ERISA Exhaustion Defense Still Viable In Some Jurisdictions

By **Art Marrapese** (January 7, 2021)

Art Marrapese

This article addresses the viability of the Employee Retirement Income Security Act's claims exhaustion doctrine as a defense in lawsuits alleging fiduciary breaches and other ERISA statutory violations.

A recent decision out of the U.S. District Court for the Northern District of Georgia — Fleming v. Rollins Inc. — reminds us that defending ERISA breach of fiduciary duty claims based on a plaintiff's failure to exhaust a plan's administrative remedies is a viable option in some federal court jurisdictions.[1]

ERISA class actions against 401(k) and 403(b) plan sponsors and their fiduciaries continue to be filed in federal courts around the country at an alarming rate. The trend is due, in part, to the reasonably high odds of surviving a motion to dismiss even where the complaint contains copycat allegations borrowed from other class actions.

The plaintiffs bar is aware that if the suit can get to the discovery phase, the chances of a settlement — and a payday — increase because of the substantial defense costs, the prospect of having to make restorative contributions to the plan in addition to payment of the plaintiffs' attorney fees and the reputational costs incurred by the plan fiduciaries.[2]

The federal appeals court jurisdictions that permit fiduciaries to raise a failure to exhaust defense in connection with ERISA statutory claims base their decisions, in part, on the premise that doing so weeds out meritless claims. Arguably, the goal of reducing meritless litigation has not been well-served by the procedural mechanism of a motion to dismiss.

A brief overview of ERISA's claims process and the related exhaustion doctrine will be helpful in understanding the decision in Fleming and the potential advantages of pleading such a defense where it may apply.

The Exhaustion Doctrine

Section 503 of ERISA requires ERISA-governed employee benefit plans to maintain procedures for resolving disputes involving a participant or beneficiary's benefits under the plan.[3] U.S. Department of Labor regulations detail the specific standards and requirements that govern the claims dispute process.[4]

Every federal appeals court in the country has held that ERISA plaintiffs must exhaust available plan administrative remedies before suing for benefits in federal court, even though neither ERISA nor the DOL claims regulation expressly require exhaustion. The exhaustion doctrine is designed to ensure consistent treatment of claimants by plans, weed out frivolous lawsuits, encourage disputes to be resolved without litigation and develop an administrative record that will assist a court in determining whether plan fiduciaries abused their discretion.

As a general rule, the exhaustion requirement does not apply where: (1) the plan either does not have a claims process or does not mandate exhaustion of the plan's administrative remedies as a condition of filing suit (e.g., where a document or summary plan description states that participants may file claims); (2) the claims procedure does not apply to the

disputed right or benefit (e.g., by its terms, the claims procedure does not explicitly cover ERISA statutory claims); (3) where requiring exhaustion would be futile; or (4) where the claims fiduciary made a substantial error in adjudicating the claim.[5]

Application of the Exhaustion Doctrine to ERISA Breach of Fiduciary Duty Claims

A statutory violation occurs when a plan is administered in a way that violates an ERISA provision — e.g., a breach of fiduciary duty under ERISA Section 404 — in contrast to a plan-based claim, which involves the interpretation of plan language and its application to a set of facts.

Of the 12 circuit courts of appeal, the U.S. Court of Appeals for the Third Circuit, the U.S. Court of Appeals for the Fourth Circuit, the U.S. Court of Appeals for the Fifth Circuit, the U.S. Court of Appeals for the Sixth Circuit, the U.S. Court of Appeals for the Ninth Circuit, the U.S. Court of Appeals for the Tenth Circuit, and the U.S. Court of Appeals for the D.C. Circuit do not require exhaustion of administrative remedies prior to bringing a claim alleging breach of fiduciary duty or other ERISA statutory violations.[5]

Two circuits — the U.S. Court of Appeals for the Seventh Circuit and the U.S. Court of Appeals for the Eleventh Circuit — have held to the contrary,[7] reasoning that administrative claim-resolution procedures further the essential purposes of reducing the number of frivolous lawsuits, minimizing the cost of dispute resolution, enhancing plan fiduciaries' ability to carry out their fiduciary duties efficiently by preventing premature judicial intervention in the fiduciary decision-making process, and allowing a final fiduciary decision to assist the court's analysis if the dispute is eventually litigated.

