The Limits Of Arbitration Provisions In The ERISA Context

By **Elizabeth Hopkins** (March 6, 2023)

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From the perspective of plan sponsors and fiduciaries, the main advantage of mandatory arbitration is that it has been perceived as a way of avoiding the potentially large recoveries available to plaintiffs in class action lawsuits.

But in the Employee Retirement Income Security Act of 1974 context, accomplishing this through arbitration provisions may not be as easy as it seems.

Two recent decisions — Burnett v. Prudent Fiduciary Services in the U.S. District Court for the District of Delaware[1] and Harrison v. Envision Management Holding in the U.S. Court of Appeals for the Tenth Circuit[2] — illustrate the limits of mandatory arbitration provisions in keeping ERISA claims out of federal court.

Both cases involved employee stock ownership plans, or ESOPs, sponsored by privately held companies, and both sought recoveries to the ESOPs for damages resulting from alleged stock price manipulation.

In both instances, the courts looked to the specific claims made and remedies sought by the plaintiffs, as well as the particular language of the arbitration agreements, in analyzing whether the plaintiffs could be compelled to arbitrate their claims. Both times, the courts held that the answer was no.

The common thread is an exception to compelled arbitration known as the effective vindication doctrine, which holds that litigants can't be forced to arbitrate a claim under a federal statute if they can't effectively vindicate their statutory cause of action in the arbitration proceeding.

In Burnett, participants in the Western Global Airlines Inc. ESOP alleged breaches of fiduciary duties in connection with the creation of the ESOP through what plaintiffs claim was a sale of stock to it at inflated prices.

Significantly, the plaintiffs expressly sought planwide relief holding defendants liable for plan losses measured by the amount of the overpayment, along with a disgorgement of corresponding profits made by the fiduciaries in the challenged transaction and the removal of the plan trustee and other fiduciaries.[3]

The defendants moved to compel arbitration pursuant to the Federal Arbitration Act. The participants, however, argued that the arbitration provision at issue was invalid because it contained a nonseverable arbitration clause barring them from obtaining the planwide relief that they sought and that ERISA permits.

In a decision recommending that the motion to compel be denied, a magistrate judge agreed that the clause banning planwide relief rendered the arbitration provision invalid.[4]

The judge pointed out that ERISA "gives plan beneficiaries the right to sue on behalf of a plan and recover plan-wide damages for a breach of fiduciary duty. ... [b]ut what the

statute provides, the arbitration provision takes away."

Thus, the arbitration provision's elimination of the "right to pursue a remedy provided by a federal statute" rendered it invalid.[5]

In Harrison, the Tenth Circuit applied similar reasoning to invalidate a comparable arbitration provision unabashedly designed to eliminate planwide relief.

The defendants sought to compel arbitration and stay the court proceedings under a provision in the ESOP plan document titled "ERISA Arbitration and Class Action Waiver."

Plaintiff Robert Harrison was opposed, arguing that enforcing the provision would impose a severe limitation on the substantive relief afforded under ERISA. The U.S. District Court for the District of Colorado agreed, concluding that the arbitration provision conflicts with the act, and it accordingly denied the motion to compel arbitration and to stay.[6]

The Tenth Circuit affirmed the district court's decision.

The appellate court turned first to the complaint itself in order to determine whether enforcement of the arbitration provision would prevent Harrison from obtaining the remedies he sought.

The court specifically looked to the section of the complaint helpfully titled "Plaintiff Seeks Plan-Wide Relief," which set forth six causes of action, each with claims for relief.[7] The court noted that four of the six counts sought relief under ERISA Sections 502(a)(2) and 409, which provide remedies for the plan.[8]

The Tenth Circuit next reviewed the terms of the ESOP's arbitration provision, concluding that the terms of the provision encompassed Harrison's claims and expressly provided that such claims must be brought in an "individual capacity and not in a representative capacity or on a class, collective, or group basis."

The court found the representative capacity provision more problematic than the prohibition on class actions, noting that the U.S. Supreme Court has blessed the latter. But the appeals court did not, however, decide the arbitration issue on that basis.[9]

Instead, it looked to the second sentence of the plan's arbitration provision, which specified that the "Claimant may not seek or receive any remedy which has the purpose or effect of providing additional benefits or monetary or other relief to any Eligible employee, Participant or Beneficiary other than the Claimant."

