DRAFTING AND ADMINISTERING PLANS WITH AN EYE TOWARDS AVOIDING OR WINNING LITIGATION

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I. Introduction

As we once again continue another round of plan amendments designed to ensure compliance with various laws, we should not forget that other provisions not required for tax qualification may, nevertheless, prove just as important. Such provisions may be necessary to include or omit in order to place the plan in the best possible position to either avoid litigation or to prevail in the event of litigation.

In addition to plan provisions, built in defenses in the actual administration of the plan may prove equally important to avoiding or minimizing the chances of litigation.

This Outline will address some of the drafting and administration decisions deserving of consideration in this regard.

II. Are there Potential Fiduciary Issues That Might Instead be Characterized as Plan Design Issues?

Background

Notwithstanding the broad reach of ERISA's fiduciary duty provisions, both the courts and the Department of Labor ("DOL") continue to recognize that some issues, even when addressed by a fiduciary, are not fiduciary functions in nature, but rather, are within the purview of the settlor. These so called nonfiduciary settlor decisions include issues regarding the establishment, design and termination of a plan. The Supreme Court previously confirmed this position in Hughes Aircraft Co. v. Jacobson, 119 S. Ct. 755 (1999). Therein, the Court specifically held that an employer did not violate ERISA's anti-inurement provision when it amended its contributory defined benefit plan to provide that the surplus, including surplus attributable to employee contributions, would be used to provide increased benefits to other participants.

Employer Stock as an Investment

In this regard, one area that continues to result in significant amounts of litigation revolves around the offering of employer stock in a defined contribution plan. While the Pension Protection Act of 2006's ("PPA") new diversification requirement applicable to individual account plans that hold publicly traded employer stock may work to reduce the number of these suits, [IRC Section 401(a)(35)] it is likely that such suits will continue to

be brought. As such, while PPA's diversification requirement may well serve to reduce the total number of these suits and the potential for liability by virtue of both the required notice and the provision of the right to elect out of the company stock as an investment, it is unlikely to completely eliminate the potential for liability. This is because, in the past, much of the litigation has previously arisen in the context of defined contribution plans that merely offer, but do not mandate, investment in company stock. Typically, although company stock may be one of only several investment options made available under the plan and participants may have the right to direct the investment of their accounts, participants often allege that the fiduciaries were aware or should have been aware of information that made the retention of the company stock as a continuing investment option imprudent and that the failure to disclose to participants this non-public information or to remove the fund as an on-going option violated ERISA's fiduciary duty provisions.

Attempting to Employer Stock Investment Structure as a Design Issue

Because even under a plan that satisfies the requirements of ERISA Section 404(c), fiduciaries with the discretion to pick and retain the investment options available under the plan remain liable for the selection and continued maintenance of the options, plans may wish to consider attempting to structuring that investment in such a way as to remove the potential for fiduciary discretion by specifying company stock as an option under the terms of the plan that can only be removed or frozen as an option via a valid amendment to the plan. Stock drop cases have been given even more life after the Supreme Court's decision in LaRue v. DeWolff, Boberg & Associates, Inc. 128 S. Ct. 1020 (2008) opening the door to individual relief under Section 502(a)(2) of ERISA. [see, for example, Rogers v. Baxter International, Inc. No. 06-3241 (7th Cir. 2008)] A plan containing such a provision will be in a much better position to argue that the provision is a design, or settlor decision, not subject to ERISA's fiduciary standards.

This is an issue or defense that is only now being reviewed by the courts.

Failed Attempt—RJR Reynolds Case

One of the first cases in which the plan provision was used as a defense was in a case arising from the spin off of the tobacco portion of the company from R.J. Reynolds. The case, Tatum v. R.J. Reynolds Tobacco Company, 2004 WL 2857376 (4th Cir. 2004), arose when the parent company, RJR Nabisco, spun off its tobacco company and, as a result, the parent company's 401(k) plan was divided into two plans. The now separate plan covering only tobacco company employees was amended to freeze the Nabisco stock funds prohibiting any further investment in those funds. Participants were told that the fund would be eliminated in approximately six months after the spin off.

When the plan was amended to eliminate the Nabisco stock fund, the amendment was accomplished by listing seven funds which would be maintained under the plan, a list that did not include the Nabisco stock fund. The amendment further provided that:

> "[i]n addition, the Trustee shall maintain any other Investment Funds as are designated by the RJR Pension Investment Committee."

When the plan sold its holdings in the Nabisco stock fund, it did so at a substantial loss and participants sued claiming a breach of fiduciary duty.

The defendants argued that the claim failed to state a claim for breach of fiduciary duty because the liquidation of the Nabisco funds was a nondiscretionary act required by the plan amendment.

Although the court recognized that there was indeed an issue as to whether fiduciaries can avoid fiduciary responsibility where the fiduciary merely follows the mandates of the plan, the court found that it did not need to address that issue to resolve the case. This was because the court concluded that the language of the amendment itself did not serve to strip the fiduciaries of their discretion to re-designate the Nabisco stock fund as an investment option under the plan post amendment. That is, the court interpreted the amendment as providing that effective February 1, 2000, the Nabisco funds were unfrozen, were not listed as investment options, and were no longer required to be maintained as investment funds under the plan. The amendment did not, however, in the view of the court, require the elimination of the Nabisco funds from the plan, nor did it require the sale of the Nabisco funds. As such, the suit was allowed to proceed.

A Successful Attempt---In re Reliant Energy

The issue was subsequently addressed by the court in In re Reliant Energy Litigation, , not reported in F. Supp. 2d, 2006 WL 148898, 36 Employee Benefit Cases 2648 (01/18/2006), affirmed 456 F. Supp. 2d 1262 (5th Cir. 2008). In Reliant Energy, the plaintiffs claimed that the plan sponsor's benefits committee breached its fiduciary duty by allowing the company stock fund to continue as an investment option under the company's plan. The plaintiffs claimed that at some point, the company stock became an imprudent investment based upon both public and non-public information. The plan involved was a Section 401(k) plan that also contained an ESOP feature which, under the 401(k) portion, allowed participants to direct the investment of their accounts in various options including the Reliant stock fund. Under the ESOP portion, the company matched a minimum of 75% and a maximum of 125% of the first 6% of a participant's contributions to the plan with the matching contributions paid in REI stock from the ESOP and allocated to the company stock fund. The stated purpose of the ESOP component was to invest substantial sums in company stock for the benefit of participants and beneficiaries. The 401(k) portion specified by its terms, that the REI common stock fund be an investment option, stating specifically that investments could be added or deleted "with the exception of the REI stock fund."

The court interpreted the plan's language as leaving no discretion to the benefits committee as to whether to continue to offer the stock fund. Because the court concluded that the plan's language meant that the benefits committee had no discretion whether to offer the company stock fund as an investment option and did not have any discretion to

delete the fund as an investment option, the court therefore concluded that the committee members had no fiduciary duty to act otherwise.

Pedraza v. Coca-Cola

Pedraza v. Coca-Cola, 456 F. Supp. 2d 1262 (N.D. Ga. 2006) involved several claims of fiduciary breach surrounding the plan's investment in Coca-Cola stock. The plan was a combination thrift and ESOP. The thrift portion allowed participants to direct the investment of their accounts from among various investment options made available under the plan including a company stock fund. The company match, or ESOP portion, mandated that the company match be made in company stock. Essentially, an employee who acquired investments in the thrift component would automatically acquire an interest in Coca-Cola stock in the ESOP portion. As such, all participants in the plan held Coca-Cola stock even if they did not choose, via their participant direction rights under the thrift portion, Coca-Cola stock as an investment. Further, the thrift portion of the plan mandated the inclusion of company stock as an investment option from which participants could choose to invest.

Coca-Cola experienced various difficulties that resulted in its stock trending downward including: the need to close and abandon plants in Russia, a suit brought by Burger King, (one of its investment partners), and a consent cease and desist order against the company brought by the SEC arising from claims that it had filed materially misleading Forms 10-K and 10-Q.

