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Supreme Court Lowers the Bar for ERISA Prohibited Transaction Claims Based on Excessive Fees

By Joseph J. Torres and Katherine M. Funderburg

In this article, the authors discuss a recent decision by the U.S. Supreme Court clarifying the applicable pleading standard for prohibited transaction claims under the Employee Retirement Income Security Act of 1974 and resolving an existing three-way circuit split.

The U.S. Supreme Court recently issued its ruling in *Cunningham v. Cornell University*,¹ clarifying the applicable pleading standard for prohibited transaction claims under the Employee Retirement Income Security Act of 1974 (ERISA) and resolving an existing three-way circuit split. The *Cunningham* decision significantly lowers the bar for plaintiffs bringing prohibited transaction claims based on allegedly excessive fees paid to plan service providers, making it more likely that plaintiffs pursuing such claims will be able to survive motions to dismiss and proceed to discovery. However, the decision also highlights various tools that district courts can use to dispose of “meritless claims,” with the Court recognizing that its ruling is likely to cause concerns about an increase in meritless litigation given the more plaintiff-friendly pleading standard.

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PROHIBITED TRANSACTIONS

Two sections of ERISA are relevant to prohibited transaction claims, and pre-*Cunningham*, courts had split on whether to treat the two as establishing a single, combined pleading standard or as elements and affirmative defenses. Under § 406 of ERISA,² certain types of transactions between a plan and a “party in interest” are prohibited – namely, “[e]xcept as provided in section 1108” [§ 408 of ERISA], “[a] fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect – A) sale or exchange, or leasing, of any property between the plan and a party in interest; B) lending of money or other extension of credit between the plan and a party in interest; C) furnishing of goods, services, or facilities between the plan and a party in interest; D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan or E) acquisition, on behalf of the plan, of any employer security or employer real property.”

Section 408, in turn, sets out certain exemptions to the list of prohibited transactions, including “reasonable arrangements with a party in interest” for services “if no more than reasonable compensation is paid” and certain disclosure requirements are met.³

PATH TO THE COURT

In *Cunningham*, participants in Cornell University’s retirement plans sued the university and plan fiduciaries, alleging that the defendants had violated ERISA § 406. The university, as the plan administrator for the plans at issue, had retained certain service providers to provide record-keeping services to the plans. The plan participants alleged that the payments made to these service providers violated ERISA’s prohibited transactions provision because they were excessive and also were paid out of plan assets.⁴

The U.S. District Court for the Southern District of New York dismissed the prohibited transaction claim, reasoning that although the plaintiffs had alleged that the fees paid to the service providers were unreasonable, the plaintiffs nonetheless had failed to plead facts suggesting that the defendants engaged in self-dealing or other disloyal conduct.⁵

On appeal, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of the prohibited transaction claim, but on different grounds. The Second Circuit held that in order to state a prohibited transaction claim, a plaintiff must – in addition to pleading the elements of § 406 – sufficiently allege that none of the exemptions set forth in § 408 apply. Because the plaintiffs had not alleged that the transactions at issue fell outside the exemptions set forth in § 408, the Second Circuit concluded that they failed to state a claim.⁶

THE SUPREME COURT'S RULING

On April 17, 2025, the Supreme Court issued a unanimous decision in *Cunningham*. The Court reversed the Second Circuit's decision, holding that an exemption under § 408 is an affirmative defense that a defendant must assert and prove – not an element of a prohibited transaction claim that a plaintiff must affirmatively plead around in their complaint.⁷ The Court reasoned that reading § 406 to incorporate the exemptions set forth in § 408 as necessary pleading requirements would violate basic rules of statutory construction, and would raise fairness concerns given that plan fiduciaries – not plaintiffs – have the necessary information to determine whether an exemption applies.⁸

This ruling resolved an existing circuit split, as the Second Circuit's ruling in *Cunningham* diverged from those of the Eighth and Ninth Circuits, which had previously held that no additional pleading requirements beyond the elements of § 406 apply to prohibited transaction claims.⁹

Additionally, the U.S. Courts of Appeals for the Third, Seventh and Tenth Circuits had all previously held that in order to make out a prohibited transaction claim, a plaintiff must plead facts suggesting fraud or breach of fiduciary duty, such as facts suggesting that the transaction at issue was intended to benefit the party in interest, was self-dealing, or that the service provider had a preexisting relationship with the fiduciary.¹⁰

Recognizing that the lowered pleading standard for prohibited transaction claims raised “serious concerns” about a flood of meritless litigation, the Court in its decision highlighted certain existing tools that district courts can use to eliminate meritless claims before they progress to discovery – which can be costly and time-intensive for plan fiduciaries.¹¹

