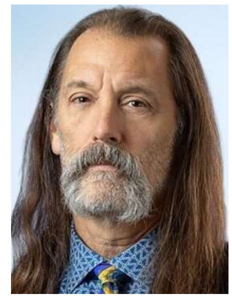
Justices Could Stitch Up ERISA Circuit Split With Cornell Case

By **Scott Tippett** (January 16, 2025)



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On Jan. 22, the U.S. Supreme Court will hear oral argument in Casey Cunningham v. Cornell University, setting the stage for a showdown between plan participants on the one hand, and plan administrators and plan fiduciaries on the other, regarding the interplay of Title 29 of the U.S. Code, Sections 1106(a) and 1108.

The petitioners are plan participants in two defined contribution plans maintained by the respondent, Cornell University.

The issue before the Supreme Court is whether the reasonable-arrangements exemption in Section 1108(b)(2) is incorporated into the Employee Retirement Income Security Act's prohibitions against party-in-interest transactions in Section 1106(a) or are the exemptions contained in Section 1108 defenses that a defendant fiduciary must plead and prove.

Section 1106(a) of ERISA begins "Except as provided in Section 1108" then broadly prohibits a fiduciary from causing "the plan to engage" in certain transactions with a "party in interest."

"Prohibited transactions" include the "furnishing of goods, services, or facilities between the plan and a party in interest."[1]

A "party in interest" includes various plan insiders, such as the plan's administrator, sponsor and its officers, as well as entities "providing services to [the] plan."[2]

Title 29 of the U.S. Code, Section 1108(b), contains a list of common transactions between plans and service providers that are exempted from the general prohibition under Section 1106.

Known as the reasonable arrangement exemption, chief among the exemptions are contracts "with a party in interest" for "services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor."[3]

A party in interest includes anyone providing services to a plan, which would include recordkeeping and other administrative services.[4]

The Cunningham case asks the question of what is the proper pleading standard to survive a motion to dismiss: Does a plaintiff have to plead facts that negate the Section 1108 defenses, or is it sufficient if a plaintiff only alleges a violation of Section 1106(a)?

Beyond being simply a matter of notice pleading, this is an issue of proof: Is it the plaintiff's burden of proof to show the exemptions in Section 1108 do not apply, i.e., allege and prove the compensation was unreasonable, or is it the defendant's burden to prove the exemptions do apply, which would require the defendant to plead and prove the compensation was reasonable?

Cornell hired Teachers Insurance and Annuity Association of America-College Retirement Equities Fund, or TIAA, and Fidelity Investments Inc. as investment advisers to offer investment selections to plan participants.

The plans have "over 30,000 participants and manag[e] approximately $3.34 billion in assets," according to court documents.[5]

As a result, "the Plans are considered 'jumbo plans,' with significant bargaining power in the retirement plan services market."[6]

TIAA and Fidelity also were engaged by Cornell to provide recordkeeping services to plan participants, which included tracking account balances and providing account statements.

Plan recordkeeping fees usually are paid one of two ways: (1) through revenue sharing; or (2) as a flat per-participant fee. When recordkeeping fees are paid through revenue sharing, the providers — in this case TIAA and Fidelity — were paid fees based on a set portion of plan assets.

The plaintiffs brought suit against Cornell, The Retirement Plan Oversight Committee, Mary G. Opperman and CapFinancial Partners LLC (doing business as CAPTRUST Financial Advisors), alleging the violations of Title 29 of the U.S. Code, Section 1106(a), because allegedly the respondents caused the plans to engage in prohibited transactions for recordkeeping services.

The petitioners argued "because TIAA and Fidelity are service providers and hence parties in interest, their furnishing of recordkeeping and administrative services to the [p]lans is a prohibited transaction unless Cornell proves an exemption."[7]

The petitioners contended that Cornell paid TIAA and Fidelity substantially more than reasonable recordkeeping fees in the $115 to $183 paid annually per participant for one plan and annually $145 to $200 paid per participant for the other. The petitioners contended a reasonable annual recordkeeping fee is approximately $35 per participant per year.

The respondents contended that because Section 1106(a) incorporates the exemptions under Section 1108, the petitioners were required to plead specific facts that negate the exemptions provided by Section 1108. Because the petitioners' complaint failed to do so, the respondents moved the U.S. District Court for the Southern District of New York to dismiss the petitioners' complaint.