Plaintiffs brought suit alleging, among other claims, that the plan's Asset Management Committee (the Committee) failed to act prudently and loyally in the management of the plan's assets. That is, the plaintiff alleged that the Committee breached its fiduciary duty under ERISA by failing to take action to protect participants from losses as a result of the plan's investment in company stock.

The court recognized that the Committee was in fact a fiduciary responsible for making investment decisions. However, the court found that with respect to both portions of the plan, no exercise of fiduciary duty was implicated as the plan specifically required that only Coca-Cola stock be supplied in the ESOP and required that company stock be offered as an investment option under the thrift portion. Plaintiff's argument therefore, was essentially that the Committee should ignore the terms of the plan.

The court noted that among ERISA's fiduciary duties is the duty to follow the terms of the plan unless those terms are inconsistent with ERISA and plaintiff did not contend that the plan provisions were facially inconsistent with ERISA. While ERISA generally requires that a fiduciary diversify the investment of plan assets, it also excuses from that duty a fiduciary in an eligible individual account plan. Therefore, under the express provisions of ERISA, the fact that the plan was heavily invested in company stock does not itself show that the fiduciaries were negligent or abused their discretion.

In support of the plaintiffs argued that the Committee should have in fact ignored the plan's provisions, the plaintiffs pointed to the third circuit's decision in Moench v. Roberston, 62 F. 3d 553 (3d Cir. 1995), in which the court concluded that ERISA creates a presumption that an ESOP's investment in employer stock is prudent, however, a plaintiff may overcome that presumption with facts showing that the fiduciary abused its discretion in failing to choose a different investment in a particular situation. In the absence of controlling authority, however, the court was more persuaded by decisions such as In re Reliant rather than by Moench. Moreover, the court found that even if it applied the Moench standard, the court would still rule that the plaintiff had not alleged sufficient facts to overcome Moench's presumption of prudence. Rather, the "drastic" action the plaintiff advocates would only be appropriate, in the view of the court, in the case of a company on the brink of collapse, where employee participants in the plan have no further incentive to participate.

As such, the court dismissed this claim.

Lesson Learned

Courts are just beginning to be confronted with the argument that by establishing an employer stock fund as a required investment under the terms of the plan, fiduciaries lack the discretion to remove or freeze the option and therefore, no fiduciary duty is breached as a result. Time will tell whether other courts accept this argument and/or whether participants counter by asserting that even in the face of such a plan provision, ERISA's prudent man rule would require that fiduciaries override plan language because to continue to maintain such an investment, when it is otherwise imprudent to do so, would override the duty to follow the terms of the plan. That is, that a fiduciary's duty to follow the terms of the plan is qualified so that the fiduciary has such a duty only insofar as the documents and plan instruments are consistent with ERISA. [ERISA Section 404(a)(1)(D)] Where following the plan's terms would inherently violate the prudent man rule, the argument would be that the prudent man rule must prevail. However, both the In re Reliant and the Coca-Cola cases provide some hope that more courts may be amendable to such an argument. However, in all events, if the defense is to prevail, the RJR Reynolds case emphasizes the need for careful drafting to ensure that no discretion remains to the fiduciary with respect to the company stock investment.

III. Plan Imposed Periods of Limitation

ERISA only sets forth specific statutes of limitations for claims involving breaches of fiduciary duty and claims by the Pension Benefit Guaranty Corporation. [ERISA §413; 4003(e)(6)] This means, for example that one the areas likely to generate significant amounts of litigation, i.e, claims for benefits, has no ERISA-designated limitations period.

Courts have dealt with this void by borrowing the most analogous underlying state law statute of limitations where an ERISA claim is not subject to an ERISA-designated limitations period. This meant that in the case of benefit claims, courts have historically

looked to the underlying state contract statute of limitations. Such a limitations period may provide a participant or beneficiary a substantial period of time in which to file suit for benefits after exhausting the plan's administrative claims procedures.

In an attempt to impose a more reasonable and definitive period in which litigation can be pursued following a claimant's exhaustion of his/her administrative appeals, some plans instead include, as part of their plan provisions, a plan-specified limitations period for filing suit for claims for benefits.

Whether a plan-specified limitations period for the pursuit of a claim denial must be adhered to has not been tested in all of the circuits. However, where it has been used as a defense in court, courts have virtually with unanimity held such provisions enforceable by the plan. One of the earliest circuits to do so was the Seventh Circuit.

In Doe v. Blue Cross & Blue Shield United of Wisconsin, 112 F. 3d 869, 20 EBC 2889 (7TH Cir. 1997), the 7th Circuit held enforceable a plan provision which required potential claimants to file suit within thirty-nine months of the first date of services on which the action was commenced. The plan also contained a provision prohibiting the filing of suit until after the completion of the plan's internal administrative claims procedures. As such, the thirty-nine month period in which the participant had to file suit was reduced by the time required to fully complete the plan's internal administrative claims procedure. In upholding the plan's period of limitations, the court noted that the dominant view in contract law is that a contractual limitation period shorter than the statute specified period of limitation is permissible, provided it is reasonable. The court concluded that the limitations period was reasonable particularly in light of market forces that effectively force an employer to deal fairly with its employees.

Other courts holding some plan-imposed limitations period as enforceable:

11th Circuit in Northlake Regional Medical Center v. Waffle House System Employee Benefit Plan, 22 EBC 1970 (11th Cir. 1998) upholding a provision in a medical plan precluding suits after 90 days from the date plan fiduciaries make a final determination to deny benefits;

District Court in Maine in Sheckley v. Lincoln Nat'l Corp. Employees' Ret. Plan, 366 F. Supp. 2d 140 (D. Me. 2005) enforcing a plan-imposed six month limitations period;

Texas Court of Appeals in Hand v Stevens Transport, Inc. Employee Benefit Plan, 83 SW 3d 286 (Tex. Ct. App. 2002) holding a 27 month period reasonable;

4th Circuit cites such decisions favorably but did not need to actually decide on that basis in White v. Sun Life Assurance Co. of Canada, 488 F. 3d 240 (4th Cir. 2007), and

District Court in Arizona finding a one year limitations period to be reasonable in the case of a disability plan in Solien v. Raytheon Long Term Disability Plan #590, 2008 WL 2323915 (2008).

However, a **district court in Oregon**, in an unreported case styled Hansen v. Aetna Health and Life Insurance Company, 1999 WL 1074078 (D Or.) found a two year limitations period unreasonable where it included the internal review period and thus, in practice, in the court's view, would render the provision unreasonable in practical terms.

It must also be noted that in Solien v. Raytheon Long Term Disability Plan #590, 2008 WL 2323915 (2008), while the court found the one year limitations period reasonable, the court did not strictly enforce due to its analysis that the notice provided of the one year limitations period was inadequate. While the information was in the summary plan description, the court found the failure to include it in the administrative provisions lacking. Further, the court suggest that the better course may well have been to specifically include the time limit in the plaintiff's denial letter. Finally, in addition to finding the manner of notice insufficient, the court also concluded that the specific notice itself was insufficient concluding that it was dubious at best that a lay person would understand that her limited right to file any "action at law or in equity" referred to her right under ERISA to "file suit in a state or federal court."

Lesson Learned

Courts confronted with a plan-imposed limitations period have almost uniformly been receptive and willing to enforce such provisions. In the face of some extremely long state contracts claims statutes of limitations, more and more plans will want to impose their own periods of limitations.

However, Solien points to the need to ensure that any plan-imposed limitations period is fully disclosed, both in the denial letter, as well as in the proper location in the plan's summary plan description.

IV. Rid the Plan of Unnecessary Mandates and Directives

Unnecessary Directives that May or May not be Followed

The plan document should be scrutinized to determine whether it contains unnecessary language, provisions or instructions that may ultimately result in plan disqualification and/or claims of fiduciary breach.

In this regard, the inclusion in the plan document of minutia not necessary for qualification, could lead to the disqualification of the plan where plan fiduciaries fail to comply to the letter with such details.

