Simpson Thacher

Securities Law Alert

KEY DEVELOPMENT IN ERISA LITIGATION

Supreme Court: Settles Circuit Split on Pleading Standards for Prohibited-Transaction Claims

May 23, 2025

On April 17, 2025, the Supreme Court unanimously reversed and remanded the Second Circuit's dismissal of an ERISA claim that was brought by plan participants alleging that their employer and other plan fiduciaries violated §1106(a)(1)(C) [1] by causing the plans to engage in prohibited transactions for recordkeeping services. *Cunningham v. Cornell Univ.*, 145 S. Ct. 1020 (2025) (Sotomayor, J.). The Second Circuit had held that "the exemptions to §1106(a)'s prohibited transactions contained in §1108 imposed additional pleading requirements." Disagreeing, the Court held "that plaintiffs seeking to state a §1106(a)(1)(C) claim must plausibly allege that a plan fiduciary engaged in a transaction proscribed therein, no more, no less. Plaintiffs are not required to plead and prove that the myriad §1108 exemptions pose no barrier to ultimate relief."

Litigation Background and Procedural History

In 2017, current and former employees who participated in their university employer's defined-contribution retirement plans sued the university and other plan fiduciaries alleging that they violated §1106(a)(1)(C) by causing the plans to engage in prohibited transactions for recordkeeping services. In 2011, the university had retained two financial services companies to offer investment options to plan participants and the companies also served as recordkeepers for the plans by, among other things, tracking account balances and providing account statements. Plaintiffs claimed that the companies' furnishing of recordkeeping and administrative services was a prohibited transaction unless the university proved an exemption. The district court granted defendants' motion to dismiss the §1106(a)(1)(C) claim, finding that plaintiffs failed to plead both the prohibited-transaction elements in §1106(a)(1)(C) and "some evidence of self-dealing or other disloyal conduct."

The Second Circuit affirmed the dismissal but on a different ground, concluding that "the language of §1106(a)(1) cannot be read to demand explicit allegations of self-dealing or disloyal conduct." Instead, seeking to limit the reach of §1106(a)(1)(C)–lest it prohibit fiduciaries from paying third parties to perform essential services in support of a plan–the Second Circuit "held the exemptions to §1106(a)'s prohibited transactions contained in

[1] The three elements of §1106(a)(1)(C) prohibit "fiduciaries from (1) causing 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 plan and a party in interest."

§1108 imposed additional pleading requirements." In doing so, the Second Circuit created a circuit split with the Eighth Circuit, which had held in *Braden v. Wal-Mart Stores, Inc.*, 588 F. 3d 585 (8th Cir. 2009) that no additional pleading requirements beyond §1106(a)(1) apply to prohibited-transaction claims. In the Second Circuit's view, the exemption for reasonable and necessary transactions codified by §1108(b)(2)(A) [2] was incorporated into §1106(a)'s prohibitions. Concluding that plaintiffs had failed to affirmatively plead both that there was a prohibited transaction and that the transaction was unnecessary or involved unreasonable compensation, the Second Circuit affirmed the dismissal. The Supreme Court "granted certiorari to decide whether a plaintiff can state a claim for relief by simply alleging that a plan fiduciary engaged in a transaction proscribed by §1106(a)(1)(C), or whether a plaintiff must plead allegations that disprove the applicability of the §1108(b)(2)(A) exemption."

