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Publications

Cunningham v. Cornell: Supreme Court Lowers Bar for ERISA 406 Claims

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PUBLISHED
04/22/2025

SOURCE
Groom Publication

SERVICES
Employers & Sponsors
- Fiduciary & Plan Governance
- Retirement Programs

Litigation

On April 17, 2025, the Supreme Court ruled in *Cunningham v. Cornell University* that, to state a claim under ERISA section 406, plaintiffs need only allege the elements contained in section 406. Prior to the Supreme Court's ruling, circuits were split regarding whether plaintiffs must also allege that none of ERISA section 408's exemptions applied. In a unanimous opinion, the Court held that section 408's exemptions are affirmative defenses that the defendant must plead and prove with respect to section 406 claims.

The Court, however does, include language suggesting that ERISA's section 408 statutory exemptions provide relief from violations of both ERISA section 406 subsections (a) and (b).

The Court's holding makes it significantly easier for plaintiffs to defeat early-stage motions to dismiss, reach costly discovery, and extract a settlement as to an alleged section 406 prohibited transaction claim. The new dynamic is likely to embolden the plaintiffs' bar to file more lawsuits involving 401(k) and employee stock ownership plans.

Background

Cornell University offers its employees two types of 403(b) retirement plans, which are similar in function and regulation to typical 401k retirement plans. Since 2011, Cornell retained two recordkeepers to administer the 403(b) plans, compensating them with asset-based recordkeeping fees. In 2017, plaintiffs representing a putative class of current and former Cornell University employees sued, alleging that the plans' fiduciaries violated ERISA section 406(a)(1)(C), which prohibits fiduciaries from causing a plan to enter into a transaction that causes a "furnishing of goods, services, or facilities between the plan and a party in interest," when they engaged the plans' recordkeepers.

The district court dismissed the claim and held that, in addition to pleading the elements of section 406(a)(1)(C), plaintiffs bear the burden of plausibly alleging "some evidence of self-dealing or other disloyal conduct." The Court reasoned that failing to add the requirement of self-dealing would make most basic operations for retirement pension plans prohibited transactions under section 406.

The Second Circuit affirmed the dismissal on different grounds on appeal. According to the Second Circuit, the district court was wrong to require plaintiffs to plead allegations of self-dealing or disloyal conduct. Instead, the Court held that plaintiffs must plead more than the simple elements of section 406—which, read literally, would create a cause of action for every necessary service provider engagement—and instead must allege that section 408(b)(2)(A) exemption does not apply. The Court reasoned that failing to apply section 408 exemptions to section 406 claims would lead to "absurd results"—namely, prohibiting fiduciaries from paying for essential services.

The Supreme Court's Cunningham v. Cornell Decision

Justice Sotomayor delivered the Court's unanimous decision, with Justice Alito filing a concurring opinion to which Justices Thomas and Kavanaugh joined. The Court reversed, holding that there is no statutory basis for requiring a plaintiff to plead elements beyond those contained in section 406. The Court reasoned that to read in other elements from section 408 would violate basic tenets of statutory interpretation and relevant Supreme Court precedent regarding which party has the burden to plea and prove statutory exemptions. The Court also commented on the lack of reasonable justification for requiring the plaintiffs to address certain section 408 exemptions and not others, when there are twenty-one exemptions listed in section 408 and many exemptions incorporated through the authority of the U.S. Department of Labor.

Specifically, the Court held, "The Court holds that [section 408] sets out affirmative defenses, so it is defendant fiduciaries who bear the burden of pleading and proving that a [section 408] exemption applies to an otherwise prohibited transaction under [section 406]."

The Court was sympathetic to Cornell's argument that its ruling would likely increase meritless litigation and harm plans, identifying it as a "practical" and "serious" concern. To address this concern, the Court highlighted five "tools" that district courts could use to dismiss and discourage meritless claims: 1) Federal Rule of Civil Procedure 7, which permits a court to order plaintiff to file a detailed response to a defendant's answer, 2) dismissal for lack of an injury-in-fact sufficient to establish Constitutional standing, 3) targeted early discovery, 4) Rule 11 sanctions, and 5) cost shifting under ERISA section 502(g).

Analysis

Viewed through a textualist lens—the prevailing method of Constitutional interpretation for the current Court— *Cunningham v. Cornell*'s decision and rationale are not altogether surprising. It is, however, disappointing for the defense bar. As the concurrence acknowledged, the Court's "straightforward" textualist interpretation lowered the pleadings stage bar, which could lead to "untoward practical results"—namely, a flood of meritless, lawyer-driven lawsuits that could leverage costly discovery to extract a cost-of-defense settlement.

The Court suggested that lower courts have a number of tools at their disposal—some more promising than others—to deal with that problem. Going forward, it will be up to defendants to use these tools and others to help courts identify, eliminate, and discourage these meritless strike suits.

Fortunately for the defense bar, the Court's opinion is cabined to section 406 claims and does not upend the Court's other recent decisions regarding the pleading standard for section 404 breach of fiduciary duty claims, like *Dudenhoeffer* and *Hughes*. Those opinions emphasized that courts must apply "careful, context-sensitive scrutiny" to "weed out meritless lawsuits" at the pleadings stage and effectuate ERISA's goal of balancing employee and employer interests.

Finally, we expect to see the defense bar use the Court's holding and textual focus (combined with the Court's recent *Loper Bright* decision) to argue to overturn regulations and caselaw that suggested that certain statutory exemptions only provide 406(a) relief.