relevant sections of ERISA's civil enforcement provisions.

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[4]*Cf. Griggs v. E.I. du Pont de Nemours & Co.*, 237 F.3d 371, 385 n.7 (4th Cir. 2001) (rejecting such suits as inconsistent with 29 U.S.C. § 1109); *Fisher v. J.P. Morgan Chase & Co.*, 230 F.R.D. 370 (S.D.N.Y. 2005) (denying motion for class certification because plaintiffs were impermissibly seeking individualized relief under 29 U.S.C. § 1132(a)(2)); *accord Comer v. Micor, Inc.*, 436 F.3d 1098, 1100 (9th Cir. 2006); *Horan v. Kaiser Steel Ret. Plan*, 947 F.2d 1412 (9th Cir. 1991), with *In re Schering-Plough Corp. ERISA Litig.*, 420 F.3d 231 (3d Cir. 2005) (reversing order that dismissed ERISA stop-drop breach of fiduciary duty action as untenable under § 1109).

[5]*See* 29 U.S.C. §§ 1002(34), (35).

[6]29 U.S.C. § 1002(34); *see also Pension Benefit Guaranty Corporation v. LTV Corp.,* 496 U.S. 633, 637 n.1 (1990) (discussing the fundamental differences in such plans).

[7]*Alabama Power Co. v. Davis,* 431 U.S. 581, 593 n.18 (1977).

[8]*Hughes Aircraft Co. v. Jacobson,* 525 U.S. 433, 439 (1999) (quoting *Nachman Corp. v. Pension Benefit Guaranty Corp.,* 446 U.S. 359, 364 n.5 (1980)).

[9]*Hughes Aircraft Co.*, 525 U.S. at 439 (quotations omitted).

[10]*Id.* at 439.

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***The* Russell *Decision and Section 1109*.** ERISA's civil enforcement provisions, *see* 29 U.S.C. § 1132, are exclusive and provide only specific forms of relief (for example, plaintiffs may not recover punitive damages, and are not entitled to trial by jury). The Supreme Court has held that these provisions must be read literally, given the specificity with which Congress drafted the statute. Indeed, it has taken a dim view of actions seeking remedies apart from those expressly incorporated in ERISA. The statute, moreover, generally permits specified persons to recover monetary relief in only two circumstances: in a suit under 29 U.S.C. § 1132(a)(1)(B) to recover benefits, or in an action arising under 29 U.S.C. § 1109. Section 1132(a)(1)(B) allows a participant or beneficiary to bring a civil action "to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan[.]" Under § 1132(a)(2), a civil action may be brought "by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under [29 U.S.C. § 1109][.]"

In *Russell*, the Court observed that, under § 1109, individuals may not seek monetary relief for their own account. If the Court's comments were merely dicta, it could not have made the point more clearly: "Petitioner contends, however, that recovery for a violation of § [1109] inures to the benefit of the plan as a whole. We find this contention supported by the text of § [1109], by the statutory provisions defining the duties of a fiduciary, and by the provisions defining the rights of a beneficiary."[11] The Court added: "A fair contextual reading of the statute makes it abundantly clear that its draftsmen were primarily concerned with the possible misuse of plan assets, *and with remedies that would protect the entire plan, rather than with the rights of an individual beneficiary*."[12]

Although the *LaRue* Court found that *Russell* was distinguishable, it has functionally overruled *Russell* with respect to participant standing to sue for monetary relief for breach of fiduciary duty under § 1109. While the Court had concluded that an individual participant or beneficiary may sue for breach of fiduciary duty under § 1132(a)(3),[13] this provision limits plaintiffs to equitable relief. After certain courts suggested that restitution was a permissible form of equitable relief, the Court held that restitution will almost never include money damages.[14] Thus, plaintiffs will seek to sue under § 1132(a)(2) whenever they can.

The Court's Decision in LaRue

In *LaRue*, the plaintiff was a participant in a 401(k) retirement savings plan sponsored by his employer and alleged that the employer failed to comply with his instructions that it change the composition of the investments held by his account, as a result of which he sustained a $150,000 loss. He argued that the defendants' conduct was actionable under § 1132(a)(2). The Supreme Court agreed, reasoning that its interpretation of this section in *Russell* was outdated and incorrect: "*Russell's* emphasis on protecting the 'entire plan' from fiduciary misconduct reflects the former landscape of employee benefit plans. That landscape has changed."[15] The Court concluded that it had spoken too broadly in *Russell* and had failed to

[11] *Russell*, 473 U.S. at 140.

[12] *Id.* at 141 (emphasis added).

[13] *See Varity Corp. v. Howe,* 516 U.S. 489, 513 (1996).

[14] *See Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002).

[15] 2008 U.S. LEXIS 2014, *11.

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anticipate the issues that could arise in fiduciary liability litigation involving defined contribution plans. (Indeed, the plan in *Russell* was not a pension plan at all, but an employee disability plan.) Having made that admission, the Court reinstated the plaintiff's complaint.

What's Next?

LaRue will likely lead to an increase in ERISA fiduciary liability litigation, which can involve the second guessing of a defendant's conduct in administering the employee benefit plan in question. Since *LaRue* increases fiduciaries' exposure to suits for money damages, it is important that plan fiduciaries remain vigilant in administering their plans and be able to defend their investment strategies, the investment options they offer their participants, and the disclosures they make to participants about the plan and any employer securities that participants may be allowed to acquire. To this end, it is critical that fiduciaries regularly secure advice from competent portfolio managers, that they review the performance of the investment options offered by their plans, and that they engage qualified attorneys, accountants, and investment advisors to guide them accordingly. Although reliance on experts in plan administration does not necessarily exempt a fiduciary from liability, courts have held that it can constitute substantial evidence of prudent plan administration.

Even so, courts must avoid the temptation to serve as Monday morning quarterbacks in assessing fiduciary conduct. The focus should remain on the methodology used by the fiduciary and on what he reasonably could have known at the time – not on after-the-fact outcomes. Although defined benefit plans place the risk of investment loss on the employer, many employers fail to adequately fund such plans, which can result in a takeover of the plan by the Pension Benefit Guaranty Corporation (PBGC). However, a plan under PBGC control will ordinarily pay participants only a fraction of their accrued benefits. Further, the defined benefit plan model optimistically presumes that the employer will still be around when the participant retires.

Defined contribution plans, by contrast, require funding on an ongoing basis and allow participants to better control their own destiny by structuring their portfolios as they see fit, even if they want to acquire heavy concentrations of employer stock offered by the plan. Accordingly, courts must recognize that Congress has expressly allowed participants to assume as much or as little risk as they wish. With this legislative judgment has come the potential for participant losses, which should not be shifted to plan fiduciaries absent a demonstrable breach of duty and substantial evidence of proximate cause and damages.