AALU GAMA INTERNATIONAL

WRMarketplace

An AALU/GAMA Washington Report

The WRMarketplace is created exclusively for AALU/GAMA members by experts at Troutman Sanders and the AALU/GAMA staff. WR Marketplace #20-14 was written by **Jim Earle and Christopher Stock.**

The AALU/GAMA WR Newswire and WR Marketplace are published by AALU/GAMA as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU/GAMA members—the nation's most advanced life insurance professionals.

---

**Thursday, July 23, 2020** **WRM#20-14**

**TOPIC: Defined Benefit Pension Plans Face Less ERISA Fiduciary Risk Under Recent Supreme Court Decision**

**MARKET TREND**: In *Thole v. U.S. Bank N.A.*, decided in June 2020 in a 5-4 decision, the Supreme Court held that participants in a defined benefit pension plan lacked constitutional standing to sue the plan's fiduciaries for alleged breaches of their ERISA fiduciary duties in managing plan assets.

**SYNOPSIS:** In *Thole*, the participants claimed that their employer had mismanaged the investment of plan assets backing up the employer's defined benefit pension plan governed ERISA, resulting in over $750 million in excess losses during the 2008/2009 financial crisis and causing the plan to go from overfunded to underfunded. But by the time the case was heard, additional funding contributions and investment performance returned the plan to being overfunded. The Supreme Court held that the participants lacked standing under Article III of the U.S. Constitution to sue the plan's fiduciaries based on losses to the plan that did not result in an individual financial injury. The Court explained that plaintiffs lacked such an injury because, regardless of the alleged investment losses to the plan, plaintiffs will receive the exact same monthly payments they are already entitled to receive, whether they win or lose the case. As a result, plan participants in a defined benefit pension plan alleging breach of ERISA fiduciary duties as to investment of plan assets will have a difficult time establishing standing, likely ending such participant claims in all but the most extreme circumstances.

**TAKEAWAYS:** Although the *Thole* decision affords fiduciaries of defined benefit pension plans additional protection from claims for breaches of their ERISA fiduciary duties, fiduciaries should remain vigilant of their duties. The PBGC and the Department of Labor (DOL) may still enforce such claims. *Thole* also explicitly does not apply to ERISA fiduciary breach claims related to 401(k) and other defined contribution plans.

---

**Background**

ERISA imposes significant duties on the fiduciaries who oversee employee benefit plans, particularly fiduciaries who oversee and manage the investment of trust assets for tax-qualified retirement plans. The duties include a duty of loyalty (i.e., to act for the exclusive benefit participants and their beneficiaries) and a duty to act prudently. Courts like to say that ERISA fiduciary duties are the highest duties known to law.

In recent years, fiduciaries of 401(k) and other defined contribution plans have faced significant litigation—alleging ERISA fiduciary breaches and challenging 401(k) plan investments, investment fees, and vendor expenses.[1] But can similar claims be made against fiduciaries of defined benefit pension plans? The U.S. Supreme Court, in *Thole v. U.S. Bank N.A.* (June 1, 2020), says no, in most cases. This article explains this decision and implications to plan sponsors of defined benefit plan going forward. *Thole* does nothing, though, to limit the scope of ERISA fiduciary breach claims for 401(k) plan fiduciaries.

**The Lead-Up to the Supreme Court's Decision**

The *Thole* plaintiffs, James Thole and Sherry Smith, were retired participants in the U.S. Bank Pension Plan (the "Plan"). As retirees and vested participants in the Plan, each received a specified amount of monthly retirement benefits for life under the Plan's benefit formula. In a defined benefit pension plan, participants are entitled to a fixed periodic payment. According to the Court, the participants at all times received their promised benefits, and no facts were alleged that their benefits would not be paid.

