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Epic End to ERISA Class Actions?

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Is the *Epic Systems* case the end for class actions under the Employee Retirement Income Security Act (ERISA)? Probably not quite yet. The Ninth Circuit Court of Appeals just ruled otherwise (discussed below). That said, the U.S. Supreme Court on May 21, 2018, ruled in *Epic Systems Corp. v. Lewis, et al.*[1] that a class action waiver contained in an employee's arbitration agreement is enforceable under the Federal Arbitration Act (FAA). It also found obtaining class action waivers from employees did not constitute a violation of the National Labor Relations Act (NLRA).

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SUPREME COURT DECISIONS FORESHADOWING *EPIC SYSTEMS*

The Supreme Court has consistently interpreted Section 2 of the FAA as reflecting a "liberal federal policy favoring arbitration agreements."[2] Lower courts are to apply a presumption of arbitrability when deciding challenges to arbitration.[3] Arbitration clauses in all agreements in state or federal court "involving commerce" are subject to the FAA.[4] The FAA preempts conflicting state law.[5] Finally, the Supreme Court has ruled federal statutory claims are arbitrable as a matter of public policy unless Congress explicitly states that they are not.[6]

The "central purpose" of the FAA is to "ensure 'that private agreements to arbitrate are enforced according to their terms.'"[7] Because arbitration "is a matter of consent, not coercion,"[8] the Act leaves it to the parties to establish the nature and scope of their arbitration, though a "written provision" in a contract or separate "agreement in writing," limiting the scope of the parties' arbitration agreement.[9] The Supreme Court has stated that parties to an arbitration agreement may "specify by contract the rules under which that arbitration will be conducted."[10] "There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate."[11]

Three recent Supreme Court decisions (all written by Justice Scalia) foreshadowed how the Court would treat a class action waiver in the NLRA context:

1. ***Rent-A-Center, West, Inc. v. Jackson.***[12] 561 U.S. 63, 68 (2010). Who decides whether an arbitration agreement is unconscionable when the agreement expressly delegates that decision to the arbitrator? Prior to this decision, it was settled that courts, not arbitrators, decided challenges to the substantive arbitrability of the dispute, absent an express agreement to the contrary.[13] In *Rent-A-Center*, the Supreme Court ruled that 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. When an arbitration clause has a proper delegation provision, giving the arbitrator the power to determine all questions as to arbitrability, then employees or potentially ERISA plan participants will be hard pressed to avoid arbitration.

2. ***AT&T Mobility v. Concepcion.***[14] 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 U.S. Court of Appeals for 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 FAA. 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.

3. ***American Express Co. v. Italian Colors Restaurant.***[15] 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 FAA, even when the plaintiff can show that the cost of individually arbitrating a federal statutory claim would likely exceed any potential recovery. "The fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[16] In *Italian Colors*, the Court also took note of its prior ruling in *Gilmer v. Interstate/Johnson Lane Corp.*,[17] where the Court stated it had "no qualms in enforcing a class waiver in an arbitration agreement even though the federal statute at issue, the Age Discrimination in Employment Act [ADEA], expressly permitted collective actions."[18] In *Gilmer*, the Court explained that limiting the plaintiff to arbitration did not infringe on the ADEA's goal of combating age discrimination. The plaintiff could still pursue his discrimination claim and arbitration. The EEOC, the federal agency charged with enforcing the ADEA, retained independent authority to investigate age discrimination claims and still bring collective actions.[19]

THE *EPIC SYSTEMS* DECISION

The employee plaintiffs in *Epic Systems* had sought to litigate Federal Labor Standards Act (FLSA) and related state law claims through class or collective actions in federal court. Justice Gorsuch recently filled

Justice Scalia's seat. In writing for the majority, he framed the question as follows:

> Should employees and employers be allowed to agree that any disputes between them will be resolved through one-on-one arbitration? Or should employees always be permitted to bring their claims in class or collective actions, no matter what they agreed with their employers?
>
> As a matter of policy these questions are surely debatable. But as a matter of law the answer is clear. In the Federal Arbitration Act, Congress has instructed federal courts to enforce arbitration agreements according to their terms—including terms providing for individualized proceedings. Nor can we agree with the employees' suggestion that the National Labor Relations Act (NLRA) offers a conflicting command. It is this Court's duty to interpret Congress's statutes as a harmonious whole rather than at war with one another. And abiding that duty here leads to an unmistakable conclusion. The NLRA secures to employees rights to organize unions and bargain collectively, but it says nothing about how judges and arbitrators must try legal disputes that leave the workplace and enter the courtroom or arbitral forum.

