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401(K) Party May Sue for Fiduciary Breach Under ERISA

On Feb. 20, 2008, the U.S. Supreme Court unanimously held that an individual 401(k) plan participant may sue a plan fiduciary under the Employee Retirement Income Security Act (ERISA) §502(a)(2) to recover losses caused by a fiduciary breach that only affected the participant's individual account.

Background

Section 409 of ERISA imposes personal liability on plan fiduciaries to "make good to [the] plan any losses to the plan resulting from a breach" of fiduciary duty and to restore to the plan any profits derived from the fiduciary's improper use of plan assets.[1] ERISA §502(a)(2) authorizes the secretary of Labor, a participant, beneficiary, or fiduciary to bring a civil action to redress a breach of fiduciary duty under §409(a) of ERISA.

The Supreme Court has consistently explained that it is "reluctant to tamper with an enforcement scheme crafted with such evident care as the one in ERISA," as the "[t]he federal judiciary will not engraft a remedy on a statute, no matter how salutary, that Congress did not intend to provide." *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 144, 147. (1985). Accordingly, because the text of ERISA §409 provides for recovery by the plan, not the participant who brings suit, the Supreme Court has found that although a single participant may bring a civil action under ERISA §502(a)(2), any recovery must "inure[] to the benefit of a plan as a whole." Id. at 140.

In *Massachusetts Mutual Life Insurance Co. v. Russell*, the Supreme Court held that a plan beneficiary could not bring an action for monetary damages against a plan fiduciary who had been responsible for the untimely processing of the beneficiary's benefit claim. Id. The plaintiff in that case brought suit under ERISA §502(a)(2), alleging that she had been injured by her employer's improper termination of her disability benefits, even though her employer had later reinstated her benefits and paid retroactive benefits for the period in which she was not covered. Id. at 137. The Supreme Court rejected the beneficiary's claim. The Court explained that based on the plain text of the statute, "recovery for a violation of §409 inures to the benefit of the plan as a whole." Id. at 141. As a plaintiff could only recover losses on behalf of the entire plan under §409, relief for an individual beneficiary was not available under that provision.

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After the Supreme Court's holding in *Russell*, lower courts struggled to apply the Court's holding to claims alleging fiduciary breaches affecting only a subset of plan participants. While some courts allowed plaintiffs to proceed with claims for breach of fiduciary duty under §502(a)(2) where the alleged breach did not harm all participants, it remained an open question whether a particular subset of participants could be too small to plausibly represent the "plan as a whole." See e.g., *Milofsky v. Am. Airlines, Inc.*, 442 F.3d 311 (5th Cir. 2006); *In re Schering-Plough Corp. ERISA Litig.*, 420 F.3d 231 (3d Cir. 2005); *Steinman v. Hicks*, 352 F.3d 1101 (7th Cir. 2003); *Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995). This question was starkly presented in *LaRue v. DeWolff, Boberg & Associates*, in which a single participant sued for losses due to an alleged fiduciary breach affecting exclusively his individual 401(k) plan account.

'LaRue v. DeWolff, Boberg'

James LaRue participated in a 401(k) plan sponsored and administered by his employer, DeWolff, Boberg & Associates, Inc. (DeWolff). *LaRue v. DeWolff, Boberg & Associates*, 450 F.3d 570, 572 (4th Cir. 2006). Plan participants managed their own accounts by selecting from a menu of investment options. Id. Mr. LaRue claimed that in 2001 and 2002, DeWolff failed to execute his instructions for changes to the investments in his plan account, resulting in a loss of approximately $150,000 to his "interest in the plan." Id. Mr. LaRue claimed that DeWolff had breached its fiduciary obligations by failing to carry out his instructions and sought reimbursement of the resulting losses. Id. In his complaint, Mr. LaRue relied exclusively on ERISA §502(a)(3) (which authorizes "appropriate equitable relief") for his requested relief. Id. at 572, 574. The defendants moved for judgment on the pleadings under Federal Rule of Civil Procedure 12(c), arguing that the monetary remedy sought by Mr. LaRue is unavailable under ERISA. Id. at 572. The district court agreed and granted judgment for defendants on the ground that Mr. LaRue's requested remedy was not available under ERISA.

Mr. LaRue appealed to the U.S. Court of Appeals for the Fourth Circuit, and argued (for the first time) that defendants were liable for the $150,000 to his plan account under ERISA §§502(a)(2) and 409, which together make a fiduciary liable for "losses to the plan" resulting from breaches of fiduciary duties. Id. at 574. Mr. LaRue also argued, as he had in the district court, that he was entitled to recover the losses to his account as appropriate equitable relief under ERISA §502(a)(3). Id. The Fourth Circuit rejected both bases of recovery and affirmed the district court's judgment.