The participants alleged that the fiduciaries who oversaw the investment of the trust assets for the Plan breached their ERISA fiduciary duties of loyalty and prudence. They said that U.S. Bank caused the Plan to be invested 100% in equity strategies for a period of time into 2007, and that certain investments were in U.S. Bank proprietary investment funds. When the 2008/2009 financial crisis hit, they say the Plan lost over $1 billion dollars, and as a result the Plan went from being from overfunded (i.e., having more assets than benefit liabilities) to underfunded. They alleged that these loses were about $750 million more than they would have been had a prudent investment strategy been used. They also alleged that the strategy was used to benefit U.S. Bank and its shareholders, rather than Plan participants. In the plaintiff's complaint, they requested (i) that U.S. Bank repay the Plan approximately $750 million in Plan loses, (ii) removal the Plan's fiduciaries, (iii) an injunction against the use of the 100% equity investment strategy, and (iv) $31 million in attorney's fees.

U.S. Bank argued that the participants did not have standing to sue, because they had not alleged any harm caused to them by defendants' actions. "Standing" refers to whether a plaintiff has alleged a

---

[1] See our Marketplace article from March 2019, *401(k) Fiduciary Litigation: Morals from the Story*

harm that can be redressed by the courts. U.S. Bank argued that the participants had been paid, and were continuing to be paid, their entire Plan benefit, and therefore had not been harmed. Initially, the District Court found that the participants did have standing to sue, because the Plan was underfunded, and the participants may have been harmed given that the alleged breach decreased their benefit security. But during the course of the litigation, the Plan went from being underfunded to overfunded, the result of additional contributions by U.S. Bank and investment performance. Once the Plan was overfunded, the District Court changed its mind and determined that the plaintiffs' claims were now barred because they were moot. Their claims were dismissed. On appeal, the U.S. Court of Appeals for the Eighth Circuit affirmed the dismissal on the grounds that the plaintiffs lacked standing to bring the suit.

**The Supreme Court's Decision**

On June 1, 2020, a 5-4 majority of the Supreme Court affirmed the Court of Appeals ruling on the ground that the plaintiffs lacked standing under Article III of the U.S Constitution. As the Court explained, Article III requires that a plaintiff demonstrate (1) that he or she suffered an injury in fact that is concrete, particularized, and actual or imminent, (2) that the injury was caused by the defendant, and (3) that the injury would likely be redressed by the requested judicial relief.

Justice Kavanaugh, writing for the majority, reasoned that, "Thole and Smith have received all of their monthly benefit payments so far, and the outcome of this suit would not affect their future benefit payments. If Thole and Smith were to lose this lawsuit, they would still receive the exact same monthly benefits that they are already slated to receive, not a penny less. If Thole and Smith were to win this lawsuit, they would still receive the exact same monthly benefits that they are already slated to receive, not a penny more." In essence, the plaintiffs had not experienced an "injury in fact" to establish standing under Article III. The Court noted, however, that if the plaintiffs had not received all of their vested pension benefits, then they would have had standing to sue and a cause of action under ERISA §502(a)(1)(B).

The plaintiffs advanced four alternative arguments, but the Court rejected each of them.

First, the plaintiffs argued that, similar to beneficiaries of a trust, the Plan participants have standing to sue for breaches of fiduciary duty, even if the Plan participants have not suffered any monetary harm. The Court rejected that argument reasoning that defined benefit pension plans are more contractual in nature than a trust, because the value of the participants' benefits is fixed and not tied to the value of the plan or how well the plan is managed. Moreover, the onus over the value of the plan is on the plan sponsor, not the participants, meaning the plan sponsor is entitled to any surplus assets but is also obligated to cover any shortfall. Thus, the Court concluded that in the absence of a monetary loss, the participants in the Plan "possess no equitable or property interest in the plan."

Second, the plaintiffs contended that they had Article III standing to sue because they are representative of the Plan. However, the Court rejected this contention concluding that in order to claim standing based on the interests of others, absent some special legal relationship, the plaintiffs still must demonstrate they suffered an "injury in fact" on account of the fiduciary breach. Thus, the Court reasoned that the plaintiffs here do not have a financial interest in the outcome of the case.

Third, the plaintiffs argued that that they have standing because ERISA created a general cause of action for participants and beneficiaries to sue for restoration of plan losses and other equitable relief. The Court disagreed, stating "Article III standing requires a concrete injury even in the context of a statutory violation."

