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In Split Ruling Second Circuit Declines to Compel Arbitration of ERISA Plan Claims

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They say that April showers bring May flowers, but there were no flowers for ERISA plan sponsors and fiduciaries on May 1 when the Second Circuit held, in a ruling that provoked a vigorous dissenting opinion, that an ERISA plan's arbitration provision was not enforceable because it required the plan participant to forgo his statutory right to seek plan-wide relief. *Cedeno v. Sasson*, 2024 WL 1895053 (2d Cir. May 1, 2024). With this decision, the Second Circuit joins the Third, Seventh, and Tenth Circuits in holding unenforceable plan arbitration provisions on the ground that they prevent a plaintiff from vindicating statutory rights guaranteed by ERISA sections 502(a)(2) and 409.

Background

Plan participant Ramon Dejesus Cedeno sued his former employer, Strategic Financial Solutions, LLC, along with Argent Trust Company, the trustee of the Strategic Employee Stock Ownership Plan (Plan), and others alleging breach of fiduciary duties in connection with the Plan's purchase of shares of Strategic Family for more than fair market value. Cedeno brought a claim under ERISA section 502(a)(2), which provides a plan participant with the right to bring a civil action for appropriate relief under ERISA section 409(a). Section 409(a), in turn, makes fiduciaries who breach their duties liable to make good to the plan any losses to the plan resulting from their breaches.

The Plan document included a mandatory arbitration provision, which provided that: participant claims concerning the Plan would be settled by binding arbitration, such claims must be brought in an individual capacity and not in a representative capacity or on a collective basis, and the participant may not seek or receive any remedy that has the purpose or effect of providing additional benefits or monetary or other relief to anyone other than the participant bringing the claims. The Plan also contained a non-severability clause, meaning that if a court were to find part of the arbitration provision unenforceable, then the entire arbitration provision would be void.

The district court denied the defendants' motion to compel arbitration because the arbitration provision was unenforceable under the Federal Arbitration Act (FAA) insofar as it purported to waive Cedeno's statutory rights. In so ruling, the court explained that ERISA section 502(a)(2) provides Cedeno the right to seek plan-wide relief in a representative capacity on behalf of the plan, but here the Plan's arbitration provision limited Cedeno to seeking individualized relief. Because of the Plan's non-severability clause, the defendants' motion to compel arbitration was denied. The defendants filed an interlocutory appeal.

The Majority's Decision

A panel majority (2-1) agreed with the district court's reasoning and affirmed the denial of the motion to compel arbitration based on what previously has been coined the "effective vindication doctrine." The majority explained that a "core concern of the FAA is protecting the enforceability of agreements to vindicate substantive rights through an arbitral *forum* using arbitral *procedures*." But the FAA does not reach agreements to waive "*substantive rights and remedies*." Here, the majority observed that the Supreme Court previously ruled that the statutory remedies available to participants like Cedeno—under ERISA sections 502(a)(2) and 409(a)—run only to the plan and, since this Plan's arbitration provision purported to waive Cedeno's substantive rights under ERISA to seek relief on behalf of the Plan, it was unenforceable.

In so ruling, the majority rejected all of defendants' arguments. First, the majority rejected defendants' argument that Cedeno had no unwaivable statutory right to pursue collective arbitration, because: (i) Cedeno asserted a right to pursue statutory remedies to enforce his statutory rights under section 409(a), and the Plan's arbitration provision would leave him without any means of securing the remedies available to him; and (ii) the Plan's arbitration provision did not only waive Cedeno's right to collective-action procedures, but it precluded him from arbitrating in a representational capacity. The panel found additional support for its conclusion—that a section 502(a)(2) claim is inherently representational—in the Second Circuit's earlier ruling in *Coan v. Kaufman*, 457 F.3d 250, 254 (2d Cir. 2006), which held that a participant seeking relief under section 502(a)(2) must "take adequate steps under the circumstances properly to act in a 'representative capacity on behalf of the plan.'"

The majority also rejected defendants' argument that Cedeno can effectively vindicate his statutory rights by pursuing individualized claims for relief that make him whole without impacting the rights of other participants. The majority observed that *LaRue v. DeWolff, Boberg & Assocs., Inc.*, 552 U.S. 248 (2008) reinforced that the remedies available under section 502(a)(2) for fiduciary breaches that violate section 409(a) inure to the benefit of the plan and only provide indirect relief to individual plan participants. Furthermore, according to the majority, even if there were a mechanism for making Cedeno financially whole through adjustments only to his individual account, there was no legal way to provide many of the equitable remedies allowed by statute without impacting the accounts of other Plan participants or binding the plan administrator or trustee vis-à-vis other participants.

The Dissent's Opinion

In a vigorous dissent, Judge Steven J. Menashi first observed that, like others who have agreed to arbitrate claims yet try to avoid arbitration later, Cedeno had conjured up a conflict between the FAA and a federal statute. Observing that the effective vindication doctrine is a judge-made exception that originated as dictum in a Supreme Court case that has never been applied, Judge Menashi explained that the Plan's arbitration provision would not diminish Cedeno's ability to vindicate his rights under ERISA because participants in a defined contribution plan have an individualized right to relief under ERISA sections 502(a)(2) and 409(a), and it did not follow that relief must inure to the plan as whole.

Judge Menashi also rejected the argument that ERISA section 502(a)(2) turned a plaintiff into a plan representative—unlike, for example, in a shareholder derivative action where the shareholder brings an action that the corporation could have brought. Furthermore, even if Cedeno's claims were brought in a representative capacity, Judge Menashi concluded that arbitration should still be compelled because the Court should not decide for itself to prohibit the waiver of non-individual claims where Congress did not provide for it.

Lastly, Judge Menashi observed that the defendants had agreed that the Plan's arbitration procedure did not prevent Cedeno from securing relief that may benefit other participants, such as removal of a fiduciary, but rather only prohibited Cedeno from securing monetary relief for other participants.

Proskauer's Perspective

There are now four circuits—the Second, Third, Seventh, and Tenth Circuits—that have held unenforceable plan arbitration provisions on the ground that they prevent a plan participant from vindicating statutory rights guaranteed by ERISA sections 502(a)(2) and 409. Although the Ninth Circuit currently stands alone in holding that class action ERISA claims brought on behalf of an entire ERISA plan are subject to individual arbitration with relief limited to the individual plaintiff's claims, the Sixth Circuit recently heard oral argument on these issues. With a split among the five circuit courts that have weighed in, a vigorous dissent in the Second Circuit's decision, and another circuit court decision expected soon, we may see the issue make its way to the Supreme Court in the not-too-distant future. Stay tuned.

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