In upholding the three arbitration clauses in dispute, the Supreme Court rejected three different arguments. First, the employees argued the FAA's savings clause allows courts to refuse to enforce arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract."[20] Justice Gorsuch found this argument to be fundamentally flawed. He explained the savings clause recognizes only defenses that applied to "any" contract. This means that arbitration agreements can be invalidated by "generally applicable contract defenses, such as fraud, duress, or unconscionability."

> Under our precedent, this means the savings clause does not save defenses that target arbitration either by name or by more subtle methods, such as by "interfering with fundamental attributes of arbitration." Because the employees objected to the nature of the individualized arbitration proceedings, the Supreme Court concluded that this was merely an objection to fundamental attribute of arbitration. As such, it was not subject to challenge under the FAA's savings clause.

The employees' second argument was that NLRA's Section 7 rendered their arbitration agreements unenforceable. Justice Gorsuch began by observing, "This argument faces a stout uphill climb." The Supreme Court ruled that, while the NLRA has a comprehensive regulatory

scheme, it contains no reference to arbitration or class or collective action procedures. The Court found the "catchall" language contained in Section 7 protects only the same kinds of collective bargaining activities that are otherwise protected under the NLRA. Nothing in the NLRA gave the employees the unhindered right to pursue class actions claims in court.

Justice Gorsuch wondered why the employees had not argued the FLSA itself gave them the right to pursue class actions in federal court. He answered they did not make that argument because the Supreme Court had ruled decades ago that the FLSA does not displace the FAA or prohibit individualized arbitration proceedings citing *Gilmer v. Interstate/Johnson Lane Corp*.[21]

Finally, the Court rejected the employees' third argument that it must defer to the NLRB's most recent interpretation that the NLRA made class action waivers invalid under the FAA. The Supreme Court explained the NLRB was not seeking deference as to its interpretation of the NLRA. Instead, it found the NLRB was seeking to impose its own interpretation of the NLRA that limited the application of the FAA, a separate federal statute that the NLRB does not administer.

EPIC SYSTEMS' IMPACT ON ERISA CLASS ACTIONS

A disappointed ERISA plan participant has three available remedies: (1) a claim for additional plan benefits arising under 29 U.S.C. 1132(a)(1)(B); (2) a claim for breach of fiduciary duty to make the plan whole for any losses, 29 U.S.C. 1132(a)(2); and (3) a claim for breach of fiduciary duty seeking to enforce the terms of the plan or other appropriate equitable relief arising out of 29 U.S.C. 1132(a)(3).

An employee who wants to sue over a denied plan benefit is obviously suing on his or her own behalf. As the Supreme Court made clear in *Epic Systems*, individual claims (such as those for additional plan benefits) can be subject to an agreement to arbitrate, as well a class action waiver. Fiduciary breach claims arising under ERISA are much more problematic. Suing to make the plan whole for any losses is a form of derivative action. Plaintiff is not suing to obtain his own personal monetary relief, but instead he is seeking relief for the entire plan.[22]

THE NINTH CIRCUIT REJECTS USC'S MANDATORY ARBITRATION CLAUSE FOR ERISA BREACH OF FIDUCIARY DUTY CLAIMS

In *Munro v. University of Southern California*,[23] the Court ruled that participants bringing fiduciary duty claims are not seeking individual

damages for themselves but rather were seeking relief for the entire ERISA plan. Each of the employees had signed an employment arbitration agreement that stated they agreed to arbitrate "all claims that … Employee may have against the University or any of its related entities … and all claims that the University might have against Employee." The Ninth Circuit found that this language did "not extend to claims that other entities have against the University."

