No. 05-1756

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

JAMES LARUE,

Plaintiff-Appellant,

v.

DEWOLFF, BOBERG & ASSOCIATES, INC.;
DEWOLFF, BOBERG & ASSOCIATES, INC. EMPLOYEES' SAVINGS PLAN,

Defendants-Appellees

On Appeal from the United States District Court
for the District of South Carolina

SECRETARY OF LABOR'S AMICUS CURIAE BRIEF IN SUPPORT OF PETITION FOR REHEARING AND REHEARING EN BANC

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INTEREST OF THE SECRETARY

The Secretary of Labor (the "Secretary") has primary authority to interpret and enforce the provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). 29 U.S.C. §§ 1132, 1135. See Donovan v. Cunningham, 716 F.2d 1455, 1462-63 (5th Cir. 1983). The Secretary's interests include promoting the uniform application of the Act, protecting plan participants and beneficiaries, and ensuring the financial stability of plan assets. Secretary of Labor v. Fitzsimmons, 805 F.2d 682, 692-93 (7th Cir. 1986) (en banc). The panel held that a plan participant may not sue to recover losses attributable to his account in a defined contribution 401(k) plan that were caused by fiduciary breaches. This decision is inconsistent with the statutory text and contrary to ERISA's express purposes. Although this case involves a single plan participant who seeks recovery to his own account, there is no statutory or policy basis, nor does the panel provide guidance, for distinguishing such cases from those involving losses to more than one account. Read broadly, the decision could undermine, if not eliminate, the ability of participants in such plans, which nationally hold approximately $2.9 trillion in assets, Board of Governors of the Federal Reserve System, Flow of Fund Accounts of the United States: Flows and Outstandings, First Quarter 2006, Statistical Release Z.1, at 113 (June 8, 2006), to effectively remedy fiduciary breaches and recover monetary losses to their plans under any provision of ERISA. At a minimum, combined with ERISA's preemptive effect and the panel's holding that no monetary relief is available under ERISA section 502(a)(3), 29 U.S.C. § 1132(a)(3), the decision leaves

LaRue, and individual plaintiffs like him, without any means whatsoever to recover losses caused even by the most egregious fiduciary breaches.

ARGUMENT

The panel's decision is contrary to the express language of ERISA sections 409 and 502(a)(2), which authorize participants and beneficiaries alleging fiduciary breaches to bring suit to obtain "any losses to the plan resulting from each such breach." 29 U.S.C. § 1109(a). LaRue alleges that, as a direct result of a fiduciary breach, the plan has fewer assets available for the payment of his benefits. If the allegations are true, LaRue is entitled to an order restoring "any losses" to the plan. As four courts of appeals have recognized, ERISA section 502(a)(2) allows participants to seek money damages on behalf of a plan even if the alleged fiduciary violation affected only a subset of participants and the money recovered will ultimately be allocated to individual accounts. To hold, as the panel did, that a lawsuit cannot be brought under ERISA section 502(a)(2) if the participant seeks to have the recovery paid into his individual account to make up for losses suffered as a result of a duty owed to him would leave serious violations of ERISA without a remedy.

Moreover, by reading section 502(a)(2) to disallow a claim for monetary relief by a 401(k) plan participant who alleges that a fiduciary breach caused losses to his defined benefit plan account, the decision has the potential to adversely affect all 401(k) plans and all other defined contribution plans that offer a number of investment options to plan participants, and that allow participants to direct investments among those options.

Although this case involves a single plan participant in a 401(k) plan whose claim for loss is based on the defendants' failure to follow his investment directions, there is no clear and logical basis upon which to draw a line between this case and the many other cases involving the recovery of losses stemming from fiduciary breaches that primarily will benefit the accounts of only some defined contribution plan participants. Indeed, it is seldom the case that a fiduciary breach has a direct impact on every single participant's account in a 401(k) plan because the plans typically offer a range of investment options, and different participants elect to participate in different funds. Moreover, it is always the case that recoveries are necessarily allocated to individual accounts in such plans, because ERISA requires the allocation of all of the plan's assets between individual accounts.

