

A “Changed Landscape” May Render Plan Administrators Liable For Breaches of Fiduciary Duty in Administering 401(k) Accounts

By James J. Fournier

The United States Supreme Court on February 20, 2008 unanimously held that individual participants in “defined contribution plans” — typically 401(k) plans — regulated by the Employee Retirement Income Security Act of 1974 (“ERISA”) can sue their plan administrator for breaches of fiduciary duty that reduce the value of their individual account. *LaRue v. DeWolff, Boberg & Associates, Inc.*, 128 S. Ct. 1020 (2008).

The 9-0 decision was immediately hailed as one of the most important rulings in years on ERISA. It’s hard to understate the ruling’s potential impact, considering that approximately 70 million people hold about \$3 trillion in 401(K) investments. See Greenhouse, Washington Post, February 21, 2008.

But the impact of that unanimity was clouded by two separate concurrences, one of which, by Chief Justice Roberts, “appeared to offer companies a roadmap for combating similar cases in the future.” See Francis and Anderson, Wall Street Journal, February 21, 2008 at D1.

The suit was filed by a 401(k) plan participant, LaRue, against his former employer and the ERISA-regulated 401(k) retirement savings plan administered by the employer. LaRue

alleged that he had directed his employer to make certain investment changes to his individual 401(k) account. It failed to do so, allegedly resulting in a loss of about \$150,000.

The lower courts both held that while the plan administrator did breach its fiduciary duty, LaRue’s suit must be dismissed because ERISA permitted a breach of fiduciary duty suit only on behalf of the entire plan, not on behalf of an individual account holder. That conclusion was based upon *Massachusetts*

Mutual Life Insurance Company v. Russell, 473 U.S. 134 (1985) (“Russell”), a United States Supreme Court decision generally understood to hold that lawsuits for breach of fiduciary duty could not be brought by individual participants in “defined benefit plans” — typically pension plans — unless the alleged breach caused losses to the entire plan.

But the United States Supreme Court in *LaRue* ruled that the “landscape has changed” since its ruling in *Russell* more than 20 years ago. Now that defined contribution plans “dominate the retirement plan scene,” the Court ruled that LaRue’s suit should be allowed to proceed.

This ruling reflected the reality that participants in pension plans do not have individual accounts and depend on the health of the plan

“... participants in pension plans do not have individual accounts and depend on the health of the plan as a whole, whereas a defined contribution plan consists of individual accounts only.”

A Note from the Editor

The *LaRue* decision has been hailed as one of the most important decisions regarding the Employee Retirement Income Security Act of 1974 in years and will greatly affect the retirement plan scene. In this issue we explore the *LaRue* decision in detail and discuss several questions as to the likelihood of the success of this type of suit.

—Rhonda D. Orin

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as a whole, whereas a defined contribution plan consists of individual accounts only.

The Impact of the LaRue Decision Remains to Be Seen

Though the Court unanimously agreed that an individual plan participant could sue the plan administrator for breach of fiduciary duty in administering the plan, the decision raises additional questions concerning the likelihood of the success of such a suit.

First, cases brought by individual plan participants are necessarily dependent upon the specific

facts of each individual case. For instance, the Court expressly declined to consider whether the alleged investment directions were made "in accordance with the requirements specified by the plan, whether [LaRue] was required to exhaust remedies set forth in the plan before seeking relief in federal court pursuant to ERISA § 502(a)(2), or whether [LaRue] asserted his rights in a timely fashion." The Court simply allowed the suit to proceed, but did not weigh any of the proof essential to a successful claim.

Second, Chief Justice Robert's concurring opinion significantly blurs the impact of *LaRue*. His concurrence, which was joined by Justice Kennedy, states that the trial court on remand should determine whether LaRue's suit is really a claim for benefits under § 502(a)(1)(B), and if so, whether that will require dismissal of the breach of fiduciary duty claim.

Although observing that the argument was not raised below and that LaRue had not sought relief under § 502(a)(1)(B), Justice Roberts wrote, "I simply highlight the fact that the Court's

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Key Factors in Minimizing Your Exposure

By James J. Fournier

Although the failure to follow a participant's investment directions or to adhere to a plan's provisions and requirements is not likely to be a systemic problem, the following steps should help employers who administer their own 401(K) plans to minimize exposure to suits by individual plan participants:

