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Benefits Alert

May 29, 2024

Courts divide on applicability of individual action arbitration clauses

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Recent Second Circuit opinion deepens debate over whether benefit plan language requiring arbitration and limiting claims to individual actions impermissibly deprives ERISA claimants of the ability to seek plan-wide *monetary* relief.

What's the impact?

- Recently, the Second Circuit in *Cedeno v. Sasson* joined three other circuits in refusing to enforce plan language requiring individual arbitration of plan-wide claims seeking monetary relief. However, the Ninth Circuit has enforced plan language requiring arbitration and limiting actions to individual arbitrations.
- Plan sponsors should consult counsel regarding their jurisdiction's approach to individual arbitration and consider tailoring any plan language requiring arbitration to fit within ERISA's evolving limits.

In *Cedeno*,[i] the Second Circuit joined the Third, Seventh, and Tenth Circuits in declining to enforce an ERISA plan's arbitration clause that would preclude participants from pursuing plan-wide relief under ERISA Section 502(a)(2). That section allows participants to bring civil actions for

"appropriate relief" under ERISA Section 409. ERISA Section 409, in turn, imposes personal liability on breaching fiduciaries, requiring them to "make good to such plan *any* losses to the plan" resulting from their breaches.

The effective vindication doctrine

The Second Circuit majority relied on the "effective vindication doctrine"—the principle that "provisions within an arbitration agreement that prevent a party from effectively vindicating statutory rights are not enforceable." Because it determined ERISA Section 502(a)(2) provided for plan-wide relief that was impermissibly barred by the non-severable arbitration clause at issue, the Second Circuit held the plan's arbitration clause ran afoul of the effective vindication doctrine and found it unenforceable. The Second Circuit distinguished the Ninth Circuit's decision in a related dispute enforcing an individual-arbitration clause disallowing plan-wide monetary relief because the Ninth Circuit did not have occasion to consider the effective vindication doctrine in that case.

After the Second Circuit's *Cedeno* decision, the Department of Labor (DOL), as amicus curiae, asked the Sixth Circuit to follow *Cedeno* in a pending appeal, *Parker v. Tenneco, Inc.*[ii] The DOL argued that the Sixth Circuit should recognize and apply the effective vindication doctrine.

Other interpretations of enforceability

Most recently, the Central District of California issued its decision in *Yagy v. Tetra Tech, Inc.,*[iii] disagreeing with the Second Circuit's conclusion that ERISA Section 502(a)(2), by its nature, is a plan-wide remedy. Instead, the *Tetra Tech* court enforced the arbitration clause and upheld the plan's restriction on the ability of participants to seek plan-wide *monetary* relief in arbitration. The court disagreed that individualized arbitration is an impermissible prospective waiver of a plaintiff's substantive statutory remedies under ERISA.

Why the Second Circuit refused to enforce the plan's arbitration clause when applied to representative claims.

In *Cedeno*, the plaintiff sued Argent Trust Company, the trustee of his former employer's employee stock ownership plan (ESOP), and others, alleging that Argent breached its fiduciary duties by causing the ESOP to overpay for company stock. Among other remedies, Mr. Cedeno sought restoration under ERISA Section 502(a)(2) for alleged plan-wide losses. Argent and the other defendants moved to compel arbitration, citing the ESOP's arbitration clause requiring participants to resolve any legal claims under the ESOP in individualized arbitrations. The clause expressly limited relief sought under ERISA Section 502(a)(2) to individual restoration and prohibited relief that would benefit another employee, participant, or beneficiary.

The district court held that the arbitration provision was unenforceable because ERISA Section 502(a)(2)'s remedies are inherently plan-wide, and an arbitration clause's purpose is to narrow procedural options but not substantive rights. The Second Circuit affirmed, in a split decision, relying primarily on the *Massachusetts Mutual Life Insurance Company v. Russell*[iv] proposition that "Section 502(a)(2) claims can *only* be brought to pursue relief *on behalf of a plan*, and cannot be used as a mechanism to seek individual equitable relief for losses arising from the mismanagement of a plan." (emphasis added). Because Section 502(a)(2) provides for plan-wide relief, the Second Circuit held that individualized arbitration impermissibly curbs substantive rights provided by Section 502(a)(2). In so holding, the Second Circuit joined the Third, Seventh, and Tenth Circuits.

Dissent in *Cedeno* casts doubt on the majority's application of the effective vindication doctrine.

