REQUIEM FOR ERISA CLASS ACTIONS

James Baker, Baker & McKenzie LLP

Twenty years from now there will be no more Employee Retirement Income Security Act ("ERISA") class actions. The law, like the rest of life, is not immune from disruptive innovations. In our own lifetime, we have seen disruptive innovations from chemical photography to digital photography, from personal computers to smart phones and from snail mail to email. Just as *Brown v. Board of Education*, 349 U.S. 483, 495 (1954) created a legal sea change by finding racial discrimination in public education was unconstitutional, a series of recent U.S. Supreme Court decisions have established another legal sea change -- employment class action lawsuits are no longer necessary. These new cases taken together indicate that ERISA plan sponsors who adopt mandatory arbitration provisions with class action waivers for employee benefit plan disputes will kill off all future ERISA class actions. I know this sounds far-fetched, but it isn't.

Why is Eliminating Class Action Lawsuits Important?

In class action litigation, similarly situated legal claims are combined under a single lawsuit. The theory justifying the use of class actions is that they can be an efficient mechanism for resolving large numbers of relatively low-dollar value claims. The reality, however, is quite different. In the real world, the class action process is notoriously inefficient. Class actions are often used as a means to enrich plaintiffs' lawyers at the expense of claimants. Plaintiffs' lawyers recognize that class action lawsuits have very little economic value to individual plaintiffs.

Accordingly, individual plaintiffs, even when named as class representatives, have little incentive to monitor the lawyer's handling of the case. Class action lawsuits usually take years to reach a settlement. When a settlement is eventually reached, Plaintiffs' lawyers have an incentive to structure the settlement to recover as much in attorneys fees as they can. This adverse economic incentive sometimes makes it difficult for class members to obtain any real substantive relief. More importantly, given the large expense of defending class actions, and in the absence of significant procedural protections against self-dealing settlements, plaintiffs' lawyers have an incentive to maintain a class action lawsuit until a settlement is reached, even those that have little merit. As such, the deterrent effect of class actions against bad behavior is relatively modest because innocent defendants are treated by the judicial system much like the guilty. In comparison with class action lawsuits, individual arbitration is less costly and more effective at protecting the litigants' rights. Instead of taking years, the average arbitration takes just short of seven months to complete.

More importantly, the adoption of mandatory arbitration language containing class action waivers will have an "in terrorem" effect on plaintiffs' lawyers. The reason complaints are framed as class actions is so plaintiffs' lawyers can receive a significant share (20% to 40%) of any "common fund" recovery. For example, attorney's fees for individual fiduciary breach claims under ERISA are subject to rigorous judicial scrutiny. The lodestar analysis applied to individual ERISA attorney's fee applications multiplies the number of hours reasonably expended by a reasonable hourly rate. *Hensley v. Eckenhart*, 461 U.S. 424, 433 (1983); *D'emanuele v. Montgomery Ward & Co., Inc.,* 904 F.2d 1379, 1383 (9th Cir. 1990) *overruled on other grounds by Burlington v. Daque,* 505 U.S. 557 (1992).

Six Recent Supreme Court Cases Uniformly Enforced Mandatory Arbitration Clauses

Over the last four years, the Supreme Court decided six cases favoring mandatory arbitration clauses. Taken together, these six Supreme Court rulings strengthen the case for including mandatory arbitration clauses with class action waivers in all ERISA-regulated plans and all employment agreements. So long as the arbitration clauses and class waivers are properly drafted and the elements of contract formation are properly observed, employers will be able to eliminate their exposure to the runaway costs of class action litigation.

- ***American Express Co. v. Italian Colors Rest.***

  In *American Express Co. v. Italian Colors Restaurant*, the Supreme Court ruled that an express waiver of class action claims in a written arbitration agreement is enforceable under the Federal Arbitration Act ("FAA"), even when the plaintiff can show that the cost of individually arbitrating a federal statutory claim would likely exceed any potential recovery.

- ***Oxford Health Plans v. Sutter***

  In its second decision in the 2013 term regarding class action waivers, a unanimous Supreme Court reiterated that parties who agree to an arbitration clause that is silent on whether class arbitration of claims is allowed and who later agree to ask the arbitrator to decide whether or not class action claims are permitted, will be stuck with the arbitrator's decision on that issue.