> Turning to the particular arbitration agreements entered into between the Employees and USC, we must decide "whether the agreement encompasses the dispute at issue."[24] Because the parties consented only to arbitrate claims brought on their own behalf, and because the Employees' present claims are brought on behalf of the Plans, we conclude that the present dispute falls outside the scope of the agreements.

Chief Judge Thomas, writing for the Court, found there were many similarities between *qui tam* lawsuits under the False Claims Act and ERISA breach of fiduciary duty lawsuits. He explained that both *qui tam* relators and ERISA fiduciary breach plaintiffs are not seeking relief for themselves.

> A party filing a *qui tam* suit under the FCA seeks recovery only for injury done to the government,[25] and a plaintiff bringing a suit for breach of fiduciary duty similarly seeks recovery only for injury done to the plan.[26]

The Court also observed it was constrained by its prior precedents. In *Bowles v. Reade*,[27] the Court ruled that a plaintiff seeking relief for breach of fiduciary duty under ERISA could not settle a claim on behalf of a plan, but rather could only settle if the plan consents to the settlement. The Court then rejected USC's assertion that the Supreme Court in *LaRue* had indicated breach of fiduciary duty lawsuits could be viewed as individual claims. The Ninth Circuit in *Munro* explained, "The claims brought by the Employees arise from allegedly fiduciary misconduct as to the Plans in their entireties and are not, as in *LaRue*, limited to mismanagement of individual accounts."[28] The Ninth Circuit, in affirming the district court, concluded:

> In sum, the claims asserted on behalf of the Plans in this case fall outside the scope of the arbitration clauses in individual Employees' general employment contracts.

The Ninth Circuit's decision in *Munro* thus rested on the specific arbitration language before it. It explained, "Although the Supreme

Court has never expressly held that ERISA claims are arbitrable, there is considerable force to USC's position.[29] However, given our decision that the claims asserted in this case fall outside the arbitration clauses in the employee agreements, it is unnecessary to decide that question here."

Other district courts in California have also rejected class action waivers in cases where plaintiffs have alleged a breach of fiduciary duty under ERISA. These courts reason that fiduciary breach claims cannot be compelled into arbitration for two reasons: (1) 29 U.S.C. 1132(a)(2) provides a participant with a statutory right to bring a breach of fiduciary duty lawsuit on behalf of the ERISA plan; and (2) the ERISA plan, itself, did not sign an arbitration agreement or an agreement to waive class or representative actions.[30]

WHY TRY TO ELIMINATE CLASS ACTION LAWSUITS?

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 little economic value to individual plaintiffs. Accordingly, individual plaintiffs, even when named as class representatives, have little incentive to monitor the lawyers' 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 important, 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 often less costly and more effective at protecting the litigants' rights. Instead of taking years, the average arbitration takes less than one year to complete.

The adoption of mandatory arbitration language containing a class action waiver may also make the ERISA plan unattractive to plaintiffs'

lawyers who bring class action claims seeking plan benefits under ERISA Section 502(a)(1)(B). ERISA Section 502(a)(2) claims are an entirely different kettle of fish. This provision allows a single participant to bring a derivative claim on behalf of a plan. Given the derivative nature of ERISA Section 502(a)(2) claims, why then do plaintiffs' lawyers need to bring a class action claim? The simple reason is money. Plaintiffs' lawyers frame ERISA breach of fiduciary duty claims as class actions because by doing so they can receive a significant share of any "common fund" recovery (between 20 and 40 percent).

Arbitration, itself, has its own problems and limits. A key benefit of class action federal court litigation is that it achieves finality. If the plan fiduciaries win, or lose, or if they settle, the case is over. Res judicata forbids class members from litigating the same dispute again. Arbitration does not produce that same protection. In fact, arbitration decisions are not generally reviewable by a court.