The three remaining circuit courts — the U.S. Court of Appeals for the First Circuit, the U.S. Court of Appeals for the Second Circuit, and the U.S. Court of Appeals for the Eighth Circuit — do not appear to have squarely addressed the issue.[8] There is no way to know how the remaining courts will decide the issue, although the more recent case law suggests the trend is leaning against requiring exhaustion in cases alleging ERISA violations.

For example, although the Second Circuit has not directly addressed the question, it made a point in Nechis v. Oxford Health Plans Inc. to mention that district courts within the Second Circuit have drawn a distinction between claims relating to violations of the terms of a benefit plan — which require exhaustion — and claims relating to statutory violations of ERISA — which do not.

Fleming v. Rollins

Fleming involves a putative class action filed in a district court in the Eleventh Circuit that, like many fiduciary breach cases, alleges that the plan's fiduciaries imprudently selected and offered high-cost investment funds with historically poor performance records, made excessive payments to service providers from plan assets, and failed to adequately diversify the plan's investment options.

In Fleming, the defendants succeeded in dismissing the plaintiff's complaint on the grounds that the class action plaintiff failed to exhaust the plan's claims procedure. In opposing the motion to dismiss, the plaintiff argued that the plan's claims procedure did not cover statutory violations of ERISA, and that even if it did, the failure to exhaust administrative remedies fell within the recognized exception of futility.

The court rejected both claims, finding that the plan document broadly defined the term

claim to include "any grievance, complaint, or claims concerning any aspect of the operation or administration of the plan or trust, including but not limited to claims for benefits and complaints concerning the investment of Plan assets."

Because the plan's provisions would encompass the plaintiff's claims for breaches of fiduciary duty, the court ruled that the plaintiff was required to exhaust administrative remedies — noting that within the Eleventh Circuit, the exhaustion doctrine applies to ERISA statutory claims. The court rejected the plaintiff's claims of futility, noting that such a claim would not apply where a claimant completely bypasses the administrative process as was the case in Fleming.

Takeaways

Defending ERISA breach claims on the grounds that the plaintiff has failed to exhaust plan administrative remedies is a viable litigation strategy in the Seventh and Eleventh Circuits, and may be worth asserting in a case arising in the First, Second and Eighth Circuits, which do not appear to have ruled out the defense.

The advantages of defending an ERISA breach case based on the exhaustion doctrine could be significant in light of the deferential review standard that typically applies to judicial review of an administrator's decision, and the limited scope of discovery associated with judicial review of administrative decisions.

As the courts in the Seventh and Eleventh Circuits have noted, administrative claim-resolution procedures have the potential to further the essential purposes of reducing the number of frivolous lawsuits under ERISA, minimizing the cost of dispute resolution, and enhancing plan fiduciaries' ability to carry out their duties expertly and efficiently by preventing premature judicial intervention in the fiduciary decision-making process.

The Seventh and Eleventh Circuit authority that favors the application of the exhaustion doctrine in ERISA breach cases is somewhat dated and is at odds with circuit courts that have more recently addressed this issue, most notably the Sixth Circuit's 2017 decision in Hitchcock v. Cumberland University 403(b) Plan.[9]

Fleming may present an opportunity for the Eleventh Circuit to revisit its precedent. In any event, sponsors should ensure plan claims procedures preserve the opportunity to assert the exhaustion defense. At least one court — the U.S. District Court for the Eastern District of Pennsylvania — in the Third Circuit, which does not apply the exhaustion doctrine to statutory claims, has held that such a defense is available in specific circumstances.[10]

Action Steps

Plan sponsors and fiduciaries should review governing plan documents and summary plan descriptions to:

- Ensure the plan document references the plan's claims procedure and that the summary plan description details a claims procedure that complies with the DOL claims regulations.

