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Client Alert

Business Litigation

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Cunningham v. Cornell University: ERISA Claims Are Now Much More Costly and Difficult to Defend

In *Cunningham v. Cornell University*,[i] the Supreme Court unanimously held that plaintiffs who bring a prohibited transaction claim under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") are only required to plead a violation of the prohibited transaction rule and need not address whether there is an applicable exemption. Instead, the defendant must plead and prove the exemption, as they would any other affirmative defense.

The decision is somewhat surprising and will pose a significant burden on ERISA plan sponsors and fiduciaries going forward – most routine ERISA plan transactions are prohibited transactions that rely on an exemption. ERISA plaintiffs will now be able to easily plead and prove that these routine transactions (e.g., paying a 401(k) recordkeeper) are prohibited transactions. The burden will shift to ERISA defendants to plead and prove that an exemption applied (e.g., that the 401(k) recordkeeper fees were reasonable).

BACKGROUND

Section 406(a) of ERISA broadly prohibits a fiduciary from causing an employee benefit plan subject to ERISA ("ERISA Plan") to engage in a transaction with any "party in interest." Party in interest is broadly defined to include an ERISA Plan's sponsoring or participating employers, fiduciaries, and service providers, as well as certain affiliates of such persons. Because of the breadth of prohibitions under this rule, ERISA has statutory and administrative exemptions from prohibited transactions. Without these exemptions, ERISA Plans would be very restricted in their ability to transact.

Lower courts have divided on whether plaintiffs have adequately stated a prohibited transaction claim if they do not allege facts negating at least

some of the exemptions.[ii] In this case, the Second Circuit held that the plaintiffs had to plead that the conditions of the applicable exemption had not been satisfied. According to the Second Circuit, reading the prohibited transaction provision "in isolation of the exemptions" would produce "absurd results," namely "'prohibit[ing] fiduciaries from paying third parties to perform essential services in support of a plan,' including 'recordkeeping and administrative services.'"[iii]

The Supreme Court reversed the Second Circuit. The Court emphasized that a transaction with an ERISA Plan is "presumptively unlawful" if it satisfies three basic elements: a fiduciary "(1) 'caus[es a] plan to engage in a transaction' (2) that the fiduciary 'knows or should know . . . constitutes a direct or indirect . . . furnishing of goods, services, or facilities' (3) 'between the [ERISA Plan] and a party in interest.'"[iv] Because the prohibited transaction exemptions are set forth in separate sections of ERISA, the Supreme Court found that the exemptions constitute affirmative defenses that are "entirely the responsibility of the party raising" them.[v]

CONSEQUENCES

The Supreme Court's decision is significant because most ERISA Plans regularly transact with their parties in interest for various purposes, and thus most are engaging in prohibited transactions under the plain language of the statute. As Justice Alito noted in concurrence, to survive a motion to dismiss, plaintiffs need only "allege that the administrator did something that, as a practical matter, it is bound to do."[vi]

The Court acknowledged defendants' "serious concerns" that plaintiffs could "too easily get past the motion-to-dismiss stage," but those concerns did not carry the day.[vii] The "statutory text and structure" controlled.[viii] However, Justice Sotomayor identified potential pleading obstacles and deterrents to the filing of meritless claims. Specifically:

- Plaintiffs need to plead injury to establish constitutional standing.[ix]
- Rule 11 sanctions are available against lawyers who file complaints "where an exemption obviously applies, and a plaintiff and his counsel lack a good-faith basis to believe otherwise."[x]
- ERISA gives district courts discretion to shift costs by awarding attorneys' fees in favor of the prevailing party.[xi]

The Court also pointed to the procedural tools available to district courts to speed resolution, such as ordering limited discovery and replies to answers under Fed. R. Civ. P. 7.[xii]

Justice Alito's concurrence particularly highlighted the infrequently used procedural mechanism set out in Rule 7, which states that "if the court orders one, a reply to an answer" may be filed.[xiii] Rule 7 gives courts discretion to require a plaintiff to reply to a defendant's answer and "'put[] forward specific, nonconclusory factual allegations, showing that the exemption does not apply."[xiv] The concurrence highlighted Rule 7 as "perhaps the most promising" safeguard proposed by the majority, even though "it does not appear that [Rule 7] is a commonly used procedure."[xv] Still, the Court had "endorsed its use in the past."[xvi]

