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REPORT FROM WASHINGTON

Supreme Court Considers Whether ERISA Fiduciaries May Be Liable for Damages to an Individual Participant's Account

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TO VIEW A TRANSCRIPT OF THE ORAL ARGUMENTS BEFORE THE SUPREME COURT OF THE UNITED STATES IN THE *LARUE* CASE, PLEASE CLICK HERE.

The Supreme Court yesterday heard oral arguments in *LaRue v. DeWolff, Boberg & Assoc., Inc.*, Docket No. 06-856 (U.S.), the decision of which has potentially wide ranging implications for so-called "stock drop" Employee Retirement Income Security Act of 1974 ("ERISA") class actions, an increasingly common form of litigation that seeks to assert rights otherwise protected by the federal securities laws without the heightened scienter or pleading particularity the securities laws require.

The *LaRue* case involved a claim of breach of fiduciary duty under ERISA against the fiduciaries of a 401(k) plan, a form of defined contribution retirement plan under ERISA. Such plans typically allow a participant to direct the manner in which funds contributed to the participant's individual account in the plan will be invested. The participant is ultimately entitled to the funds in the account as the retirement benefit, which funds will have grown, shrunk or stayed the same depending on how the investment performs. Approximately $3 trillion is currently invested in defined contribution retirement plans in the United States. The Court's decision in this case may help determine the circumstances under which fiduciaries of defined contribution retirement plans may be sued under ERISA for breaches of fiduciary duty that cause damage to some, but not all, plan participants.

The Court's decision may have particular applicability to the ERISA-based "stock drop cases" that now often accompany federal securities fraud actions. These cases involve companies whose 401(k) plans permit, encourage or sometimes require company employees to keep some portion of their 401(k) funds in a company stock fund. The suits are often brought following a significant drop in the company's stock on behalf of a class of plan participants who had 401(k) funds in

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company stock. Plaintiffs typically claim that it was imprudent for the plan fiduciaries to allow participants to make such investments. Although the *LaRue* case is not a stock drop class action, the Court's ruling will likely determine whether or not plaintiffs in stock drop cases have standing to seek monetary damages from plan fiduciaries.

BACKGROUND

James LaRue was a participant in a 401(k) retirement plan offered by DeWolff, Boberg & Assoc., Inc. He claims that he requested that Defendants make specific changes with respect to the investments in his plan account, but they failed to do so – a failure Mr. LaRue alleges was a breach of fiduciary duty. He seeks to recover approximately $150,000 in potential lost appreciation as a result of the alleged breach.

The two subsections of ERISA at issue in *LaRue* are § 502(a)(2) and § 502(a)(3). Pursuant to § 502(a)(2), a civil action may be brought "by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title." Section 1109 provides that a plan's fiduciary, "shall be personally liable to make good to such plan any losses to the plan resulting from such breach." Section 502(a)(3), on the other hand, prescribes equitable relief generally, allowing a civil action to be brought, "by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan."

Before the United States District Court for the District of South Carolina, Mr. LaRue initially sought relief only under § 502(a)(3). In their motion for judgment on the pleadings, Defendants argued that a § 502(a)(3) remedy was unavailable to Plaintiff because he was asking for compensatory damages in the form of lost profits, which did not qualify as "equitable relief." The district court agreed and dismissed the complaint with prejudice. Mr. LaRue did not claim standing based on § 502(a)(2) before the district court.

Affirming the lower court's decision, the United States Court of Appeals for the Fourth Circuit first noted that Mr. LaRue potentially waived his argument for relief under § 502(a)(2) by raising the argument "for the first time on appeal." The Fourth Circuit stated, however, that, even if the § 502(a)(2) argument were not deemed waived, Plaintiff "could not succeed on the merits" because § 502(a)(2) affords recovery to the plan "'as a whole,' not to particular persons with rights under the plan." Noting that Mr. LaRue was seeking recovery for his own personal loss caused by a "failure to follow Plaintiff's own particular instructions," the Fourth Circuit concluded that he did not seek recovery for the plan as a whole.

