PUBLICATION

LaRue Part II: Fourth Circuit Rules That Former Employees Can Sue You for Retirement Plan Investments

July 29, 2008

The Supreme Court's February ruling in *LaRue v. DeWolff, Boberg & Associates, Inc., et al*. allows former employees who participated in 401(k) and other defined contribution plans to sue plan fiduciaries for breach of duty claims, if the result of the breach is a reduced account balance which is then used to cash those employees out of the plan. In *LaRue*, the claim was straightforward - the fiduciary failed to invest plan assets as directed by the participant. The impact of *LaRue* is already being felt.

On June 16, 2008, the Fourth Circuit Court of Appeals decided *In re Mutual Funds Investment Litigation*, which similarly involved claims by former employees who had already been paid their account balances. Here, the fiduciaries being sued (plan sponsors, administrators, trustees and investment committee members) invested plan assets in mutual funds which engaged in illegal market timing trading practices. The plaintiffs alleged that, as a result of those practices, the funds' internal operating expenses increased and, therefore, the value of the funds decreased. Ultimately, the investors received less when they sold their interest in the fund, though there is no indication that the plaintiffs lost money on their investments.

Under the reasoning of *LaRue*, the Circuit Court concluded that the cashed out former employees remained "participants" entitled to sue under ERISA for the benefits they otherwise would have received, had their plan accounts been prudently managed. Unlike the clear and direct breach of duty in *LaRue*, the Fourth Circuit's opinion dealt with an alleged breach with no direct activity of the fiduciaries, other than investing in funds which they allegedly knew were engaged in higher-cost, improper trading practices.

In late 2007, a series of class action suits were filed against the fiduciaries of a number of large plans, claiming that excessive or unnecessary fees, both direct and indirect, were paid. In light of *LaRue* and this new Fourth Circuit decision, it seems likely that the plaintiffs in those plan expense suits will be expanded to include former employees. It seems equally probable that progressively smaller plans may face the same type of litigation by former employees as well as current participants. By allowing any former employee to join as a plaintiff, possibly long after he or she has cashed-out of the plan, the costs of defense could be far higher. If the plaintiffs are successful in those suits, the administrative burden and expense of restoring accounts, crediting lost earnings, locating individuals, re-establishing accounts, processing new distribution elections, etc. could be immense.