EPIC SYSTEMS' UNANSWERED QUESTIONS

The Ninth Circuit's decision in *Munro* is not the end of this story. The *Munro* Court's ruling was actually quite narrow. It found the arbitration language between the employees and USC was inadequate because the language applied to employee/employer disputes. The language did not apply to fiduciary breach claims seeking to make the plan whole for losses. The question remains whether the retirement plan, itself, could be amended to exclude class action breach of fiduciary duty claims. Prior rulings of the U.S. Supreme Court suggest that these types of plan amendments may be permissible. For example, in *Lockheed Corporation v. Spink*,[31] a unanimous Supreme Court reversed the Ninth Circuit's ruling that amending a retirement plan to benefit the employer was a breach of fiduciary duty. It ruled Lockheed Corporation did not violate ERISA when it amended its defined benefit pension plan to offer early retirement benefits only to employees who agreed to execute a complete release of any employment-related claims against Lockheed. The Lockheed Court explained, "Plan sponsors who alter the terms of a plan do not fall into the category of fiduciaries." So, changing the plan's design through a plan amendment is not a fiduciary act. On a second question, the Court split seven to two in ruling that members of Lockheed's retirement committee, who administered the pension plan, could not be sued because ERISA does not forbid a *quid pro quo* under which employees gain a benefit if they meet a particular condition set by the employer:

> According to Spink and the Court of Appeals, however, Lockheed's early retirement programs were prohibited transactions within the

> meaning of Section 406(a)(1)(D) because the required release of employment related claims by participants created a "significant benefit" for Lockheed. 60 F. 3d, at 624. Spink concedes, however, that among the "incidental" and thus legitimate benefits that a plan sponsor may receive from the operation of a pension plan are attracting and retaining employees, paying deferred compensation, settling or avoiding strikes, providing increased compensation without increasing wages, increasing employee turnover, and reducing the likelihood of lawsuits by encouraging employees who would otherwise have been laid off to depart voluntarily. Brief for Respondent 11.
>
> We do not see how obtaining waivers of employment-related claims can meaningfully be distinguished from these admittedly permissible objectives. Each involves, at bottom, a *quid pro quo* between the plan sponsor and the participant: that is, the employer promises to pay increased benefits in exchange for the performance of some condition by the employee. By Spink's admission, the employer can ask the employee to continue to work for the employer, to cross a picket line, or to retire early. The execution of a release of claims against the employer is functionally no different; like these other conditions, it is an act that the employee performs for the employer in return for benefits. Certainly, there is no basis for Section 406(a)(1)(D) for distinguishing a valid from an invalid *quid pro quo*.

Perhaps this same paradigm will work for ERISA plan amendments implementing class action waivers. The Supreme Court may find that a change of forum, from federal court to arbitration, is lawful under ERISA. Like other statutes, the Supreme Court has reviewed in this same context (Sherman Act, FLSA, ADEA, NLRA, etc.), ERISA is silent about class actions. In *Hughes Aircraft Co. v. Jacobson*,[32] the Ninth Circuit reaffirmed the rule that ERISA plan amendments do not constitute fiduciary conduct. Hughes Aircraft used surplus employee contributions in its defined benefit pension plan to fund an early retirement incentive plan. The Supreme Court in *Hughes* pointed to its decision in *Spink* stating again that "Plan sponsors who altered the terms of a plan do not fall into the category of fiduciaries. Amending a defined benefit plan funded by employee contributions is no different from amending a plan funded only by employer contributions."[33]

Given these rulings, could an ERISA plan be amended to contain a clause where participants waive their right to bring class action or collective claims? I think the answer is, "yes."

A number of unanswered questions remain. The district courts in *Munro* and *Dorman* observed that a plan provision or agreement limiting the ability of a plan participant to bring a fiduciary breach claim on behalf of the plan is a violation of ERISA Section 410.[34] Otherwise, "fiduciaries would essentially never be held to account for their potential wrongdoing in court" and they would receive "many procedural advantages at the outset of any Section 502(a)(2) action that they would not be entitled to in a court proceeding.... Indeed[,] allowing such arbitration agreements to control participants' Section 502(a)(2) claims would, in a sense, be allowing the fox to guard the henhouse."[35] These district court rulings may be off base given the Supreme Court's rulings in *Lockheed* and *Hughes* (each time reversing the Ninth Circuit), finding plan amendments benefitting the plan sponsor are not ERISA-regulated fiduciary conduct.