- ***CompuCredit Corp. v. Greenwood***

  In *CompuCredit*, the Supreme Court held that an arbitration clause in an agreement subject to the Credit Repair Organizations Act ("CROA") may be enforced even though the CROA statute requires a disclosure telling consumers of their right to file a lawsuit for a violation of any rights provided by the CROA.

- ***AT&T Mobility v. Concepcion***

  The plaintiffs in *Concepcion*, claimed that AT&T cheated them when they agreed to select AT&T as their mobile phone carrier in exchange for a free phone. Notwithstanding AT&T's promise of a "free" telephone, the Concepcions subsequently discovered that they were required to pay $30 in sales tax based on the retail value of the phone. AT&T's customer service agreement contained a consumer friendly mandatory arbitration agreement and a class action waiver. Both the federal district court and the Ninth Circuit agreed with the plaintiffs, relying on the so-called "Discover Bank Ruling" -- a common law rule propounded by California's Supreme Court that found arbitration agreements prohibiting class arbitration are unconscionable. The U.S. Supreme Court reversed. It held that California's Discover Bank rule was aimed at regulating arbitration agreements and was therefore superseded by the Federal Arbitration Act. Justice Scalia, writing for the majority noted that while the FAA's savings clause preserves generally applicable contract defenses to arbitrability, it supersedes state law rules that contravene the FAA's overriding policy favoring arbitration.

- ***Stott-Nielsen S.A. v. Animal Feeds International***

  In *Stolt-Nielsen*, the Supreme Court ruled that, absent a mutual agreement to participate in class-wide arbitration, a party could not be compelled to arbitrate class-wide claims. The parties in *Stolt-Nielsen* had stipulated that while their disputes were subject

to binding arbitration, they had never reached an agreement on class arbitration. Relying on FAA § 10(a)(4), the Supreme Court vacated the arbitrator's decision approving class proceedings because, in the absence of such an agreement, the arbitrators had "simply . . . imposed [their] own view of sound policy." *Id.* at 672.

- ***Rent-A-Center, West, Inc. v. Jackson***

  Who decides whether an arbitration agreement is unconscionable when the agreement expressly delegates that decision to the arbitrator? In *Rent-A-Car Center,* the Supreme Court ruled the arbitrator does. A district court can only intervene if a party challenges the validity of the agreement to delegate that decision to the arbitrator. Where an arbitration clause has a proper delegation provision, giving the arbitrator the power to determine all questions as to arbitrability, then employees or ERISA plan participants will be hard pressed to avoid arbitration.

Can Statutory Claims Be Subject to Arbitration?

Again, the short answer is "yes." As noted above, the Supreme Court has ruled that federal statutory claims may be arbitrated unless there is an express command to the contrary in the statute. The ERISA statute, 29 U.S.C. § 1132(e)(1), does not expressly preclude the arbitration of statutory (also known as fiduciary breach) claims. Nor does the FLSA. It indicates that while both state and federal courts have concurrent jurisdiction over claims for benefits, federal courts have "exclusive jurisdiction" over statutory claims. Nowhere, however, does ERISA state that statutory violations cannot be arbitrated. Other parts of ERISA expressly embrace arbitration (such as for withdrawal liability disputes). 29 U.S.C. § 1401.

In the wake of the U.S. Supreme Court's recent decisions, every Circuit Court of Appeals to have considered whether FLSA (wage and hour) collective actions can be waived in an arbitration agreement have answered that the FLSA does not preclude the waiver of collective action claims. *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2d Cir. (N.Y.) 2013); *Owen v. Bristol Care, Inc.,* 702 F.3d 1050, 1055 (8th Cir. (Mo.) 2013) and *Quilloin v. Tenet Health System Phila., Inc.*, 673 F.3d 221 (3d Cir. (Pa.) 2012).