FUTURE IMPLICATIONS

The *Cunningham* decision will likely make it more difficult and more costly for ERISA Plan fiduciaries to resolve prohibited transaction claims. Amicus briefs from the Chamber of Commerce and others warned that ERISA defendants would have to undertake discovery based solely on allegations of ordinary contracting behavior.[xvii] According to the Chamber:

ERISA filings could easily skyrocket as countless lawful practices and everyday transactions will be actionable in a class-action lawsuit, leading to asymmetrical and extraordinarily expensive discovery. Plan sponsors will have to litigate claims for years based solely on their participation in garden-variety transactions that everyone agrees are entirely permissible—indeed, expressly contemplated by Congress.[xviii]

It is unclear how effective the structural deterrents and procedural mechanisms identified by the Supreme Court will be in providing relief for fiduciaries. For example, Rule 7 replies seem unlikely to play a meaningful role because they would effectively require a second round of motion practice on the pleadings.[xix] We are skeptical that many district courts will have an appetite for multiple, costly rounds of pre-discovery motion practice.

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[i] --- S.Ct. ----, 2025 WL 1128943 (Apr. 17, 2025) ("Opinion").

[ii] Petition for Writ of Certiorari, *Cunningham*, 2024 WL 1116522, at *3. The Second, Third, Seventh, and Tenth Circuits held that a plaintiff had to plead facts negating exemptions. *Id.* The Eighth and Ninth Circuits held that a plaintiff needed only to plead the elements of a prohibited transaction. *Id.*

[iii] *Id.* at 973 (quoting *Albert v. Oshkosh Corp*., 47 F.4th 570, 584–85 (7th Cir. 2022)).

[vi] *Id.* at 2 (Alito, J., concurring) ("Concurrence").

[vii] Opinion at 14.

[viii] *Id.*

[ix] *Id.* at 15 (citing *Thole v. U.S. Bank N.A.*, 590 U.S. 538, 544 (2020) (affirming dismissal of ERISA claim alleging a statutory violation without "plausibly and clearly alleg[ing] a concrete injury").

[x] *Id.*

[xi] *Id.* (citing 29 U.S.C. § 1132(g)(1))

[xii] *Id.* at 15.

[xiii] Concurrence at 3 (Alito, J., concurring); Fed. R. Civ. P. 7(a)(7).

[xiv] Opinion at 14 (quoting *Crawford-El v. Britton*, 523 U.S. 574, 598 (1998)).

[xv] Concurrence at 3.

[xvi] *Id.* (citing *Crawford-El*, 523 U.S. at 598).

[xvii] *See, e.g.*, Br. of amicus, American Council on Education, 2025 WL 81441, at *12 ("Use of a third-party service provider places the [fiduciary] at risk of being dragged into discovery based on prohibited transactions claims—no matter how diligent the [fiduciary] in its contracting, and no matter how essential or ordinary the contract."); Br. of amicus, Chamber of Commerce for the U.S., 2025 WL 81442, at *15 ("[A] plaintiff need not have any suspicion or hint of wrongdoing, but instead can merely point to the retention of a service provider to open the door to discovery.").

[xviii] Br. of amicus, Chamber of Commerce for the U.S., 2025 WL 81442, at *21.

[xix] Take a plaintiff who filed a complaint alleging a prohibited transaction claim and various other causes of action. Typically, the defendant would move to dismiss the entire complaint, setting off a first round of briefing on the pleadings. *Cunningham* makes it likely that the prohibited transaction claim would survive the Rule 12(b)(6) motion. At that point, defendant must answer. Only then could defendant file a motion asking the court to require the plaintiff to file a Rule 7 reply to the answer. There could be briefing on that request itself. In short, there are many steps between the filing of a complaint and potential relief for fiduciaries under Rule 7.