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Fiduciaries Exposed to New Liability Under ERISA: The Supreme Court Clears the Way for Participants to Recover for Losses Resulting from Plan Fiduciaries' Actions

Until the decision of the United States Supreme Court in *LaRue v. DeWolff, Boberg & Associates, Inc.*, employee benefit plan participants who sued plan fiduciaries for investment losses in their retirement account faced significant legal hurdles to recovery. In *LaRue*, an opinion released February 20, 2008, the Court removed most of those hurdles, potentially opening the floodgate to new lawsuits. As fiduciaries of employee benefit plans are personally liable for losses to the plan, this decision represents a significant expansion of the liability faced by fiduciaries. This alert provides a brief summary of the *LaRue* case, as well as outlines the problems it may create for plan sponsors and fiduciaries and posits several actions that they may wish to take to help address those problems.

Summary of *LaRue*

The fact scenario in *LaRue* was straightforward: LaRue's employer offered a 401(k) plan to its employees. Plan participants could direct the investments in their individual accounts. According to the allegations, LaRue gave instructions to the plan fiduciary to make changes in the investment of his individual account. For whatever reason, those instructions were not followed. As a result, La Rue's account was allegedly worth \$150,000 less than it would have been had his instructions been followed. LaRue sued the plan fiduciary for his investment losses.

The Employee Retirement Income Security Act ("ERISA") governs the enforcement of claims involving employee benefit plans. Since the U.S. Supreme Court's decision in *Massachusetts Mutual Life Ins. v. Russell* in 1985, a participant's ability to recover for individual losses due to an alleged fiduciary breach has been significantly limited. In *Russell*, a plan participant received her benefits, but sued the plan fiduciary for damages allegedly resulting from a delay in processing her benefit claim. The Court ruled that while ERISA Section 502(a)(2) allowed recovery for fiduciary breaches damaging the plan as a whole, it did not allow recovery for damages to an individual participant. After *Russell*, unless a disgruntled plan participant could allege a class-action type of harm, the ability to recover for individual losses appeared severely limited.

In *LaRue*, however, the Court opened the door for individual participant lawsuits by focusing on the type of retirement plans at issue: the plan in *Russell* was a defined benefit plan, and the plan assets were not affected by the alleged breach about which the participant complained. The

LaRue Court reasoned that with a 401(k) plan (a defined contribution plan), an individual participant's account was a part of the plan's assets, and therefore, investment losses to an individual account affected the plan.

Problems Created by the *LaRue* Decision

The *LaRue* decision creates several problems for sponsors of employee benefit plans and plan fiduciaries, including the following:

- **No administrative review.** The *LaRue* decision appears to allow participants to file suit for individual damages for fiduciary breach under ERISA Section 502(a)(2) without first utilizing the plan's administrative review procedures. Lawsuits brought under ERISA Section 502(a)(1)(B) generally cannot be brought until a participant exhausts the administrative remedies provided by the plan, which gives plan sponsors and fiduciaries time to resolve conflicts in a less costly manner than federal court litigation. It is unclear whether participants bringing suit under ERISA Section 502(a)(2) must comply with these administrative prerequisites.
- **No deferential review.** Plan fiduciaries' decisions may not be entitled to deferential review where participants allege claims under ERISA Section 502(a)(2). When participants bring claims for benefits under ERISA Section 502(a)(1)(B), plan fiduciaries are entitled to a deferential "abuse of discretion" standard of review for their decisions, provided that the plan provides for such authority. It is unclear from the Court's decision, as well as the decisions of other lower courts, whether such an abuse of discretion standard will apply to fiduciary actions when such actions are challenged in lawsuits brought under ERISA Section 502(a)(2).
- **Loss of substantive defense.** The decision removes a substantive defense that has been relied on by sponsors of individual account plans (including 401(k) plans and profit sharing plans), namely, that recovery for alleged individual losses was not allowed in a lawsuit under ERISA Section 502(a)(2).
- **Lack of clarity.** The decision leaves open several important questions with which lower courts will struggle, namely, whether employees should be forced to bring certain breach suits under ERISA Section 502(a)(1)(B) as a denial of benefits claim and whether the deferential standard of review will apply to suits under ERISA Section 502(a)(2).

