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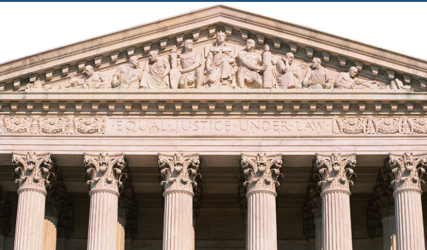

REPORT FROM WASHINGTON

Supreme Court Finds that ERISA Fiduciaries May Be Liable for Damages to an Individual 401(k) Plan Participant's Account

February 21, 2008

TO VIEW THE SUPREME COURT'S DECISION IN *LARUE V. DEWOLFF, BOBERG & ASSOC., INC.*, — S.CT. —, NO. 06-856, 2008 WL 440748 (2008), PLEASE CLICK HERE.

TO VIEW A TRANSCRIPT OF THE ORAL ARGUMENTS BEFORE THE SUPREME COURT OF THE UNITED STATES IN THE *LARUE* CASE, PLEASE CLICK HERE.

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Yesterday, the Supreme Court unanimously vacated the Fourth Circuit's decision in *LaRue v. DeWolff, Boberg & Assoc., Inc.*, — S.Ct. —, No. 06-856, 2008 WL 440748 (2008). The Court held that § 502(a)(2) of the Employee Retirement Income Security Act of 1974 ("ERISA") authorizes recovery by an individual 401(k) plan participant for breaches of fiduciary duty that impair the value of the plan assets in an individual participant's account, even if all (or even most) participants in the plan are not affected. Although all nine Justices voted to vacate the Fourth Circuit's ruling, the Justices released three separate opinions. The five-member majority opinion was authored by Justice Stevens. Chief Justice Roberts, joined by Justice Kennedy, and Justice Thomas, joined by Justice Scalia, filed separate concurrences.

The Supreme Court's ruling in *LaRue* has potentially wide ranging implications for 401(k) cases in general and specifically for so-called "stock drop" ERISA class actions, an increasingly common form of litigation that seeks to assert rights otherwise covered by the federal securities laws without the heightened scienter or pleading particularity the securities laws require. These cases involve companies whose 401(k) plans permit, encourage or sometimes require company employees to keep some portion of their 401(k) funds in a company stock fund. The suits are often brought following a significant drop in the company's stock on behalf of a class of plan participants who had 401(k) funds in company stock. Plaintiffs typically claim that it was imprudent for the plan fiduciaries to allow participants to make such investments. Yesterday's ruling gives tacit approval to the rights of individual plan participants, or subsets plan participants, to bring these "stock drop cases."

"[A]lthough § 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."

JUSTICE STEVENS

BACKGROUND

The *LaRue* case involved a claim of breach of fiduciary duty under ERISA against the fiduciaries of a 401(k) plan, a form of defined contribution retirement plan under ERISA. Such plans typically allow a participant to direct the manner in which funds contributed to the participant's individual account in the plan will be invested. The participant is ultimately entitled to the funds in the account as the retirement benefit, which funds will have grown, shrunk or stayed the same depending on how the investment performs. Approximately $3 trillion is currently invested in defined contribution retirement plans in the United States.

James LaRue was a participant in a 401(k) retirement plan offered by DeWolff, Boberg & Assoc., Inc. He claimed that he requested that Defendants make specific changes with respect to the investments in his plan account, but they failed to do so – a failure Mr. LaRue alleges was a breach of fiduciary duty. He sought to recover approximately $150,000 in potential lost appreciation as a result of the alleged breach.

The two subsections of ERISA at issue in *LaRue* were § 502(a)(2) and § 502(a)(3). Pursuant to § 502(a)(2), a civil action may be brought "by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title." Section 1109 (ERISA § 409(a)) in turn provides that a plan's fiduciary, "shall be personally liable to make good to such plan any losses to the plan resulting from such breach." Section 502(a)(3), on the other hand, prescribes equitable relief generally, allowing a civil action to be brought, "by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan."

Before the United States District Court for the District of South Carolina, Mr. LaRue initially sought relief only under § 502(a)(3). In their motion for judgment on the pleadings, Defendants argued that a § 502(a)(3) remedy was unavailable to Plaintiff because he was asking for compensatory damages in the form of lost profits, which did not qualify as "equitable relief." The district court agreed and dismissed the complaint with prejudice. Mr. LaRue did not claim standing based on § 502(a)(2) before the district court.

Affirming the lower court's decision, the United States Court of Appeals for the Fourth Circuit first noted that Mr. LaRue potentially waived his argument for relief under § 502(a)(2) by raising the argument "for the first time on appeal." The Fourth Circuit stated, however, that, even if the § 502(a)(2) argument were not deemed waived, Plaintiff "could not succeed on the merits" because § 502(a)(2) affords recovery to the plan "'as a whole,' not to particular persons with rights under the plan." Noting that Mr. LaRue was seeking recovery for his own personal loss caused by a "failure to follow Plaintiff's own particular instructions," the Fourth Circuit concluded that he did not seek recovery for the plan as a whole. The Fourth Circuit also affirmed the district court's holding that a § 502(a)(3) remedy was unavailable to Mr. LaRue.

