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Insights

Mandatory Arbitration, Class Action & Exhaustion Provisions: Cause to Amend Claims Procedures?

February 24, 2020

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Nearly two months into 2020, you are finally beginning to recover from yet another chaotic group health plan open-enrollment, so now might be the perfect time to consider updating your organization's retirement plan documents. A couple of ERISA cases from the fourth quarter of 2019 provide you with a good basis to start this process. This Alert highlights, in the context of these recent opinions, evolving case law respecting two categories of retirement plan provisions: (i) mandatory arbitration and class-action waivers, and (ii) mandatory exhaustion of administrative remedies. One thing is clear, if you want to avoid the headache of lengthy and expensive court proceedings, it may be time to consider amending your retirement plan claims procedures.

A. Mandatory Arbitration and Class-Action Waiver

The Ninth Circuit Court of Appeals recently revisited whether ERISA claims may be subject to mandatory arbitration and class-action waiver provisions. In *Dorman v. Charles Schwab Corp.*, 934 F.3d 1107 (9th Cir. 2019), the court held, in light of intervening Supreme Court case law, that its precedent prohibiting mandatory arbitration should be overturned. Accordingly, employers and plan administrators may wish to incorporate mandatory arbitration and class-action waiver provisions in their plans, as a means to reduce potential exposure to class action litigation.

The lead-plaintiff in *Dorman*, an ex-employee and 401(k) plan participant, filed a class action against Charles Schwab alleging a breach of fiduciary duty on the basis that Schwab-affiliated investment funds were kept in the plan to generate fees despite poor performance. Shortly before Dorman had departed Schwab, the company amended its plan to add a mandatory arbitration provision that included a waiver of collective action – i.e. participants were required to submit to individual arbitration. Charles Schwab moved to compel arbitration pursuant to the plan's arbitration provision, but the district court denied the motion.

On appeal, the court primarily considered whether its holding in *Amaro v. Continental Can Co.*, 724 F.2d 747 (9th Cir. 1984), remained good law. In *Amaro*, the Ninth Circuit had determined that the minimum standards of ERISA could not be maintained by arbitral proceedings, as many arbiters are not lawyers, and thus lack competence to interpret and apply statutes as Congress intended. However, since that holding, the Supreme Court in *American Express Co. v. Italian Colors Rest.*, 570 U.S. at 233, 133 S.Ct. 2304, 186 L.Ed.2d 417 (2013), ruled that "arbitrators are in fact

competent to interpret and apply federal statutes." The Ninth Circuit thus found *Amaro* overruled and reversed the decision of the district court.

Dorman appears to signal a growing endorsement of mandatory arbitration and class-action waiver provisions under ERISA, as the Ninth Circuit has traditionally been among the most antagonistic of its sister circuits when called upon to enforce them. Here, the Ninth Circuit joined the Second, Third, Fifth, Eighth, and Tenth Circuits to hold that statutory claims arising under ERISA may be subjected to mandatory arbitration.

There is a growing consensus among the federal courts that mandatory arbitration provisions should be enforced in a dispute arising from a claim for benefits, as stronger policy reasons exist there for permitting non-judicial remedies. In either context, the basis for upholding these provisions is contract law, where the plan participant and employer have entered into a bilateral agreement, pursuant to a participant accepting the terms of the plan upon enrollment. Accordingly, plan administrators and employers may desire to take advantage of alternative dispute resolution by incorporating mandatory arbitration and class action waiver provisions into their plans. It is important to consult with advisors in reaching a decision whether to do so as there are competing issues to consider as well. Although mandatory arbitration and class action waiver provisions may prevent litigation, matters that are arbitrated are generally not able to be appealed to a higher authority if the arbitration decision is not favorable. Additionally, if an issue cannot be dealt with in a class action, an employer could be faced with multiple individual arbitration actions.

B. Mandatory Exhaustion of Administrative Remedies

ERISA contains no explicit requirement that a participant exhaust administrative remedies prior to suing to recover benefits due to the participant under the plan. However, federal courts have established precedent that an ERISA plaintiff claiming a denial of benefits must follow a plan's internal review process prior to bringing suit – i.e. mandatory exhaustion of administrative remedies. This court-made doctrine has begun to shift in recent years resulting in a split among the circuits on the issue. As a recent federal district court case illustrates, *Grieff v. Life Ins. Co. of N. Am.*, 386 F.Supp.3d 1111 (D. AZ, 2019), plans that fail to explicitly require a participant to exhaust plan remedies prior to suit may face greater exposure to litigation.

The federal district court in *Grieff* ruled that a long-term disability plan participant's suit to obtain benefits could proceed despite the fact he had not exhausted administrative remedies. The defendant insurer argued to no avail that the plan made exhaustion a mandatory prerequisite to filing a civil action. The court disagreed, citing *Spinedex Physical Therapy USA Inc. v. United Healthcare of Ariz., Inc.*, 770 F.3d 1282, 1298-1300 (9th Cir. 2014), which established that exhaustion is not obligatory where the plan documents could be reasonably read by the average claimant to make the administrative appeals process optional.

Grieff thus illustrates the exception to the general exhaustion requirement as adopted by at least the Second, Seventh, Eighth, Ninth, and Eleventh Circuits. Generally, where a plan document clearly requires exhaustion, the claimant will be required to exhaust administrative remedies before the claimant is permitted to pursue legal action. The exhaustion requirement must, however, be clearly stated in the plan document in terms that are unambiguous and can reasonably be interpreted by the average participant as requiring exhaustion. Further, it is prudent to incorporate the exhaustion requirement directly into the claim procedures section of the plan document or SPD, as opposed to relying on a separate notice referenced by the plan. Plan administrators and

sponsors should consider adding an unambiguous provision requiring exhaustion of administrative remedies to reduce exposure to potential litigation, and further, to build an adequate record for the court to consider in the event the plan's internal review process has been exhausted.

For further information regarding the mandatory artbitration, class action waivers or exhaustion of administrative remedies, or to discuss any other retirement plan, executive compensation or welfare plan matters, please contact any member of our Employee Benefits and Executive Compensation Practice Group.