Actions to Consider for Plan Sponsors/Fiduciaries

In response to the *LaRue* decision, plan sponsors and fiduciaries may wish to consider the following actions to help limit the impact of the Court's decision:

- **Determine who are a plan's fiduciaries.** As noted above, fiduciaries are personally liable for any losses caused to the plan. That means the fiduciary's individual assets are subject to loss in a fiduciary breach suit. If you are reading

this and you are not certain whether you are a fiduciary, it is time to find out. If you are a fiduciary, it is important to know exactly to what your fiduciary duties extend. Plan documents often impose different fiduciary duties on various individuals. Generally, a fiduciary's responsibility is limited to those duties imposed upon him or her. Again, if you are uncertain whether you are a fiduciary under an employee benefit plan and the responsibilities that you have as that fiduciary, now is a good time, in light of the expansion of fiduciary liability under *LaRue*, to take stock of this issue.

- **Determine the extent of fiduciary bonding and indemnification.** Many plan sponsors provide fiduciaries serving the plan a bond for any damages resulting from a fiduciary breach. In addition, many plans provide for indemnification of a fiduciary by a plan sponsor in the event of the fiduciary's liability for actions with respect to a plan. If you are a fiduciary and you are uncertain of the extent to which you are indemnified by a plan or for what you are indemnified, or are uncertain of the existence of and amount of any bond that may have been purchased to reimburse you for damages incurred as a fiduciary, now is the time to review this information and determine its impact upon you.
- **Review ERISA Section 404(c) compliance.** ERISA Section 404(c) provides that fiduciaries are not liable for investment losses sustained by a participant in a self-directed individual account plan, provided that certain requirements are met. Among those requirements are that plan participants are offered a sufficiently diversified array of investment choices, as defined under ERISA regulations, from which to choose. To help decrease the potential for investment loss lawsuits under ERISA Section 502(a)(2), plan sponsors and fiduciaries should review all aspects of ERISA Section 404(c) compliance to help ensure maximum protection for fiduciaries.
- **Consider carefully the terms of nonqualified and equity arrangements.** Nonqualified deferred compensation and equity arrangements can oftentimes be drafted to either be subject to, or exempt from, certain of ERISA's provisions. Being subject to ERISA may be beneficial for a nonqualified plan, as ERISA preempts state law claims (such as fraud, negligence, misrepresentation) and, for a claim for benefits, limits the damages that are available to the participant. However, the *LaRue* decision reminds nonqualified deferred compensation and equity plan sponsors to consider carefully the pros and cons of being subject to, or exempt from, ERISA.
- **Don't forget welfare plans.** While many plan sponsors immediately think of qualified pension plans (such as defined benefit, 401(k) and profit sharing plans) when thinking of ERISA and fiduciary liability, welfare plans—such as life insurance, disability coverage, and medical coverage—are also subject to ERISA's fiduciary requirements. The *LaRue* decision and its expansion of fiduciary liability applies to these plans also.

- **Choose ERISA litigation counsel carefully.** As the *LaRue* decision amply demonstrates, ERISA litigation is complex. Different standards of review apply to the various types of claims that may be brought under ERISA. In addition, different types of remedies are either available or precluded by the various civil enforcement provisions of ERISA. Experienced ERISA litigation counsel is necessary to help ensure that claims and potential claims are thoroughly defended.
- **Review third-party administrator contracts.** Many employers hire TPAs to administer their retirement or health and welfare plans. In many instances, the employer's contract with these TPA firms explicitly states that the TPA will not be considered a fiduciary under the plan and that the employer, or a committee or individual employee of the employer, is a fiduciary for the plan. In such a case, the fiduciary exposure created by *LaRue* will potentially fall squarely on the fiduciary, even if the TPA's actions precipitate any alleged loss. In addition, many TPA contracts limit the liability of the TPA, meaning that the employer or fiduciary may not be able to recover against the TPA. Employers should, in light of the *LaRue* decision, review all TPA agreements and decide how best to address these issues.

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