The district court dismissed the plaintiffs' claims, holding that they must provide "some evidence of self-dealing or other disloyal conduct" to plead a violation of Section 1106(a) in connection with the provision of services. The petitioners' allegations "that the Plans paid too much for [the recordkeeping] services" did not suffice to allege such self-dealing or disloyal conduct.

On appeal, the U.S. Court of Appeals for the Second Circuit held that the district court applied the wrong standard, but even under the standard the Second Circuit thought correct, the plaintiffs' complaint still failed to state a claim upon which relief may be granted. According to the Second Circuit, the plaintiffs were required to "plausibly allege that the services were unnecessary or involved unreasonable compensation."

Presently, there is a split among the circuits regarding what a plaintiff must plead with respect to an alleged prohibited transaction claim violation under Title 29 of the U.S. Code, Section 1106(a)(1).

The U.S. Court of Appeals for the Eighth Circuit merely requires plaintiffs to plead an arrangement whereby plan payments are "exchange[d] for services rendered" by a "party in interest," per the court's 2009 decision in Braden v. Walmart Inc.[8]

Like the petitioners in Cunningham, the plaintiff in Braden alleged the revenue-sharing payments for recordkeeping fees were not reasonable because, like Cornell here, the Walmart plan had "over one million participants and nearly $10 billion in assets."[9]

The U.S. Court of Appeals for the Ninth Circuit likewise does not require plaintiffs bringing claims for Section 1106(a) violations to plead facts that negate the Section 1108 exemptions.[10]

The Ninth Circuit rejected the rationale and holding of the U.S. Court of Appeals for the Third Circuit[11] imposing a scienter requirement for violations of Section 1106(a), observing in Bugielski v. AT&T Services Inc. in 2023, "[w]e believe our reading is more faithful to the text of § 406(a)(1)(C), which does not include any intent requirement."[12]

At least in the Eighth and Ninth Circuits, plaintiffs only need allege the existence of a contract or reasonable arrangement between a plan and a service provider to avoid dismissal at the pleading stage. In these circuits, the defendants must raise and prove that the compensation was reasonable as an affirmative defense.

On the other hand, three other circuits — the Third, Seventh and Tenth, plus the Second Circuit in the case at issue — in varying ways impose additional pleading requirements on plaintiffs bringing claims for Section 1106(a) violations.

As noted above, in Sweda v. University of Pennsylvania in 2019, the Third Circuit construed Section 1106(a) to require scienter for a violation. In Sweda, the Third Circuit held

> absent factual allegations that support an element of intent to benefit a party in interest, a plaintiff does not plausibly allege that a "transaction that constitutes a direct or indirect ... furnishing of goods, services, or facilities between the plan and a party in interest" prohibited by § 1106(a)(1)(C) has occurred.[13]

At least in the Third Circuit, if a plaintiff fails to plead facts showing scienter, its complaint will be dismissed at the pleading stage.

The U.S. Court of Appeals for the Seventh Circuit took a slightly different approach. While not imposing the scienter requirement as the Third Circuit did in Sweda, the Seventh Circuit observed in Albert v. Oshkosh Corp in 2002, "[i]t would be nonsensical to read § 1106(a)(1) to prohibit transactions for services that are essential for defined contribution plans, such as recordkeeping and administrative services."[14]

Citing an earlier 2016 Seventh Circuit decision in Allen v. GreatBanc Trust Co.,[15] the Seventh Circuit seems to now require plaintiffs to plead and prove that a violation under Section 1106(a) involves an element of self-dealing that benefits the party-in-interest.

Still, the Seventh Circuit noted that Section 1108 affirmative defenses must be proved by the defendant.[16]

Finally, the U.S. Court of Appeals for the Tenth Circuit requires plaintiffs alleging a Section 1106(a) violation to plead — and prove — some other preexisting relationship between the plan and the service provider to bring the services within the scope of Section 1106(a), per its 2021 decision in Ramos v. Banner Health: "The class has provided no evidence to show that the service agreement between Fidelity and Banner was anything less than an arm's length deal or that Fidelity had some pre-existing relationship with Banner."[17]

Like the Seventh Circuit in Albert, the Tenth Circuit in Ramos interpreted Section 1108 as affirmative defenses to be raised and proved by defendants and, unlike the Second and Third Circuits, does not require plaintiffs to plead — and prove — the exemptions in Section 1108 do not apply.[18]

The effect of the Second, Third, Seventh and Tenth Circuits requires plaintiffs to plead and prove the contract or arrangement and the compensation paid were over and above an ordinary, arms-length transaction or that the contract was intended to benefit a service provider at the expense of the plan — and by extension the plan participants.

