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To Arbitrate or Litigate Under ERISA—That Is the Question

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It is common knowledge among the benefits community that there is now a flood of class action lawsuits being filed against plan fiduciaries alleging that they have breached their fiduciary duties under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Allegations include plan fiduciaries causing their plan to pay excessive recordkeeping costs and offering costly and underperforming investment funds. The stakes are high and these lawsuits affect plans of all sizes.

What can plan fiduciaries do to protect themselves? Aside from engaging in good fiduciary practice, plan fiduciaries should consider adopting an amendment to their plan which provides for mandatory arbitration and a class action waiver. This column explores the relevant issues and offers advice for plan fiduciaries who wish to consider such an amendment.

ERISA Landscape

ERISA is silent on arbitration and class action waivers. However, it does allow plan participants and others to bring a lawsuit under a comprehensive legislative scheme.

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Under Section 502(a)(1)(B) of ERISA, participants and beneficiaries are permitted to sue for benefits under the terms of the plan.[1] Remedies are limited to the benefits provided by the plan terms.[2]

Under Section 502(a)(2) of ERISA, participants, beneficiaries, other fiduciaries, and the U.S. Department of Labor are permitted to sue plan fiduciaries for breaches of fiduciary duties.[3] In this case, remedies are limited to losses to the plan, disgorgement of profits, and other equitable or remedial relief.[4]

Finally, under Section 502(a)(3) of ERISA, participants, beneficiaries, and fiduciaries may sue for statutory violations and violations of the plan.[5] The remedies in this case are limited to equitable relief.[6] ERISA also provides that a court may, in its discretion, allow reasonable attorney's fee and costs of action to either party.[7]

Supreme Court Landscape

The U.S. Supreme Court has not determined whether mandatory arbitration provisions and class action waivers are permitted under ERISA, although the Court has upheld arbitration clauses in the employment context.

For example, in *Epic Systems Corp. v. Lewis*,[8] the Supreme Court upheld an agreement between an employee and employer that provided for mandatory arbitration and a class action waiver.

In *Epic,* the National Labor Relations Board ("NLRB") originally determined that the agreement violated the National Labor Relations Act ("NRLA") because it impermissibility restricted the employee's ability to engage in "concerted activities" in pursuit of "mutual aid" or "protection." However, the Supreme Court held that the Federal Arbitration Act ("FAA") mandates federal courts to enforce arbitration agreements according to their terms, including provisions that include a class action waiver. The Court reasoned that although the NLRA protects "concerted activities," this protection would not override the FAA as there was no manifest intent to do so. The Supreme Court further opined that both laws can be given effect and one should not override the other with vague language.

Lower Court Landscape

Lower courts have examined whether mandatory arbitration provisions and class action waivers are permitted under ERISA. The results have been somewhat mixed.

In *Dorman v. Charles Schwab*,[9] a class action suit was brought alleging that Charles Schwab breached its fiduciary duties by, among other things, offering poorly performing proprietary investment funds to its 401(k) plan participants. While the lead plaintiff, Michael Dorman, was employed with Schwab, Schwab amended its 401(k) plan document to include an

arbitration clause. Another plan in which Dorman participated also contained an arbitration and waiver clause. Schwab then filed a motion in the district court to compel arbitration based on the language of the plans.

The district court denied the motion but the U.S. Court of Appeals for the Ninth Circuit reversed holding that the plan provisions were enforceable and that Schwab should be permitted to arbitrate Dorman's claims. The court reasoned that the claims were subject to arbitration because the plans, in effect, had expressly agreed in the governing documents that all ERISA claims should be arbitrated.

In *Smith v. GreatBanc Trust Company, et al.,*[10] it was alleged that plan fiduciaries caused the employee stock ownership plan of Triad Manufacturing, Inc. ("ESOP") to buy Triad stock at an inflated price, harming the employees who participated in the ESOP and benefiting the plan fiduciaries who were also the sellers of the stock. When the ESOP was established, it contained no arbitration provision or requirement that participants waive their right to file a class action lawsuit in the event of a dispute. After the alleged fiduciary breach, the board of directors amended the ESOP to add these provisions.

In contrast to *Dorman*, the district court refused to enforce the plan's arbitration provision and allowed participants to continue their fiduciary breach lawsuit on a class-wide basis. The case is now being appealed to the U.S. Court of Appeals for the Seventh Circuit.[11]

In *Cooper v. Ruane, Cunniff & Goldfarb Inc.*,[12] an employee had signed an agreement to arbitrate ordinary employment claims and then later brought suit for breach of fiduciary duty under ERISA. Neither the plan nor the plan's summary plan description contained an arbitration provision or class action waiver.

