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Cornell Retirement Plan Dispute Tees Up Circuit Split at SCOTUS

By Jacklyn Wille

Argument Preview

- **Justices have chance to resolve three-way circuit split**
- **Dispute implicates common practice of hiring outside vendors**

The US Supreme Court on Wednesday will hear arguments over Cornell University's retirement plan, giving the justices a chance to clarify what employees challenging 401(k) service provider fees must allege to advance their claims.

The court's decision could dictate how easy—or difficult—it is for workers to successfully argue that retirement plan service provider arrangements violate the Employee Retirement Income Security Act's prohibited transaction rules. These rules, which put guardrails on relationships between plans and interested parties, have driven a circuit split partly based on how the statute is drafted: one section of ERISA defines prohibited transactions in broad terms, while another provides multiple exemptions that allow an arrangement to remain legal if, for example, it's appropriately priced.

The justices are tasked with deciding whether these exemptions must be addressed in a plaintiff's complaint, or whether they're defenses to be proven by the plan fiduciary. A Cornell loss could act as a green light for workers seeking discovery or hefty settlements, but a victory could frustrate genuine attempts to rectify mismanagement, attorneys told Bloomberg Law.

"In effect, the Supreme Court is deciding whether a defendant has to prove that a service provider's compensation was reasonable or whether a plaintiff has the burden of proving it was unreasonable," Lindsey R. Camp, an ERISA litigation partner with Holland & Knight LLP, said.

Parsing the Text

The dispute could turn on a close reading of the statutory text, which Radha Pathak said would favor employees.

The workers have a “compelling text-based argument” that they’re not required to plead the absence of exemptions in ERISA Section 408, because those exemptions are affirmative defenses to the transactions prohibited by Section 406, said Pathak, a Stris & Maher LLP partner who frequently represents plaintiffs.

“Typically, that’s where things would end, with the court analyzing what the most natural reading of the statute is,” Pathak said. But here, the defense bar has “found itself in a position of not liking the result that the text compels,” she said.

According to Camp, there’s a strong argument that the Section 408 exemptions are “incorporated by reference” into Section 406’s prohibited transaction rules, which would place the burden of pleading that the exemption doesn’t apply on the plaintiffs bringing suit.

Three-Way Split

The case gives the justices an opportunity resolve a three-way circuit split.

In ruling for Cornell, the US Court of Appeals for the Second Circuit said prohibited transaction claims based on service provider compensation must include allegations the services were unnecessary or overpriced. The Third, Seventh, and Tenth circuits require something beyond the mere existence of a service provider relationship, such as self-dealing or fraud.

But the Eighth and Ninth circuits say simple allegations of a paid service provider arrangement could be enough to state a claim.

The process for defending these cases therefore “varies dramatically” across the country, which wasn’t Congress’s intention in creating ERISA, Camp said.

More Litigation?

Attorneys predict an increase in litigation and administrative costs if the employees prevail.

“If the plaintiffs’ view is correct, then the only thing they need to plead is the existence of an actual contractual or service relationship, not whether the relationship is necessary or reasonable,” William Delany, a principal and litigation co-chair at Groom Law Group, said.

That would be a very low bar for allowing a case to advance, Delany said, because it’s “nearly impossible” to operate a retirement plan without hiring outside vendors.

But Pathak said concerns about a spike in meritless litigation are overblown, because no plaintiff wants to write a complaint a district court will view as a “sure loser,” even with a lower pleading bar.

Rather, a Cornell victory could create an unworkable situation for employees trying to rectify mismanagement without detailed information about how their retirement plan operates, Pathak said.

If the Second Circuit’s approach is affirmed, “there’s really no stopping point to the number of exemptions that a plaintiff would have to affirmatively plead around,” she said.

Predicting Scope

Some of the Supreme Court's recent ERISA decisions have been relatively narrow, but attorneys say the Cornell case could be poised for a broader ruling with clear guidance.

It's also likely to affect a similar case involving AT&T Services Inc.'s 401(k) plan, which is the subject of an outstanding petition for Supreme Court review.

The Cornell case gives the justices a "good set up" to provide some thoughtful consideration of ERISA's underlying policy and the interplay between its prohibited transaction rules and exemptions, Delany said.

Pathak agreed that the justices may be poised to offer clear answers, because the statute "just doesn't lend itself" to a middle-ground position.

"It would be an opportunity missed if the court didn't add clarity to such an important area of the statute," Delany said.

The case is Cunningham v. Cornell Univ., U.S., No. 23-1007, arguments scheduled 1/22/25 .

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