- Review your compliance with the conditions for fiduciary relief under § 404(c) of ERISA, the ERISA "safe harbor." The LaRue Court recognized that a plan's compliance with the provisions of § 404(c) "exempts fiduciaries from liability for losses caused by participants' exercise of control over own assets in their individual accounts." It was the plan's failure to follow the plan participant's directions that rendered the safe harbor unavailable as a defense in LaRue;
- Review your procedures for processing participant directions, and if necessary, strengthen those procedures to ensure compliance. An administrative, compliance, or investment audit may be helpful in pointing out weaknesses;
- Review any service agreements with third-party administrators for limitations on liability to ensure a proper allocation of liability and indemnification rights between yourself and the third-party administrator, and;
- Confirm that adequate fiduciary liability, errors and omissions, and directors and officers insurance has been purchased. Although a fiduciary liability insurance policy is not required by most corporate by-laws or required by statute, it may be helpful for employers to review their risk management program to determine whether a potential increase in exposure may necessitate such coverage or, if already in place, to determine the adequacy of the current policy limits.

determination that the present claim be brought under § 502(a)(2) is reached without considering whether the possible availability of relief under § 502(a)(1)(B) alters that conclusion.”

He concluded that “I see nothing in today’s opinion precluding the lower courts on remand, if they determine that the argument is properly before them, from considering the contention that LaRue’s claim may proceed only under § 502(a)(1)(B). In any event, other courts in other cases remain free to consider . . . what effect the availability of relief under § 502(a)(1)(B) may have on a plan participant’s ability to proceed under § 502(a)(2).”

The concurrence is important because § 502(a)(1)(B) requires exhaustion of administrative remedies, a point which the majority expressly declined to review, and a requirement which would make individual suits against plan sponsors and fiduciaries more difficult to prosecute.

Conclusion

Although the LaRue decision unquestionably allows an individual plan participant to sue the plan’s sponsors and fiduciaries, the sky is not necessarily falling. The full impact of the decision remains unclear and, for the immediate future, there are many steps that employers may take to ensure that their exposure to a LaRue-inspired suit is limited. ▲



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SPOTLIGHT

Was It Confusion or Just Good Politics?

Sen. John Edwards and the Nataline Sarkisyan Story

By Rhonda D. Orin

This primary season, Democratic presidential candidate John Edwards made a *cause celebre* of the Nataline Sarkisyan story: a 17-year-old leukemia patient who died while awaiting a liver transplant. Sen. Edwards announced at multiple press conferences — often accompanied by Nataline’s bereaved parents — that CIGNA Corp. had wrongfully denied coverage for the transplant surgery and relented after a public protest, but the reversal came too late for Nataline.

Sen. Edwards proclaimed that this story illustrated a profound flaw with “health insurance” in this country. Celebrity attorney Mark Geragos joined in the clamor, vowing to make CIGNA pay millions for its “bad faith” denial of Nataline’s “coverage claim.”

Sen. Edwards was right that this story was illustrative. But what it illustrated was not CIGNA’s failings as a “health insurer.” It illustrated the extent of the public misunderstanding about how most health benefits are provided in this country.

Here are some of the things that were missed by Sen. Edwards, along with the media outlets that carried his press conferences on this issue without further comment.

First, he missed that CIGNA was *not* the Sarkisyans’ “health insurer.” According to CIGNA’s web site, CIGNA was just the administrator of Nataline’s health plan, which was sponsored by her father’s employer. As a participant in a self-funded health plan, Nataline did not have “health insurance” at all. Thus, she was not entitled to “insurance coverage” in the first place and CIGNA had no exposure to a claim for a “bad faith” coverage denial.

Second, Sen. Edwards missed that Nataline’s family lacked contractual privity to sue CIGNA for anything. Their only legal relationship was with Nataline’s father’s employer, which, in turn,

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had an administrative contract with CIGNA. So the Sarkisyan family could sue the employer and the employer could sue CIGNA – but it would be extremely difficult, if not impossible, for them to sue CIGNA directly.

Third, a lawsuit by the Sarkisyans against the employer would be subject to all the limitations of ERISA. Among other things, they would be limited to federal court, not state court. They would be limited to statutory causes of action under ERISA, not common law. Their possible recovery would be the cost of the denied procedure and perhaps their legal fees. They would be legally precluded under ERISA from suing for bad faith, and from seeking recovery of punitive or exemplary damages from anyone.

It's impossible to know whether Sen. Edwards appreciated these distinctions, but found them too

complex for a national stage, or whether he was genuinely confused by the structure of self-funding. But the uncritical acceptance of this story as a "health insurance debacle" suggests that, if Sen. Edwards was confused about the legal distinctions between health insurance and self-funding, he has a lot of company. ▲



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More than half of the businesses in America now self-fund their employee benefits plans, rather than purchasing traditional insurance policies. This percentage is likely to increase, due to the up-front cost-savings that can be achieved by self-funding and the opportunity for certain legal protections. Yet self-funding is complicated and its advantages are accompanied by a wide variety of disadvantages. This quarterly publication is dedicated to exploring all aspects of self-funding, with a focus on the practical needs of employers.

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