



THE SUPREME COURT RULES FOR LARUE

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A VICTORY FOR PARTICIPANTS. A WARNING SHOT FOR PLAN SPONSORS

The headline is that retirement plan participants won a big one today. [LaRue v. DeWolff, Boberg & Associates, Inc., et al](#) is easily the most significant ERISA case in years. Was the Supreme Court brilliant? Truthfully, any average person would have known the answer. If a participant in a self-directed 401(k) plan gives investment directions, and if a Plan fiduciary ignores the directions, the fiduciary should be liable for damages to the participant's account.

The federal courts, not composed of average persons, never saw it that way, at least until today. The courts have typically reasoned that fiduciaries who goof are off the hook, unless they harm an entire plan. This left participants without recourse, unless they could prove an entire plan, not just their own account, was wronged due to a fiduciary's dishonest or incompetent conduct.

Such reasoning was out of step with the current world of self-directed defined contribution plans. Fiduciary errors these days will often not affect the entire plan. Instead, the mistakes may relate solely to the way a single person has directed a plan account. Were the participant's instructions followed? Was the participant given information about investments that was timely and properly informative? The LaRue decision recognizes that plans with individual accounts are different from plans in which benefits depend on a common trust fund, such as traditional defined benefit or health plans. After LaRue, damage to a single account is considered to be damage suffered by the entire plan. The negligent fiduciary has to pay up, and the payment goes to the wronged account.

LaRue obviously opens a Pandora's box of potential liability for Plan sponsors and other fiduciaries. Mr. LaRue was not an ailing retiree who lost his savings due to fiduciary incompetence. His beef was that he claimed he lost \$150,000 in potential profit when his instructions were not followed to make a particular investment. (As the case progressed, he conceded to the District Court that \$150,000 was a bit of hyperbole, but reflected what he "believed" the error had cost him when he filed the complaint.) The District Court never gave him a chance to go to trial, and dismissed the suit. The Appeals Court (4th Circuit) affirmed the dismissal. His victory today simply gives Mr. LaRue an opportunity to start over again to prove that he actually gave those instructions, and to overcome defenses that he didn't lose as much

as he claimed and that he may have dallied after receiving reports that showed his instructions were not carried out.

FOR LAWYERS, THERE ARE SOME INTERESTING FOOTNOTES TO ALL THIS

The Court granted Mr. LaRue relief under ERISA Section 502(a)(2), which allows participants to sue fiduciaries who breach their ERISA responsibilities, obligations, or duties. The remedy is that a wrongdoing fiduciary must restore to the plan all losses resulting from the breach. LaRue makes clear that this protection now extends to any individual account in a plan, even if it represents only 1% of the plan's assets.

To use the Court's exact words, ERISA Section 502(a)(2) "does authorize recovery for fiduciary breaches that impair the value of plan assets in a participant's individual account."

Chief Justice Roberts concurred in the decision, but issued a separate opinion with Justice Kennedy. He suggests that the proper remedy for individual claimants is not Section 502(a)(2) at all, but Section 502(a)(1), which authorizes participants to recover benefits and to enforce rights under the terms of a plan. In this case, because the plan provided for self-direction, and because the plan terms may not have been followed, Mr. LaRue should have made a claim for benefits under Section 502(a)(1). That goes well beyond the understanding of the Department of Labor, which advocated for Mr. LaRue, and even beyond the hopes of Mr. LaRue's lawyer. Each of them said in the [oral argument](#) that Section 502(a)(1) relief -- a plain claim for denied plan benefits -- would not capture losses in value, and would only apply if a Plan refused to make any payment at all.

"most my client could get is a declaration under (a)(1) that doesn't ultimately get him any money." LaRue's lawyer, in oral argument transcript at p. 17.

"he doesn't have a claim under that provision (502(a)(1)) now." Assistant to Solicitor General, in oral argument transcript at p. 27.