The Supreme Court Reverses

Justice Sotomayor, writing for the Court, held that plaintiffs seeking to state a prohibited-transaction claim under §1106(a)(1)(C) need only plausibly allege that a plan fiduciary engaged in a transaction proscribed. The Court explained that §1106(a)(1)(C) creates a categorical bar, such that any transaction that satisfies its three elements is presumptively unlawful. Justice Sotomayor noted that "[n]othing in that section removes from its categorical bar transactions that were necessary for the plan or involved reasonable compensation." Justice Sotomayor then concluded that "under §1106(a)(1)(C), plaintiffs need only plausibly allege each of those elements of a prohibited-transaction claim" and continued that "[t]he exemptions set forth in a different part of the statute, §1108, do not impose additional pleading requirements to make out a §1106(a)(1) claim." To support this conclusion, Justice Sotomayor drew on the "general rule of statutory construction that the burden of proving justification or exemption under a special exception to the prohibitions of a statute generally rests on one who claims its benefits" as stated in *FTC v. Morton Salt Co.*, 334 U.S. 37 (1948). Further, Justice Sotomayor cited *Meacham v. Knolls Atomic Power Laboratory*, 554 U. S. 84 (2008) for the proposition that exemptions ordinarily constitute "affirmative defenses" when a statute has exemptions laid out apart from the prohibitions and the exemptions expressly refer to the prohibited conduct as such. Justice Sotomayor found that ERISA has this structure because "[t]he exemptions to §1106(a) prohibited transactions are enumerated separately in §1108, and §1108 recognizes that the substantive 'prohibitions' are 'provided in section 1106' of the statute." Notably, Justice Sotomayor pointed out that if "plaintiffs bring barebones §1106(a)(1)(C) suits" district courts have "existing tools . . . to screen out meritless claims before discovery." Among other options, Justice Sotomayor noted that Federal Rule of Civil Procedure 7 empowers district courts to require the plaintiff to file a reply to an answer with "specific, nonconclusory factual allegations showing the exemption does not apply." In any event, a claim under §1106(a)(1)(C) remains subject to ERISA's other restrictions, including the statute of limitations under 29 U.S.C. §1113.

[2] Section 1108(b)(2)(A) of ERISA exempts any transaction that involves "contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor."

For further information regarding this Securities Law Alert, please contact one of the following:

CONTACTS

Martin S. Bell
+1-212-455-2542
martin.bell@stblaw.com

Stephen P. Blake
+1-650-251-5153
sblake@stblaw.com

Michael J. Garvey
+1-212-455-7358
mgarvey@stblaw.com

Nicholas S. Goldin
+1-212-455-3685
ngoldin@stblaw.com

Bo Bryan Jin
+1-650-251-5068
bryan.jin@stblaw.com

Meredith Karp
+1-212-455-3074
meredith.karp@stblaw.com

Peter E. Kazanoff
+1-212-455-3525
pkazanoff@stblaw.com

Meaghan A. Kelly
+1-202-636-5542
mkelly@stblaw.com

Jeffrey H. Knox
+1-202-636-5532
jeffrey.knox@stblaw.com

Chet A. Kronenberg
+1-310-407-7557
ckronenberg@stblaw.com

Joshua A. Levine
+1-212-455-7694
jlevine@stblaw.com

Laura Lin
+1-650-251-5160
laura.lin@stblaw.com

Linton Mann III
+1-212-455-2654
lmann@stblaw.com

Lynn K. Neuner
+1-212-455-2696
lneuner@stblaw.com

Michael J. Osnato, Jr.
+1-212-455-3252
michael.osnato@stblaw.com

Joshua Polster
+1-212-455-2266
joshua.polster@stblaw.com

Karen Porter
+1-202-636-5539
karen.porter@stblaw.com

Rachel S. Sparks Bradley
+1-212-455-2421
rachel.sparksbradley@stblaw.com

Alan C. Turner
+1-212-455-2472
aturner@stblaw.com

Craig S. Waldman
+1-212-455-2881
cwaldman@stblaw.com

George S. Wang
+1-212-455-2228
gwang@stblaw.com

Jonathan K. Youngwood
+1-212-455-3539
jyoungwood@stblaw.com

David Elbaum
+1-212-455-2861
david.elbaum@stblaw.com

Janet A. Gochman
+1-212-455-2815
jgochman@stblaw.com

Simona G. Strauss
+1-650-251-5203
sstrauss@stblaw.com