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Legal Sidebar

Foxes, Henhouses, and Pension Plans: Supreme Court Concludes Pensioners Receiving Promised Benefits Can't Sue for Retirement Plan Mismanagement

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In early June 2020, the Supreme Court handed down its decision in *Thole v. U.S. Bank* concerning the ability of pension plan participants to sue plan fiduciaries who engage in alleged misconduct. In *Thole*, the Court's majority held, in a 5-4 decision, that pensioners receiving the full amount of their retirement benefits lacked standing to sue plan fiduciaries for self-dealing and mismanagement of pension plan investments. This Legal Sidebar provides background on federal pension plan regulation under the Employee Retirement Income Security Act (ERISA) and standing to sue in federal courts; discusses the Court's decision in *Thole*; and concludes with selected legal considerations for Congress.

Background

ERISA's Regulation of Pension Benefits

ERISA provides a comprehensive federal scheme for regulating private-sector employee benefit plans, and currently governs approximately 710,000 retirement plans. The Act does not require employers to offer pension benefits, but those that do must comply with the Act's requirements. In general, ERISA regulates two types of pension plans: defined benefit plans and defined contribution plans. The *Thole* case involves a defined benefit plan, which "consist[s] of a pool of assets, rather than individual dedicated accounts." In a defined benefit plan, an employee is promised a specified future benefit (traditionally, an annuity beginning at retirement) based on factors such as the employee's salary, age, and years of service. ERISA generally requires the employer to fund a defined benefit plan adequately, invest plan assets and bear the risk for such investments, and compensate for any shortfalls. Should a defined benefit plan be terminated with insufficient funds to pay retirement benefits, the Pension Benefit Guaranty Corporation (PBGC) pays certain guaranteed benefits to plan participants, subject to statutory limits.

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By contrast, a defined contribution plan (e.g., a 401(k) plan) is a retirement plan in which the contributions, but not the benefits, are specified. These plans provide each participant with an individual account that accrues benefits based on employer and employee contributions, as well as any income, expenses, and investment gains or losses to the account. The employee bears the investment risk, and the account value at the time of retirement may fluctuate or decline over time. Defined contribution plan benefits are not PBGC-insured.

Over the past few decades, there has generally been a steady decline in the number of defined benefit pension plans, while the number of defined contribution plans has continued to increase. According to 2017 data from the Labor Department, there are approximately 35 million participants in defined benefit plans, and over 102 million participants in defined contribution plans.

A central goal in enacting ERISA was to "protect . . . the interests of participants and . . . beneficiaries" of employee benefit plans and assure that participants receive promised benefits from their employers. To this end, ERISA imposes certain obligations on plan fiduciaries—persons who are generally responsible for the management and operation of employee benefit plans. Fiduciaries must adhere to standards of conduct, which include a duty of loyalty, prudence, and diversification of plan investments. ERISA also "provid[es] for appropriate remedies, sanctions, and ready access to the Federal courts." Under the Act, private parties as well as government entities can bring various civil actions to enforce ERISA's provisions. Among these enforcement provisions, ERISA authorizes the Secretary of Labor, a participant, a beneficiary, or another plan fiduciary to bring a civil action to redress a breach of fiduciary duty. ERISA makes a plan fiduciary personally liable for breaches against an ERISA plan, and a breaching fiduciary may have to return "any losses to the plan resulting from a breach" and restore to the plan any profits made from misusing plan assets.

Standing to Sue

Before a court can decide issues under ERISA or any other federal statute, it must determine whether it has jurisdiction to examine the issues in the case. As part of this inquiry, plaintiffs must convince a court that they have standing under Article III of the Constitution to bring the legal action. Standing requirements generally involve determining the proper party to seek relief from a federal court. These requirements compel a plaintiff to demonstrate, among other things, an injury that is "concrete and particularized." As the Supreme Court has explained, such injury must be "real" and "not abstract," and "it must affect the plaintiff in a personal and individual way." While Congress has the power to give a plaintiff the right to sue under a federal statute (so-called "statutory standing"), such a statutory right does not automatically confer constitutional standing under Article III. The Supreme Court has declared that plaintiffs must demonstrate a cognizable injury under Article III even when there is a statutory violation.

