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Direct Action Theory: Should a Single 401(k) Participant Be Allowed to Sue on Behalf of All Participants Without Certifying a Class Action?

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In the past decade, it has become increasingly common for 401(k) plan participants to sue plan fiduciaries for alleged mismanagement of plan assets. For a variety of reasons, participants have generally filed these actions under ERISA Section 1132(a)(2) to recover alleged losses to their plan. Initially, plaintiffs claimed that fiduciaries should not have allowed participants to invest in company stock funds. More recently they have challenged that plan investment management or administrative fees are excessive and/or that fiduciaries selected imprudent investment options. Almost uniformly, participants have sought

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to prosecute these lawsuits as class actions. But, increasingly, plaintiffs have advanced a new "direct action" theory as an alternative to class actions as they have experienced difficulty obtaining certification.[1]

Simply put, the theory is that ERISA Section 1132(a)(2) authorizes a single 401(k) plan participant to sue to recover all plan-wide losses—that is, losses allegedly suffered in tens or hundreds of thousands of other *participants' accounts—without satisfying the procedural protections embodied in Rule 23, joining affected participants, or indeed even giving them notice of the action. The direct action theory, if accepted, would upend historic notions of due process and work a sea change in ERISA fiduciary litigation. Thus, this article argues that Constitutional considerations, as well as ERISA's language, structure and history, strongly suggest that courts ought to reject the direct action theory and instead hold 401(k) plaintiffs to Rule 23's well-tested class action procedures when they seek to adjudicate losses supposedly suffered by other participants.*

BACKGROUND REGARDING CLAIMS FOR BREACH OF FIDUCIARY DUTY UNDER SECTION 1132(A)(2)

A plan fiduciary's potential liability for breach of fiduciary duties is set forth in ERISA Section 1109, which provides that:

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.[2]

ERISA Section 1132(a)(2) in turn allows the Secretary of Labor, a "participant, beneficiary, or fiduciary" to file suit seeking relief under Section 1109 for alleged breaches of fiduciary duty.[3] Until 2008, based on the Supreme Court's decision in *Massachusetts Mutual Life Insurance Co. v. Russell,* courts had generally allowed suits under Section 1132(a)(2) only where the recovery would benefit the plan "as a whole."[4] Thus, individual participants could not sue under Section 1132(a)(2) to recover for breaches of fiduciary duty that damaged only the individual participant; they were confined instead to Section 1132(a)(3) with its more limited remedial provisions.[5]

In *LaRue v. DeWolff, Boberg & Associates, Inc.,* however, the Supreme Court rejected this interpretation of Section 1132(a)(2), at

least for participants in individual account plans.[6] LaRue sued the fiduciaries of his 401(k) plan under Section 1132(a)(2), alleging that they had failed to follow his investment decisions, causing his 401(k) account to lose approximately $150,000. The Fourth Circuit affirmed the district court's dismissal of his suit, holding that LaRue's Section 1132(a)(2) action was not permitted under *Russell,* because it would benefit only LaRue's account.[7] The Supreme Court rejected this decision, holding that a loss in LaRue's individual account was a "loss to the plan" that could be remedied under Sections 1109 and 1132(a)(2). As a result, it is now clear that 401(k) participants have the ability individually to sue under Section 1132(a)(2) for losses caused to their own plan accounts and need not sue only to recover losses to the plan "as a whole."

THE DIRECT ACTION THEORY UNDER SECTION 1132(A)(2)

The direct action theory is that any 401(k) plan participant can bring an *individual* action to recover all plan losses—that is, losses in other participants' accounts—without certifying a class, joining affected participants, or even giving them notice of the action. The theory proceeds from a very simplistic and essentially pre-*LaRue* interpretation of the statute. Section 1132(a)(2) authorizes "a participant" to bring suit under Section 1109 to recover "losses to the plan." Since the phrase "losses to the plan" is not qualified, plaintiffs argue that Section 1132(a)(2) must allow "a participant" to sue for *all* plan losses. In support of this interpretation, plaintiffs have relied on *Russell*'s pronouncement that Section 1132(a)(2) was meant to protect the plan "as a whole."[8] Furthermore, because a House draft of the provision would have made class actions mandatory, while the final enacted version of Section 1132(a)(2) is silent as to class actions, plaintiffs argue that a participant need not seek class certification to proceed on behalf of all other participants.[9]

Only one circuit court has addressed this argument. In *Coan v. Kaufman*, based on ERISA's legislative history, the Second Circuit held that an individual plan participant could sue in a representative capacity on behalf of other plan participants without necessarily seeking class certification.[10] Instead, the Second Circuit concluded that a plaintiff could sue on behalf of absent participants so long as the plaintiff took certain, unspecified "adequate steps under the circumstances properly to act in a 'representative capacity.'"[11] A number of district courts have followed *Coan* without reevaluating its holding in light of *LaRue* and without addressing any of the other problems with the opinion. These courts also have not specified what procedures must be followed to protect absent participants—though all agree that some procedures are necessary to protect them.

