

by Donald Glazier and Tara Cummins

*The Supreme Court's recent decision in LaRue v. DeWolff, Boberg & Associates, Inc., has broadened the scope of fiduciary liability risk. Given that over 450,000 companies offer 401(k) plans to millions of employees, this decision warrants close attention, especially regarding its potential impact on the fiduciary liability insurance coverage purchased by most companies.*

## The High Court Weighs In

James LaRue, an employee of DeWolff, Boberg & Associates participated in a 401(k) plan administered by his employer. LaRue alleged that his instructions to change his mutual fund investments were ignored, resulting in a loss of \$150,000 to his portfolio. He brought suit for relief under ERISA's section 502(a)(3), seeking to make whole his individual retirement account.

The Fourth Circuit Court of Appeals denied the claim on the grounds that established law allows for recovery on behalf of the entire plan, not for individual loss. Citing the 1985 case of Massachusetts Mutual Life Insurance Company v. Russell, the Appeals court ruled that since LaRue's loss was not a loss to the plan at large, nor brought on its behalf, individual recovery relief was not actionable.

In its decision, the Supreme Court acknowledged a changing pension landscape, noting that, "Defined contribution plans dominate the retirement plan scene today." The reasoning in Russell – that an action must be rooted in damage to the plan at large – augured well for defined benefit plans. Yet, in the context of LaRue, the court noted that, "the rationale for Russell's holding supports the opposite result in this [the LaRue] case."<sup>1</sup>

Recognizing this shifting landscape and understanding the need for individual relief in the defined contribution context, the Supreme Court vacated the Appeals Court decision holding that 502(a)(2), "does authorize recovery for fiduciary breaches that impair the value of plan assets in a participant's individual account." The case was remanded for further proceedings.

Although Chief Justice Roberts agreed with the principal of individual actions, his concurrence deviated with the avenue of relief. Roberts would characterize the claim as one of benefit recovery, as opposed to damages for fiduciary breach. The distinction is subtle, but it has important ramifications because the standards for benefit recovery vs. damages can be quite different.

For his part, Justice Thomas also agreed with the outcome, but argued that the distinction between defined contribution and defined benefit plans should not matter. Fundamentally, according to Thomas, the losses to LaRue's individual account were part of the plan at large, and therefore the loss was actionable. Thomas wanted it made clear that his opinion rests on the unambiguous text of the statute.

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<sup>1</sup> It is important to note the distinction between a defined benefit plan and a defined contribution plan. In a defined benefit plan, portfolio management is under control of the company and employees are promised a certain amount of benefits at retirement no matter what happens to plan investments prior to retirement. In defined contribution plans, however, individual accounts exist for the participant and benefits, which in this case are equal to investment results, are based on however the individual chooses to invest within a limited scope of investment vehicles.

Some pundits argue that the LaRue case will open floodgates to ERISA litigation. However, it is important to note that while the case sets a precedent for bringing an individual action, it did not resolve the issue of relief; but rather remanded the action back to the lower court. Mr. LaRue must still prove that a fiduciary breach occurred, and further, that the “make-whole” relief that he seeks is indeed equitable relief available under ERISA.

## **Fiduciary Liability Coverage**

Most companies that offer 401(k) plans carry liability insurance coverage for fiduciary claims. These policies may get much closer scrutiny to see if they will respond in the event of a claim based on the LaRue ruling. One area of close focus will be a common exclusion found in many fiduciary liability policies. The exclusion typically bars coverage, except for defense costs, for amounts “which constitute benefits due under any plan.” In the event of claims like LaRue, insurers will have to take a stand as to whether the amounts sought in those claims represent “benefits” not covered by the terms of the policy, despite being brought under Section 502(a)(2) of ERISA.

Besides the applicability of the benefits exclusion, Fiduciary Liability insurers will have to consider how to respond to a potential flood of LaRue-type claims. Many Fiduciary policies carry a small self insured retention when compared to D&O coverage. As such, any increase in claims frequency may lead to insurers significantly increasing retention amounts so the coverage addresses only very large or class claims.

Near term, the insurance industry may take a wait and see position, especially because the case has been remanded. After the lower court provides some additional clarity on the risk involved, carriers may adjust their coverages or exclusionary language to address LaRue and clarify their appetite for risk through retentions and, of course, pricing. In the current soft marketplace, with abundant capacity available, carriers may decide to aggressively cover the risk stemming from this decision, adjusting how their policies respond in the event of claims like LaRue’s.

Regardless of the insurance industry response, the LaRue case reinforces the importance of having appropriate fiduciary liability coverage in place to deal with claims that may arise as baby boomers reach retirement and look at the dollars they expect from their retirement plans set up under 401(k) plans.

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