Professional Perspective

Using Mandatory Arbitration to Avoid ERISA Class Actions (Part 1 of 3)

Carol Buckmann, Cohen & Buckmann P.C.

COHEN & BUCKMANN

Bloomberg Law

Using Mandatory Arbitration to Avoid ERISA Class Actions (Part 1 of 3)

Contributed by Carol Buckmann, Cohen & Buckmann P.C.

A Changing Legal Landscape

Employee benefit plan litigation increased significantly in 2020 over its previous high level. Many of these lawsuits are class actions in which plaintiffs allege that plan fiduciaries breached their fiduciary responsibilities under the Employee Retirement Income Security Act ("ERISA") by choosing underperforming and expensive investments for their 401(k) plans. Plaintiffs typically seek lost profits based on a benchmark for investments they claim a prudent fiduciary would have chosen and equitable relief such as replacement of plan fiduciaries and/or hiring an independent fiduciary to assist in selecting investments. Many of these cases are settled out of court, but recoveries of $50 million and more are not unheard of.

In their search to gain some control over and rein in this litigation, some plan sponsors have turned to provisions such as contractually shortened statutes of limitation, designated venues for suit, and most significantly, mandatory arbitration of ERISA fiduciary breach claims. Mandatory arbitration can be combined with class action waivers which require claims and relief to be pursued only on an individual basis.

Provisions mandating arbitration have the potential to curb the ability of participants to pursue class action litigation and, by requiring plaintiffs' counsel to pursue claims on a participant-by-participant basis, may alter the economics that have made it so profitable for law firms to pursue ERISA fiduciary breach litigation. However, there are legal uncertainties regarding whether and how arbitration may be required of ERISA plan participants. In the absence of Supreme Court guidance on point, federal courts have struggled with these issues, but no consistent analysis has emerged.

The Statutory Framework

The Federal Arbitration Act ("FAA"), 9 U.S.C. 1, predates ERISA and was enacted to encourage the use of arbitration. It mandates that contractual ambiguities be resolved in favor of arbitration. Despite the fact that the FAA was in effect when ERISA was adopted, ERISA's statutory text and its Conference Report fail to discuss whether ERISA claims are arbitrable.

Section 502 of ERISA sets out a comprehensive scheme for participants and beneficiaries to enforce their rights through "civil actions". Section 502 specifically provides that such suits may be brought in the federal district court where the participant resides, the breach took place, or the plan is administered. Section 502(a)(1) of ERISA authorizes suits to recover benefits owed to the participant and Sections 409, 502(a)(2) and 502(a)(3) authorize participants to sue for damages, such as lost profits, resulting from a fiduciary breach as well as for equitable relief such as removing fiduciaries who fail to fulfill their fiduciary responsibilities. It is clear from the text that ERISA contemplates that a participant suit can result in plan-wide relief.

ERISA does not preempt other federal law. This means that ERISA could be overridden by the FAA if the FAA requires enforcement of agreements to arbitrate ERISA claims. However, ERISA Section 410(a) states that any provision in an agreement or instrument purporting "to relieve a fiduciary from responsibility or liability for any responsibility, obligation or duty under this Part [meaning Part 4 of Title 1 of ERISA] shall be void as against public policy."

Unanswered Questions

Questions raised by the statutory language remain unanswered today, though courts have been grappling with them for many years. Among these questions are: Should ERISA's statutory claims be treated differently than commercial claims under the FAA? Must there be consideration and a voluntary agreement for a waiver of the right to sue? Can participants be required to waive the right to bring a class arbitration, which is similar to a class action? How can plan-wide relief be awarded in individual arbitrations? Should arbitrators be deciding complex ERISA claims and possibly even issues of first impression when there may be no effective right of appeal in arbitration? Is there any room for state action in the ERISA sphere? Some courts have even considered whether Section 410(a) of ERISA means that arbitration of fiduciary breach claims is against public policy.

Prior Case Law

Even though the U.S. Supreme Court has never ruled on arbitration of ERISA claims, some plan sponsors have noted the lack of a statutory prohibition and attempted to enforce mandatory arbitration of ERISA claims. Many courts were receptive and upheld the ERISA arbitration clauses. Among the appellate cases were *Williams v. Imhoff*, 203 F. 3d 758 (10th Cir. 2000), *Arnulfo P. Sulit, Inc. v. Dean Witter Reynolds, Inc.*, 847 F. 2d 475 (8th Cir. 1988), and *Pritzker v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110 (3d Cir. 1993).

These decisions applied the reasoning in the U.S. Supreme Court's decision in *Shearson v. American Express Inc. v. McMahon*, 482 U.S. 220 (1987) analyzing the Securities Exchange Act of 1934, 15 U.S.C. 78a. The '34 Act, like ERISA, gave jurisdiction of disputes to federal district courts, and has a provision similar to Section 410(a) of ERISA. Section 29(a) of the '34 Act provides that any provision binding any person to waive compliance with the Act is void. The Supreme Court determined that statutory claims were arbitrable absent evidence that Congress intended to exclude them from the FAA's reach.

In the *Sulit* decision, the court rejected the arguments that ERISA was too complex to be interpreted by arbitrators and that the absence of a provision in ERISA allowing a waiver of rights meant that such waivers were not permissible. There was also no "inherent conflict between arbitration and the statute's underlying purposes." *Sulit* also rejected the argument that an arbitration agreement was against public policy under ERISA Section 410. The Pritzker decision determined that arbitration was permissible where statutory rights were involved so long as the litigant can effectively vindicate a statutory cause of action in arbitration.

However, the courts were not unanimous in upholding ERISA arbitrations. The Ninth Circuit in *Amaro v. Continental Can Company*, 724 F. 2d 747 (1984) [overruled in 2019] held that arbitrators lacked the competence to interpret statutes as Congress intended and that ERISA minimum standards for plan equity could not be satisfied in arbitration proceedings. *Id.* at 750-752.

The Supreme Court Reopens the Issue

Against this background, the Supreme Court issued two recent decisions, *Epic Systems v. Lewis*, 1385 S. Ct. 1612 (2018) and *Lamps Plus v. Varela*, 1395 S. Ct. 1407 (2019) supporting the right of employers to compel arbitration of employment claims. The Court applied a contract law analysis. Neither of these decisions dealt with ERISA, but the majority in each was broadly supportive of mandatory arbitration. In one of the cases, the Court ruled that federal labor law (the National Labor Relations Act) did not override the FAA and that the arbitration contract would be unenforceable only if there were traditional equitable factors such as fraud or unconscionability. Section 2 of the FAA itself recognizes that an arbitration agreement is enforceable "save upon such grounds as exist in law or equity for the revocation of any contract." In the Lamps Plus case, the Supreme Court held that ambiguous provisions would not be interpreted as permitting class action waivers.

A vigorous dissent to these decisions declared that the actions upheld by the Court turned the concept of arbitration on its head, as arbitration was intended to be a dispute resolution procedure negotiated by parties with equal bargaining power rather than something forced on employees. In fact, the Court upheld arbitration where employees were told that they would be fired if they did not agree to mandatory arbitration.

Recent Federal Court Decisions

After the Supreme Court's recent decisions, federal courts have struggled anew with whether mandatory arbitration of ERISA fiduciary breach claims is permissible and the correct way to analyze the issues. Should contract law analysis be applied, or are there special consideration that attach to ERISA claims?

The next installments in this series will analyze those cases, weigh the pros and cons of mandatory arbitration, and distill recommendations from the cases to increase the chances that ERISA mandatory arbitration provisions will be upheld.