For example, it is not unusual for plans to include language specifying that the fiduciary is required to file certain reports, notify participants as to their eligibility to participate within a certain number of days of becoming eligible to participate and other similar directives. The problem with the inclusion of such unnecessary language in the plan document is that the failure of the plan fiduciary to strictly adhere to these specific directives could result in disqualification of the employer's plan notwithstanding the fact

that the failure itself would otherwise not constitute a disqualifying event. This is because, the Service broadly states in its Employee Plans Compliance Resolution System ("EPCRS") guidance that a qualification failure includes any qualification failure that arises solely from the failure to follow the terms of the plan.[See Rev. Proc. 2006-27, 2006-22 IRB, May 15, 2006, Part III, Section 5.01(2)(b)] While the argument can and should be made that this result should be restricted solely to those failures that themselves would constitute a qualification failure, some IRS agents, when auditing a plan that purports to be tax qualified, have construed this definition so broadly such that the failure to adhere to language in the plan, even where the provision is itself not required to be included in the plan, may, nevertheless, be viewed as a disqualifying defect. In such a case, the plan sponsor may find itself being forced, nonetheless, to negotiate a monetary sanction, or at best, a correction method.

Plan Loan Provisions

This has particularly been the case where a plan allows for loans and the loan provisions included in the plan reflect the requirements of Section 72(p). Where a participant loan is in default, the failure generally only leads to taxable income and potentially to the assessment of excise taxes for the defaulting participant under Section 72(t). However, where the failure of the loan also means that the default runs afoul of the plan's terms, the failure of the loan may also be treated by the agent as a failure to adhere to the plan's terms and thus, as a disqualifying operational failure.

As with the case with some of the provisions referenced above, the plan may be better served by including only those provisions specifically required under ERISA to be contained in the plan document authorizing the establishment of a loan policy, but providing that no loan may be made from the plan unless it satisfies the requirements of the plan's loan administration manual or loan policy or other separate document. While the separate document may be considered part of the plan for purposes of ERISA, for qualification purposes it will not. The manual or policy would then be made available to participants. By having those provisions designed to satisfy the requirements of Section 72(p) of the Code in a document, separate and apart from the plan document, the failure to repay the loan within the time provided in Section 72(p) or the failure to satisfy the maximum loan amount requirements of that Section, while resulting in taxable income to the participant, will not jeopardize the tax qualification of the plan itself.

Fiduciary Breach Issues

With respect to the failure to follow unnecessary plan language leading to a claim of fiduciary breach, it should be noted that one of the duties of a fiduciary is to administer a plan in accordance with its terms except where the plan's terms run afoul of ERISA. [ERISA §404(a)(1)(D)] While it is likely the unusual case where the failure to provide information or documents required by the plan but not required by ERISA would result in a viable fiduciary breach claim, it is certainly not beyond the realm of possibilities. This is particularly the case where the plan document includes among its duties for the named

fiduciary an obligation that can be viewed as requiring the fiduciary to assist or aid the participant for example, an obligation to:

> *assist participants regarding their rights or available benefit options under the plan.*

For example, in In re ADC Telecommunications, Inc., ERISA Litigation, 2004 WL 1683144 (D. Minn.), plaintiffs were allowed to proceed with a claim (against a defendant's motion to dismiss) asserting the failure to inform participants and provide accurate and complete disclosures not only on the basis of the ERISA obligation but also based upon the plan's own internal communications commitment. Specifically, the plan's Investment Policy Statement [which is viewed by the DOL as one of the documents and instruments governing the plan within the meaning of ERISA Section 404(a)(1)(D)] provided that the plan's Retirement Committee communicate periodically with participants and beneficiaries to provide beneficial and helpful information.

V. Failure to Include Sufficient Broad Discretionary Authority for Plan Fiduciaries

General Rules

Prior to the Supreme Court's decision in Firestone Tire & Rubber v. Bruch, 489 US 101 (1989), courts routinely applied the arbitrary and capricious standard in reviewing fiduciaries' decisions in denying claims for benefits. Under the arbitrary and capricious standard, in determining whether a fiduciary's denial, in whole or in part, was appropriate, the court did not review the issue anew. Rather, the court would determine whether the fiduciary's decision was arbitrary and capricious. Generally, so long as there was some evidence to support the decision, and evidence that the decision was made on a basis similar to other similar claims, the decision was sustainable.

However, in Firestone, the Supreme Court concluded that the arbitrary and capricious standard should no longer be applied automatically. Rather, after tracing the origins of the arbitrary and capricious standard, the Court concluded that traditional principals of trust law apply. Under these rules, the arbitrary and capricious standard will apply only where the plan specifically grants discretion to the fiduciary.

Subsequent court cases have wrestled with the language necessary to be present in the plan in order that a plan will be deemed to have a sufficient grant of discretion on the matter of claim denials and thus, to have the arbitrary and capricious standard apply.

In Boyd v. Trustees of the United Mine Workers Health & Retirement Funds, 873 F 2d 57 (4th Cir. 1989), the court held that language granting the fiduciaries the power of "full and final determination as to all issues concerning eligibility for benefits" and authorizing them "to promulgate rules and regulations to implement the plan" was sufficient discretion to apply the arbitrary and capricious standard.

In Guy v. Southeastern Iron Workers' Welfare Fund, 877 F 2d 37 (11th Cir. 1989), the arbitrary and capricious standard was held to apply where the plan granted the trustees "full power to construe the provisions of the Trust".

Note, however, that the same language can result in different conclusions by different courts. For example, language requiring the participant to provide the plan administrator with "satisfactory proof of total disability" and requiring the administrator to make a "full and fair review" was held by the Sixth Circuit to constitute the grant of sufficient discretion as to cause the arbitrary and capricious standard to be the proper standard of review [Yeager v. Reliance Standard Life Insurance Co., No. 95-5872 (6th Cir. 1996)] while the Ninth Circuit ruled that the language did not unambiguously give the administrator the requisite discretionary authority. Thus, the Ninth Circuit ruled that the de novo standard of review applied. [Sandy v. Reliance Standard Life Insurance Co., 9th Cir. No. 99-55366 (8/22/00)]

Some courts have proven willing to extend the arbitrary and capricious standard to what would normally be thought of as legal determinations. For example, in Administrative Committee of the Sea Ray Employees' Stock Ownership and Profit Sharing Plan v. Robinson, 22 EBC 2513 (6th Cir. 1999), the court of appeals applied the arbitrary and capricious standard to the plan administrator's determination that the plan had not undergone a partial termination. The court concluded that the plan had sufficient language to vest discretionary authority to the committee such that the judicial review of the committee's decision should, under the standard of Firestone, be held to the lesser standard of arbitrary and capricious. The court concluded that the plan language granted the necessary discretion even though the plan did not specifically define the term "partial termination" and the language did not specifically mention the term.

Courts continue to wrestle with the language necessary to result in the lower standard of review. In Woods v. Prudential Insurance Company of America, No. 07-1580 (4th Cir. 2008), the Fourth Circuit Court of Appeals concluded that the plan language itself was not sufficient to grant discretionary authority to Prudential. While the summary plan description contained language that would be sufficient stating that Prudential, as claims administrator:

> "has the sole discretion to interpret the terms of the Group Contract, to make factual findings, and to determine eligibility for benefits."

the court determined that this language was not relevant to its determination as the same language was not contained in the plan itself. While the plan specified that Prudential had the authority to make benefit determinations, the court found that this language did not confer the necessary discretion. Rather, the court concluded, almost all ERISA plans designate an administrator who, in order to carry out its duties, must determine whether a participant is eligible for benefits. Such mere authority does not, in the view of the court, carry with it the requisite discretion required under Firestone.

Requirement for Determination-Specific Language?

