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Pleading Standards for Prohibited Transaction Claims: What Is Next?

This column examines the circuit split on which pleading standard applies to prohibited transaction claims.

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The Supreme Court has agreed to wade into the existing circuit split on the issue of which pleading standard applies to prohibited transaction claims under 29 U.S.C. Section 1106(a). On October 4, 2024, the Supreme Court granted *certiorari* in *Cunningham v. Cornell Univ.* [86 F.4th 961 (2d. Cir. 2023)], a Second Circuit case holding that a heightened pleading standard applies to prohibited transaction claims. The Second Circuit is consistent with the Third, Seventh, and Tenth Circuits, but it conflicts with the less stringent pleading standard articulated by the Eighth and Ninth Circuits.

Cunningham v. Cornell Univ. is one of many lawsuits involving claims alleging that a retirement plan fiduciary failed to employ adequate processes for monitoring the retirement plans in their charge in violation of 29 U.S.C. Section 1104 (resulting in the retention of underperforming investment options and the payment of excessive fees) and engaged in transactions prohibited under 29 U.S.C. Section 1106. In

Cunningham, the Second Circuit upheld the district court's grant of defendants' motion to dismiss plaintiffs' prohibited transactions claim. Plaintiffs' prohibited transactions claim focused on 29 U.S.C. Section 1106(a)(1)(C), which prohibits transactions between a plan and a party in interest where the transaction involves the "furnishing of goods, services, or facilities." [*Cunningham,* 86 F.4that 977]

The Second Circuit agreed with the Third, Tenth, and Seventh Circuits, holding that reading 29 U.S.C. Section 1106(a)(1)(C) in isolation "would appear to prohibit payments by a plan to any entity providing it with any services." [*Id.* at 973] However, the court found that the exemption for reasonable and necessary transactions codified by 29 U.S.C. Section 1108(b)(2)(A) should be incorporated into 29 U.S.C. Section 1106(a)'s prohibitions and "that to plead a violation of [29 U.S.C. Section] 1106(a)(1)(C), a complaint must plausibly allege that a fiduciary has caused the plan to engage in a transaction that constitutes the 'furnishing of ... services ... between the plan and a party in interest' *where that transaction was unnecessary or involved unreasonable compensation*. 29 U.S.C. Sections 1106(a)(1)(C), 1108(b)(2)(A)." [*Id.* at 975 (emphasis in original)]

The Second Circuit explained that its interpretation of the statute "flows directly from the text and structure of the statute," as 29 U.S.C. Section 1106(a) begins with the carveout "[e]xcept as provided in section 1108 of this title…", and therefore the exemptions set out in 29 U.S.C. Section 1108, including the exemption for "reasonable compensation" paid for "necessary" services under 29 U.S.C. Section 1108(b)(2)(A), should be incorporated directly into 29 U.S.C. Section 1106(a)'s definition of prohibited transactions. [*Id*.] The Second Circuit noted this language contrasted with the language of 29 U.S.C. Section 1106(b) governing "[t]ransactions between plan and fiduciary," which does not directly reference the 29 U.S.C. Section 1108 exemptions in setting out the scope of the transactions it prohibits. [*Id.*] Because the exemption is incorporated directly into the text of the statute, the court held that the presumption that the exemption is understood to serve as a defense that must be raised affirmatively by the defendant did not apply. [*Id.*] While the plaintiffs alleged the fees the plans paid to the service provider were too high, the court affirmed dismissal of plaintiff's claims as plaintiffs "failed to allege any facts going to the relative quality of the recordkeeping services provided, let alone facts that would suggest the fees were 'so disproportionately large' that they 'could not have been the product of arm's-length bargaining.'" [*Id.* at 978-979]

In *Albert v. Oshkosh Corp.* [47 F.4th 570 (7th Cir. 2022)], the Seventh Circuit similarly affirmed the district court's dismissal of the plaintiff's prohibited transaction claims where the district court held that bare allegations that defendants paid "excessive fees" in compensation for services provided to the plan, without more, did not state a prohibited transaction claim. [*Albert,* 47 F.4th at 586] The Seventh Circuit held that interpreting 1106(a)(1)(C) literally would prohibit payments to an entity providing services for the plan which would be inconsistent with the purpose of the Employee Retirement Income Security Act (ERISA). [*Id.* at 584] The court held "[i]t would be nonsensical to read [29 U.S.C.] Section 1106(a)(1) to prohibit transactions for services that are essential for defined contribution plans, such as recordkeeping and administrative services." [*Id.* at 585 (*citing Lockheed v. Spink*, 517 U.S. 882, 895 (1996))] To state a claim, the alleged transaction must "look[] like self-dealing," as opposed to "routine payments for plan services." [*Id*.]

Similarly, the Third Circuit in *Sweda v. Univ. of Penn.*, [923 F.3d 320 (3d. Cir. 2019)], held that 29 U.S.C. Section 1106(a)(1) is not a "*per se* rule barring all transactions between a plan and party in interest" as that "would miss the balance that Congress struck in ERISA, because it would expose fiduciaries to liability for every transaction whereby services are rendered to the plan." [*Id.*at 335-336] The court held that "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 [29 U.S.C.] Section 1106(a)(1)(C) has occurred." [*Id.* at 338] Likewise, the Tenth Circuit in *Ramos v. Banner Health* [1 F.4th 769 (10th Cir. 2021)] noted a limitation in the statute's apparent scope by holding that "some prior relationship must exist between the fiduciary and the service provider to make the provider a party in interest under [29 U.S.C.] Section 1106." [*Ramos,* 1 F.4th at 787]

However, two circuits have held that a more expansive reading of 29 U.S.C. Section 1106(a) is appropriate. Both the Eighth and Ninth Circuits require only allegations of an arrangement in which payments are exchanged for services by an interested party. In *Braden v. Wal-Mart Stores, Inc*. [588 F.3d 585, 601 (8th

Cir. 2009)], for example, the Eighth Circuit reversed the district court's dismissal of prohibited transaction claims at the pleadings stage, holding that the district court incorrectly dismissed the prohibited transaction claims on the basis that the plaintiff had not pled facts raising a plausible inference that payments to a service provider were unreasonable. [*Braden,* 588 F.3d at 600] The Eighth Circuit held that because the statutory defenses under 29 U.S.C. Section 1108 are defenses that must be proven by the defendant, the plaintiff did not have the burden of pleading facts showing payments to a service provider were unreasonable in proportion to the services rendered. [*Id.* at 601]

In *Bugielski v. AT&T Servs., Inc*. [76 F.4th 894 (9th Cir. 2023)], the Ninth Circuit similarly embraced what it characterized as a "literal reading" of 29 U.S.C. Section 1106(a)(1)(C), holding that a longstanding service provider to the plan was a party in interest and that the new service contract between the plan and service provider constituted a prohibited transaction under its reading of 29 U.S.C. Section 1106(a)(1)(C). [*Bugielski*, 76 F.4th at 908]

By granting the petition for *certiorari* in *Cunningham* the Supreme Court has signaled its interest in resolving the competing interpretations of the pleading standard for prohibited transaction claims under ERISA. While *Cunningham* focuses on prohibited transactions under 29 U.S.C. Section 1106(a)(1)(C), the Court's ruling could impact prohibited transaction claims under other subsections of 29 U.S.C. Section 1106(a) given the numerous exemptions listed under 29 U.S.C. Section 1108(b). ERISA fiduciaries and practitioners across the country will be watching the Court this spring.