Thus, if left standing, the decision is likely to cause at least two harmful and unintended consequences: (1) it is likely to place in doubt the ability of plan participants in defined contribution plans to recover monetary remedies for losses to their plans stemming from fiduciary breaches; and (2) concomitantly, it is likely to force district courts and this Court to revisit the issue in numerous factual contexts as it attempts to draw the line between permissible and impermissible loss recoveries, despite ERISA's express authorization of the recovery of "any losses to the plan." In reasoning that the statute only allows a suit under section 502(a)(2) in cases where "that plaintiff's individual remedial interest can serve as a legitimate proxy for the plan in its entirety," 2006 WL 1668873, at *3, the decision raises the specter that no suit under section

502(a)(2) will be allowed in the Fourth Circuit unless all the participants have been affected by a breach. To avoid these results, the Secretary requests that the Court grant rehearing or rehearing en banc, and further requests that: (1) if the Court concludes that LaRue in fact waived his argument under section 502(a)(2), it vacate the portion of the decision holding that section 502(a)(2) provides no remedy; or (2) if the Court concludes that LaRue sufficiently raised and preserved the section 502(a)(2) argument, it reverse the order of the district court dismissing the claim and hold that section 502(a)(2) provides a cause of action and a remedy in the circumstances of this case.[1]

I. THE PANEL'S DECISION IS UNSUPPORTED UNDER THE STATUTE AND IS OF EXCEPTIONAL IMPORTANCE BECAUSE OF ITS LIKELY IMPACT ON PLANS

ERISA section 502(a)(2), 29 U.S.C. § 1132(a)(2), permits an action to be brought by the Secretary, or by plan participants, beneficiaries or fiduciaries for "appropriate relief under [§ 409]." As relevant here, section 409(a), in turn, provides that "[a]ny person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this [title], shall be personally liable to make good to such plan, any losses to such plan resulting from each such breach." 29 U.S.C. § 1109(a) (emphasis added).

In his brief to the panel, LaRue noted that he did not seek losses to be paid directly to him, but instead sought "to have his interest in the plan made whole for the losses

[1] The Secretary takes no position on whether the section 502(a)(2) argument was waived or on the merits of LaRue's claims.

suffered as a result of the breach of fiduciary duty." Appellants' Br. 20. Thus, assuming he did not waive this argument in the district court, LaRue's claim falls squarely within the plain statutory text of section 409(a), which provides for the recovery of "any losses" to a plan resulting from a fiduciary breach, and section 502(a)(2), which permits a plan participant to bring suit to recover such losses. Because LaRue asserts that the fiduciaries' actions resulted in a diminution of the plan's assets, particularly including the assets allocable to his account, he is entitled to an order restoring the lost assets to the plan, as the Act expressly authorizes.

The ultimate allocation of the losses to LaRue's plan account does not defeat their status as "losses to the plan." All losses recovered by individual account plans are necessarily allocated between individual accounts. The necessity of such an allocation is inherent in the nature of a defined contribution or individual account plan, which ERISA defines as a "pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." 29 U.S.C. § 1002(34). Any "contributions are made to a single funding vehicle," and "[a]s amounts are contributed to the trust," and earnings and losses occur within particular investments, these amounts "are allocated to the participants' accounts" through accounting or bookkeeping entries. David A. Littell et al., Retirement Savings Plans: Design, Regulation and Administration of Cash or Deferred Arrangements 6 (1993). Thus,

although the plan assets are allocated to individual accounts in this manner, and the individual participant's benefit is ultimately dependent on the amounts so allocated, ownership of the accounts and of the plan's assets never passes, even in part, to participants. Rather, as a matter of statutory design, the participants have a beneficial interest in their accounts, but legal title is held in trust by one or more trustees, who have authority and discretion to manage and control the assets of the plan. See 29 U.S.C. § 1103(a); see also 26 U.S.C. § 401(a); Rev. Rul. 89-52, 1989-1 C.B. 110.

Thus, the panel correctly recognized that "the recovery plaintiff seeks could be seen as accruing to the plan," but erred in concluding that allowing a suit under such circumstances would amount to an overly "narrow" reading of the "losses to the plan" requirement of section 409. 2006 WL 1668873, at *3. In fact, the total amount of assets held in the DeWolff 401(k) plan, like the assets of any other defined contribution plan, are not only used to pay plan benefits, but may also be used to defray the operating costs of the plan as a whole, including recordkeeping, legal, auditing, annual reporting, claims processing and similar administrative expenses. All of the plan's assets are allocated to individual accounts, and all of those allocated assets are available to defray plan expenses. Therefore, a recovery that is (and must be) allocated to one or more of the plan's individual accounts, must be paid to and held by the trust and increases the overall assets of the plan, not just in some "narrow" sense, as the panel suggests, but in a fundamental sense, given the nature and structure of individual account plans, and ERISA's stringent trust requirement for pension plan assets.