In In re the Marriage of Oddino, 939 P. 2d 1266 (Cal. S. Ct. 1997), cert. denied, 118 S. Ct. 1831 (1998), where the California Supreme Court was asked to rule on the division of retirement plan assets incident to a divorce, the court suggested in dicta that the necessary discretion under the standard of Firestone must be specific to the issue at hand. Specifically, in responding to the DOL's argument that state courts do not have jurisdiction to determine whether an order constitutes a QDRO, the court states:

> "Even if relevant to the jurisdictional questions, which we doubt, DOL's argument that state courts would have limited authority to review decisions of plan administrators is not well taken. Firestone actually holds that 'a denial of benefits challenged under §1132(a)(1)(B) is to be reviewed under a de novo standard unless the benefit gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan.... Although the Plan does give [the company] the authority to interpret the Plan's terms, it gives [the company] no discretionary authority to determine whether a state court order is a QDRO as defined in ERISA or as defined in the Plan....The determination that an order is not a QDRO is therefore, under Firestone, reviewed de novo."

This language may suggest that, at least some courts, may be unwilling to apply the arbitrary and capricious standard absent a specific grant of discretionary authority over the particular issue at hand.

Lesson Learned

In addition to providing broad discretionary language, plan sponsors may wish to consider also adding specific grants of authority to do such things as determine whether a domestic relations order constitutes a QDRO, how it is to be administered etc.

Being mindful of the court's decision in Oddino, plan sponsors may also wish to look for language that has, not only, general discretionary language, but also language providing a specific grant of discretion with respect to certain particularly thorny decisions. For example, the plan may wish to specifically provide that the plan administrator is to have full and complete discretion to determine whether a domestic relations order constitutes a Qualified Domestic Relations Order, as defined in Section 414(p) of the Code, and to determine whether someone who is attempting to obtain benefits under the plan pursuant to such an order does or does not qualify for benefits under the plan.

It should be noted that, ideally, the DOL wants QDRO determinations to fall outside the realm of a plan's claims procedures specifically to avoid having the determinations being reviewed possibly subject to the "arbitrary and capricious" standard. This position is reflected in the Preamble to the Claims Regulations at "Other Issues", note 39. However,

courts, particularly the California Courts, have demonstrated that they are more than willing to apply their own interpretation to the rules governing QDROs.

VI. Language Governing the Payment of Expenses from a Defined Contribution Plan

Provided an expense otherwise satisfies ERISA's basic requirements to be payable from a plan without resulting in a breach of fiduciary duty or a prohibited transaction, in the case of a defined contribution plan, two other decisions will remain: (i) will the fee be paid from the plan as a whole or can it be properly allocated to the account of an individual participant, and (ii) if paid from the plan as a whole, how should it be allocated among participants. In Field Assistance Bulletin 2003-3, May 19, 2003, the DOL sets forth the general principle that in determining whether an expense should be allocated to the plan as a whole or allocated to the accounts of specific participants, a fiduciary is bound by ERISA's basic fiduciary duties. This means then, if the plan document itself provides for the specific method of allocation, a fiduciary is obligated to follow that method, provided it does not violate ERISA. Where the plan is silent or ambiguous, the fiduciary must make the determination taking into consideration its fiduciary duties under ERISA, including particularly ERISA's prudent man rule and its requirement that the plan be operated solely in the interest of participants and their beneficiaries.

Therefore, if the provisions of the plan allows (or do not prohibit) and provided the surrounding facts and circumstances don't necessitate another approach in light, for example, of the prudent man rule, the Field Assistance Bulletin states the following are examples of expenses that may be allocated to the accounts of the individual participants or beneficiaries involved:

1. hardship withdrawals;

2 calculation of benefits payable under different plan distribution options;

3. benefit distributions;

4. QDROs, and

5. administrative fees to the accounts of separated vested participants.

Other situations in which the DOL has previously recognized the right to allocate the expense to the account of the individual involved is in the case of the cost associated with self-directing the participant's account and the cost of obtaining a participant loan.

In all events, however, the plan document must be reviewed to ensure that it permits (or at least does not prohibit) the specific allocation and the summary plan description should further reflect this approach before an expense is allocated to the account of a specific participant or beneficiary. Further, if the language is specified in the plan, then rather than the decision being deemed a fiduciary decision, it can be argued that the allocation

of a specific expense to the participant's account is instead, a settlor or plan design issue not subject to fiduciary review.

With respect to the issue of specifically addressing the issue in the summary plan description as to expenses that will be allocated directly to a participant's account, it can be argued that the provision requiring that the summary plan description contain a statement "clearly identifying circumstances which may result in disqualification, ineligibility, or denial, loss, forfeiture, suspension, offset, reduction, or recovery...of any benefits that a participant or beneficiary might otherwise reasonably expect the plan to provide on the basis of the description of benefits...would require such a result. [Labor Reg. §2520.102-3(l)]

VII. Language Allowing Recognition of Trading Restrictions

As a result of the various mutual fund scandals involving market-timing abuses, some plans may ultimately find it necessary to either impose their own trading restrictions or allow as investment options under the plan funds that themselves impose reasonable fees on trading designed to restrict such market-timing abuses. Questions had arisen as to whether such restrictions would cause a plan to lose its potential ERISA Section 404(c) status with respect to those affected participants.

However, the DOL states that neither the inclusion of an investment that imposes reasonable redemption fees nor the plan's or investment company's imposition of reasonable limits on the number of times a participant can move in and out of a particular investment within a particular period would, in and of itself, affect the availability of the relief under ERISA Section 404(c).

However, as is the case with all restrictions, adequate disclosure is paramount. Specifically, the DOL notes that the imposition of trading restrictions that are not contemplated by the plan raises issues as to whether Section 404(c) relief is available as well as whether those restrictions constitute a "black-out" for purposes of Sarbanes/Oxley. [The statement of the DOL can be retrieved at www.dol.gov/ebsa/newsroom/sp021704.html]

In Straus v. Prudential Employee Savings Plan,, 253 F. Supp 2d 438 (E.D. New York 2003), participants and former participants sued the plan, the plan administrator and the employer for violations of ERISA Section 510. The plaintiffs had been participants in the Prudential Employee Savings Plan (PESP), a Section 401(k) plan. The Summary Plan Description for the Plan provided generally that participants could make or change investment decisions on any business day in multiples of 1%. The SPD stated that changes would be effective as of the same day provided the change was made by 4 p.m. eastern time. However, the SPD warned that there may be situations (for example, in situations of excessive trading) where limitations on transfers would be imposed. Participants were referred to the various fund prospectuses and/or fact sheets for more information on any trading restrictions that may apply to the investment options and to the online Terms and Conditions on the PESP website for more details. The fund

prospectuses warned that frequent trading of shares in response to short-term fluctuations, a practice known as "market timing," may disrupt the management of the fund as well as the overall health of the fund and that therefore, the fund managers reserved the right to refuse purchase orders and fund exchanges if the fund manager believes the transaction will have a disruptive effect on the portfolio. In addition, the plan document itself further provided that the Administrative Committee "may decline to implement investment instructions where it deems appropriate..."

Plaintiffs had engaged in what Prudential considered excessive trading and the company began imposing restrictions on them. Beginning in September 2001, plaintiffs began receiving letters from the company warning them that they had conducted at least one trade that violated the plan's policies on frequent trading and referred them to the fund prospectuses. Four months later, the Administrative Committee sent letters to the plaintiffs stating that each had violated the plan's trading policies and stating that, as a result, the Administrative Committee had suspended the plaintiff's ability to conduct trades electronically or by telephone for a period of thirty day. The plaintiffs retained the ability, however, to submit requests by letter.

In April 2002, the Administrative Committee published a formal policy statement which tracked the language of its earlier letters to the plaintiffs, and outlining three criteria that had to be satisfied in order for a trade to be considered a "frequent trade" prohibited under the policy and set forth the following consequences: (1) one violation would result in a warning letter, and (2) after two violations, the investor would receive a "suspension notification letter" signifying the beginning of a thirty-day suspension period in which the Administrative Committee would consider only written investment requests. Ultimately, the plaintiffs were viewed as having violated this formal policy and were subjected to the consequences.