The U.S. Supreme Court has repeatedly ruled that "federal statutory claims may be the subject of arbitration agreements that are enforceable pursuant to the FAA because the agreement only determines the choice of forum." *EEOC v. Waffle House, Inc.,* 534 U.S. 279, 295, n. 10 (2002). *Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20, 26 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

Courts routinely enforce arbitration of ERISA disputes pursuant to arbitration provisions. *See Chappel v. Lab. Corp. of Am.,* 232 F.3d 719, 725 (9th Cir. (Cal.) 2000); *Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 7 F.3d 1110, 1122 (3d Cir. (Pa.) 1993) ("statutory ERISA claims are subject to compulsory arbitration under the FAA and in accordance with the terms of a valid arbitration agreement"); *Arnulfo P. Sulit, Inc. v. Dean Witter Reynolds, Inc.,* 847 F.2d 475, 478 (8th Cir. (Mo.) 1988) ("our examination reveals no congressional intent to single out ERISA claims for exemption from the general federal policy favoring rigorous enforcement of agreements to arbitrate . . ."). In *Tenet HealthSystem Philadelphia, Inc. v. Francis Rooney*, 2012 U.S. Dist. LEXIS 116280 (E.D. Pa. 2012), the district court granted Tenet's motion to confirm an April 12, 2012 arbitration award finding that Mr. Rooney's waiver of class action claims was enforceable. *Accord, Luchini v. Carmax, Inc.*, No. CV F 12-0417 (E.D. Cal. June 7, 2013).

Courts Have Begun to Enforce ERISA Class Action Waivers

In *Tenet Healthsystem Phila., Inc. v. Rooney*, 2012 U.S. Dist. LEXIS 116280 (E.D. Pa. 2012), the district court granted Tenet's motion to compel an April 12, 2012 Arbitration Order finding that Mr. Rooney's waiver of class action claims was enforceable.

Similarly, in *Luchini v. Carmax, Inc.,* 2012 U.S. Dist. LEXIS 102198 (E.D. Cal. 2012)), the court enforced Carmax's motion to compel arbitration of plaintiff's class action claims on an individual basis. The court explained,

> [A]rbitration does not negate Mr. Luchini's substantive rights, it merely changes the forum. . . . In addition, Mr. Luchini's claims that arbitration is more expensive than court litigation are unavailing. Litigation is expensive be it in court or arbitration. Arbitration is likely to cover as much or more of the costs than Mr. Luchini would face in a court action. Widespread cost savings associated with class and related litigation does not diminish the FAA's pre-emptive effects. . . .

Id. at 2012 U.S. Dist. LEXIS 102198, at *40.

To have enforceable arbitration provisions under ERISA, Department of Labor regulations require certain "laboratory conditions." *See* 29 C.F.R. § 2560.503-1. For example, benefit claimants may not be subjected to costs arising from arbitration procedures, and the mandatory arbitration procedure cannot preclude the claimant from seeking available remedies under the statute or the claimant's subsequent right to challenge the arbitrator's decision in court. *Id.* One additional reason to consider adopting mandatory arbitration clauses in ERISA plans is because fiduciary breach claim denials brought under the claims review process may be subject to the abuse of discretion standard of review. *Tibble v. Edison Int'l,* 711 F.3d 1061, 1077 (9th Cir. (Cal.) 2013) (collecting cases).

While arbitration has numerous advantages as it is less costly than federal court civil litigation, disputes are resolved quicker than in court and the Rules of Evidence, procedure and deadlines are more flexible in arbitration. That said, arbitrating high stakes ERISA disputes comes with the risk that the arbitrator can make a bad decision. The problem is that there is little to no review of an arbitrator's decision. The American Arbitration Association ("AAA") has tried to address this problem by offering the option of a new optional procedure for appellate review of arbitration awards. The appellate panels offered by AAA consist of former federal and state judges with strong appellate backgrounds. This option of appellate arbitration procedure can be adopted in an ERISA plan. Under the AAA's Appellate Rules, the parties may agree that an appeal may be taken on the grounds that the underlying award is based on errors of law that are material and prejudicial and/or on determinations of fact that are clearly erroneous.

Next Steps

In light of this judicial trend strongly favoring mandatory arbitration, private sector employers should consider the benefits of adopting mandatory arbitration provisions in both its ERISA documents and employment agreements.