In the court's view, this clause prevented Harrison from obtaining in arbitration some of the forms of relief that he sought under Sections 502(a)(2) and 409(a), including the recovery of plan losses, some of the declaratory and injunctive relief he sought, and disgorgement of profits.

This was confirmed, according to the Tenth Circuit, by the third sentence of the arbitration provision, which specified that claimants asserting claims under Sections 502(a)(2) and 409(a) could only recover their own losses or a prorated share of the plan's losses or other relief that does not include any additional relief.

Because the arbitration provision was written in a manner intended to foreclose the planwide relief that Harrison sought, the Tenth Circuit "conclude[d] that the effective

vindication exception applies in this case."[10]

The court found this conclusion bolstered by the U.S. Court of Appeals for the Seventh Circuit's 2021 decision in Smith v. Board of Directors of Triad Manufacturing Inc.,[11] a case with "strikingly similar underlying facts and claims."[12]

In Smith, the Seventh Circuit concluded that a similar arbitration provision with a ban on representative actions and planwide remedies was unenforceable because "what the statute permits, the plan precludes." The Tenth Circuit concluded that the same was true in this case.[13]

As a result, the Tenth Circuit turned to and rejected each of the defendants' remaining arguments for compelling arbitration, including the contention that its ruling meant that arbitration provisions of this type could never be enforced with respect to ERISA plans.

On the contrary, it pointed out that its decision would not bar arbitration in a case where an ERISA plaintiff was asserting a claim unique to that plaintiff.[14]

The Tenth Circuit also rejected the defendants' argument that the Supreme Court's 2018 pro-arbitration decision in Epic Systems Corp. v. Lewis requires arbitration because ERISA did not contain a clearly expressed intention to override the Federal Arbitration Act.[15]

The Tenth Circuit, however, pointed out that Epic did not involve the "effective vindication" exception and, in any event, supported, rather than undercut, the application of the exception in a case such as Harrison, where the arbitration provision eliminated substantive forms of relief afforded to a plaintiff under ERISA, a federal statute.[16]

As a final matter, the Tenth Circuit rejected the defendants' contention that the arbitration provision did not preclude planwide relief because the U.S. Department of Labor could seek such relief.

The court wisely pointed out that "nothing in the statute requires the Secretary of the DOL to file any such suit, and it is unreasonable to assume that the DOL is capable of policing every employer-sponsored benefit plan in the country."[17]

Indeed, the Department of Labor had filed an amicus brief in support of Harrison, arguing just that and agreeing with him that the provision as written would impermissibly restrict the remedies he sought and abridge his substantive rights under ERISA.[18]

Although courts from the Supreme Court on down have viewed the Federal Arbitration Act as strongly favoring the enforcement of arbitration provisions in a variety of circumstances, the Burnett and Harrison decisions demonstrate that there are limits. These decisions correctly recognize that plan sponsors may not stymie the ability of plan participants to effectively vindicate their rights under ERISA.

The takeaway is rather simple: Arbitration provisions that expressly forbid planwide relief are not likely to be enforced in ERISA cases seeking such relief.

Elizabeth Hopkins is a partner at Kantor & Kantor LLP.

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[1] C.A. No. 22-270, 2023 WL 387586 (D. Del. Jan. 25, 2023).

[2] No. 22-1098, -- F.4th -- , 2023 WL 1830446 (10th Cir. 2023).

[3] Burnett, 2023 WL 38786, at *1.

[4] Id. at *2-*3.

[5] Id. at *6.

[6] Id. at *3.

[7] Id.

[8] Id. at *8-*9.

[9] Id. at *10-*11.

[10] Id. at *11-*12.

[11] 13 F. 4th 613 (7th Cir. 2021).

[12] Harrison, 2023 WL 387586, at *12-*13.

[13] Id.

[14] Id. at *14.

[15] 138 S. Ct. 1612(2018).

[16] Harrison, 2023 WL 387586, at *14.

[17] Id. at *15.

[18] Id. at *3.