ERISA Arbitration In The Wake Of 9th Circ. Schwab Ruling

By **Chris Meyer**

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The past two decades have seen a proliferation of Employee Retirement Income Security Act class actions against plan sponsors and fiduciaries, some leading to significant trial victories or substantial settlements for plaintiffs. At the same time, the U.S. Supreme Court has reiterated and reinforced the breadth of the Federal Arbitration Act, enforcing agreements to arbitrate in a wide variety of contexts.

These two trends crossed paths in a recent pair of opinions in Dorman v. The Charles Schwab Corp. et al.,[1] in which the U.S. Court of Appeals for the Ninth Circuit reversed its precedent prohibiting arbitration in ERISA cases and upheld a plan provision requiring that claims be arbitrated on an individual, not classwide or planwide, basis. This article discusses the Ninth Circuit's rulings and highlights issues that plan sponsors should keep in mind when considering whether to add arbitration clauses to their plans.

The Ninth Circuit's Rulings in Dorman

Michael Dorman filed a putative class action against the fiduciaries of his employer's 401(k) plan, alleging that they breached their fiduciary duties by offering employer-affiliated funds to plan participants.

The plan document contained a provision requiring that any claims related to the plan be settled by binding arbitration. The provision also required that any arbitration be conducted on an individual basis, not on a class, collective or representative basis.

The district court denied the defendants' motion to compel individual arbitration. The court reasoned that the claims were brought on behalf of the plan, not on the plaintiff's own behalf, and that the plaintiff could not waive rights (such as the right to sue in court) that belonged to the plan.

The Ninth Circuit reversed. In one of its opinions, it overruled its own precedent in Amaro v. Continental Can Co.,[2] which had held that ERISA claims are not arbitrable. Amaro was based on the notion that arbitrators lacked the competence of courts to interpret and apply statutes as Congress had intended. But the Dorman court recognized that in the 35 years since Amaro was decided, the Supreme Court has consistently held that there is nothing unfair about arbitration and that arbitrators are competent to interpret and apply federal statutes.

In a separate opinion, the Ninth Circuit enforced the plan's arbitration clause. The court held that, even if the plaintiff's claims were brought on behalf of the plan, the plan consented to individual arbitration because the plan document itself included the arbitration provision. In addition, it observed, an individual plaintiff does not give up substantive rights that belong to others simply by agreeing to an individual arbitration. The Ninth Circuit explained that claims alleging a violation of a federal statute are generally arbitrable absent a contrary congressional command, and held that ERISA contains no such contrary command.

Finally, citing the Supreme Court's opinions in Stolt-Nielsen SA v. AnimalFeeds International Corp.[3] and Lamps Plus Inc. v. Varela,[4] the court reaffirmed that a party cannot be compelled to arbitrate on a classwide basis unless it agrees to do so by contract. Because the plan's arbitration clause required individual arbitration and expressly foreclosed classwide arbitration, the arbitration must be conducted on an individual basis.

Pros and Cons of Arbitrating ERISA Claims

In light of Dorman, plan sponsors should consider whether it makes sense to add arbitration clauses with class action waivers to their plan documents. While banning class actions offers significant benefits, there are potential downsides to individual arbitrations that plan sponsors should consider.

Beginning with the upsides of arbitration, parties can usually expect a more streamlined process in arbitration than in court. Arbitration is often less expensive, and arbitrators are typically more willing to cabin discovery and prevent the proverbial fishing expedition that often consumes significant time, money and resources during the discovery process in court.

Parties to an arbitration also typically have some input into the selection of the arbitrator who will hear the case, as opposed to the random assignment of a judge in court. In addition, arbitrations usually can be conducted on a confidential basis, although the results can be made public if one of the parties seeks to vacate or confirm the award in court, or if the arbitration clause does not provide for confidentiality. Litigation, on the other hand, is generally a matter of public record, and courts are increasingly reluctant to maintain the confidentiality of documents.

From the plan sponsor's perspective, perhaps the most significant benefit of an individual arbitration provision is that it can foreclose class actions. Absent an arbitration clause that forbids class treatment, a plaintiffs lawyer may only need to find a single individual, or a handful of individuals, to seek recovery on behalf of hundreds, thousands or tens of thousands of plan participants. This is not an option for a plaintiffs lawyer if the plan has a provision requiring individual arbitrations.