It is not, therefore, inconsistent with the "statutory text" and with "the careful limitations Congress has placed on the scope of ERISA relief" to allow LaRue to sue under section 502(a)(2). 2006 WL 1668873, at *3. The recovery for the alleged breach must be paid to the plan itself and, although it will inure ultimately to LaRue's benefit, it will increase the overall assets in the plan. Thus, as the panel decision appears to require, LaRue's individual "remedial interest" does "serve as a legitimate proxy for the plan in its entirety." Id.

To the extent, however, that the panel is suggesting that a recovery must be allocated to all or most participant accounts within a defined contribution plan, its decision is inconsistent with the statute, which expressly allows a participant to bring a suit against a fiduciary who breaches "any of the responsibilities, obligations, or duties" imposed upon him and to recover "any losses" to a plan resulting from "each such" breach. 29 U.S.C. § 1109(a). The panel's construction not only reads a significant limitation into the statute's broad and unqualified language, but it could preclude most suits to recover losses to a defined contribution plan, even those stemming from the most egregious fiduciary breaches. Thus, for instance, it could preclude many cases that have routinely been brought under ERISA section 502(a)(2), such as the one brought by participants in Bannistor v. Ullman, 287 F.3d 394 (5th Cir. 2002), against fiduciaries who failed to forward some, but not all, employee contributions to their plan. The Secretary of Labor brings many such cases annually, some of which involve substantially fewer than all of a plan's participants, and takes the position that if a fiduciary pockets even a

single employee's contribution to the plan, the plan has received fewer assets than it is entitled to receive and has suffered a loss under ERISA's plain language. Because there is no principled way to distinguish between the wrongful failure to pay a single participant's contribution into a plan and the wrongful failure to carry out a single participant's directed investment instructions, under the panel's decision, such a suit presumably would be precluded.

ERISA 401(k) plans, in particular, typically offer many investment options to plan participants. As a result, a fiduciary's mismanagement of a particular investment fund's assets will seldom significantly affect the account balances of every participant, many of whom have not invested in the particular fund at issue. Under ERISA, such losses are nevertheless recoverable as "any losses to the plan." 29 U.S.C. § 1109(a). In contrast to this statutory bright-line test of "any losses," the panel's standard is unclear and unworkable, leading to uncertainty as to the number or percentage of participants who must be affected before a loss can count as a loss to the plan. While one participant would appear to be insufficient under the panel's decision, it is unclear how many more participants or how great a fraction of the plan's participants, short of 100%, would suffice. Nothing in ERISA, however, suggests that the availability of recovery for a fiduciary breach should turn on whether 1%, 50%, or 100% of participants in a plan are directly affected; it is enough that the fiduciary breach caused a loss of plan assets, regardless of the assets' allocation between accounts.

It is no answer to say that such cases can be distinguished because the breaches alleged here by LaRue – that the defendants improperly managed plan assets by failing to invest the amounts attributable to his account in the manner in which he directed – were of a "duty owed solely" to him. 2006 WL 1668873, at *3. Plan fiduciaries have a duty to manage all of the assets of a plan prudently, solely in the interest of plan participants and beneficiaries, and in accordance with the documents and instruments governing the plan. 29 U.S.C. § 1104(a). The failure to follow one participant's investment direction is a violation of those duties just as the failure to follow the directions of a greater number of participants likewise would be a violation. Similarly, although the amount of the losses might differ, the nature of the relief – payment of money to the plan – is the same whether the violation is directed to one participant or every participant in the plan. Certainly, nothing in ERISA's remedial provisions suggests that the availability of a recovery turns on whether the participant alleged breach of a duty allegedly owed solely to him, as opposed to the plan; rather, a breach of "any of the responsibilities, obligations, or duties" is sufficient to trigger a right to recover "any losses." 29 U.S.C. § 1109(a). Moreover, if the panel is correct in its questionable conclusion that the breaches alleged by LaRue – mismanagement of plan assets for failure to follow investment directions – are of duties owed solely to him, it would seem that many other breaches, such as failure to remit participant contributions, or allowing excessive fees to be charged with regard to an individual investment option, would likewise not be remediable under section 502(a)(2).

To the contrary, Congress plainly intended such suits to be brought under sections 409 and 502(a)(2). This is apparent given ERISA's fundamental goal to prevent the "misuse and mismanagement of plan assets," Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 140 n.8 (1985), and given the specific purpose of section 502(a)(2), which is designed to allow suits to enforce "fiduciary obligations related to the plan's financial integrity," in accordance with the "special congressional concern about plan asset management" reflected in section 409. Varity Corp. v. Howe, 516 U.S. 489, 511, 512 (1996).

