BAD FACTS MAKE BAD LAW: INDIVIDUAL PLAINTIFFS MAY NOW BRING ACTIONS AGAINST QUALIFIED DEFINED CONTRIBUTION PLANS

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As they teach in law school, bad facts make bad law. The recent Supreme Court case of LaRue v. DeWolff, Boberg & Associates, Inc., helps to illustrate this point. Everyone is sympathetic to poor Mr. LaRue, for the losses he incurred in connection with the failure of his employer to follow his investment changes under the employer's Section 401(k) plan. Everyone would agree that fairness should dictate a remedy for Mr. LaRue's loss. However, the creation of a new cause of action for participants against employers, plan sponsors, recordkeepers and service providers may have opened Pandora's Box for litigation against defined contribution plans.

The facts regarding Mr. LaRue are simple. Similar to most employees in the United States, Mr. LaRue participated in an employer-sponsored Section 401(k) plan, under which he was entitled to direct the investment of his individual account. Mr. LaRue requested a change in investments to be more conservative in his investment allocation. Unfortunately, the requested change in investments was not made. Due to the failure to effectuate the change, Mr. LaRue lost approximately **$150,000** in value in his account.

Section 502(a)(2) provides for suits to enforce the provisions of Section 409 of ERISA, generally concerning breaches of fiduciary duties. The primary statutory responsibilities imposed under Section 409 relate to proper management, administration and investment of plan assets to ensure that benefits authorized under a plan are paid to participants. Prior to the LaRue decision, defendants in ERISA cases regarding breaches of fiduciary duty were able to rely upon the Supreme Court's holding in the Massachusetts Mutual Life Insurance Co. v. Russell, which held that ERISA Section 502(a)(2) only authorized recovery by the plan as an "entity", and did not permit individuals to bring lawsuits when they did not seek relief on behalf of a plan. This "entire plan" rule worked well in connection with defined benefit plans where no individual accounts existed. The entire plan rule also may have been appropriate in connection with suits for disability and other benefits. However, the Supreme Court has found that the entire plan rule does not work well in a defined contribution plan context. In case of actions seeking recovery of losses to individual defined contribution plan accounts, the majority of the Supreme Court reasoned that a fiduciary's misconduct need not threaten the entire plan's solvency to reduce benefits before creating a claim. Accordingly, the Supreme Court found that Russell's entire plan rule did not bar a participant's suit to recover losses to an individual account, allegedly resulting from the breach of a fiduciary duty.

Lessons Learned

Practitioners and employers are still in the process of analyzing the LaRue case and determining the impact it will have on employers. Although the case will be used by recordkeepers seeking new work, investment advisors hoping to take on new investments and differentiate their services, and employee benefit professionals in general, the result of the case will not create anything new or novel. Employers will be required, as they have been required, to carefully monitor the administration of their qualified retirement plans. In response to the case, the **best practices** an employer can implement include the following:

- Review the terms of all retirement plans to ensure that administration is consistent with plan documents. It continues to be common that employees are not informed of their eligibility to participate, incorrect compensation is used for purposes of determining contribution, and proper periods are not taken into consideration in determining vesting. When errors now occur in these basic administrative areas, employees can bring or threaten a cause of action to encourage an employer to make them voluntarily whole. Although this is generally the correct result, the stick that participants and plaintiff attorneys will be carrying will be far greater, than in the past.

- Analyze all systems to confirm that proper instructions are being followed and that accurate records are being kept of all actions.

- Perform an annual review of all investments, with quarterly or semi-annual follow-up for investments that are being monitored, on a watch list, or that warrant replacement. It is generally going to be the minutes of the meeting that will protect an employer from liability. Everyone makes mistakes. However, if employers have valid reasons for decisions they make, it will be hard to impose liability. For example, if a fund is underperforming other peer group funds, but has only been in a plan for approximately **1** year, an employer might not immediately replace it. The employer may place the stock on watch list and evaluates it in **6** months. If such action is documented, it is hard to argue that such action is imprudent. Documentation of a thought process in retaining a fund, and allowing new employee contributions to be invested in such a fund will be the insurance policy an employer will have, when a participant questions whether or not an employer was prudent in retaining any specific investment fund.

- It is prudent to periodically conduct self-audits of a retirement plan. These audits will be beyond the scope of a traditional financial audit obtained for purposes of a Form 5500. The audit will review eligibility, compensation, contributions, vesting, distributions and forfeitures. By identifying errors early, employers may take corrective actions. More importantly, when errors are significant, and corrected within **2** years, the IRS permits such action to occur on a voluntary basis. If errors have been more pervasive for a longer period of time, employers can take advantage of the IRS Voluntary Compliance Resolution Program ("VCP"). Self-audits are important to protect an employer from increased penalties in the event of an IRS or DOL audit, and now to identify and rectify administrative errors before participants bring the lawsuits.

To this practitioner, the case is not novel, but will help to encourage good behavior in employers. The threat of litigation is always more motivating than fear of the occasional IRS or DOL audit.

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