There are, of course, a number of circumstances where arbitration is not always a better litigation option. A key drawback is that arbitration decisions are not precedential.[36] A favorable arbitration decision in one fiduciary breach case would not prevent other participants from pursuing separate arbitrations on identical issues. There is also the problem of what the plan fiduciary is to do if separate arbitrations reach conflicting conclusions on the same fiduciary breach claim. On the other hand, a class action waiver makes ERISA plan fiduciaries unattractive defendants. The economics of a single plaintiff fiduciary breach arbitration pales in comparison to the allure of 20- to 40-percent "common fund" recovery in a class action federal court claim. Perhaps *Epic Systems* is pointing ERISA lawyers to the new epic side of truth.

NOTES

1. *Epic Systems Corp. v. Lewis, et al.*, __ U.S. __ Nos. 16-285, 16-300, 16-307 (May 21, 2018).

2. *MosesH.ConeMemorialHospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

3. *Id.* at 24–25.

4. 9 U.S.C. § 2, *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 273–274 (1995).

5. *Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Jr., U.,* 489 U.S. 468, 477 (1989).

6. *CompuCredit Corp. v. Greenwood*, 565 U.S. 95 (2012) (federal statutory rights are arbitrable absent a "contrary Congressional command").

7. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53–54 (1995) (quoting *Volt Info Sciences, Inc.*, *supra* n.5 at 479); *see also, e.g. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985) (FAA is "at bottom a policy guaranteeing the enforcement of private contractual arrangements").

8. *Volt*, *supra* n.5 at 479.

9. 9 U.S.C. § 2.

10. *Volt*, *supra* n.5 at 479.

11. *Id*.at 476.

12. *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 68 (2010).

13. *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002).

14. *AT&T Mobility v. Concepcion*, 131 S.Ct. 1740 (2011).

15. *American Express Co. v. Italian Colors Restaurant*, 133 S.Ct. 2304 (2013).

16. *Supra* n.15 at 2311.

17. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991).

18. *Supra* n.15 at 2311.

19. *Gilmer*, *supra* n.17 at 28.

20. 9 U.S.C. § 2.

21. *Gilmer v. Interstate/Johnson Lane Corp.*, *supra* n.17 at 32.

22. *Massachusetts Mut. Life Ins. Co. v. Rusell*, 473 U.S. 134, 140 (1985); *Pfahler v. National Latex Products Co.*, 517 F.3d 816, 825 (6th Cir. 2007).

23. *Munro v. University of Southern California*, __F.3d __, No. 17-55550 (9th Cir. July 24, 2018).

24. *Coxv. Ocean View Hotel Corp.*, 533 F.3d 1114, 1119 (citation omitted).

25. *Vt. Agency of Nat. Res. v. U.S. ex rel. Stevens*, 529 u.s. 765, 771–772 (2000).

26. *LaRue v. DeWolff, Boberg& Assoc., Inc.*, 552 U.S. 248, 256 (2008); *accord id.* at 261 (Thomas, J., concurring).

27. *Bowles v. Reade*, 198 F.3d752, 760 (9th Cir. 1999).

28. *Id.* at 250–251.

29. *See, e.g., Comer v. Micro, Inc.*, 436 F.3d 1098, 1100-01 (9th Cir. 2006) (discussing the issue in dicta).

30. *See, e.g., Cryer v. Franklin Templeton Res., Inc.*, (2017) WL4410103 (N.D. Cal. Oct. 4, 2017); *Dorman v. Charles Schwab & Co. Inc.*, Case No. 17-cv-00285-CW (Jan. 18, 2018) ("Just as a participant suing on behalf of a plan under Section 502(a)(2) cannot waive a plan's right to pursue claims, a participant cannot waive a plan's right to file its claims in court.").

31. *Lockheed Corporation v. Spink*, 517 U.S. 882 (1996).

32. *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999).

33. *Id*.at 444.

34. *See Johnson v. Couturier*, 572 F.3d 1067, 1080 (9th Cir. 2009) (citing ERISA § 410(a) and holding that "if an ERISA fiduciary writes words in an instrument exonerating itself of fiduciary responsibility, the words, even if agreed upon, are generally without effect").

35. *Munro*, 2017 WL 1654075, at *6.

36. *Comedy Club, Inc. v. Improv West Assoc.*, 553 F.3d 1277, 1289 (9th Cir. 2009).

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