With respect to § 502(a)(3), the Fourth Circuit examined "whether the form of relief a plaintiff seeks is, like an injunction, historically one that a court of equity rather than a court of law would have granted." The Fourth Circuit agreed with the district court. It concluded that the desired relief was monetary damages, which traditionally is a form of legal,

"But if you're right that you can go under (a)(2), then all of [the Court's] work [under (a)(1)] has been in vain. You can avoid all the limitations on (a)(1) just by saying we want the same relief under (a)(2)."

CHIEF JUSTICE ROBERTS

"It's an individualistic kind of breach when it is viewed . . . as only one account, but it is a breach against the plan when it is understood that there is nothing to the plan except an aggregation of accounts. You can't have a breach against one without a breach against the plan."

JUSTICE SOUTER

rather than equitable, relief. Acknowledging that the equitable remedy of restitution might at times encompass monetary relief, the court found restitution inapplicable because Mr. LaRue, "does not allege that funds owed to him are in defendants' possession, but instead that these funds never materialized at all."

Mr. LaRue requested a rehearing of the Fourth Circuit's decision, as well as a rehearing en banc. Although the Department of Labor filed an *amicus* brief in support of Mr. LaRue, the Fourth Circuit denied the petition, stating that the Secretary of Labor's "expansive view of fiduciary liability would lead to its own parade of horribles."

Subsequent to the Supreme Court granting *certiorari*, Mr. LaRue took his distribution from the plan, and thus ceased being a participant in the plan. The Supreme Court denied Defendants' motion to dismiss the writ on this ground and, yesterday, no further argument was presented on this issue.

SUMMARY OF THE ARGUMENT

In yesterday's argument before the Supreme Court, Petitioner LaRue argued that, for the purposes of asserting a claim for breach of fiduciary duty under § 502(a)(2), any diminution of plan assets constitutes a loss to the plan as a whole, and is thus actionable "regardless of the number of participants ultimately affected." Petitioner argued that it was thus of no consequence that the breach and subsequent loss only impacted an individual participant.

Chief Justice Roberts and Justice Scalia questioned Petitioner as to why Mr. LaRue did not seek recovery under § 502(a)(1)(B), which permits an action against the plan, *inter alia*, "to recover benefits due to him under the terms of his plan." Both Justices seemed to suggest that Petitioner could have first brought his claim pursuant to 502(a)(1), with Justice Scalia asking "why doesn't [Petitioner] proceed first under (a)(1)(B)" since it is the plan that "owes him this money"? Justice Scalia stated that "only that matter of proceeding preserves the structure of . . . the legislation." Chief Justice Roberts added that Petitioner appeared to be seeking to "avoid all the limitations on (a)(1)." Petitioner responded by pointing out an action under § 502(a)(1)(B) is an action against the plan itself. Such an action might not result in any recovery to a plaintiff since the plan has no money to compensate a participant and thus itself could not satisfy any judgment, other than by impermissibly "pick[ing] the pockets" of other plan participants: "Whether or not Mr. LaRue could have brought an (a)(1)(B) claim, it would not under any circumstances have resulted in getting money from the fiduciary back into the plan." Thus, Petitioner argued, § 502(a)(2) affords the only available remedy. Justice Scalia, however, suggested that if an action were first brought under (a)(1)(B), the plan could always implead the fiduciary and the fiduciary would ultimately be held liable if that fiduciary's breach of duty caused the loss at issue.

Justices Alito and Ginsburg both questioned Petitioner regarding whether the Court needed to address the § 502(a)(3) issue if the Court agreed with Petitioner on the § 502(a)(2) issue. Petitioner argued that the Court should reach the § 502(a)(3) regardless of how it read § 502(a)(2) because "we shouldn't be required to choose at this point in time," with an undeveloped factual record, the ultimate relief to which Petitioner is entitled. Only Justice Alito questioned whether the § 502(a)(2) argument should even been addressed by the Court, in light of the Fourth Circuit's apparent position that such argument had been waived by Petitioner's failure to raise the argument in the District Court, thus raising the possibility that the Supreme Court could avoid the § 502(a)(2) issue altogether.