Constitutional considerations, however, as well as ERISA's language, structure, and legislative history, all undercut the direct action theory and suggest that circuit courts ought to reject *Coan*'s reasoning and require a 401(k) participant to proceed as a class action under Rule 23 if the plaintiff seeks to bind other participants (and by extension the defendants) in any judgment. As this article argues, the direct action theory carries substantial Article III standing and due process problems. In addition, it necessarily rests on a statutory interpretation that ignores *LaRue* and other important sections of the statute. Also, *Coan*'s crucial decision that ERISA's legislative history indicates that a participant need not proceed as a class action is mistaken and logically flawed. In other words, Section 1132(a)(2) should not be interpreted to authorize a direct action on behalf of absent plan participants without satisfying the requirements of Rule 23.

STATUTORY CONFLICTS

At the outset, it is important to note that the direct action theory is not the only, or even the best, interpretation of the statute. There is no statutory text compelling the illogical conclusion that a 401(k) participant is able to sue, without seeking class certification, to recover money for any other participant's account. Indeed, this construction conflicts with ERISA's very definition of an individual account plan. ERISA defines an "individual account plan" as one that provides "benefits based *solely* upon the amount of contributions to the participant's account, and any income, expenses, gains or losses, and any forfeitures of accounts of other participants which may be allocated to *such participant's account*."[12]

In other words, the statute expressly grants each participant in a defined contribution plan an interest *only* in his or her own account and not the accounts of other participants. This definition of course conflicts with the direct action theory, which would allow one or more participants to effectively make decisions regarding other participants' accounts without first properly obtaining certification under Rule 23.

The direct action theory also conflicts with other ERISA provisions. For example, ERISA's statute of limitations for breach of fiduciary duty applies where the plaintiff had "actual knowledge" of a fiduciary breach more than three years before filing suit.[13] Determining actual knowledge is, necessarily, specific to an individual participant. This statute of limitations is inconsistent with a construction that allows one participant to sue on behalf of all others. A single participant's potentially idiosyncratic knowledge should not preclude suits that other participants could themselves bring. On the other hand, a plaintiff's idiosyncratic lack of knowledge cannot revive the claims of other participants that would have been barred had they brought

their own action. The direct action theory, therefore, is not the best interpretation of the statutory language read in context.

ARTICLE III STANDING

Even assuming the direct action theory was the best statutory interpretation, however, it suffers from an obvious constitutional defect: it purports to allow participants to sue to redress injuries they did not suffer. In order to meet Constitutional standing requirements under Article III, a plaintiff must demonstrate a *personal*, concrete injury in fact.[14] Bringing suit on behalf of other plaintiffs does not eliminate or abrogate this requirement. As the Supreme Court explained in *Lewis v. Casey*, the decision to bring suit as a class action "adds nothing to the question of standing, for even named plaintiffs who represent a class must allege and show that they *personally* have been injured, not that injury has been suffered by other, unidentified members of the class to which they belong and which they purport to represent."[15]

The direct action theory, however, would permit a 401(k) plan participant to sue on behalf of the plan—that is, other participants—without necessarily demonstrating he or she suffered any damages. Allowing a participant to sue based on losses to any *other* participant's account would not meet Article III's personal injury requirement. A plaintiff must have standing individually before he or she can act in a representative capacity for other potential plaintiffs.[16] The direct action theory would contravene this established requirement. Using the *LaRue* case as an example, the direct action theory would purportedly have allowed any other plan participant to sue based on Mr. LaRue's alleged losses. Such a result would fall far short of Constitutional standing requirements.