In a robust dissent, Judge Menashi noted that parties who have agreed to arbitrate sometimes try to avoid arbitration later by conjuring conflicts between the Federal Arbitration Act (FAA) and other statutes and that the Supreme Court has "rejected *every* such effort to date." Judge Menashi also highlighted the Supreme Court's warning that "we must be alert to new devices and formulas by which litigants seek to revive the old judicial antagonism toward arbitration." He concluded that the conflict in *Cedeno* was manufactured and relied on a "tendentious reading of ERISA" when, in fact, the case was straightforward and should be resolved by respecting and enforcing the arbitration provision as written.

Judge Menashi specifically attacked the "effective vindication doctrine" as a "judge-made exception to the FAA" that originated in dicta and, therefore, was "a questionable principle of uncertain legal status." Rather than "ruminate[ ] over the abstract question of whether Sections 502(a)(2) and 409(a) of ERISA transform an individual claimant into a representative of the plan[,]" Judge Menashi stated that nothing in ERISA required Cedeno to act in a representative capacity. Finally, Judge Menashi explained that the arbitration clause allowed Cedeno to obtain any relief necessary to make him whole and that there was no reason for an interpretation that would prohibit its enforcement. In short, Judge Menashi reasoned that "[i]n this case, the effective vindication exception is a solution in search of a problem. Both the arbitration clause and ERISA afford Cedeno the right to seek remedies for harm to himself."

District Court in the Ninth Circuit focuses on statutory and plan language to enforce arbitration clause.

After acknowledging the effective vindication doctrine, the *Tetra Tech* court explained that ERISA Section 409(a) describes consequences to an errant fiduciary, not the right of a plan participant under ERISA Section 502(a)(2). ERISA Section 409(a) provides for "appropriate" relief, and ERISA Section 502(a)(2) provides for the restoration of "any" losses to the plan. The *Tetra Tech* court

concluded that "nothing in § 502(a)(2) suggests [ ] an unqualified right to bring a collective action to recoup all of a fiduciary's losses and gains at once. [I]t does not follow that 'appropriate relief' in all cases must include the right to pursue plan-wide monetary relief, rather than relief for a participant's own distinct harm." Thus, the court concluded that solo arbitration of claims under ERISA Section 502(a)(2) does not waive substantive statutory remedies.

The court distinguished the class action waiver at issue there from the "problematic" language at issue in contrary decisions from outside the Ninth Circuit. "Indeed, each of the waivers in those cases would have prohibited a plaintiff from obtaining *any* relief that had a plan-wide effect, including, for example, the removal of a fiduciary, even though such relief was expressly contemplated by ERISA and would have been available in his or her individual capacity." Moreover, the plan at issue in *Tetra Tech* included limitations on the class action waiver, which, when paired with the plan's savings clause, contemplated preserving individualized rights to the extent ERISA permits. Thus, despite the deepening split over whether ERISA Section 502(a)(2) is inherently representative, plan fiduciaries may see arbitration provisions survive a challenge if the plan language is sufficiently tailored to ERISA relief mechanisms.

How can plan sponsors ensure that their arbitration clauses are enforceable?

Not all benefit plans require claims to be arbitrated. However, where a plan does have an arbitration provision, plan sponsors should consult with counsel on proactive measures they can take to ensure that any plan arbitration provisions are in line with the views of their jurisdiction. As it stands, four Circuits and the DOL oppose compelling individualized arbitration of ERISA Section 502(a)(2) claims.

To avoid an arbitration clause being deemed unenforceable in its entirety, plan sponsors should consult with counsel regarding severability, savings clauses, and carve-out provisions for claimants seeking plan-wide relief. For example, such language could include bifurcation of proceedings to determine the merits and what, if any, relief is available, thus potentially containing the dispute to enforceable arbitration and reducing exposure to meritless litigation. Plan sponsors should carefully tailor the severability of an arbitration clause for any intersection with ERISA claims for plan-wide relief.

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[i] No. 21-2891-CV, 2024 WL 1895053, -- F. 4th -- (2d Cir. May 1, 2024).

[ii] No. 23-10816, 2023 WL 5350565 (E.D. Mich. Aug. 21, 2023), *on appeal*, No. 23-1857 (6th Cir.).

[iii] No. 2:24-cv-01394-JFW-AS (C.D. Cal. May 17, 2024).

[iv] 473 U.S. 134, 105 S.Ct. 3085, 87 L.Ed.2d 96 (1985).