In reversal of the district court's order to compel arbitration, the U.S. Court of Appeals for the Second Circuit determined that the arbitration agreement banned the employee from bringing a lawsuit regarding employment claims – but not ERISA claims alleging breach of fiduciary duty. The court reasoned that such ERISA claims are not claims related to employment. The court also indicated that ERISA explicitly authorizes plan beneficiaries and others to sue fiduciaries in federal court for breach of their duties under ERISA.

We have not heard the final word on ERISA plans that contain mandatory arbitration and class action waivers as case law in this area continues to develop. The issue will likely appear before the Supreme Court in the near future.

To Arbitrate or Litigate

Based on the cases that have been supportive of mandatory arbitration and class action waivers in ERISA plans, e.g., *Dorman*, plan sponsors and fiduciaries should evaluate with their ERISA attorney whether to adopt an amendment to their 401(k) and/or pension plan under which

plan participants are compelled to arbitrate disputes and fully waive their right to bring a class action.

A proper evaluation should begin with an analysis of the relative advantages and disadvantages of arbitration and litigation:

- Requiring arbitration and a class action waiver may make it far less appealing for a plaintiff's lawyer to target a retirement plan;
- Allowing class actions may encourage weak or marginal claims;
- Arbitration is often less expensive and speedier than litigation;
- Arbitration offers more flexible procedures and a limited scope of discovery;
- Arbitration can be less predictable than litigation;
- The outcome of an arbitration does not establish binding precedent;
- Arbitration offers a limited right to appeal;
- Motions to dismiss and summary judgements are not available in arbitration; and
- The possibility of facing repeated arbitration of individual claims.

Plan sponsors and fiduciaries who wish to adopt a plan amendment that adds a mandatory arbitration and class action waiver to their plan should make sure that the amendment broadly covers any and all claims relating to the plan, including claims for breach of fiduciary duty under ERISA. The amendment should provide that arbitration will be conducted only on an individual participant basis (not a class or collective basis). It should also state that participants waive all rights to be part of a class action and prohibit them from acting in a representative capacity on behalf of their plan. To prevent unusual or unanticipated remedial actions or awards by an arbitrator, the amendment should state that the arbitrator is only permitted to award remedies that are available under ERISA. It should require the arbitrator to have experience in arbitrating ERISA claims. The amendment should also contain a settlement process that is designed to promote dispute resolution prior to arbitration. Finally, plan sponsors should consider drafting the amendment to promote and enable the arbitration process, such as by having the plan sponsor pay for the costs of the arbitration and allowing the arbitration to take place in the participant's city or state.

Plan sponsors and fiduciaries should also give some thought as to how to enhance the enforceability of their plan amendment. Generally, it is important to show that plan participants were aware of the amendment. Thus, plan sponsors should provide plan participants with notice of the amendment as soon as possible after the amendment is adopted. The arbitration clause should also be referred to in all communications with participants regarding ERISA claims.

Obtaining participants' acquiescence to the amendment would also be helpful for the enforceability of such an amendment. Arbitration, employment, and other agreements can be used to obtain the consent of participants. Plan sponsors and fiduciaries should be aware that the amendment may not be enforceable with respect to plan participants who left employment and cashed out of the plan prior to the adoption of the amendment.

In sum, plan sponsors and fiduciaries who wish to add a mandatory arbitration and class action waiver to their plans should take the following steps:

- Adopt a plan amendment providing for broad mandatory arbitration and a class action waiver;
- Distribute notice of the amendment as soon as possible following its adoption (e.g., by distributing copies of revised SPDs);
- Reference the arbitration clause in any and all communications regarding ERISA claims, including when issuing initial denials and decisions upon appeal; and
- Require all employees to sign an arbitration or other agreement that specifically references ERISA claims, including breach of fiduciary duty claims, and contains a definitive class action waiver.

Conclusion

Claims against plan sponsors alleging breaches of ERISA fiduciary duty are at an all-time high. To stem this tidal wave of ERISA cases which cost plan sponsors many millions of dollars each year in settlements, plan sponsors and fiduciaries should consider amending their plan to require participants to arbitrate ERISA disputes and waive ERISA class actions. A plan amendment, broadly drafted to cover all ERISA claims and provide a complete waiver of class actions, may be beneficial to the plan sponsor when handling such claims, as well as potentially dissuading plaintiff attorneys from bringing a costly lawsuit.

Notes

1. 29 U.S.C. Section 1132(a)(1)(B).
2. *Id.*
3. 29 U.S.C. Section 1132(a)(2).
4. 29 U.S.C. Section 1109.
5. 29 U.S.C. Section 1132(a)(3).
6. *Id.*
7. 29 U.S.C. Section 1132(g)(1).
8. 138 S. Ct. 1612 (2018).
9. 934 F. 3d 1107 (9th Cir. 2019).
10. No. 1:20-cv-02350 (N.D. Ill. 2020).
11. No. 20-2708 (7th Cir. 2021).
12. No. 17-2805 (2d Cir. 2021).