DUE PROCESS CONSIDERATIONS

The direct action theory also would cause Constitutional due process violations, no matter how it is construed. It is well-established that "one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process."[17] Under the direct action theory, however, any participant can bring an action on behalf of the other participants without joining them in the action. Accordingly, any participant could hypothetically bind all absent participants to the result of the lawsuit without any of the due process protections provided in Rule 23, such as the right to receive notice, opt out, or intervene, raising very serious Constitutional due process concerns.[18] This is particularly so in the defined contribution context, where plan participants have an individual interest in both the contributions made to their account, as well

as any additional proceeds that would be returned to those accounts based on a successful breach of fiduciary duty claim.[19]

The Supreme Court has articulated just six limited exceptions where a nonparty can be bound to a particular judgment, most of which clearly cannot apply in this context.[20] Nonparties may be bound if they:

1. Agree to be bound by the judgment;
2. Have certain qualifying relationships with the plaintiffs, such as assignee and assignor;
3. Are "adequately represented by someone with the same interests";
4. Assume control of the litigation;
5. Attempt to re-litigate a prior claim by proxy; or
6. Face a statutory scheme that prohibits successive litigation by absent parties.[21]

In a typical fiduciary breach case under ERISA, only the adequate representation and unique statutory scheme exceptions are potentially applicable.

As the Supreme Court explained, certain statutory provisions that "*expressly* foreclos[e] successive litigation by nonlitigants[,]" including the bankruptcy and probate codes, can bind absent parties.[22] Nothing in ERISA, however, remotely resembles the detailed, express prohibition on successive litigation contained in the bankruptcy code.[23] For example, a discharge under the bankruptcy code operates as an automatic injunction against further actions involving the debtor's discharged debt.[24] Since ERISA does not contain any comparable express prohibition on successive litigation, this exception cannot cure the direct action theory's Constitutional problems.

The direct action theory also cannot satisfy the adequate representation exception outlined in *Taylor v. Sturgell*. In *Taylor*, the Court explained that there are "certain limited circumstances" where a nonparty can be bound by a judgment provided they were adequately represented in the action.[25] "Representative suits with preclusive effect on nonparties include properly conducted class actions … and suits brought by trustees, guardians, and other fiduciaries."[26] An ERISA plan participant is not a trustee, guardian, or fiduciary to other plan participants, so a judgment in an action should bind nonparties only if the court properly certifies a class.

The direct action theory's attempt to authorize "de facto" class actions without satisfying Rule 23 is an endeavor the Supreme Court squarely

rejected in *Taylor*. *Coan* purported to allow a participant to represent all other participants subject only to the vague requirement that the plaintiff take unspecified "adequate steps under the circumstances" to properly act in a representative capacity. Strangely, *Coan* held that a plaintiff need not necessarily comply with Rule 23's provisions—which, of course, are designed precisely to protect the interests of absent parties. *Taylor*, however, specifically rejected an analogous doctrine, virtual representation, because it would allow "courts to create *de facto* class actions at will."[27] Indeed, lest there be any doubt, the Supreme Court reiterated the point this term in *Smith v. Bayer Corp.*:

> We could not allow "circumvent[ion]" of Rule 23's protections through a "virtual representation doctrine that allowed courts to 'create *de facto* class actions at will.'" *We could hardly have been more clear that a "properly conducted class action," with binding effect on nonparties, can come about in federal courts in just one way—through the procedure set out in Rule 23.*[28]

Thus, as a matter of due process, unspecified "adequate" measures are not sufficient to protect the interests of absent parties so as to bind them to the results of the action.[29] In other words, a 401(k) plaintiff should not be allowed to represent absent participants without satisfying Rule 23's requirements, which are designed to protect those participants.[30] Courts, therefore, should reject the direct action theory—whatever its merits as a matter of statutory interpretation—because of its Constitutional infirmities.

THE DIRECT ACTION THEORY AND ERISA'S LEGISLATIVE HISTORY

The basis for the Second Circuit's holding in *Coan* that a plaintiff need not comply with Rule 23's provisions was its reading of ERISA's legislative history. The *Coan* panel grounded its decision in a comparison of the House and Senate versions of the bills that became ERISA. The House bill made a class action mandatory, while the Senate bill made a class action permissive when a participant brought an action "for breach of fiduciary duty" or "to enjoin any act or practice violating the Act."[31] In light of this history, the court reasoned that:

> [t]he fact that Congress, having considered mandatory and permissive provisions relating to class actions, ultimately remained silent on the issue suggests to us that it deliberately declined to adopt any general rule as to whether class actions are mandatory or permissive. … It seems to us, rather, that Congress was content to leave the procedures necessary to protect absent parties, and to prevent redundant suits, to be worked out by parties and judges according to the circumstances on a case by case basis.[32]

