February 26, 2008

MEMORANDUM

RE: Supreme Court Gives "Green Light" to ERISA Breach of Fiduciary Duty Claims Related to Individual 401(k) Participant Accounts

Last week, the Supreme Court ruled unanimously that an individual participant in a 401(k) defined contribution plan can maintain a breach of fiduciary duty claim under ERISA, even though the alleged breach affected only the value of his own individual account. LaRue v. DeWolff, Boberg & Assocs., Inc., No. 06-856, 2008 WL 440748 (Feb. 20, 2008).

The decision clears the way for lawsuits by 401(k) participants against plan fiduciaries for alleged mismanagement of the participants' individual accounts. Although some ERISA attorneys are claiming the litigation "floodgates" are now open, we do not see the decision as especially harmful to plan fiduciaries and sponsors. Actions concerning individual plan accounts are relatively infrequent, and typically do not expose defendants to the risk of large damages awards. We suspect that the real impact of LaRue will depend on how courts hereafter apply the varied reasoning in the majority opinion and in Chief Justice Roberts' concurrence. The majority opinion opens the door for plaintiffs to argue that the limitations imposed by Russell on relief under ERISA apply only to defined benefit plans. Chief Justice Roberts' approach provides an opening for the defense bar to argue that many fiduciary lawsuits are simply disguised claims for benefits – so a fiduciary's conduct arguably should be judged (1) after administrative remedies are exhausted, and (2) possibly under a more deferential standard of review. We discuss these and other aspects of the three opinions in the "unanimous" decision further below.

Analysis

LaRue alleged in the lawsuit that the value of the holdings in his 401(k) account had decreased $150,000 when his former employer failed to follow his instructions to move his money to different investments. Relying on the Supreme Court's prior decision in Massachusetts Mutual Life Insurance Company v. Russell, 473 U.S. 134 (1985), the Fourth Circuit held that ERISA only authorizes breach of fiduciary duty claims that affect the entire plan and the statute does not permit individualized recovery for alleged fiduciary breaches in cases like LaRue's. However, several other federal appeals courts had already allowed such suits to proceed.

Justice Stevens wrote for a majority of the Court, reversing the Fourth Circuit's decision. He asserted that the Supreme Court's focus in Russell on protecting the "entire plan" from fiduciary misconduct reflected (1) the fact that defined benefit plans were the predominant form of retirement plan for many years, and (2) the impact that fiduciary misconduct has on the overall solvency of a defined benefit plan. According to the majority opinion, defined contribution plans now predominate and, in connection with such plans, "fiduciary misconduct need not threaten the solvency of the entire plan to reduce benefits below the amount that participants would otherwise receive." Accordingly, the majority opinion concludes that, in connection with defined contribution plans, ERISA section 502(a)(2) "does authorize recovery for fiduciary breaches that impair the value of plan assets in a participant's account." While approving LaRue's claim under ERISA section 502(a)(2), the Court did not reach LaRue's other argument that he could seek "make-whole" monetary relief under ERISA section 502(a)(3).

The decision in LaRue was unanimous, but not all agreed with the reasoning adopted by the majority. Justices Thomas and Scalia wrote separately to state their view that the text of ERISA compelled the conclusion that LaRue, as an individual participant, could bring his fiduciary breach claim. In his concurring opinion joined by Justice Scalia, Justice Thomas reasoned that the Russell approach should still be used because a defined contribution plan itself is the entity that has sustained the investment losses, even though those losses are allocated, as a bookkeeping matter, to fewer than all participant accounts. Thus, according to Justice Thomas, a claim to recover losses stemming from a defined contribution plan can be maintained under ERISA section 502(a)(2), even though the recovery obtained for the plan will be allocated among fewer than all plan accounts.

Chief Justice Roberts, in a concurring opinion joined by Justice Kennedy, questioned whether ERISA section 502(a)(2) should even govern LaRue's claim, suggesting instead that LaRue's claim may essentially be a claim for benefits, not a claim for breach of fiduciary duty. Thus, Justice Roberts ventured that LaRue's claim may be more appropriately brought under ERISA section 502(a)(1)(B), which allows a participant to recover benefits due him under the terms of his plan. Justice Roberts warned that the choice of selecting the right remedial provision to proceed under is significant. He pointed out that recasting a claim for benefits as a fiduciary breach claim could allow participants to circumvent safeguards for plan administrators, such as the requirement that a participant exhaust administrative remedies before filing suit. Justice Roberts did not believe the Court was in a position to answer whether LaRue's claim is appropriately characterized as a claim for benefits since LaRue had not sought relief on that basis, and the court below had not had occasion to address the issue. Still, Justice Roberts made it clear that, going forward, the courts are free to consider the availability of benefit claim relief, and whether that would preclude participants, like LaRue, from proceeding with a fiduciary breach claim.

Although most commentators had predicted that the Court would overturn the Fourth Circuit, many were surprised by the evolving plan "landscape" rationale articulated by a majority of the Court. The conventional wisdom was that the majority would adopt a rationale similar to that advanced by Justice Thomas and Justice Scalia. The Court, in a footnote, also commented on the question of whether LaRue, who had withdrawn his funds from the plan after filing the case, had standing to proceed with a lawsuit. The Court noted that LaRue's withdrawal of funds may have relevance when the case is returned to the lower courts for further proceedings, but advised that the withdrawal of funds did not necessarily make the case moot, given that an ERISA participant with standing to sue may include "a former employee with a colorable claim for benefits."

One thing that is apparent is that LaRue is not the last word on a host of litigation issues. Please call one of the following, or the Groom attorney you regularly contact, if you have any questions.

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