Was the Chief Justice being overly sympathetic in suggesting that Section 502(a)(1) was the better remedy? Not at all. To claim benefits under Section 502(a)(1), a participant must first go through a plan's claims procedures before starting suit. The Chief Justice reasoned that decades of Supreme Court precedent give deference to decisions arrived at through a plan's claims process. [Firestone Tire & Rubber Co. v. Bruch](#), 109 S. Ct. 948 (1989). A judicial policy which promotes the resolution of disputes through required claims procedures, rather than immediate litigation, encourages employers to sponsor plans. Chief Justice Roberts clearly regrets that participants claiming a Section 502(a)(2) fiduciary breach may be able to sidestep claims procedures altogether and simply head to federal court. It's a reasonable concern, and not fully resolved due to the narrow scope of the LaRue decision.

The Court did not address the third ERISA remedy provision, Section 502(a)(3), which is an interesting catch-all. If nothing else is available, participants may sue for "appropriate equitable relief." Having decided that Section 502(a)(2) provided a framework for recovery, the Court declined to rule on whether Section 502(a)(3) would permit monetary relief. That's sensible judicial policy.

However, it's unfortunate not to know how the Court would have addressed a novel argument which Mr. LaRue's lawyers advanced [in their brief](#). Traditionally, ERISA courts have held that money damages could not be assessed under Section 502(a)(3) and that any of its remedies had to be of the type that a court of equity (in the old days of a "divided" bench) would award. [Sereboff et ux v. Mid Atlantic Medical Services, Inc.](#) , 126 S.Ct. 1869 (2006).

Although the divided bench is a thing of history, ERISA clearly enshrines its remedies under Section 502(a)(3). Mr. LaRue's lawyers didn't agree that money damages were not awarded historically by courts of equity. They dusted off the venerable Restatement (First) of Trusts (1935) and pointed to a very clear equitable remedy, that of "surcharge." The theory of "surcharge" requires trustees to make up for loss, depreciation, and lost profits in a trust estate resulting from a fiduciary breach. It's an award of money, plain and simple, which would have been required by a court of equity, and it will be up to another plaintiff, on another day, to make the case that Section 502(a)(3) can, in fact, permit money damages.

THE HEIGHTENED LIABILITY OF SELF-DIRECTED PLANS

The lesson of LaRue is that it is extremely dangerous for employers to sponsor defined contribution plans which are self-directed. It's not only LaRue. This is a developing trend over recent years. Consider:

- ▶ the rash of class actions charging that employers have not properly analyzed the cost structures of open end mutual funds in self-directed plans.
- ▶ the ERISA 404(c) regulations, which theoretically insulate fiduciaries from bad investment decisions of participants, but only if near-impossible information distribution requirements (i.e. providing current prospectuses and reports) are met.
- ▶ the concerns about whether participant education is appropriate or over-stepping, even with the recent legislation meant to encourage employers to sponsor such efforts.
- ▶ the new qualified default investment alternative ("QDIA") regulations, which require new analysis of the funds in which accounts are invested until such time as participants provide directions.

I will be writing more on this subject in future. Today's mission was to acquaint you with LaRue. A first practical step is for employers who sponsor self-directed plans not to forget that they, or a committee of their employees, are the plan administrators under ERISA. If there is a mistake, they will be the ones who are sued. If they are using a professional third party administrator ("TPA"), any liability it has to make good on mistakes will be limited by contracts it has signed with the employer. Unbelievably, many contracts, using boilerplate from the TPAs' lawyers, still exculpate TPAs from wrongdoing unless they have been "grossly negligent." Clearly, any such contract must be renegotiated, or a new TPA should be hired. After LaRue, claims for simple negligence with respect to individual accounts are likely, so the contract with the TPA must be tight, and the TPA must be sufficiently solvent or adequately insured so that it can make good on claims.

The next step is more profound. With all this additional liability, is it wise to sponsor self-directed plans, with the extra expenses associated with open-end mutual funds and daily

investment switching? Are participants really better off self-managing their retirement assets, doing something they were not educated to do? Perhaps it's safer, and better for all parties, just to have an "old fashioned" managed fund, without participant direction, and to employ properly certified investment managers who can be delegated fiduciary liability under ERISA. A dividend of LaRue is that it may cause employers to step back and reconsider the current, expensive, and dangerous fad of self-direction.

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