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BLOG

Supreme Court to Decide Pleading Standard in Prohibited-Transaction Litigation

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On October 4, 2024, the U.S. Supreme Court agreed to resolve a three-way circuit split regarding the pleading standard for alleged prohibited-transaction claims under the Employee Retirement Income Security Act of 1974, as amended (ERISA). The case is *Cunningham v. Cornell University*, Nos. 21-88, 21-96, 21-114 (U.S. Oct. 4, 2024). See here. The Court's decision will have a significant impact on the extent to which retirement plan fiduciaries are exposed to the risk and cost of prohibited-transaction litigation.

QUESTION BEFORE THE COURT

Under ERISA section 406(a)(1)(C), plan fiduciaries are prohibited from causing the plan to transact with parties-in-interest who furnish services to the plan (such as record keepers or third-party administrators), unless a statutory or other prohibited-transaction exemption applies. One such statutory exemption allows a service provider to provide necessary services for the plan in exchange for reasonable compensation.

The question before the Court is:

- whether a plaintiff may sufficiently plead a party-in-interest prohibited transaction under ERISA section 406(a)(1)(C)—and thereby survive a motion to dismiss—by simply pleading that a transaction involved the furnishing of services between the plan and a party-in-interest (i.e., a service provider), or
- whether the plaintiff must also plead additional facts alleging that an exemption (e.g., the statutory exemption under ERISA section 408(b)) is unavailable or otherwise show the transaction involved misconduct by the plan fiduciary.

THREE-WAY CIRCUIT SPLIT

Below is a summary of the current pleading standards adopted by federal circuits:

Second Circuit. In *Cornell v. Cunningham*, which the Supreme Court agreed to review, the Second Circuit ruled that plaintiffs must plead both (1) that a transaction involved a party-in-interest providing services to the plan *and* (2) that the statutory exemption under ERISA section 408(b) does not apply (e.g., by showing compensation received by the service provider was unreasonable).

Third, Seventh, and Tenth Circuits. In these circuits, plaintiffs must plead that a transaction involved a party-in-interest providing services to the plan and must also plead facts suggestive of traditional fraud or breach of fiduciary duty—such as facts indicating that the transaction was intended to benefit the party-in-interest (*Sweda v. Univ. of Pa.*, 923 F.3d 320, 340 (3d Cir. 2019)), that the transaction looked like "self-dealing" (*Albert v. Oshkosh Corp.*, 47 F.4th 570, 585 (7th Cir. 2022)), or that a prior relationship existed between the fiduciary and the service provider. *See Ramos v. Banner Health*, 1 F.4th 769, 787 (10th Cir. 2021).

Eighth and Ninth Circuits. Finally, the Eighth Circuit (*Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585 (8th Cir. 2009)) and the Ninth Circuit (*Bugielski v. AT&T Servs., Inc.*, 76 F.4th 894 (9th Cir. 2023)) adopted the most relaxed pleading standard, holding that a plaintiff only needs to plead that a transaction involved a party-in-interest providing services to the plan; then the burden shifts to the plan fiduciary to show that no more than reasonable compensation was paid for the services. (The Supreme Court also is considering whether to agree to review the Ninth Circuit's decision in *Bugielski*.)

WINSTON TAKEAWAYS

If the Court adopts too relaxed a pleading standard—such as the Eighth and Ninth Circuits—any routine, arm's-length agreement between a plan and a third-party service provider could become the basis of a plausible violation of ERISA section 406(a)(1)(C). Such a standard may hamper day-to-day plan operations (e.g., by complicating or even prohibiting the renegotiation of existing service provider agreements to add routine services, such as managed accounts or brokerage windows) and expose plan sponsors and fiduciaries to prolonged and expensive litigation in connection with routine service provider arrangements. On the other hand, adopting a narrower pleading standard limits the risks of litigation and is less likely to disrupt existing service provider arrangements. We anticipate that the Court will hear the *Cornell* case early next year and issue its decision prior to the end of its term in June.

To learn more about how this case and other important ERISA litigation trends may impact your company's retirement plans, contact your Winston & Strawn relationship attorney or a member of Winston's Employee Benefits and Executive Compensation team.

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