The *Thole* Decision

In *Thole*, two retired participants in U.S. Bank's defined benefit pension plan filed a class action lawsuit, claiming the company and others violated ERISA's fiduciary duty and other requirements by improperly investing the plan's entire portfolio in high-risk equities (including a large portion in mutual funds managed by the company's subsidiary) and paying themselves excessive fees. The retirees further claimed that this investment strategy resulted in approximately $750 million in losses to the plan and caused the plan to be underfunded. The participants sought various remedies in federal court, including a restoration of the losses to the plan and removal of the allegedly offending fiduciaries. However, as the litigation proceeded, U.S. Bank made a large contribution to the plan that allowed the plan to meet ERISA's minimum funding standards. This change to the plan's funding status spelled doom for the participants' case. Because the plan was no longer at risk of default, the district court dismissed the retirees' case as moot. The U.S. Court of Appeals for the Eighth Circuit affirmed the district court's decision, but on the grounds that ERISA does not authorize plan participants to sue for a breach of fiduciary duty when the plan is adequately funded.

In comparison to the Eighth Circuit, which held that the participants lacked *statutory standing* under ERISA, the Supreme Court in *Thole* affirmed the judgment of the Eighth Circuit because the plan participants did not have *constitutional standing* to bring a case against the plan fiduciaries. Justice Kavanaugh, writing for the Court's majority, concluded that the plan participants did not have constitutional standing "for a simple, commonsense reason: [t]hey have received all of their vested pension benefits so far, and they are legally entitled to receive the same monthly payments for the rest of their lives." As the Court explained, because the plan participants receive the same level of benefits regardless of the case's outcome, they had no concrete injury to support their standing to sue.

The plan participants in *Thole* asserted, among other arguments, that they had constitutional standing to sue because they have an interest in the plan's assets as a whole, and that injuries to the plan constitute injuries to individual participants. The Court rejected this argument, observing that, because the participants' benefits are fixed and independent of the plan's value, the participants had no cognizable interest in the plan itself. The participants also argued that they had standing to sue because they were the only party that could meaningfully police the plan fiduciary's conduct. The Court refused to accept this argument as supporting Article III standing, explaining that defined benefit plan fiduciaries "face a regulatory phalanx," including regulation and monitoring by the Labor Department and other co-fiduciaries.

Justice Sotomayor authored a dissent in *Thole*, joined by three other Justices. As the dissent put it: "Does the Constitution compel a pension plan to let a fox guard the henhouse? Of course not." Disagreeing with the Court's majority, the dissent indicated, among other things, that the plan participants could sue to protect their interests in their pension plan's assets. In the dissent's view, "because petitioners have an interest in payments from their . . . [pension] fund, they have an interest in the integrity of the assets from which those payments come." The dissent further maintained that the participants had standing to sue because a breach of fiduciary duty is an injury to the participants, regardless of financial loss.

Legal Considerations

The Court's ruling in *Thole* appears to restrict the circumstances in which defined benefit plan participants can sue pension plan fiduciaries for making allegedly poor investment decisions, particularly when the amount of the participants' pension benefits is unaffected by those decisions. While constitutional standing requirements may prevent plan participants from bringing legal actions against plan fiduciaries under these circumstances, the *Thole* decision does not curtail the authority of the Labor Department or other plan fiduciaries to sue to enforce ERISA's fiduciary responsibilities. Additionally, it is possible that the *Thole* case may have limited application in fiduciary breach cases involving more prevalent *defined contribution* plans. As the Court recognized, defined contribution plans are structured differently—unlike defined benefit plans, the value of defined contribution plan accounts may fluctuate based on a fiduciary's investment choices. Because of this key difference, plan participants in these cases may have an easier time demonstrating their standing to sue.

Going forward, a "wrinkle" in the *Thole* case may be the subject of future litigation. In its majority opinion, the Court pointed to an argument of the plan participants' amici: that the participants would have constitutional standing to sue when "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." The Court contended that the plan participants in *Thole* did not allege this theory of standing, and that a "bare allegation" of plan underfunding did not demonstrate this risk of default on pension obligations. Based on this language, the Court arguably seems to imply that there could be cases in which defined benefit plan participants could sue plan fiduciaries despite receiving promised benefits, assuming the participants can show that their benefits were in substantial jeopardy.

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