The plaintiffs brought suit claiming, among other charges, a violation of ERISA Section 510, the section that prohibits any person from discharging, firing, suspending, expelling, disciplining, or discriminating against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan. The plaintiffs sought a preliminary injunction enjoining the defendants from enforcing the trade restriction policies and granting them permission to transfer funds in and out of any of the investment options made available under the plan, on any business day, in unlimited amounts.

The court held in favor of the defendants on this charge concluding that plaintiffs had been unable to demonstrate that they were "exercising any right to which [they were] entitled" or that defendants "interfered with the attainment of any rights" as required for an ERISA Section 510 violation. This was because, in the view of the court, both the plan document and the SPD made it clear that there may be restrictions and limitations on the participants' abilities to transfer funds among the investments. Nowhere, the court noted, do the words "transfer of unlimited amounts" appear in either the plan document or the SPD. On the contrary, the plan explicitly states that the Administrative Committee

may decline to implement investment instructions where it deems appropriate. As a result, the court dismissed this claim.

VIII. Does the Plan's Investment Policy Statement Help or Hurt?

All too frequently, plans adopt Investment Policy Statements without either giving sufficient thought to what is included and whether it can or will be followed or without ever reviewing it again post initial adoption. In such cases, an Investment Policy Statement, while recommended by the DOL but not required to be adopted under ERISA may ultimately cause plan fiduciaries more harm than good?

404(c) Compliance Description

For example, some Investment Policy Statements include ERISA Section 404(c) language that might well argue against ERISA Section 404(c) status. For example, rather than including the basic language that the plan's investment options have been selected "which in the aggregate enable the participant or beneficiary by choosing among them to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant or beneficiary;" [Labor Reg. §2550.404c-1(b)(2)(ii)(C)(3)], the language may be more limited or qualified. For example, perhaps in recognition of just how difficult that objective is to achieve, the language may be qualified by saying that the options have been chosen to allow "most" or "many" or "the typical participant" to so construct such a portfolio. However, the use of such limitations or qualifications would seem to support the claims of participants who might want to argue that the plan did not achieve ERISA Section 404(c) status.

Language that is Never Followed

In other instances, the Investment Policy Statements may contain language that the plan will never actually follow in practice thus setting up the Investment Policy to be used as a sword against the plan rather than as a shield. For example, many of the standards include, among the requirements that an investment manager of a provider of any investment under the plan has to meet, a provision that the investment manager must be (1) in good standing with regulators and clients, and (2) must not have any material pending or concluded legal actions. First, while the requirement that the investment manager be in good standing with regulators is relatively easy to check, it would seem impossible for any investment manager to actually be, as well as to demonstrate, that it is good standing with all of its clients. Finally, the restriction that the investment provider not have material concluded legal actions with no time restrictions would seem to exclude virtually all investment providers and further, makes no allowance or distinction for those where the litigation was concluded favorably with respect to the investment manager.

Most importantly, can any plan that has adopted such a provision as part of its Investment Policy Statement show that it is in compliance?

The biggest concern here is that the plan, by adopting such language, may ultimately be doing itself more harm than good to the extent that potential claimants could prove that specific provisions were not followed.

Failure to Update and Review Statement

Finally, there is the concern that, after adopting the Investment Policy, a small plan may never look at the policy again or attempt to comply with the parameters that have been adopted thus again opening itself up to have the policy used against it. For example, the plan may have initially adopted an Investment Policy that required that all mutual finds made available under the plan must be in the top 10% by return for their investment category for the last prior 5 years. That criteria may have been satisfied with respect to the funds initially picked, but may fail to be satisfied in later years or as one fund has drifted into another investment category.

IX. Distribution of SPD

ERISA Section 104(b) requires that a plan administrator furnish to each participant and beneficiary a copy of the plan's current summary plan description. Often the provision of an updated summary plan description is made at employee meetings designed to update participants to various features and/or changes to the plan. However, unless plan officials take measures to ensure actual delivery to each eligible employee and beneficiary, merely making the summary available at a meeting where attendance is not mandated, may not satisfy this requirement.

Such was the case in Leyda v. AlliedSignal, Inc., 322 F3d 199 (2d Cir. 2003). The facts involved a decedent who had been employed by Textron. The company provided insurance coverage in the amount of 2 ½ times an employee's salary. However, the company's assets were purchased by AlliedSignal and AlliedSignal provided life insurance coverage, at no cost, of only 1 ½ times salary. However, employees could purchase additional coverage.

In order to acquaint employees to the company and its policies and benefits, Allied held several meetings a day with employees. However, the meetings were not mandatory and attendance was not taken. Employees who attended the meetings were given copies of Allied's summary plan descriptions. Employees who were on sick leave, traveling or on extended leave were also forwarded copies. Packages were also mailed to any employee who notified human resources that they could not attend the meetings.

Leyda never received a copy of the Allied summary plan descriptions. As a result, while he opted for the additional coverage made available by Allied at a cost to the employee, he did so at an amount equal to his salary of $40,000 believing this provided coverage in addition to the $120,000 for which he had opted at Textron. Over the years, he declined to purchase additional coverage believing he had total coverage of $160,000. On his death, his wife, as both his beneficiary and executor of his estate, sued for the difference between the amount of his total actual coverage ($100,000) and the total coverage he

believed existed ($160,000). She claimed that Allied, as administrator, had failed to provide Leyda with a summary plan description that would have notified him of the change.

On appeal, the Second Circuit found in favor of the plaintiff concluding that ERISA requires that a summary plan description be provided in a manner "likely to result in full distribution" and that the administrator must take steps "reasonably calculated to ensure actual receipt." The court concluded that a method of distribution that relies upon employee meetings where attendance is neither mandated nor taken did not satisfy this standard.

X. Death Benefit Issues

QDROs and Waiver Issues

So many plans become embroiled in the untangling of death benefit proceeds where a deceased participant has been married more than once. Often the problem arises due to the failure of the participant to change his/her original death beneficiary designation therefore leaving his/her various family members to argue over both the decedent/participant's intent as well as the effect of a divorce decree on the waiver or lack thereof of a former spouse's interest in the decedent's benefit.

A prime example is the case of Kennedy v. Plan Administrator for Dupont Savings and Investment Plan, 497 F 3d 426 (5th Cir. 2007) which the Supreme Court has now agreed to hear. The fact pattern, which is typical, involves a husband who had designated his first wife as the beneficiary of the company's Savings Investment Plan (SIP). The couple subsequently divorced after 23 years and pursuant to their divorce decree, his first wife agreed to be divested of "all right, title, interest and claim in and to…the proceeds therefrom, and any other rights related to any retirement …retirement plan, pension plan, or like benefit program existing by reason of [decedent's] employment." While a QDRO was prepared and approved, it did not discuss the SIP and no separate QDRO for the SIP was ever submitted. Moreover, the decedent never changed his death beneficiary designation form for the SIP designating his first wife as his sole beneficiary.

Upon the death of the decedent, the estate filed a claim for the SIP benefits, which Dupont denied relying upon the beneficiary designation. The estate filed suit claiming that the wife had waived her rights to the SIP as part of the divorce decree.

The district court awarded summary judgment to the estate concluding that federal common law applied to determine whether Kennedy's execution of the divorce decree waived her right to the SIP benefits; and, as a matter of law, that decree constituted a valid waiver.

On appeal, the Fifth Circuit concluded instead that the anti-alienation provision controls and the federal common law waiver approach was not applicable. Because, in the marital dissolution context, the QDRO provides the sole exception to the anti-alienation

provision, where the QDRO is not invoked, there is no basis to formulate a federal common law rule the court determined. Requiring the company to recognize the waiver where not in compliance with a QDRO would conflict with ERISA by purporting to determine rights to pension benefits in a manner not authorized by the QDRO provisions and not permitted by ERISA's anti-alienation provision. Accordingly, judgment was rendered by the court for Dupont.

