

CLIENT ALERT

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Employers Sponsoring 401(k) Plans Exposed to New Risk

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The Supreme Court has changed the risks to which fiduciaries – and particularly employers – are exposed when dealing with 401(k) plans. In *LaRue v. DeWolff, Boberg & Assoc., Inc.*, decided on February 20, 2008, the U.S. Supreme Court held that an individual participant may sue his employer for failure to timely change his investment choice, which, he alleged, resulted in a loss in the participant's 401(k) account.

The plaintiff contended that his employer failed to make certain requested changes to investments in the plaintiff's individual account and that, as a result, his 401(k) account lost \$150,000. Under the old rules, the plaintiff would not have had standing to sue, because the only damage alleged was to himself, not to the plan as a whole. The lower courts followed the old rules, and refused to give him a day in court.

In reversing the Fourth Circuit, the Supreme Court changed the rules, holding

that ERISA authorizes lawsuits to remedy breaches of fiduciary duties under ERISA, even if the breach only affects individual assets in a 401(k) plan.

The majority for the Court rejected the old rules, holding that they should not apply to damages under a "defined contribution plan" (today's standard 401(k) plan, in which assets are not pooled, and the participant's benefit is equal to the amount in his or her account), from a claim under a "defined benefit plan" (the older style of pension plan, in which assets are pooled, and each individual is only entitled to a specific benefit, not a specific asset or group of assets). The Court considered the historical evolution away from defined benefit plans toward defined contribution plans in concluding that ERISA should be interpreted to allow a suit for damages to an individual participant's account, and not just for damages to a plan as a whole, with respect to defined contribution plans.

The Supreme Court only gave the partici-

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part the right to sue. He has not won his claim, and there were concurring opinions that may be used to limit the scope of the *LaRue* decision in future cases. That being said, the Supreme Court has changed the landscape of potential fiduciary liability under ERISA, and employers that sponsor 401(k) plans need to be aware that there may be increased risk of participant lawsuits from their operation and administration of 401(k) plans.

A specific issue that employers should consider in light of *LaRue* is how contracts with 401(k) service providers are written. For example, it has been standard practice for many years for service providers to disclaim fiduciary liability, claiming that their services are merely ministerial. If *LaRue* means that employers can be held liable for losses to participants caused by administrative acts that the employer has outsourced – such as implementing participant investment directions – then the employer should consider taking back the outsourced function, explicitly approving every action by the service provider, or requiring the service provider to accept fiduciary liability for the services it provides.

In a concurring opinion, Justice Roberts suggested that the plaintiff's claim should have been reviewed in the context of ERISA §502(a)(1)(B) which would have required exhaustion of administrative remedies and review of the claim in accordance with the

underlying "plan terms". Justice Roberts did not suggest that a different result under this section of ERISA was a certainty, but employers are left to wonder whether plan terms can be adjusted to provide more protection from those suits factually similar to *LaRue*.

The next step is to review service contracts, and other aspects of potential fiduciary liability, in light of *LaRue*, and develop strategies to move forward. We would be happy to assist you in this process. If you have questions about this Client Alert, please contact David C. Morganelli or Kimberly I. McCarty for more information.

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