Clearly the stakes are high. A number of amicus curiae briefs have been filed on each side in the Cunningham litigation.

AARP and the AARP Foundation, the American Association for Justice, the Pension Rights Center and Quinn Curtis at the University of Virginia School of Law, together with 13 other professors of law at various law schools, have all filed briefs in support of the petitioner.

The U.S. Department of Labor has also filed an amicus brief in support of the petitioner. More importantly, on Dec. 20 the solicitor general filed a motion for leave to participate in oral argument.

For the respondents, amicus curiae briefs have been filed by Encore Fiduciary, an insurance carrier that provides fiduciary liability insurance; AT&T Services Inc., the defendant in 2023's Bugielski v. AT&T at the Ninth Circuit; the American Benefits Council; the American Council on Education; and the U.S. Chamber of Commerce.

With Cunningham, the Supreme Court has the opportunity and ability to provide clarity and guidance for an issue that has clearly vexed the various circuit courts by providing uniform pleading standards for Section 1106(a). No longer will parties be subject to varied pleading standards determined solely by the circuit in which a suit is brought.

If the Supreme Court agrees with the respondents, or adopts the rationale of the Third, Seventh or Tenth Circuits, the court will effectively require plaintiffs to plead facts distinctly within the knowledge of the defendants, leaving plaintiffs and plaintiffs counsel with a Hobson's choice: Plead facts not known at the time the complaint is filed (and unknowable without discovery), risking a Rule 11 violation, or forgo pleading unknown facts (so as to avoid a Rule 11 violation) but running the clear risk of dismissal at the pleading stage before any discovery may be had.

This could have a very chilling effect on private actions to enforce this particular section of ERISA, which is the chief enforcement vehicle upon which the Department of Labor relies.

Conversely, what's next if the Supreme Court agrees with the plaintiffs in Cunningham? That would mean plaintiffs only need allege the existence of a contract between a plan and a party in interest that provides services to a plan — which is all Section 1106(a) requires on its face — without anticipating and pleading the absence of affirmative defenses (as in Cunningham), or without alleging scienter (Sweda), self-dealing (Albert), or some other preexisting relationship (Ramos).

Will it open the floodgates of litigation and subject plans, plan trustees, plan administrators and service providers to endless litigation for contracts for ordinary services that must plead and prove the compensation was reasonable under Section 1108(b)(2)(B) to avoid liability?

Regardless of which way the Supreme Court rules, its ruling will have a substantial and lasting impact on Section 1106(a) litigation.

The audio portion of oral argument on Jan. 22 will be livestreamed on the court's website. This is an oral argument employee benefits counsel will not want to miss.

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[1] 29 U.S.C. 1106(a)(1)(C).

[2] 29 U.S.C. 1002(14).

[3] 29 U.S.C. § 1108(b)(2)(A).

[4] 29 U.S.C. § 1002(14)(B).

[5] Pet. App. 6a.

[6] Pet. App. 90a.

[7] Pet. App. 25a.

[8] Braden v. Walmart, Inc., 588 F3d 585 (8th Cir. 2009).

[9] Braden at 589.

[10] Bugielski v. AT&T Services, Inc., 76 F.4th 894 (2023)

[11] Sweda v. Univ. of Pennsylvania, 923 F.3d 320 (2019)

[12] Bugielski, 76 F4th at 906.

[13] Sweda 923 F.3d at 338.

[14] Albert v. Oshkosh Corp., 47 F.4th 570, 585 (7th Cir. 2002)

[15] Allen v. GreatBanc Trust Co., 835 F.3d 670 (7th Cir. 2016)

[16] Id.

[17] Ramos v. Banner Health, 1 F. 4th 769 (10th Cir. 2021).

[18] Ramos, 1 F. 4th at 788.