Contrary to the panel's decision, allowing LaRue's suit to proceed under section 502(a)(2) is entirely consistent with the Supreme Court's decision in Russell in which the Court stated that a recovery under section 502(a)(2) must "inure[] to the benefit of the plan as a whole." 473 U.S. at 140. Unlike this case, the plaintiff in Russell brought suit for compensatory and punitive damages payable not to the plan for a loss of plan assets, but directly to her to compensate her for a delay in the payment of her benefits under a disability plan. Id. at 137-38. In holding that the plaintiff in that case did not have standing to sue under sections 409 and 502(a)(2), Russell distinguished relief to be paid to the plan to recoup losses arising from the mismanagement of plan assets – which is available under those provisions – from relief to be paid directly to an individual as damages for pain and suffering caused by a benefit payment delay, as sought in that case. Id. at 143-44. Thus, when the Supreme Court stated in Russell that recoveries under sections 409 and 502(a)(2) must "inure[] to the benefit of the plan as a whole," id. at 140,

there is every reason to believe that the Court had in mind suits, such as this one, where, if the plaintiff's allegations are true, the plan holds fewer assets in trust due to the fiduciaries' mismanagement of the investment of some of the plan's assets, and thus has suffered "losses" under section 409. Furthermore, given both the plain statutory text and the fact that "the crucible of congressional concern was misuse and mismanagement of plan assets," Russell, 473 U.S. at 140 n.8, there is simply no support for the panel's conclusion that Congress intended to leave plans and their participants without a monetary remedy under ERISA for plan losses stemming from such mismanagement. 2006 WL 1668873, at *7.[2]

II. THE PANEL'S HOLDING CREATES A CONFLICT WITH DECISIONS OF THE THIRD, FIFTH, SIXTH AND SEVENTH CIRCUITS

The panel's decision that 401(k) plan losses that will be allocated to an individual account are not recoverable under section 502(a)(2) is also of exceptional importance because it creates a conflict with the decisions of every other court of appeals to have

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[2] Although it is not an issue on rehearing, the Secretary also disagrees with the panel's conclusion that section 502(a)(3) likewise precludes the recovery of monetary losses for a fiduciary breach. 2006 WL 1668873, at *3-*6. Instead, it is the Secretary's position that make-whole relief against a breaching fiduciary, known in equity as "surcharge," is available under section 502(a)(3). See, e.g., Green v. Exxon Mobil, Corp., 431 F. Supp. 2d 103 (D.R.I. 2006), appeal docketed, No. 06-1452 (1st Cir. filed Mar. 14, 2006); Pereira v. Farace, 413 F.3d 330, 339-41 (2d Cir. 2005) (rejecting argument), cert. denied, 126 S. Ct. 2286 (2006); Callery v. United States Life Ins. Co., 392 F.3d 401 (10th Cir. 2004) (same), cert. denied, 126 S. Ct. 333 (2005) ; cf. Aetna Health Inc. v. Davila, 542 U.S. 200, 222-23 (2004) (Ginsburg & Breyer, JJ., concurring) (noting and discussing issue). It is especially disturbing that the panel decision here leaves the plaintiff, and those like him, with no possible avenue to obtain suitable relief for his alleged losses.

addressed the issue. For instance, the Third Circuit recently held that "[p]laintiffs may seek money damages on behalf of the fund, notwithstanding the fact the alleged fiduciary violations affected only a subset of the saving plan's participants," reversing a district court decision to the contrary. In re Schering-Plough Corp. ERISA Litig., 420 F.3d 231, 232 (3d Cir. 2005). In so holding, the court reasoned that a "fiduciary's liability is not limited to plan 'losses that will ultimately redound to the benefit of all participants,'" and further noted that "the fact that the assets at issue were held for the ultimate benefit of Plaintiffs does not alter the fact that they were held by the Plan." Id. at 235.

Likewise, the Fifth Circuit, sitting en banc, recently vacated a split decision of a panel of that court that had held that a small subset of pilot-participants in an American Airlines 401(k) plan lacked standing to sue under section 502(a)(2) because they sought losses to be allocated to their individual accounts stemming from a delay in the transfer of their assets from a prior plan – breaches that were not, in the panel's view, "targeted [at] the plan as a whole." Milofsky v. Am. Airlines, Inc., 404 F.3d 338, 343-44 & n.16 (5th Cir. 2005). In a per curium decision, the en banc court held simply that the district court erred in dismissing the claims. Milofsky v. Am. Airlines, Inc., 442 F.3d 311, 313 (5th Cir. 2006).