The Supreme Court will hear the case in the upcoming term. In its amicus brief, the Secretary of Labor argues that the court of appeals reached the right result for the wrong reason. That is, the anti-alienation provision does not preclude a divorcing spouse from waiving her rights to pension benefits and the participant spouse can then give effect to that waiver by changing his/her beneficiary forms naming a different beneficiary. However, ERISA forbids, the brief argues, courts from imposing a federal common law rule that would require plans to recognize waivers, even where the participant has not taken steps necessary to change the designated beneficiary. [Brief for the United States as Amicus Curiae in Support of Neither Party, in the Supreme Court of the United States, Kennedy v. Plan Administrator for DuPont Savings and Investment Plan, et. al.]

Lesson Learned

Plans have every right to mandate that in the case of a divorce prior to the annuity starting date, the beneficiary designation previously on file remains in effect unless either a QDRO specifies otherwise or the participant validly completes a new beneficiary designation form or the participant remarries. [Treas. Reg. Section 1.401(a)-20, Q & A-25(b)(3)]. This is further supported by the position of the DOL in its amicus brief.

However, to reduce the opportunities for such litigations, plans should make this position clear in the summary plan description. Further, at some point in the QDRO process, either when the participant submits a draft order for certification as a QDRO or upon certification, the plan should also consider forwarding a packet that reminds the participant of this default rule and enclosing a new beneficiary designation form which the participant can be advised that he/she is certainly not required to complete, but which can be completed in the event that, subsequent to the divorce, the participant desires to change a previously filed beneficiary designation.

Beneficiary Designation Forms

Beneficiary designation forms are becoming more and more a part of the litigation landscape not the least of which is due to the lack of clarity contained in the form coupled with a plan or fiduciary’s acceptance of the form which can be perceived as tacit approval that the form is properly completed.

Multiple Beneficiaries

In the case of a beneficiary designation, forms will often provide for multiple beneficiaries without specifying any default allocation where the participant fails to

specify how multiple beneficiaries of equal rank are to share. This can occur, for example, where the form permits the designation of multiple primary beneficiaries but either the form fails to require, or an individual employee fails to so specify, the percentage to be provided to each. Does the plan document itself actually have a default procedure and if so, what is it? Whatever the procedure is, it should be communicated to participants as part of the form.

Spousal Consent in the case of Multiple Primary Beneficiaries

A profit sharing plan may avoid the joint and survivor requirements if, among other requirements, the plan provides that the death benefit beneficiary is the participant's surviving spouse unless the participant waives with the spouse's consent. [Treas. Reg. §1.401(a)-20, Q&A 3(b)] However, in the case of both the profit sharing designation as well as the designation for plans subject to the joint and survivor provision, the form should make it clear that spousal consent is required not only if someone other than the spouse is designated as the primary beneficiary, but also if someone is designated as the primary beneficiary in addition to the spouse. Often, however, the form used fails to make this restriction clear.

Notarization

Further, in order to avoid situations of plan officials or employees of the company who happen to be notaries acknowledging spousal consent after the spouse has signed, the forms should be drafted to encourage third-party notarization, rather than the acknowledgment by a plan official. Moreover, the notarization should require that the spouse sign in the presence of the notary. However, plans should be prepared to actually review the forms received and reject them when it is clear that the execution was not in compliance with the plan's rules. The problems that can result can be illustrated by the case of Sun Microsystems, Inc. v. Lema, 2006 WL 278386 (N.D. Cal.). The case was an interpleader action with both the decedent's six children and his widow claiming entitlement to the benefits.

The decedent, a participant in a plan maintained by Sun Microsystems, had, in 1989 designated his six children as the beneficiaries of his account. His wife, Seaoria, signed the designation on February 6, 1989 presumably consenting to the designation and waiving her rights. However, neither a plan representative nor a notary public was present at the time she signed and, instead, a plan representative signed the form 11 days later. Twelve years later, the participant died. Both the children and the spouse claimed entitlement to the death benefit with the widow asserting that the 1989 beneficiary designation form was invalid.

The form contained only a single paragraph concerning the "Consent of Spouse" stating that:

> "If you are married and wish to designate someone other than or in addition to your spouse, your spouse must sign this form. Your spouse's consent will reduce

the potential for contested distribution of your account balance in the event of your death."

The court held that the beneficiary designation was invalid for two reasons. First, the designation did not, the court concluded, describe or explain the right that the spouse is giving up, i.e.,the right to get all the money in the account. Secondly, the court held that the designation was invalid because the spouse's consent was not actually witnessed by a plan representative or a notary public as the representative signed after the fact. As such, the widow was held to be the sole beneficiary of the decedent's account.

Missing Information

James Marier, the decedent, had been a participant in the Alliant 401(k) plan and decided to remove his siblings from his will and instead designate his stepdaughter, Tracy, as his sole beneficiary. The Alliant plan provided that a beneficiary designation becomes effective when "executed by the Participant and received by the [Plan]." The plan further provided that it would give effect to a designation of a nonspouse beneficiary by name that is accompanied by a description of the beneficiary's relationship to the participant, even if the relationship no longer exist at the time of execution or distribution.

The decedent completed the first beneficiary designation form designating Tracy's mother, who was his then wife, as the primary beneficiary of his 401(k) and Tracy as his stepdaughter as the secondary beneficiary and listing their relationship as "step-daughter." After he and Tracy's mother divorced, the participant executed beneficiary designation number two designating his mother Rose as the primary beneficiary and Tracy as his secondary beneficiary, describing their relationship as "former stepdaughter." The participant then submitted a third beneficiary designation this time listing Tracy as the primary beneficiary, but failing to specify their relationship.

A few days later, the decedent underwent surgery. While in the hospital, Fidelity, the plan's third party administrative firm, returned his third beneficiary designation form with a checklist instructing him to complete the blank for relationship. Fidelity never received a corrected form, however, when Marier called Fidelity's customer service, he was informed that Tracy was his primary beneficiary and Marier confirmed that this was in fact his desire. Apparently, the customer service representative could not pull up a full scanned copy of the form and was therefore unaware of the failure to list the relationship.

After Marier died, both his mother Rose, and Tracy claimed the benefits. Tracy argued that the form designating her as primary beneficiary was substantially completed in all material respects. Alliant agreed and reasoned that the omission did not nullify the designation particularly given that the plan could identify the decedent's relationship with Tracy from the two earlier beneficiary designations.

Ultimately, Alliant interpleaded the funds and the district court found in favor of Rose. On appeal, the Eighth Circuit, after first concluding that the administrator's failure to make a final decision on appeal did not foreclose the abuse of discretion standard of

review, the court concluded that Alliant's decision that the third beneficiary designation was enforceable was entitled to deference.

The court holds that it will uphold an administrator's decision under the abuse of discretion standard if the determination is reasonable, based upon the examination of the following five factors: (1) whether the administrator's interpretation is consistent with the plan's goals; (2) whether the interpretation renders any of the plan's language internally inconsistent or meaningless; (3) whether the interpretation conflicts with ERISA's substantive or procedural requirements; (4) whether the administrator has consistently interpreted the terms at issue; and (5) whether the interpretation is contrary to the plan's clear language.

Applying these factors, the court concludes that the determination to hold the third beneficiary designation form enforceable despite the missing relationship information is consistent with the plan's goals of distributing a decedent's account in accordance with the participant's wishes and desires. Further, the court found that it was consistent with the plan's terms which provided that the beneficiary designation would be given effect when executed by the participant and received by the plan. Moreover, nothing in the plan or the package provided indicated that the failure to provide the relationship information would render the designation null and void. Similarly, while Fidelity sent Marier instructions to supply the missing information, it did not advise him that the form was null and void.

However, serious problems can indeed arise for plans where plans purport to require information as part of its beneficiary designation form and then appears to accept forms without that information.

Forms allowing attachments to complete designation

Finally, plans may wish to administer the receipt and maintenance of beneficiary forms to ensure that if the form calls for the attachment of an external form, such as, for example, a court signed separation agreement or an order of abandonment, that the participant is made aware that the beneficiary form is not deemed to be valid absent the attached document. This may avoid embroiling the plan needless over beneficiary fights.

