Lowenstein Sandler

Client Alert

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Supreme Court Ruling Makes It Easier for Participants To Sue Plan Fiduciaries

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On April 17, the Supreme Court unanimously resolved a circuit split in *Cunningham v. Cornell University*, holding that plan participants need only allege that fiduciaries engaged in a "prohibited transaction" under the Employee Retirement Income Security Act of 1974, as amended (ERISA) to bring an action for breach of fiduciary duty. The burden to prove that a prohibited transaction did not occur falls to the plan fiduciaries.

By shifting the burden to fiduciaries to prove that a prohibited transaction did not occur, the Court's decision will make it easier for plaintiffs to claim that a breach of fiduciary duty occurred, and it is therefore likely to spark more litigation over the operation and administration of ERISA plans.

Background

ERISA generally applies to most private-sector retirement and health plans. For the protection of plan participants and plan beneficiaries, ERISA broadly prohibits transactions between a plan and a "party in interest" unless an exemption applies. Corresponding provisions of the Internal Revenue Code impose an excise tax on nonexempt prohibited transactions between a plan and a "disqualified person." A party in interest or disqualified person generally includes a fiduciary of a plan, a person who provides services to a plan, and the employer that sponsors a plan and its affiliates.

In order for plans to establish or conduct necessary operations, Section 1108 of ERISA has 21 statutorily prohibited transaction exemptions. In addition, the U.S. Department of Labor has issued numerous prohibited transaction class exemptions and individual exemptions. One statutory exemption (called the "reasonable contract exemption"), and the one focused on in the *Cornell* case, allows a transaction that involves "[c]ontracting 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." Absent this exemption, plan fiduciaries, trustees, and other service providers could not be paid for their services from plan assets without it being prohibited.

Plan participants may have standing to bring a claim under Section 1106 of ERISA by alleging that (1) a plan engaged in a transaction that (2) the plan fiduciary knows or should know constitutes a direct or indirect furnishing of goods, services, or facilities (3) between a plan and a party in interest. A circuit split emerged about whether the plan participants or the plan fiduciaries have the burden of showing that the prohibited transaction met, or didn't meet, the criteria for an exemption under Section 1108 of ERISA.

Cunningham v. Cornell University

In *Cornell*, participants of two defined contribution plans claimed that Cornell University, as named administrator of the plans, engaged in a prohibited transaction by causing the plans to pay excessive fees to service providers for recordkeeping services. The District Court dismissed the complaint, holding that the plaintiffs must also allege some evidence of self-dealing or other disloyal conduct. The U.S. Court of Appeals for the 2nd Circuit upheld the lower court's dismissal of the complaint, but not for the same reason. Instead, the 2nd Circuit held that the plaintiffs must both allege that a plan fiduciary engaged in a prohibited transaction and plausibly allege why (in the case of the reasonable contract exemption) the exemption does not apply.

Supreme Court's Holding

Siding with two other circuit courts, the Supreme Court reversed the 2nd Circuit by holding that plaintiffs need only plausibly allege that the fiduciaries engaged in a prohibited transaction. Plaintiffs need not also allege that the fiduciaries failed to satisfy the underlying elements of any possible prohibited transaction exemption. Thus, the burden rests on the accused fiduciaries to show that the prohibited transaction satisfied an applicable exemption.

Going Forward

To quell plan fiduciaries' concerns that the Supreme Court's ruling will invite "meritless litigation," the Supreme Court explained that there are other avenues available to fight off frivolous claims and courts have other procedural tools "to screen out meritless claims" at the pleading stage, such as cost shifting. Whether the additional measures available to courts to fend off meritless litigation will be used to sufficiently address this concern remains to be seen.

The *Cornell* decision places added emphasis on the importance of documenting fiduciary actions and diligence in determining how plan assets are expended. Litigation over excessive plan fees has grown over recent years, and in light of Cornell, such litigation seems likely to continue apace. Plan fiduciaries should be prepared to explain how and why a given prohibited transaction exemption applies and retain records supporting all fiduciary decisions.

For more information about how to determine who a plan fiduciary is, see our previous client alert.

Lowenstein Sandler's Executive Compensation, Employment & Benefits practice group regularly counsels clients on navigating fiduciary responsibilities and prohibited transaction rules. Please contact the authors or any Lowenstein Sandler attorney with whom you regularly work if you have any questions.

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