Employee Benefits & Executive Compensation
Bulletin

BRYAN CAVE

To: Our Clients and Friends: February 26, 2008

Supreme Court Gives the "Greenlight" to 401(k) Plan Participant Lawsuits!

Last Wednesday, the Supreme Court handed down a long-awaited decision in *LaRue v. DeWolff, Boberg & Associates, Inc.*, when it ruled in favor of a plan participant who claimed that his 401(k) plan account suffered losses of $150,000 as a result of a breach of fiduciary duty attributable to the fiduciary's failure to follow his investment instructions. The Supreme Court ruled that ERISA affords a remedy to a participant is these circumstances. Writing on behalf of the unanimous Court, Justice Stevens outlined that "[t]he principal statutory duties imposed on fiduciaries by [ERISA] relate to the proper management, administration, and investment of fund assets, with an eye toward ensuring that the benefits authorized by the plan are ultimately paid to participants and beneficiaries…. The misconduct alleged by [LaRue] in this case falls squarely within that category."

The *LaRue* opinion opens a path to potential recovery by individual participants in defined contribution plans, such as 401(k) plans. *LaRue* held that ERISA authorizes recovery for fiduciary breaches that impair the value of plan assets in a participant's individual account. In short, the Supreme Court held that ERISA authorizes breach of fiduciary duty claims by an individual seeking recovery for his or her individual plan account.

Change of Position

This decision represents a somewhat dramatic change from the Supreme Court's earlier position. Prior case law permitted recovery under a breach of fiduciary duty claim only when participants acted on behalf of the entire plan and denied recovery when participants acted solely with respect to their own benefits. Significantly, this opinion comes at a time when the majority of companies have abandoned traditional pension plans in favor of defined contribution plans, such as 401(k) plans. The Supreme Court recognized this trend in its opinion when it held that its earlier decision's "emphasis on protecting the 'entire plan' from fiduciary misconduct reflects the former landscape of employee benefit plans. That landscape has changed."

Recommended Action

After *LaRue,* an error affecting even a single defined contribution plan participant may be grounds for litigation. Accordingly, defined contribution plan sponsors may want to carefully scrutinize their administration and investment procedures to help prevent, and assist in the defense of, any fiduciary breach claims. In addition, plan fiduciaries should be aware of their other fiduciary duties, including the obligation to comply with ERISA's procedural due diligence requirements. The procedural due diligence requirements should be satisfied when fiduciaries review and revise their administrative and

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investment procedures, just as they should be satisfied when any fiduciary decision or action is made. This means fiduciaries must establish a thoughtful decision-making process, which may include: (1) identifying the information required to make a decision, (2) obtaining information from competent, independent sources; (3) giving all information its due consideration; (4) making a decision consistent with the information; (5) documenting the decision; and (6) using experts, as appropriate, but evaluating their input pursuant to fiduciary process.

IRS Reverses its Position on Performance-Based Compensation, but Delays the Effective Date

In a stunning move, the IRS issued Revenue Ruling 2008-13 reversing its long-held position on performance-based compensation under Section 162(m) of the Internal Revenue Code.

Background

Section 162(m) imposes a $1 million limit on tax deductions for compensation paid to certain highly compensated executives of public companies. There is an exception to this limit for performance-based compensation payable solely on account of the attainment of one or more performance goals under plans approved by shareholders and administered by a committee of outside directors.

The IRS had previously ruled that if the performance goals are attained, compensation will qualify as performance based even though the compensation could also be paid if the executive (1) was terminated for reasons other than cause, or (2) terminated employment for good reason or retirement.[1/] However, if such a termination did occur without the goals being attained, no part of the compensation would qualify as performance-based.

Reversal of Position

In February, 2008 the IRS made public a Private Letter Ruling issued in September, 2007, in which it reversed its position on this issue.[2/] Under this ruling, an executive was entitled to a bonus if performance goals were met. However, the executive was also entitled to the bonus if he was terminated for reasons other than cause or if he terminated his employment for good reason. The IRS ruled that even if the executive remained employed through the performance period and the performance goals were met, no part of the bonus would qualify as performance based. This ruling generated widespread concern that the IRS would apply its position retroactively thereby requiring some companies to amend prior returns and possibly even restate earnings.

In an apparent effort to avoid this result, the IRS issued Revenue Ruling 2008-13. This revenue ruling contemplated a performance-based bonus plan under which a bonus is payable if performance goals are met, but the bonus will vest immediately if the executive's employment is terminated for reasons other than cause or if the executive terminates employment for good reason or on account of death, disability or retirement. The IRS held that no part of the bonus will qualify as performance-based even if there is no termination of employment and the performance goals are in fact attained.

1/ Private Letter Rulings 199949014 and 200613012.

2/ Private Letter Ruling 20080404

Transition Relief

This revenue ruling will not be applied to disallow a deduction if either (1) the performance period begins prior to January 1, 2009, or (2) the compensation is paid pursuant to a plan or agreement in effect on February 21, 2008 (the date of the publication of the revenue ruling), without regard to any extension or renewal.

Recommended Action

Although the ruling will not be applied retroactively, plans should be reviewed to determine whether future payments under existing plan terms could be disqualified compensation from being performance-based.

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