The Fourth Circuit held ERISA §502(a)(2) does not permit a participant in a defined contribution plan to sue based on losses to the plan caused by a fiduciary breach when the losses affect only the participant's individual plan account. The court held that Mr. LaRue could not state a claim under §502(a)(2) because "[r]ecovery under [§502(a)(2)] must 'inure[] to the benefit of the plan *as a whole*,' not to particular persons with rights under the plan." Id. at 573 (quoting *Russell*, 473 U.S. at 140) (emphasis added by Fourth Circuit). The court concluded that Mr. LaRue's suit would not benefit the plan as a whole for three reasons: (1) Mr. LaRue sought "recovery to be paid into his plan account, an instrument that exists specifically for his benefit"; (2) "[t]he measure of that recovery is a loss suffered by him alone"; and (3) "that loss itself allegedly arose as the result of [DeWolff's] failure to follow [Mr. LaRue's] own particular instructions, thereby breaching a duty owed solely to him." Id. at 574. The court explained that Mr. LaRue's suit was simply "different from a [§ 502(a)(2)] action in which an individual plaintiff sues on behalf of the plan itself or on behalf of a class of similarly situated participants," because, in that other kind of case, the remedy "does not solely benefit the individual participants." Id.

The Fourth Circuit also held that a participant in a defined contribution plan cannot sue under ERISA §502(a)(3) to restore assets lost as a result of a fiduciary breach because such a suit does not seek "equitable relief" within the meaning of that provision. Id. at 576. In the court's view, Mr. LaRue's suit sought compensatory damages, which are not available under §502(a)(3). Id. The court found that Mr. LaRue's argument that he was seeking equitable relief because he was suing a fiduciary to recover losses caused by a fiduciary breach was foreclosed by *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993) and *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002). *LaRue*, 450 F.3d at 576.

The Supreme Court

The Supreme Court rejected the Fourth Circuit's decision with respect to §502(a)(2), finding that "although §502(a)(2) does not provide a remedy for individual injuries distinct from plan injuries, that provision does authorize recovery for fiduciary breaches that impair the value of plan assets in a participant's individual account. 128 S.Ct. 1020, 1026 (2008). The Court distinguished its holding in *Russell* on two grounds. First, the Court explained that the type of misconduct alleged by Mr. LaRue fell "squarely within the category" of the "principal statutory duties" imposed by ERISA that "relate to the proper plan management, administration, and investment of fund assets." Id. at 1024. In contrast, the misconduct alleged in *Russell* (the delay in processing a benefit claim) fell outside these principal duties, and the plaintiff in *Russell* had received all the benefits to which she was contractually entitled. Id.

Second, the Court explained that the emphasis in *Russell* on protecting the "entire plan" from fiduciary misconduct derived from the "former landscape of employee benefit plans," which had evolved in the years since *Russell* was decided. Id. at 1025.[2] Whereas "the defined benefit plan was the norm of American pension practice" when ERISA was enacted and when *Russell* was decided, "[d]efined contribution plans dominate the retirement plan scene today." Id. at 1025 (internal quotations and citations omitted). According to the Court, fiduciary misconduct with respect to a defined benefit plan would not affect an individual entitlement to a benefit unless the misconduct detrimentally affected the entire plan. Id. In contrast, "for defined contribution plans,…fiduciary misconduct need not threaten the solvency of the entire plan to reduce benefits below the amount that participants would otherwise receive." Id. "[W]hether a fiduciary breach diminishes plan assets payable to all participants and beneficiaries, or only to persons tied to particular individual accounts, it creates the kinds of harms that concerned the draftsmen of §409." Id. For these reasons, the Court found that the "entire plan" language from *Russell* applied only to defined benefit plans, not to defined contribution plans. Id. at 1025.

Because the Court found that the Fourth Circuit erred in its interpretation of §502(a)(2),[3] the Court declined to address the §502(a)(3) question.

Consequences of 'LaRue'

As a result of the Supreme Court's holding in *LaRue*, individual participants in a defined contribution plan may now bring claims under ERISA §502(a)(2) for alleged fiduciary breaches that result in losses to an individual's account. As the Court did not reach the §503(a)(3) question, the law on remedies under §503(a)(3) remains unchanged by the Court's opinion.

The Court's opinion also raised several questions, which the Court did not answer. One question is whether a participant is required to exhaust a plan's internal administrative review procedures before bringing suit for a breach of fiduciary duty under §502(a)(2). The Court raised this question in a footnote, but did not decide it. Id. at 1024, n.3.