In particular, the Court pointed to a rarely used rule, Fed. R. Civ. P. 7, which empowers courts to require a plaintiff to file a reply to a defendant's answer. If a plaintiff cannot put forth specific, nonconclusory factual allegations showing that a § 408 exemption does not apply, the Court explained, a district court can dismiss their suit.¹² The Court also pointed to Article III standing as another basis to screen out meritless suits, since plaintiffs bringing prohibited transaction claims will still need to meet the requirement to show a cognizable injury.¹³ Additionally, the Court explained that district courts can order limited or expedited discovery in ERISA prohibited transaction cases that survive motions to dismiss – which would help to mitigate unnecessary litigation expenses for plan fiduciaries.¹⁴ The Court also cited Fed. R. Civ. P. 11 sanctions and ERISA's fee-shifting provision as additional deterrents to frivolous prohibited transaction claims.¹⁵

IMPLICATIONS FOR EMPLOYERS, PLAN SPONSORS, AND FIDUCIARIES

After *Cunningham*, plaintiffs bringing ERISA excessive fee cases in the form of prohibited transaction claims need only allege the following in order to state a claim:

- (1) A plan fiduciary caused a plan to engage in a transaction;
- (2) The fiduciary knew or should have known that the transaction involved furnishing goods or services; and
- (3) The transaction was between the plan and a party in interest. The burden to show that a § 408 exemption applies will be placed on the defendant.

This pleading standard is a very low bar – because recordkeepers and other plan service providers are parties in interest, virtually every contract with a service provider is a violation of § 406. The potential deterrents discussed above notwithstanding, *Cunningham* is likely to result in an increased number of prohibited transaction cases, and a greater number of those cases are likely to proceed past the motion to dismiss stage. Plan sponsors should be prepared to assert the applicability of a § 408 exemption at an early stage of the litigation, including via a petition to the court for a Fed. R. Civ. P. 7 reply. This rarely used tool may see more frequent use following the Court's explicit endorsement of it in *Cunningham*.

RECOMMENDATIONS

In light of the *Cunningham* decision, plan sponsors should consider how best to mitigate the risk of litigation and better position themselves to defend against prohibited transaction claims if the need arises.

With regard to plan administration, plan sponsors should review their existing agreements with service providers to identify any that could be subject to prohibited transaction claims, and confirm that these arrangements are comprehensively documented and that the fees are reasonable. Plan sponsors may also consider using investment consultants to benchmark the fees charged and opine as to their reasonableness. Plan sponsors should evaluate any existing indemnification or other provisions in their contracts that may impact how possible litigation would be defended. Plan sponsors should also consider updating any training they offer to advise fiduciaries on the possible risks of service provider arrangements, as well as steps to mitigate risk.

As to plan terms, plan sponsors may wish to consider amending plans to include venue provisions, in order to promote consistency in how the plan is interpreted by courts in any litigation. Alternatively, plan sponsors might consider including an arbitration provision in the plan, which may be used in some circumstances to avoid litigation.

In order to prepare for possible litigation, plan sponsors should familiarize themselves with the possible strategies the Supreme Court has identified for disposing of meritless prohibited transaction claims, as discussed above. Plan sponsors should also be aware of the challenges in attempting to implement those strategies – including, for example, the fact that Fed. R. Civ. P. 7 is rarely used and most litigants (and indeed, most courts) will not have experience with it.

NOTES

1. 604 U.S. ____ (2025).
2. 29 U.S.C. § 1106(a)(1).
3. *Id.* § 1108(b).
4. Cunningham, No. 23-1007 (U.S. Apr. 17, 2025), slip op. at 3-4.
5. 2017 WL 435769, at *10 (S.D.N.Y. Sept. 29, 2017).
6. 86 F.4th at 973, 975 (2d Cir. 2023).
7. Cunningham, No. 23-1007 (U.S. Apr. 17, 2025), slip op. at 11.
8. *Id.* at 11-12.
9. Bugielski v. AT&T Servs., Inc., 76 F.4th 894 (9th Cir. 2023); Braden v. Wal-Mart Stores, Inc., 588 F.3d 585 (8th Cir. 2009).
10. Albert v. Oshkosh Corp., 47 F.4th 570 (7th Cir. 2022); Ramos v. Banner Health, 1 F.4th 769 (10th Cir. 2021); Sweda v. Univ. of Pa., 923 F.3d 320 (3d Cir. 2019).
11. Cunningham, No. 23-1007 (U.S. Apr. 17, 2025), slip op. at 14.
12. *Id.* at 14-15.
13. *Id.* at 15.
14. *Id.*
15. *Id.*

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