

401(k) arbitration agreements still not mandatory

Sponsors have interest in adding them to their retirement plan documents, but the courts are up in the air, lawyers said



July 14, 2020 *By Emile Haliez*

It has been nearly a year since Charles Schwab's court victory [regarding mandatory arbitration](#) agreements for 401(k)s — an addition many plan sponsors and fiduciaries are likely considering.

But few companies appear to have added such agreements to their plans, and it will probably be a while before more of them do.

"There is a much more of a Wild West nature of arbitration agreements than proceeding in the courts, for better or worse," said Nancy Ross, partner at law firm Mayer Brown. The use of mandatory arbitration "hasn't had a chance to really play out in the courts. My belief is that until it does ... plan sponsors are generally going to be reluctant to attach these provisions on a wholesale basis."

Ross was among several panelists speaking last week in [a webinar](#) sponsored by industry and lobbying group the American Benefits Council, regarding considerations for the inclusion of mandatory arbitration agreements in defined-contribution plans.

One such case that has yet to be resolved is a lawsuit involving Cintas Corporation's 401(k). That class-action case, which was filed in December in U.S. District Court in the Southern District of Ohio Western Division, alleges that the company breached its fiduciary duty to participants in the more than \$1 billion plan. The plan sponsor failed to select investment options that performed well and were low-cost, according to the complaint.

In March, the defendants filed a motion to compel arbitration, writing that the plaintiffs signed employment agreements that included mandatory arbitration provisions for claims under the Employee Retirement Income Security Act. The plaintiffs waived the right to pursue class-action claims, according to that filing.

The plaintiffs have contested that, replying to the court that the claims fall outside of those employment agreements. The court has yet to rule.

The outcome of that case "is going to tell us more," Ross said. But, "it's going to be a while before these cases really flesh [this issue] out."

In the Schwab lawsuit, which was decided in the 9th Circuit Court of Appeals, the court reversed a longstanding precedent that ERISA claims cannot be arbitrated, Ross said. That differed from a decision in the 9th Circuit in a separate case in 2018, *Munro v. the University of Southern California*. Unlike the lawsuit against Schwab, the USC case involved an arbitration agreement baked into employment agreements. In the Schwab case, mandatory arbitration was spelled out in the 401(k) plan document.

"After the 9th Circuit decision upholding the use of mandatory arbitration agreements, a number of plan sponsors were evaluating whether or not to implement them, but as with most decisions there are potential cons to relying upon arbitration," Marcia Wagner, managing partner of the Wagner Law Group, wrote in an email. "First, it is more difficult to have an unfavorable arbitrator's decision reversed than to have an unfavorable district court decision reversed."

Further, district court judges are more likely familiar with the complexity of ERISA than arbitrators, Wagner wrote. If employers with mandatory arbitration agreements face multiple claims, "there is a risk of inconsistent decisions with respect to participant claims, which will present practical issues in terms of ongoing plan administration."

where the great irony is that the court decisions have not been universal by any stretch.

Within the 1st and 4th circuit courts of appeal, for example, plaintiffs have successfully brought claims by showing that there was a fiduciary breach and that participants suffered harm, putting the burden of proof on the defendants, Ross noted. By contrast, most jurisdictions have required plaintiffs to show that such fiduciary breaches caused the harm, not just that the two existed, she noted.

QUICK RESOLUTIONS

One benefit for all parties in arbitration is expedience, however. While court cases can drag on for years, arbitration is generally resolved quickly, lawyers said.

Companies operating in the 9th Circuit may be able to rely on certain types of arbitration agreements being held up in court, but that doesn't necessarily mean that they should add them, said Jason Roberts, CEO of the Pension Resource Institute.

"Courts are bound to follow the law. My experience as a defense attorney is arbitration panels increasingly are less likely to follow a particular law," Roberts said.

Further, larger companies face the potential of multiple arbitrations over identical issues, which can be expensive to defend, he said.

"The notion that [arbitration] is cheaper — I've not necessarily found that to be a given," he said.

But for service providers, broker-dealers and plan record keepers, the case for mandatory arbitration can be more obvious, he said.

"As a service provider I probably don't want the headline risk of being sued in federal court by one of my retirement plan clients," he said. "I would think twice if I'm a plan sponsor, and I'm trying to imagine the worst-case scenario."

THE DETERRENT EFFECT

One of the biggest issues for employers to consider is the use of arbitration agreements as a "guard dog" against potential lawsuits, as they can prevent law firms from seeking massive amounts of fees by representing class actions, Ross said.

"If the plaintiffs' bar is hunting for a plan to break into, [and] then it hears a loud barking dog, they're going to be deterred by that plan and move onto the next plan," she said. "It can be a very valuable tool in deterring litigation."

But there is a different deterrent effect associated with class-action lawsuits, said Micah Hauptman, financial services counsel at consumer and lobbying group the Consumer Federation of American, in an email.

"Forced arbitration takes investors' rights away and makes it much less likely that cases will be brought, reducing the deterrent effect that the threat of litigation can bring," Hauptman wrote. "Without such a threat, plan fiduciaries may not have as strong an incentive to fulfill their fiduciary duties to the plan, participants and beneficiaries, which would increase the risk of harm to retirement savers."