- Remove language in the plan document and summary plan description that suggests that a claimant's administrative remedies are not mandatory but permissive. The claims procedure should make it clear that a failure to exhaust the plan's administrative remedies bars litigation.

- Define the term "claimant" broadly to encompass any person — regardless of plan status — who may claim a right or benefit under the plan. A well-crafted claims procedure will apply to all claims by any person claiming a right or benefit under the plan.

- Ensure that the plan's claims procedure encompasses disputes that involve ERISA statutory claims and fiduciary claims — e.g., ERISA 510 claims and breach of fiduciary duty claims — and requires exhaustion of such claims, in addition to benefit claims.

- Ensure, to the extent possible, that the plan's forum selection clause requires suits to be brought in federal courts in the jurisdiction of circuits that currently require exhaustion for statutory claims or that have not ruled out the application of the doctrine to such claims.

Art Marrapese is a partner at Barclay Damon LLP.

[1] Fleming v. Rollins Inc. (N.D. Ga. Nov. 23, 2020).

[2] See Jacklyn Wille, MIT Inks Largest Settlement in College Retirement Plan Lawsuits, Bloomberg Law, Oct. 29, 2019, https://news.bloomberglaw.com/employee-benefits/mit-inks-largest-settlement-in-college-retirement-plan-lawsuits, which was cited by the University of Pennsylvania in its Petition for A Writ of Certiorari following the Circuit Courts decision in Sweda v. University of Pennsylvania (923 F.3d 320 (3d Cir. 2019)). The Petition was denied.

[3] 29 U.S. Code §1133.

[4] 29 C.F.R. §2560.503-1.

[5] A number of courts have held that the exhaustion requirement applies even where the plan appears to permit exhaustion, rather than mandate it. See, e.g., Wert v. Liberty Life Ins. Co. of Boston (447 F.3d 1060 (8th Cir. 2006)).

[6] Harrow v. Prudential Ins. Co. of Am. (279 F.3d 244 (3d Cir. 2002)); Zipf v. AT&T Co. (799 F.2d 889 (3d Cir. 1986)); Smith v. Sydnor (184 F.3d 356 (4th Cir. 1999)); Chailland v. Brown & Root, Inc. (45 F.3d 947 (5th Cir. 1995)); Hitchcock v. Cumberland University 403(b) Plan (851 F.3d 552 (6th Cir. 2017)); Horan v. Kaiser Steel Ret. Plan (947 F.2d 1412 (9th Cir. 1991)); Amaro v. Continental Can Co. (724 F.2d 747 (9th Cir. 1984)); Held v. Manufacturers Hanover Leasing Corp. (912 F.2d 1197 (10th Cir. 1990)); Stephens v. PBGC (755 F.3d 959 (D.C. Cir. 2014)).

[7] Lindemann v. Mobil Oil Corp . (79 F.3d 647 (7th Cir. 1996)); Robyns v. Reliance Standard Life Ins. Co. (130 F.3d 1231, (7th Cir. 1997)); Kross v. Western Elec. Co. (701 F.2d 1238 (7th Cir. 1983)); Lanfear v. Home Depot, Inc. (536 F.3d 1217 (11th Cir. 2008)); Mason v. Cont'l Grp. , (763 F.2d 1219 (11th Cir. 1985)).

[8] Madera v. Marsh USA, Inc. (426 F.3d 56 (1st Cir. 2005)); Nechis v. Oxford Health Plans, Inc. (421 F.3d 96 (2d Cir. 2005)); Burds v. Union Pac. Corp. (223 F.3d 814 (8th Cir. 2000)).

[9] Hitchcock v. Cumberland Univ. 403(b) DC Plan (851 F.3d 552 (6th Cir. 2017)).

[10] See Robertson v. Pfizer Retirement Committee (E.D. Pa. 2018) (exhaustion for statutory claims not required, but plaintiff chose to pursue resolution of breach of fiduciary duty claim thereby implicating the plan's forum-selection clause).