For example, in Metropolitan Life Insurance Company v. Parker, 2006 U.S. App. LEXIS 2561 (9th Cir. 2006), the decedent/participant's former wife, surviving second wife and a child born to another woman born after the participant's death all claimed entitlement to some or all of the participant's ERISA covered life insurance proceeds.

At the time that he was still married to his first wife, the decedent, Parker, executed a will leaving his entire estate to his then wife, Marrero. The couple subsequently divorced. Parker then signed a Beneficiary Designation and Change Form regarding life insurance maintained on his life through his employer, Bank of America (previously Boatmen's Bank). The Change Form required that five boxes be completed: (1) name of the beneficiary designated; (2) relationship to the participant; (3) relationship code (which

consisted of six codes listed at the bottom of the page: “SP-Spouse”; “CH-Children”; “PA-Parent”; “TR-Trust”; “ES-Estate”, and “OT-Other”); (4) percentage of benefits to be allocated, and (5) Social Security Number, if available.

On the line for “Name”, Parker wrote “As indicated in My Will.” In the space provided under “Relationship Code” he wrote “ES” for estate. He then specified 100% of his benefits and left the remaining two boxes blank. However, no will was attached to the form, however, Bank of America accepted it as filed.

Approximately, 8 years later, Parker married again and he died a few months later. No evidence was found that he ever revised his 1990 will or his 1991 Beneficiary Designation Form.

Metlife, the issuer of the policies, filed an interpleader action in federal court and all three parties filed claims. The district court found that Parker had designated his estate as his beneficiary. Both of the wives appealed.

On appeal, the Ninth Circuit sought to make two determinations: (1) first, whether Parker made an unambiguous designation of a beneficiary, and (2) if he did not, whether the plan documents provide a default beneficiary.

The Ninth Circuit concluded that Parker’s beneficiary designation which referenced both his will and his estate was not unambiguous as it was impossible to tell, for example, whether Parker intended that the beneficiaries identified in the will would receive the proceeds only if the will was held to be valid in probate or whether he intended the proceeds to go to those beneficiaries without regard to whether the will was held to be valid under Arizona law. Since those who would benefit were different had the will been declared valid, rather than invalid, the decision was critical the court concluded. While the court concluded that a designation that provides for incorporation by reference is not per se invalid under ERISA, the court determined that Parker’s attempt was invalid as it failed to clearly identify the beneficiaries. Therefore, on different grounds, the Ninth Circuit also concluded that the designation “As Indicated in My Will” was ineffective.

The court was careful to stress that by its reference to the effect that Arizona law had on the designation, it was not ignoring the Supreme Court’s decision in Egelhoff v. Egelhoff, 532 U.S. 141 (2001) [holding that a Washington state law which automatically invalidated beneficiary designations running in favor of a former spouse in the event of a divorce was preempted by ERISA] Rather, the court states that it is merely using Arizona law to conclude that it cannot determine whether Parker intended to give effect to Arizona’s laws when he designated his beneficiary by incorporating by reference his will. That is, the use of Arizona law is not being used to force a result on the plan administrator, but rather, to determine whether the designation itself was unambiguous and therefore, valid.

Because the court concluded that Parker had made an invalid beneficiary designation, the court was then forced to move to the second question, i.e., whether the plan's provisions themselves provide a beneficiary designation. The court remanded the case to the district court to make a factual finding as to which of the competing plans put forth by the two wives for this purpose, actually governed.

XI. Dealing with LaRue

Background

As we know, the decision of the majority of the Supreme Court in LaRue v. DeWolff, Boberg & Associates, Inc., --U.S.---128 S. Ct. 1020 (2008) has now made it much easier for individual participants in defined contribution plans to sue plan fiduciaries for alleged fiduciary breaches that impair a participant's individual account, rather than the plan as a whole. Whether this will start a rash of litigation remains to be seen. However, in all events, plans will need to be prepared to review and possible revamp their administration as well as institute procedures designed to place the plan in the best possible position in the event of litigation.

Prior to the Court's decision, the majority of lower courts had concluded that ERISA Section 502(a)(2), (relying upon the Court's earlier decision in Massachusetts Mutual Life Insurance Company v. Russell, 473 US 134 (1985)), while allowing for suits for monetary relief, was only available where the alleged injury impacted the plan as a whole. This meant that in order for an individual participant in a Section 401(k) plan to file suit for monetary relief, that individual had to be able to demonstrate harm to the plan as a whole and that the individual was suing in a representative capacity. LaRue has now eliminated this particular impediment.

Facts of LaRue

The facts of LaRue involved an employee of DeWolff, Boberg & Associates, Inc., a nationwide management consulting firm, who was also a participant in the firm's Section 401(k) plan. Essentially, LaRue claimed that in 2001 and 2002, he directed DeWolff to make certain changes in the investments in his account under the plan but that the changes were never implemented and, as a consequence, his account had been "depleted" by approximately $150,000. LaRue sought "make whole" or other equitable relief.

Majority's Decision

Upon review by the Supreme Court, the Court assumed, for purposes of its analysis, that DeWolff and/or the plan breached their fiduciary obligations under ERISA Section 409(a) and that those breaches had an adverse impact on the value of the plan assets in LaRue's individual account. It should be noted, as the majority did, that whether LaRue can actually prove those allegations and whether DeWolff and/or the plan may have valid

defenses to the claim were not matters before the Court. This means that ultimately, on remand, LaRue will still have a significant burden if he is to prevail on the merits.

Although the case on its face would appear to be decided by Russell, the majority distinguishes LaRue from Russell in two ways. First, the Court concludes that the facts in Russell, even if true, did not allege facts that would come within the purview of ERISA Section 409, a perquisite to a filing under ERISA Section 502(a)(2)) as they did not allege violations that relate to the proper management, administration and investment of assets. This, the majority concludes, is distinguishable from the facts of LaRue where the alleged offenses fall squarely within this category. That is, the plaintiff in Russell received all of the benefits to which she was contractually entitled but alleged consequential damages arising from a delay in the processing of her claim.

Secondly, the Court distinguishes Russell based upon the types of plans involved. The majority concludes that the Court's language or Russell, relying upon damage to the entire plan was necessary in a world where most retirement plans were pension plans but not here where most retirement plans are now individual account plans. That is, the Court surmises that misconduct by a plan fiduciary in a defined benefit context will not affect an individual participant's rights to payment from the plan unless the abuse creates or enhances the risk of default by the entire plan. On the other hand, however, in an individual account plan, such as the one in LaRue, fiduciary misconduct need not threaten the solvency of the entire plan to reduce benefits below the amount which, absent the misconduct, the participant would otherwise receive. It does however, create the kind of harm that the drafters of ERISA Section 409 were concerned about. Consequently, the Court concludes, its references to the "entire plan" in Russell, which accurately reflected the operation of Section 409 in the context of a defined benefit plan, are beside the point when dealing with a defined contribution plan.

The Court found additional support for this conclusion that the phrase "entire plan" as used in its analysis in Russell was not intended to apply in the context of a defined contribution plan in ERISA Section 404(c). The Court notes that ERISA Section 404(c) exempts fiduciaries from liability for losses caused by participants' exercise of control over assets in their individual accounts. This provision, the Court reasons, would be unnecessary and serve no real purpose if, as the respondents argued, fiduciaries never had any liability for losses in an individual account.

The Roberts Concurring Opinion

Justice Roberts, joined by Justice Kennedy, writes a separate opinion concurring in the judgment but not in the reasoning. The Roberts concurring opinion appears to provide a roadmap for both the lower court on remand as well as subsequent defendants to argue that the LaRue claim should have instead been filed as a claim for benefits filed instead under ERISA Section 502(a)(1)(B). That is, at its essence, according to Roberts, LaRue's claim comes down to seeking the benefits that would have been due him had his instructions been properly followed.