Petitioner shared argument time with the United States, which argued that "ERISA authorizes a participant in a defined contribution plan to sue to recover losses to the plan caused by a fiduciary breach even if the losses are attributable to the participant's individual account." The Government also argued that § 502(a)(1)(B) did not provide an available remedy for Petitioner and that the breaching fiduciaries should thus be required to put the money back into the plan, pursuant to § 502(a)(2), even if that money was only to be allocated to an individual plan participant. Finally, the Government argued that losses for fiduciary breaches are also authorized under § 502(a)(3) through the equitable remedy of surcharge, a "make-whole remedy for pecuniary losses that are caused by breach of trust."

Respondent argued that § 502(a)(2) only permits actions for breach of fiduciary duty on behalf of the plan "as a whole" and "does not permit an individual claim" for breach of fiduciary of the kind asserted by Petitioner. According to Respondent the "the words 'losses to the plan' connotes something collective." Justices Souter, Ginsburg and Breyer each expressed skepticism during Respondent's argument. Justice Ginsburg posited that a defined contribution plan is simply a collection of individuals, while Justice Souter similarly pointed out that the plan is nothing more than an "aggregation of accounts," asking "[w]hy do we need more than one" individual for a § 502(a)(2) action. Justice Breyer colorfully expressed that it was of no consequence whether the plan is comprised of many individual accounts or one large collective account – in both instances § 502(a)(2) must provide for a cause of action. Respondent answered these questions by noting that while the entire defined contribution plan is "of course, the sum and total of the individual plan accounts" that is "different from the question of whether or not in this case" Petitioner's loss "ought to be read as losses to the plan."

Respondent attempted to distinguish this case, which alleges a breach of duty "on an individual basis, on a one-transaction basis" from cases, like a stock drop class action, in which the claim of breach of fiduciary duty is brought on behalf of a subset of plan participants. Respondent argued that an action on behalf of a "substantial subset" that implicates "something systemic" as in "stock drop cases" could be sufficient for the purposes of § 502(a)(2), even if not brought on behalf of all plan participants. In this case, Respondent contended, "there is no way that this alleged loss could have had any impact on any other plan participant, nor could any recovery here benefit the plan as a whole." Both Justices Ginsburg and Souter then asked Respondent how the Court could establish a test to determine how many participants would have to be affected by a potential claim before § 502(a)(2) standing would be found to exist, with Justice Ginsburg

"How do we read that statute to say, well, it doesn't have to be the plan as a whole because there may be some people that are not entitled to this? How do we get that number between more than one and less than everybody?"

JUSTICE GINSBURG

asking, "[h]ow do we get that number between more than one and less than everybody?"

Finally, Respondent further argued that while § 502(a)(3) affords Petitioner a remedy, that remedy is an injunction and not surcharge. Justice Ginsburg questioned the utility of an injunction in this action, however, noting that even if Mr. LaRue obtained an injunction it would be "much too late."

POTENTIAL IMPLICATIONS

The Supreme Court's decision in *LaRue* is expected to resolve the question of whether an action seeking damages for breach of fiduciary duty can be brought by less than all plan participants pursuant to § 502(a)(2) if that action seeks recovery for less than the plan "as a whole." Resolution of this issue is of importance to ERISA "stock drop cases," which are generally filed only on behalf of the subset of plan participants who invested in company stock and seek to hold fiduciaries of the plan liable in negligence for the losses the employee-investors incurred. Although the Fourth Circuit in *LaRue* found that there was not a private right of action under ERISA for damages attributable specifically to an individual's account, other circuit courts have ruled otherwise. A reversal of the Fourth Circuit could mean that fiduciaries might be liable to individual plan participants for damages caused by breaches of their fiduciary duties, even if recovery is individualized and will not go to the plan "as a whole."

With respect to § 502(a)(3), an affirmance of the Fourth Circuit's decision will confirm that § 502(a)(3) only affords traditional forms of equitable relief and excludes monetary damages. A reversal, however, could potentially open the door for individual plan participants, and subsets of plan participants, to seek damages through § 502(a)(3) even if Respondents prevail on the § 502(a)(2) argument.

For further information about this decision, please feel free to contact members of the Firm's Litigation Department, including:

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