Another question raised by the Court's opinion is whether former participants who have cashed out of the plan have standing to sue for breach of fiduciary duty. The Court did not directly decide this issue, but stated in a footnote that, contrary to the respondents' argument that the case was moot because Mr. LaRue was no longer a participant in the plan, the case was not moot because ERISA includes in the definition of "participant" "a former employee with a colorable claim to benefits." Id. at 1026, n.6. The Court then cited a Seventh Circuit opinion, which held that, based on the statutory definition of "participant," former participants who cashed out the plan do have standing to sue under ERISA, as the prospect of winning a money judgment against the plan means that such former participants "may become eligible to receive a benefit" from the plan, as required in order to qualify as a "participant" under ERISA. Id. (citing *Harzewski v. Guidant Corp.*, 489 F.3d 799, 804 (7th Cir. 2007)). The Supreme Court's position on this question is, however, unclear, as the Court also noted that Mr. LaRue's "withdrawal funds from the Plan may have relevance to the proceedings on remand." *LaRue*, 128 S.Ct. at 1026, n.6.

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Another question, raised by Justice John Roberts' concurrence, is whether a plaintiff may bring a claim under §502(a)(2) when relief is otherwise available under §502(a)(1)(B). Justice Roberts noted that §502(a)(2) makes available "appropriate relief," and, in the context of §502(a)(3), the Supreme Court has held that relief is not "appropriate" under that provision if another provision, such as §502(a)(1)(B), offers an adequate remedy. Id. at 1027. Although the Court did not decide the issue, Justice Roberts pointed out that applying that reasoning to §502(a)(2) "would accord with our usual preference for construing the 'same terms [to] have the same meaning in different sections of the same statute,' and with the view that ERISA in particular is a 'comprehensive and reticulated statute' with 'carefully integrated civil enforcement provisions.'" Id. (internal citations omitted).

Advice for Fiduciaries

In light of *LaRue*, plan sponsors and fiduciaries may want to take certain actions to evaluate their potential exposure to claims of fiduciary breach.

First, plan fiduciaries should be identified and the extent of fiduciary bonds and indemnifications should be reviewed. Since fiduciaries may be personally liable for plan losses, it is important for fiduciaries to be aware of the extent of their duties under the plan documents and those imposed by ERISA. Often plan sponsors provide fiduciaries with a bond and/or indemnification for damages resulting from certain types of breaches. This may be a good time for fiduciaries to review the amount of any bond that may have been purchased for reimbursement for damages incurred in their capacity as fiduciaries and the extent to which they may be indemnified.

Section 404(c) of ERISA limits fiduciary liability for certain investment losses in participant-directed account plans if certain requirements are met, including the requirement that the plan offers a diversified assortment of investments from which plan participants may choose. Plan sponsors and fiduciaries should review all of the requirements of, and ensure compliance with, ERISA §404(c) as a preventative measure to decrease the potential for investment loss claims.

Finally, other individual account plans such as nonqualified deferred compensation plans should be reviewed as well. These nonqualified arrangements may be subject to or exempt from ERISA, and it will become increasingly important to be aware whether the *LaRue* decision may be extended so as to impose liability under these types of arrangements as well.

1. Section 409 also subjects plan fiduciaries to "such other equitable or remedial relief as the court may deem appropriate," including removal of the fiduciary.

2. Although the plan at issue in *Russell* was a disability plan, not a defined benefit plan, the Court in *LaRue* characterized the holding in *Russell* as emanating from logic that applied only to defined benefit plans, stating that "[t]he 'entire plan' language in *Russell* speaks to the impact of §409 on plans that pay defined benefits." *LaRue*, 128 S.Ct. at 1025.

3. Although all of the justices agreed on the outcome of *LaRue*, they disagreed on the reasoning behind the Court's holding. Chief Justice Roberts, joined by Justice Anthony Kennedy, wrote a concurring opinion suggesting that it was "at least arguable" that the plaintiff's claim in *LaRue* "properly lies only under §502(a)(1)(B) of ERISA," which authorizes a plan participant or beneficiary "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." Id. at 1026 (Roberts, J. concurring). Justice Clarence Thomas, joined by Justice Antonin Scalia, wrote a separate concurrence, disagreeing with the majority's reliance on "trends in the pension market" and the "concerns of ERISA's drafters," and instead finding that Mr. LaRue had a cognizable claim based on the "unambiguous text of §§409 and 502(a)(2)." Id. at 1028 (Thomas, J. concurring). According to Justice Thomas, losses to an individual account in a 401(k) plan constitute losses to the plan under ERISA because such losses diminish the plan's aggregate assets. Id.

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