Fourth, the plaintiffs contended that "if defined-benefit plan participants may not sue to target perceived fiduciary misconduct, no one will meaningfully regulate plan fiduciaries" and for that reason they must have standing. Nevertheless, the Court noted that it "has long rejected" that type of argument for Article III standing. The Court further explained that the argument fails because defined benefit pension plans are regulated and monitored in multiple ways. In particular, the Court noted that employers and their shareholders are incentivized to monitor the plan for any fiduciary misconduct because employers are entitled to the plan surplus but obligated to restore any shortfall. Moreover, the DOL is expressly authorized under ERISA to enforce fiduciary obligations and is also incentivized to carry out these initiatives because failing to do could result in the plan and its liabilities being assumed by the Pension Benefit Guaranty Corporation ("PBGC"). As such, the Court concluded that, "under ERISA, fiduciaries who manage defined-benefit plans face a regulatory phalanx."

The Court declined to address the argument by the DOL in support of the plaintiffs, which advocated that participants in defined benefit plans may have Article III standing "if the mismanagement of the plan was so egregious that it substantially increased the risk that the plan and the employer would fail and be unable to pay the participants' future pension benefits," because the plaintiffs did not raise that argument in their brief to the Court. The Court also noted that, although the Plan was underfunded for a time, "a bare allegation of plan underfunding does not itself demonstrate a substantial increased risk that the plan and the employer would both fail."

Justice Sotomayor, writing for the four dissenting justices, contended that participants in the Plan do suffer a harm when a fiduciary fails to invest plan assets prudently and for the exclusive benefit of participants, as otherwise required by ERISA and the express terms of the Plan. She noted that the Court's decision could make defined benefit plans subject to greater risk of fiduciary breaches since participants and beneficiaries will unlikely be able to assert standing to enforce such claims on behalf of the plan.

## ***Thole* Implications**

The *Thole* decision should serve as a welcome reprieve to fiduciaries of defined benefit pension plans. As a result of this decision, it will be difficult for plaintiffs to bring fiduciary breach claims against fiduciaries of defined benefit pension plans that meet ERISA's minimum funding requirements. Plaintiffs have a high burden to show that, due to the fiduciaries' breach, the participant will not receive their individual entitlement under the plan. Moreover, even in an underfunded plan, it will be difficult to establish standing because plaintiffs have a contractual right to receive a certain amount under the plan, regardless of the fiduciary's management decisions. Unlike a defined contribution plan, where any fiduciary breach resulting in loss to the plan is borne by the participants, in a defined benefit pension plan any funding shortfall must be covered by the employer.

However, the Court did leave open the question of whether participants could establish standing where the management of the plan is so egregious that the plan and the employer may not be able to pay the benefits of the plan, putting payment of the individual's benefits in jeopardy. Further, the Court declined elaborate on what level of risk of actual injury that plaintiff must face to establish standing as a result of fiduciary's breach. The Court notes that "[e]ven if a defined-benefit plan is mismanaged into plan termination, the federal [PBGC] by law acts as a backstop and covers the vested pension benefits up to a certain amount and often in full." The Court takes this one step further and suggests that the only way participants in that situation could sue is if their benefits were not "guaranteed in full by the PBGC."

Despite the *Thole* decision, plan fiduciaries do not enjoy blanket immunity. As the Court noted defined benefit pension plan fiduciaries are subject to regulatory scrutiny from the DOL and PBGC. Defined benefit pension plans are subject to minimum funding requirements and significant reporting and disclosure requirements. Failure to adhere to these requirements could result in the PBGC assuming assets and liabilities of the plan and fiduciaries could face potentially severe penalties from the DOL for breaches of fiduciary duties.

As a result, fiduciaries of defined benefit pension plans should continue to follow fiduciary best practices as to investment of plan assets, such as adopting and following an appropriate investment policy statement, having regular meetings to review investment performance, keeping an eye on plan expenses, and ensuring that the plan and other parties in interest do not engage in prohibited transactions.