Mr. LaRue requested a rehearing of the Fourth Circuit's decision, as well as

a rehearing *en banc*. Although the Department of Labor filed an *amicus* brief in support of Mr. LaRue, the Fourth Circuit denied the petition, stating that the Secretary of Labor's "expansive view of fiduciary liability would lead to its own parade of horribles."

THE DECISION

In the opinion of the Court delivered by Justice Stevens and joined by Justices Souter, Ginsburg, Breyer and Alito, the Supreme Court vacated the Fourth Circuit's holding that a participant is not seeking recovery for the plan "as a whole," pursuant to § 502(a)(2), when a participant is seeking recovery of individualized damages. Because it decided the case based on its analysis of § 502(a)(2), the Court did not reach the § 502(a)(3) issue.

In reaching its decision the Court considered the language of § 409(a) of ERISA along with what it characterized as the changing "landscape of employee benefit plans." The Court first noted that § 409(a) imposes fiduciary obligations which "'relate to the proper management, administration, and investment of fund assets,' with an eye toward ensuring that 'the benefits authorized by the plan' are ultimately paid to participants and beneficiaries.'" The Court found that "[t]he misconduct alleged by the petitioner in this case falls squarely within the category." The Court noted that the Fourth Circuit's decision was "consistent with" the language found in precedent regarding the requirement that an action under § 502(a)(2) seek recovery on behalf of the "entire plan," *Massachusetts Mutual Life Ins. Co. v. Russell*, 473 U.S. 134 (1985). Such precedent, the Court found, was, however, from a time when defined contribution plans (and their individual accounts) were not the norm, rendering that precedent inapplicable in the defined contribution context. The Court explained that, "[f]or 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. Whether a fiduciary breach diminishes plan assets payable to all participants and beneficiaries, or only to persons tied to particular individual accounts, it creates the kind of harms that concerned the draftsmen of § 409." The Court concluded 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." The case was therefore remanded to the Fourth Circuit for further proceedings consistent with this opinion.

"Allowing a § 502(a)(1)(B) action to be recast as one under § 502(a)(2) might permit plaintiffs to circumvent safeguards for plan administrators that have developed under § 502(a)(1)(B)."

JUSTICE ROBERTS, *concurring*

Chief Justice Roberts, joined by Justice Kennedy, filed a concurring opinion. The Chief Justice agreed with the majority "that the Fourth Circuit's analysis was flawed," but found it "not at all clear" that § 502(a)(2) authorizes recovery in such a case as this. Rather, Chief Justice Roberts stated that "[i]t is at least arguable that a claim of this nature properly lies only under § 502(a)(1)(B) of ERISA," which "allows 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.'" The significance of bringing a claim under § 502(a)(1)(B), which has an administrative exhaustion requirement, as opposed to § 502(a)(2), which does not, is that an action under §

"I agree with the Court that petitioner alleges a cognizable claim under § 502(a)(2)...but it is ERISA's text and not 'the kind of harms that concerned [ERISA's] draftsmen' that compels my decision."

***JUSTICE THOMAS**, concurring*

502(a)(2) "might permit plaintiffs to circumvent safeguards for plan administrators that have developed under § 502(a)(1)(B)." "Equally significant," Justice Roberts continued, "this Court has held that ERISA plans may grant administrators and fiduciaries discretion in determining benefit eligibility and the meaning of plan terms, decisions that courts may review only for abuse of discretion."

A separate concurring opinion was filed by Justice Thomas and joined by Justice Scalia. Justice Thomas agreed with the majority "that petitioner alleges a cognizable claim under § 502(a)(2)" but believed that it was the plain text of §§ 409(a) and 502(a)(2) "and not 'the kind of harms that concerned [ERISA]'s draftsmen' that compels my decision." Justice Thomas noted that the allocation of a defined contribution plan's assets "to individual accounts for bookkeeping purposes does not change the fact that all the assets in the plan remain plan assets." Justice Thomas further stated: "[b]ecause a defined contribution plan is essentially the sum of its parts, losses attributable to the account of an individual participant are necessarily 'losses to the plan' for purposes of § 409(a)."

IMPLICATIONS

The Supreme Court's ruling in *LaRue* resolves the question, in the context of a defined contribution plan, of whether an action seeking damages for breach of fiduciary duty pursuant to § 502(a)(2) can be brought by less than all plan participants and still be considered to be seeking recovery for the plan "as a whole." This ruling is of significance to ERISA "stock drop cases," which are generally filed only on behalf of the subset of plan participants who invested in company stock and seek to hold fiduciaries of the plan liable in negligence for the losses the employee-investors incurred. Fiduciaries now face potential liability under § 502(a)(2) to individual defined contribution plan participants, or subsets of plan participants, for damages caused by breaches of their fiduciary duties. However, Chief Justice Robert's concurrence, which suggests that courts should still consider the "effect the availability of relief under § 502(a)(1)(B) may have on a plan participant's ability to proceed under § 502(a)(2)" may leave the door open for alternative adjudications in certain circumstances.

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