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Employee Benefits

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Supreme Court Addresses the Remedies Available for Fiduciary Breach Under ERISA

By Daniel W. Srsic and Russell D. Chapman

For the past 20 years, federal appeals courts have disagreed on whether participants in ERISA-governed individual account pension plans, such as 401(k) plans, may sue fiduciaries who cause losses to their accounts under those plans. The U.S. Supreme Court has now held that these claims are indeed viable under ERISA. The Court's unanimous holding in *LaRue v. DeWolff, Boberg & Associates* has opened the door to a new category of ERISA lawsuits.

James LaRue claimed that in 2001 and 2002, he directed the administrator of his 401(k) plan to change his 401(k) account investment selections, but the administrator never did. In 2004, he filed suit against the plan and the administrator under the Employee Retirement Income Security Act (ERISA), claiming the administrator's failure to follow his directions caused his account to lose $150,000 in value. After the Fourth Circuit affirmed the dismissal of LaRue's claim, reasoning that ERISA would not permit monetary recovery except on behalf of the plan as a whole, the Supreme Court agreed to decide the case.

ERISA permits six types of claims, three of which are involved here:

- Claims for benefits under Section 502(a)(1)(B);
- Claims for restoration of losses to the plan caused by fiduciary breach under Section 502(a)(2); and
- Equitable remedies for all other breaches of the plan or ERISA itself under Section 502(a)(3).

The Court's holding closed a gap in the remedies available in some circuits between so-called "(a)(2)" and "(a)(3)" claims. Some courts held that an "(a)(2)" claim must inure to the plan as a whole, meaning every participant in the plan had to be affected by the breach. Individual claims were permitted under Section 502(a)(3), but only equitable remedies were available, not "make-whole" relief, as under Section 502(a)(2), thus creating the gap between "(a)(2)" and "(a)(3)" into which LaRue's claim fell.

The gap grew out of varying interpretations of the Supreme Court's 1985 decision in *Massachusetts Mutual Life Ins. Co v. Russell*, 473 U.S. 134. In Russell, the Court concluded that ERISA's drafters, in crafting Section 502(a)(2), were primarily concerned with "remedies that would protect the entire plan, rather than the rights of individual beneficiaries." Thus, ERISA Section 502(a)(2) was understood to permit a plan participant to bring a civil action for breach of fiduciary duty only where the alleged breach has caused losses to the plan as a whole.

Now, 20 years after *Russell*, LaRue's case presented the Supreme Court with the question of whether a participant in a defined contribution pension plan may sue under Section 502(a)(2) to recover losses in his plan account caused by a breach of fiduciary duty, when those losses affected only the participant's individual account. The February 20, 2008 decision eliminated any doubt that such claims may be pursued under ERISA.

All nine justices agreed that LaRue's claim for breach of fiduciary duty under ERISA Section 502(a)(2) should not have been dismissed. Writing for the majority, Justice Stevens held that the language in the Court's earlier *Russell* decision did not limit fiduciary breach actions to those seeking a recovery for the plan as a whole. Instead, the Court explained that such authority was based on the prominence in the 1980's of the defined benefit plan, in which plan assets are not segregated into individual accounts. With the pension plan market now dominated by individual account plans, including 401(k) plans, the Court reasoned that Section 502(a)(2) must now be read as encompassing the types of claims made by LaRue, even if only one participant is affected by the loss.

While all agreed with the result, four Justices rejected Justice Stevens' reasoning. Chief Justice Roberts concurred in the result, but wrote that LaRue should have been able to pursue the alleged lost value of his account through a claim for benefits under Section 502(a)(1)(B). Justice Thomas, also concurring in the result, rejected any reliance on changes in the pension industry from defined benefit to defined contribution plans as a basis for the decision. Because all of the assets held by a 401(k) plan are "plan assets," he argued that the Court's decision could be based on the "unambiguous text of [ERISA Sections] 409 and 502(a)(2)."

What Does this Decision Mean for Plan Sponsors?

There are at least two immediate effects of the *LaRue* decision. First, there clearly will be more claims against 401(k) and other individual account plan administrators, investment managers, and other fiduciaries who previously considered themselves immune from liability for investment losses because of ERISA Section 404(c)'s limited protection for properly structured "participant directed" plans. Section 404(c) and the regulations provide that the plan's fiduciaries will not be liable for losses to a participant's account where the losses were caused by the participant's exercise of control over the investment of the account, if the plan otherwise complies with Section 404(c). Now, when there are losses in the account, whether through employer-stock fund "stock-drops" or in individual mutual funds, the participant may allege it was not because of the participant's exercise of "control," but because of something the fiduciary did or did not do. At that point, the question of causation – who caused the loss – will become the focal point of the litigation.

The second effect of the *LaRue* decision will be to spur plan sponsors into action to insulate themselves from the potential new wave of ERISA lawsuits. First, the allocation of responsibility between the plan sponsor and the administrative service providers should be clearly stated in the administrative services agreement. Then, to the extent the employer has a role in the receipt and execution of participant investment directions, safeguards should be put in place to assure that participants' investment directions are promptly and accurately carried out. However, there probably is no way for a 401(k) sponsor to completely insulate itself from LaRue actions, since the very act of choosing an outside service provider is arguably a fiduciary act that might be alleged at some point to have been a contributing cause of a loss to a participant's account, and because mistakes in handling participant investment directions probably are inevitable given the large volume of such directives handled every day.

Employers may also wish to review the administrative services agreement, which will often include a provision stating that the provider will be liable only for intentional errors or gross negligence. While this language will not protect the service provider from participant lawsuits, it may prevent the plan sponsor from bringing the service provider into litigation as a third-party defendant. In addition, the administrative services agreement should address the degree to which the service provider is willing to indemnify or defend the plan sponsor in any litigation brought by a participant where the failure to implement an investment directive was the fault (in whole or in part) of the service provider rather than the plan sponsor.

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