A careful reading of the legislative history and the final statute, however, reveals that *Coan*'s premise and logic are mistaken. The language that ultimately became Section 1132(a) was derived from Section 503(e) of the House version of the bill.[33] The original language of the bill would have made class actions mandatory only "[i]n any action by a participant under Subsection (e)(3)," which permitted an action "to enjoin any act or practice which violates any provision of [the] Act."[34] In other words, the House bill would have made a class mandatory only in what would become a Section 1132(a)(3) action, rather than a Section 1132(a)(2) action.[35] Later, the House bill was amended to make class actions mandatory in both the provision that became 1132(a)(3) and the provision that became 1132(a)(2).[36]

The Senate bill was different. It would have made a class action permissive for either a claim for breach of fiduciary duty or a claim for benefits.[37] These claims ultimately were codified in two separate sections: Section 1132(a)(1)(B) provides for an action "to recover benefits due … under the terms of [a] plan," whereas Section 1132(a)(2) addresses a breach of fiduciary duty and forms the basis of the direct action theory. The final bill that became ERISA omitted discussion of class actions from all three relevant civil enforcement provisions. Neither Section 1132(a)(1)(B) (claims for benefits), Section 1132(a)(2) (breach of fiduciary duty), nor Section 1132(a)(3) (catchall provision for appropriate equitable relief) address class actions.[38]

Accordingly, the conclusion the *Coan* court drew from Congressional silence is untenable. Since the bill that Congress passed treated all three provisions identically with respect to class actions, logically they should also be interpreted identically with regard to whether a class action is necessary. Yet nobody argues and no court has held that Sections 1132(a)(1)(B) and 1132(a)(3) authorize "direct actions" to represent all participants without certifying a class action. Thus, the *Coan* court's reliance on Congressional silence to conclude that Section 1132(a)(2) authorizes a direct action is misguided.

Moreover, just because the final statute did not expressly resolve the conflict between the House and Senate bills' treatment of class actions, it does not follow that courts are authorized to ignore Rule 23 and create *ad hoc* procedures for a "common-law kind of class action" under Section 1132(a)(2).[39] On the contrary, both the Supreme Court and the Seventh Circuit have rejected just such an approach.[40] Indeed, as the Supreme Court "emphasize[d]" nearly 15 years ago, the "safeguards provided by the Rule 23(a) and (b) class-qualifying criteria … are not impractical impediments—checks shorn of utility."[41] Rather, "a 'properly conducted class action,' with binding effect on nonparties,

can come about in federal courts in just one way—through the procedure set out in Rule 23."[42]

CONCLUSION

It seems likely that courts will be faced with more frequent calls to apply the direct action theory as 401(k) plaintiffs encounter greater difficulty in certifying class actions. Courts ought to be wary of such plaintiffs who are eager to represent the accounts of other participants while arguing they should be excused from complying with the very class certification criteria the courts have long applied precisely to protect the interests of those absent parties. As we analyze above, there are overwhelming Constitutional, statutory, and historical reasons for courts to reject the direct action theory.

NOTES

1. *See, e.g.,* Spano v. Boeing Co., 633 F.3d 574 (7th Cir. 2011) (reversing and remanding certification of stock drop and excessive fee claims).

2. 29 U.S.C. § 1109(a).

3. 29 U.S.C. § 1132(a)(2).

4. 473 U.S. 134 (1985).

5. *See, e.g.,* Great West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204 (2002) (holding that § 1132(a)(3) only allows relief that was typically available at equity).

6. 552 U.S. 248, 255–256 (2008).

7. LaRue v. DeWolff, Boberg & Assoc., Inc., 450 F.3d 570 (4th Cir. 2006).

8. Plaintiffs argue this theory is consistent with *LaRue* because, while the Court allowed individual participants to recover for damage to an individual account, it did not restrict an individual participant's right of action under ERISA § 1132(a)(2) only to suits to recover for his or her individual damages.

9. Coan v. Kaufman, 457 F.3d 250 (2d Cir. 2006).

10. 457 F.3d 250.

11. 457 F.3d at 261.

12. 29 U.S.C. § 1002(34) (emphasis added).

13. 29 U.S.C. § 1113(2).

14. *See* Lujan v. Defenders of Wildlife, 504 U.S. 555, 563 (1992) (holding "the 'injury in fact' test requires more than an injury to a cognizable interest. It requires that the party seeking review be himself among the injured.").