The Thomas Concurring Opinion

In yet another separate concurring opinion, Justice Thomas, in an opinion joined by Justice Scalia, concludes that the statute on its face allows for LaRue to proceed under ERISA Section 502(a)(2) because, in the context of a defined contribution plan, the loss to an individual participant's account indeed constitutes "losses to the plan" within the plain meaning of the statute.

Lessons Learned

While no one can prevent a rash of individual suits by participants, plans should take steps now to place themselves in the best possible position. This might involve the following options.

Review Administration Issues

First, plans should review their administration and particularly the manner in which participant investment direction is provided, checked and implemented. Any slips, delays or inaccuracies in the process should of course be corrected.

Participants in the DeWolf plan, although allowed to direct the investment of their accounts, were apparently required to do so by providing instructions to the plan administrator who was then responsible for implementing. This is a disaster waiting to happen particularly in a plan of any size. A system that requires a plan official to act as an intermediary, rather than allowing individual participants to implement their own investment choices, certainly leaves the plan open to these types of failures.

DeWolf may well have adopted this process in order to comply with the letter of ERISA Section 404(c) which requires that:

> "Under the terms of the plan, the participant or beneficiary has a reasonable opportunity to give investment instructions (in writing or otherwise, with an opportunity to obtain written confirmation of such instructions) from an identified plan fiduciary who is obligated to comply with such instructions…." [Labor Reg. Section 2550.404c-1(b)(2)(i)(A)]

It can be argued that these regulations, drafted years ago, really are not reflective of what most plans actually do in a word that includes internet access and voice response systems. Indeed, if every arrangement that does not impose a fiduciary between the participant's instructions and their implementation can be said to fail to satisfy the requirements, it would likely be impossible for any large plan to ever constitute an ERISA Section 404(c) arrangement.

However, given the fact that these regulations remain the governing guidance, plans may well prefer to attempt to draft governing documents in such a way that the plan can still argue that it is in compliance with this requirement. Where the plan's investment provider

is itself a plan fiduciary, this requirement is likely satisfied without more. If that is not the case, the plan may need to add language to the plan document and participant disclosures specifying that a participant will be deemed to have provided instructions to the requisite plan official at such time that trades are given via internet or voice response system provided that the instructions are otherwise made in accordance with the plan's governing rules and the instructions applicable to the technology used. Further, the receipt or acknowledgement provided by that technology will be deemed to constitute confirmation. That is, solely for purposes of ERISA Section 404(c), the provision of instructions through such a technical system will be deemed the provision of instructions to the applicable plan official. There would need to be disclaimers ensuring that the participant understands what happens in the event of failures of technology or in similar circumstances.

Moreover, since the regulations only require that participants be given a "reasonable opportunity" to provide the instructions and to obtain confirmation from an identified plan fiduciary, it is likely that if this option is provided fully to participants by an actual plan official, but participants are also allowed to proceed directly through self implementation via internet and/or voice response systems, few will likely pursue the option to have investment instructions given to a plan official.

Moreover, by reducing the opportunity for such missteps, even at the cost of being not technically within the letter of the regulations on this point, the plan may ultimately benefit in the long run. Any plan of significant size that attempts to require a plan fiduciary to actually implement the investment decisions of its plan participants is courting future mistakes.

Moreover, since compliance with the regulations under ERISA Section 404(c) status is a safe harbor, but not the sole way in which to obtain ERISA Section 404(c) status, a plan may still be able to argue either the protections of the statute in the event of litigation or even that under other sections of ERISA, a participant who is given a reasonable opportunity to control the investment of his/her account remains solely responsible for the direct and necessary results that flow from the participant's own investment decisions. At least one court has held that ERISA Section 404(c) status is not the sole statutory basis upon which ERISA provides relief to fiduciaries in such a case. [Jenkins v. Yager, 2006 WL 956944 (7th Cir. 2006)]

In all events, post LaRue, plans should undertake an administrative audit to determine first what processes the plan document and summary plan description and other disclosure documents purport to follow and to identify and correct any disconnect.

Subjecting Errors to the Plan's Claims Procedures

In line with the Roberts' concurring opinion, plans may wish to make it clear via summary plan descriptions and other participant disclosures, that a participant who believes that there has been an error in the implementation of his/her investment instructions should proceed under the plan's claims review procedure. Moreover, the plan

should make it clear that should a participant raise any such allegation, the plan will, upon its own motion, treat such an allegation as a claim for benefits subject to its claims review process. Successful treatment of such alleged failures as subject to the plan's claims review procedure yields two important results. First, the participant would not be allowed to proceed directly to court without first exhausting the plan's administrative procedures. This, in turn, gives the plan both the opportunity to resolve the dispute without incurring litigation expenses while also generally creating a record that most courts conclude can not be supplemented at the trial level with additional facts.

Secondly, and most importantly, such a procedure also means that provided the plan contains language granting the claim's administrator discretionary authority, any court's review will be subject to the lower standard of review of arbitrary and capricious.

Subjecting Alleged Errors to a Plan-Imposed Limitations Period

Plans may wish to not only treat an allegation of error in the implementation of participant investment direction as a claim for benefits, but further may wish to subject such claims to a plan imposed limitations period for pursuing litigation. This combination may well serve to significantly reduce the potential for future litigation involving such issues.

Review the Potential for Assessment and Allocation of Liability

Plans should keep LaRue in mind when reviewing and negotiating their agreements with third-party vendors to ensure that liability can be properly assigned.

In addition, given the potential for increased litigation, plans should review the level of their fiduciary liability insurance to ensure that it is adequate.

XII. 401(k) Enrollment Forms

Elective deferrals to a Section 401(k) plan (aside from catch-up contributions) may not exceed the Section 402(g) limit in effect for the calendar year. The regulations provide guidance on correcting excess deferrals. Where correction is made after the close of the taxable year, correction requires that the individual notify the plan, not later than April 15 (or an earlier date specified in the plan) under which excess deferrals were made of the amount of excess deferrals received by that plan. [Treas. Reg. §1.402(g)-1(e)(2)(i)] As a result of the use of the special coverage exception of Treas. Reg. §1.410(b)-6(b)(3) (allowing a plan that contains a more liberal eligibility requirement than that imposed by the statutory minimum to test the plan as two plans: one benefiting the employees who satisfy the statutory minimum and the other for those who can only satisfy the more liberal rules), more and more plans are allowing employees to participate in the 401(k) portion of a plan at earlier times. For example, the plan may allow employees to begin participating immediately as of the first day the individual performs an hour of service for the company.

In so doing, however, plan sponsors must not forget that the individual may have already made contributions during the initial calendar year into another Section 401(k) plan of another employer.

As such, in order to ensure compliance with Section 402(g), the plan's enrollment form should be reviewed to determine whether it requires the employee to specify whether elective deferrals have already been made to any other Section 401(k) plan during the calendar year and, if so, the level of such contributions.

XIII. Allowing Rollovers to Service Provider Vehicles

The suit against Principal Financial Group styled Young v. Principal Financial Group, Inc., No. 4:07-cv-00386 may well signify a new wave of litigation. While the current suit names Principal Financial and not the plan sponsor or other fiduciaries, future litigation might seek to ensure such officials. This might prove particularly appealing should the court ultimately conclude that participants cannot sustain their suit against Principal because Principal is not a fiduciary.

Plaintiffs allege that Principal, while providing third party services to their employers' retirement plans, advised terminating employees to rollover into products offering a "limited list of high-fee proprietary products" which they vigorously pushed participants to buy. The plaintiffs allege that near the time each plaintiff retired from their employer, each received a letter from Principal signed by someone in the "Retirement Planning Division" advising them that their "change in employment require[d] an adjustment to 'their] retirement account status." Plaintiffs alleged that they were told to call a specific number and each claims that they were mislead by the letter into believing that the call would be answered by a pension administration counselor rather than a sales representative. Ultimately, plaintiffs rolled into investment products which they now assert were high fee proprietary products. The plaintiffs assert that Principal effectively serves as an ERISA fiduciary.

It is still quite early in the process, but the case has been allowed to proceed currently under ERISA Section 502(a)(3).