These decisions follow an earlier decision of the Sixth Circuit that, like Milofsky, involved losses stemming from a delay in the transfer of assets of a relatively small number of plan participants from one plan to another. Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995). The court there concluded that a subclass of plan participants could sue

for losses stemming from a breach of fiduciary duty under sections 409 and 502(a)(2), reasoning that "Defendants' argument that a breach must harm the entire plan to give rise to liability under [section 409] would insulate fiduciaries who breach their duties so long as the breach does not harm all of a plan's participants. Such a result clearly would contravene ERISA's imposition of a fiduciary duty that has been characterized as 'the highest known to law.'" Id. at 1453 (citation omitted).

Finally, the Seventh Circuit addressed the issue whether a subset of participants in a profit sharing plan may sue the fiduciaries of their plan under section 502(a)(2). Steinman v. Hicks, 352 F.3d 1101 (7th Cir. 2003). The district court in Steinman had held that the plaintiffs could not maintain their action under section 502(a)(2) because they sought to "recover their individual losses . . . rather than suing on behalf of" their plan, and thus could bring their claims only as ones for individual relief under section 502(a)(3). Steinman v. Hicks, 252 F. Supp. 2d 746, 756 (C.D. Ill.), aff'd, 352 F.3d 1101 (7th Cir. 2003). The Seventh Circuit rejected this analysis, reasoning that although "[t]here was some confusion . . . over whether the suit was under section 502(a)(3) or 502(a)(2), . . . it is clearly the latter because plaintiffs are asking that the trustees be ordered to make good the losses to the plan caused by their having breached fiduciary obligations." 352 F.3d at 1102.

The arguments rejected by the courts of appeals in the cases described above are no different in substance than the argument accepted by the panel here: that a participant may not sue under section 502(a)(2) to recover losses to his defined contribution plan that

were caused by fiduciary breaches where the recovered losses will be allocated to his individual account. Contrary to the panel's suggested distinction, 2006 WL 1668873, at *3, the courts in Schering-Plough and Kuper, like the courts in Milofsky and Steinman, attached no significance to the fact that the plaintiffs in those cases brought class actions. In those cases, as here, recovery will be to only a fraction (and in some cases a small fraction) of the participants' accounts, and, of the four cases, only Steinman involved a breach that would likely be viewed as directed at the plan. Moreover, here, as in those cases, it is equally true that, because any recovery is actually paid into and legally held by the plan, the recovery "does not solely benefit the individual participants." Id. (quoting Smith v. Sydnor, 184 F.3d 356, 363 (4th Cir.1999)).

In sum, if the panel's decision is allowed to stand, courts in this circuit continually, and without guidance, will be forced to answer whether a particular breach is of a duty owed to the plan, or whether enough participants are affected by the breach that the participant can be said to be acting "as a legitimate proxy for the plan in its entirety." 2006 WL 1668873, at *3. Consistent with the decisions rendered by the Third, Fifth, Sixth and Seventh Circuits, we believe the appropriate (and more answerable) question is the one posed by the statute – whether the claim alleges that a fiduciary breach caused "any losses" to the plan. 29 U.S.C. §§ 1109(a), 1132(a)(2). If a fiduciary breached its duties with respect to the investment of plans assets (including those allocated to even one individual account, as alleged here), the plan holds fewer assets because of the breach, the plan clearly suffered a loss, and ERISA just as clearly authorizes a remedy.

CONCLUSION

For the reasons discussed above, the Secretary, as amicus curiae, requests that this Court grant panel or en banc rehearing of this matter, vacate the decision by the panel, and reverse the decision by the district court. Alternatively, if this Court concludes that LaRue waived his argument on the applicability of section 502(a)(2) by failing to raise it below, the Secretary requests that this Court vacate that portion of the panel's decision discussing section 502(a)(2).

Respectfully submitted this 11th day of July, 2006.

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CERTIFICATE OF SERVICE

I hereby certify that on July 12, 2006, two paper copies of the foregoing Brief in Support of Petition for Rehearing and Rehearing En Banc for the Secretary of Labor as amicus curiae were served using Federal Express, postage prepaid, or by courier service, upon the following counsel of record:

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