But there are potential downsides to arbitration in the ERISA context. Although it requires more legwork in locating individuals willing to pursue individual claims, in recent years plaintiffs firms have demonstrated an ability and willingness to burden defendants by filing hundreds of individual arbitrations. This may be attributable in part to the emergence of social media, which makes it easier to recruit claimants, as co-workers and retirees often network with each other.

It also may be attributable to the fact that individual ERISA claims are often worth pursuing on an individual basis. Unlike some consumer class actions, where each individual plaintiff might only stand to recover a small amount, individual ERISA claims can be worth thousands of dollars, enough to motivate a participant to go through the trouble of pursuing an individual claim.

In addition, ERISA plaintiffs can recover attorney fees, so even if the value of an individual's claim is not substantial, plaintiffs attorney fees, plus defense costs, arbitration costs and hourly rates for the arbitrators can add up quickly if many individual arbitrations are filed against the same defendant. Particularly if the defendant has strong defenses that apply to an entire class of plaintiffs, a class action in federal court may be a more efficient and cost-effective forum.

Another potential downside to arbitration is the risk that claimants may argue that an adverse judgment in a prior individual arbitration should have preclusive effect in their arbitration. Whether this argument has merit is an open question, but a plan sponsor should factor in this risk. And in some situations, if an arbitrator interprets a plan in a manner that is unfavorable to the defendants, there is a risk that the plan administrator may feel constrained to apply that interpretation in disputes involving other participants, even if no subsequent arbitrations are filed.

Compounding this risk, there are very limited rights of appeal from an arbitration decision that the plan sponsor regards as mistaken. ERISA is a fairly esoteric area of law, and there are relatively few arbitrators with significant ERISA expertise. By contrast, federal judges routinely handle ERISA cases (although not necessarily ERISA class actions) and have law clerks that can help them understand the applicable law.

If a district court errs, its decision is subject to appellate review. By contrast, an arbitrator's decision may be set aside only in narrow circumstances, such as fraud, corruption or the arbitrator exceeding his authority. Absent these unusual circumstances, an arbitrator's error in making factual findings, interpreting the law or construing a plan — even an obvious and serious error — is not grounds for reversing the decision. Thus, if an arbitrator goes off the rails, the parties generally will have no meaningful appellate review and must live with the decision.

Mistaken decisions could also pose dilemmas for the fiduciary committee that oversees a plan. The committee may disagree with an arbitrator's decision, but feel compelled to follow it. For example, many ERISA class actions challenge the prudence of investment options. If an arbitrator were to find that one of the options was imprudent, then what should the fiduciary committee do? Ignoring the decision could expose the committee to fiduciary breach claims.

Another potential downside of arbitration is that it may be more difficult for a defendant to obtain dismissal of the case at an early stage of the proceedings. Judges have busy dockets and have every incentive to dismiss claims that have no merit. By contrast, many practitioners hold the view that arbitrators are less likely to grant early dispositive motions.

One of the major advantages of arbitration, from a defendant's perspective, is that it avoids the risks associated with an unpredictable jury. However, for ERISA cases, this is a largely a nonissue because courts have held that jury trials are generally not available to plaintiffs in ERISA cases anyway.

Conclusion

While there are significant benefits to requiring individual arbitrations of ERISA claims, this is not a no-brainer decision. There are definite disadvantages that should be considered before sponsors amend their plans to add arbitration clauses.

And while the Ninth Circuit's reasoning in Dorman is sound, it is unclear if this decision would apply everywhere. The plaintiff in that case may seek en banc rehearing or Supreme Court review, and some circuits have not yet addressed this issue and might choose not to follow Dorman. Thus, even if a plan sponsor adds arbitration provisions to its ERISA plans, it should be prepared to defend those provisions from a challenge before the dispute heads to arbitration.

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[1] 2019 WL 3926990, and 2019 WL 3939644 (9th Cir. Aug. 20, 2019).

[2] 724 F.2d 747 (9th Cir 1984).

[3] 559 U.S. 662, 684 (2010).

[4] 139 S. Ct. 1407 (2019).

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