15. Lewis v. Casey, 518 U.S. 341, 357 (1996) (emphasis added, quotation marks omitted).

16. *See* Blum v. Yaretsky, 497 U.S. 991, 1001 n.13 (1982) (finding no standing where plaintiff was not injured by challenged conduct but alleged that members of the absent putative class had been); Allee v. Medrano, 416 U.S. 802, 828–829 (1974) (Burger, C.J., concurring in part and dissenting in part) ("Standing cannot be acquired

through the back door of a class action.").

17. Ortiz v. Fibreboard Corp., 527 U.S. 815, 846 (1999).

18. *See, e.g.,* AT&T Mobility LLC v. Concepcion, — U.S. —, 131 S. Ct. 1740, 1751 (2011) ("For a class-action money judgment to bind absentees in litigation, class representatives must at all times adequately represent absent class members, and absent members must be afforded notice, an opportunity to be heard, and a right to opt out of the class.").

19. *See, e.g.,* Harzewski v. Guidant Corp., 489 F.3d 799, 803–805 (7th Cir. 2007); *see also* 29 U.S.C. § 1002(34).

20. Taylor v. Sturgell, 553 U.S. 880 (2008).

21. *Id.* at 893–895.

22. *Id.* at 895.

23. *Compare* 29 U.S.C. § 1132(a)(2) *with* 11 U.S.C. § 524.

24. 11 U.S.C. § 524(a)(2).

25. *Taylor*, 553 U.S. at 894.

26. *Id.*

27. *Taylor*, 553 U.S. 901 (rejecting a doctrine that "would 'recogniz[e], in effect, a common law kind of class action' … shorn of the procedural protections in … Rule 23.").

28. — S. Ct. —, 2011 WL 2369357 at *10 (2011). Likewise, in an opinion cited with approval in *Taylor*, the Seventh Circuit rejected the creation of common law class actions: "[T]he fact that virtual representation looks like a class action but avoids compliance with Rule 23 is a weakness, not a strength, of the doctrine. … There would be little point in having Rule 23 if courts could ignore its careful structure and create de facto class actions at will. …" Tice v. Am. Airlines, Inc., 162 F.3d 966, 972–973 (7th Cir. 1998); *see also* Bittinger v. Tecumseh Prods. Co., 123 F.3d 877, 882 (6th Cir. 1997) (rejecting virtual representation argument because "In cases such as the instant case, these procedures already exist in the form of Rule 23. The application of the doctrine of virtual representation in these circumstances would create an end run around the limitations of Rule 23, and would as a result both avoid its limitations (which are explicitly grounded in due process) and replace a clear rule with an unruly standard. Such a result would defeat the purposes of both res judicata and Rule 23.").

29. Nor can this defect in the direct action theory be cured by holding that absent participants are not bound in the action. It would violate a defendant's due process rights to face potential liability for all plan participants' accounts based on a suit brought by a single participant that would not similarly bind absent plan participants. Indeed, such a scheme would virtually guarantee liability, since successive participants could sue *ad infinitum* until one suit prevailed (perhaps by luck alone). Because due process is more than a "mere form," procedures may not deny a party a "practicable" or "real" opportunity to protect its interests. Richards v. Jefferson County Alabama, 517 U.S. 793, 803–804 (1996).

30. *See, e.g., Bittinger*, 123 F.3d at 882 ("the limitations of Rule 23 … are explicitly grounded in due process").

31. *Coan*, 457 F.3d at 259–260 and n.6.

32. *Id.* at 260.

33. *Legislative History of the Employee Retirement Income Security Act of 1974*, Prepared by the Subcommittee on Labor of the Committee on Labor And Public

Welfare United States Senate, Apr. 1976, H.R. 2 at 2334–2335 (hereafter "*Legislative History*").

34. *Id*.

35. *Compare* H.R. 2 § 503(e)(3) (providing for an action to "enjoin any act or practice which violates any provision of this act[,]" *with* 29 U.S.C. § 1132(a)(3) (providing for action "to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan …").

36. *Legislative History*, H.R. 2 at 4047.

37. *Legislative History*, H.R. 4200 §§ 693–694 at 2099–2101.

38. 29 U.S.C. § 1132(a).

39. *Taylor*, 553 U.S. at 901.

40. *Id*.; *Smith*, — S. Ct. —, 2011 WL 2369357 at *10; *Tice*, 162 F.3d at 972–973.

41. Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 621 (1997).

42. *Smith*, — S. Ct. —, 2011 WL 2369357 at *10.

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