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401(k) Plan Participants May Now Sue for Administrative Errors – Supreme Court's Decision Changes Employee Rights

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On February 20, 2008 the Supreme Court decided for the first time that individual participants in "defined contribution" retirement and pension plans, such as the 401(k) plan, can sue their employer or plan fiduciaries under §502(a)(2) of the federal ERISA statute for any impairment or loss of value in the individual participant's account that is due to a breach of fiduciary duty. This decision may signal a significant increase in claims and litigation over employee benefits plans, although the Court did refer to several hurdles that will face any such claimants.

The new decision is in a case called *LaRue v. DeWolff, Boberg & Associates, Inc.* The Court's opinion charted a very different course from a decades old decision by the Court that had barred claims made by a single participant seeking personal recovery. The new approach taken by the Court is largely based on the distinction between "defined benefit" plans and "defined contribution" plans. The decision reflects the huge shift in pension and retirement plans over recent decades away from "defined benefit" plans, in which the assets of all plan participants were combined into a single investment portfolio and paid out by the employer in accord with a predetermined formula.

The vast majority of current plans are "defined contribution" plans, such as the 401(k) structure, in which each participant maintains a personal account and makes individual investment decisions within the Plan. Under the Court's decision, plan fiduciaries of "defined contribution" plans can now be directly liable to individual employee participants for breaches of their fiduciary and administrative duties.

ERISA was enacted in 1974. It created standards of conduct for plan fiduciaries, reporting requirements, standards for participation and vesting of benefits, minimum funding requirements and required administrative procedures. A major purpose of ERISA was to impose fiduciary standards of conduct on those entrusted with pension and retirement plan funds. When ERISA was enacted, most pension and retirement plans were unilaterally established commitments by an employer to pay stated benefits to employees upon retirement. Some of those plans were funded, some were not. A second large group was union negotiated and managed plans into which employers paid funds under a collective bargaining agreement. In both cases, the only employee choices were in regard to the terms of the payout. The employees had no say as to how plan assets would be invested or managed.

What has changed since ERISA was enacted is the emergence and current dominance of "defined contribution" plans, such as 401(k) type plans, in which an employee elects to contribute a percentage of pre-tax income to a personal investment account, with or without employer matching. These plans allow participants to choose from a number of investment options ranging from very conservative money market and fixed income vehicles to high risk, small cap, speculative stocks. This change has arguably placed less responsibility on plan managers to make sound investment decisions. However, administration of such plans has also become increasingly complicated and technical.

The Supreme Court decided in 1985 that where "defined benefit" plan fiduciaries have failed to act prudently and losses of plan assets have occurred, any recovery from such fiduciaries should be by "the plan as a whole." See, *Massachusetts Mutual Life Ins.*

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Co. v. Russell, 473 U.S. 134 (1985). In that case the Court also held that individual plan participants could not recover for breaches of fiduciary duty that led to plan losses. A premise of that decision was that the entitlement to benefits for all "defined benefit" plan participants was the same. Therefore any recovery would be added back into the assets of the overall plan for the benefit of all participants.

What has led to the recent change in the Supreme Court's view is that the individual management of 401(k) accounts by individual plan participants means that benefits are no longer drawn from a common pool of plan assets. Therefore any loss attributable to plan administration will directly impact individual accounts.

In the new decision, *LaRue*, an employee alleged that he had instructed the administrators of his employer-sponsored 401(k) plan to change his investment elections. The administrators allegedly failed to do so for several months, and Mr. LaRue's investment portfolio dropped in value as compared to the selections he had instructed the plan administrators to execute on his behalf.

For the future, *LaRue* can be expected to lead to claims that plan administrators did not execute buy and sell instructions promptly or accurately. However, claims that the investment options being offered were not carefully selected or that information about the selections was not accurately, comprehensively or timely provided to participants are also arguably supported by *LaRue*.

While the Court outlined this new claim for individual participants, it also described several defenses that would potentially be available for plan fiduciaries. The Court said that a claimant may have to show he has first "exhausted remedies" set forth in the plan document, and that he has followed the plan requirements for providing investment directions to the plan administrators. It is likely that plan sponsors and administrators will respond to this decision by making the trading instruction process within their plans somewhat more formalized and better documented, so that they can better defend against claims that they did not execute trading instructions promptly or accurately, especially in today's volatile market.

Employers or plan sponsors may now want to consider further steps intended to help insulate them from liability for administrative mistakes. Measures such as the following may be considered by employer-sponsors:

- Hire a third party plan administrator and obligate such administrator to adhere to the requirements of the plan;
- Consider contract provisions with such a third party administrator that help protect the employer-sponsor of the plan;
- Require the plan administrator to implement clearly stated written procedures to be followed by participants for any investment directions;
- Arrange periodic meetings between plan participants and third party plan administrators to review and provide literature on investment elections and plan procedures;
- Hire actuarial and/or accounting consultants to review or audit the financial and accounting aspects of the plan and to test compliance with plan procedures for investment changes;
- Hire qualified consultants or legal counsel to advise on specific plan provisions for management of risk and to perform an audit of actual compliance with plan procedures and implementation of investment selections; and,
- Evaluate potentially available insurance coverage to analyze plan procedures, and/or protect the sponsor and plan administrators from fiduciary liability claims like those in the *LaRue* case.

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