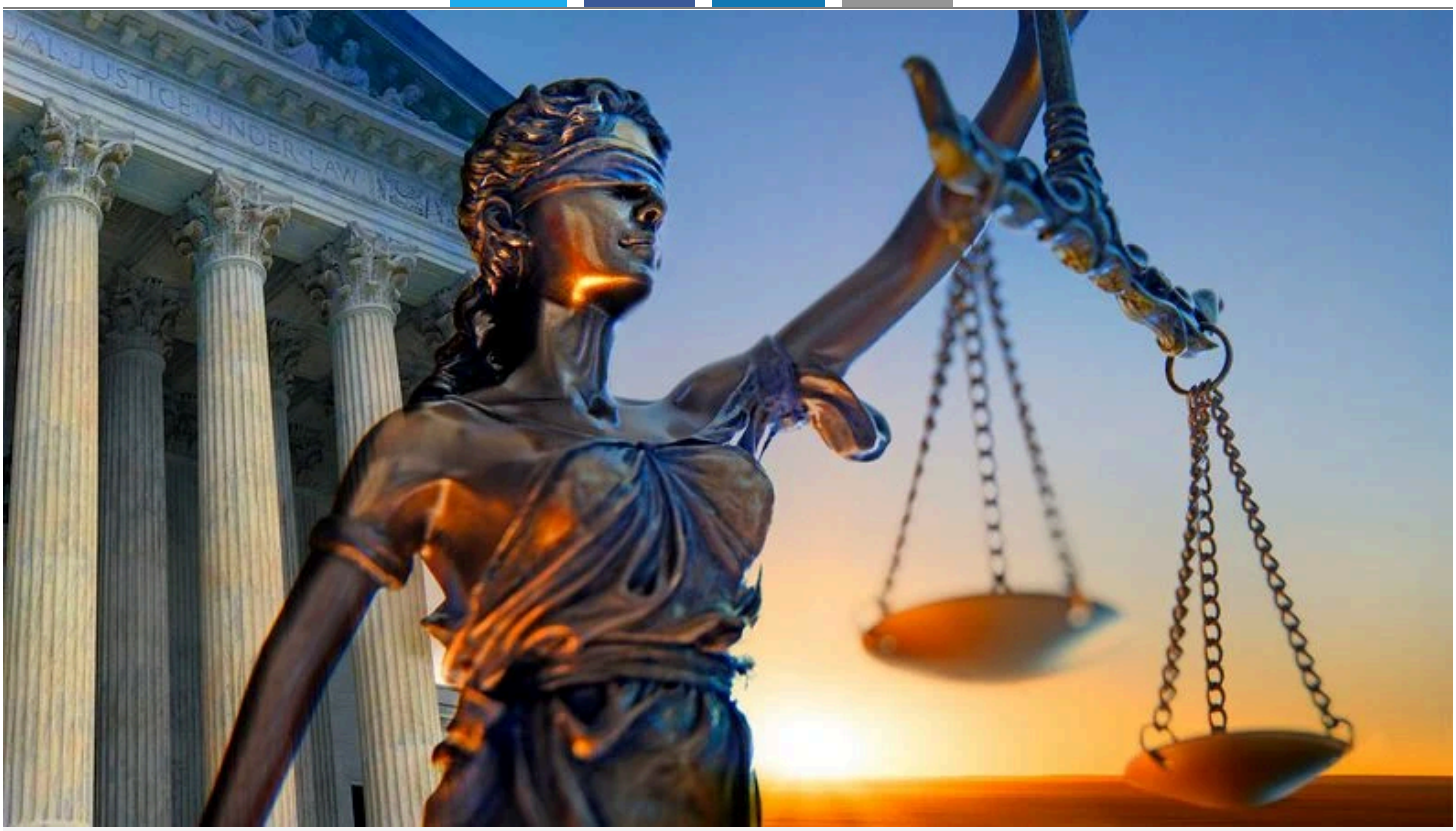
DEFINED CONTRIBUTION

April 23, 2025 03:00 PM
21 HOURS AGO

Supreme Court decision on prohibited transactions will increase ERISA lawsuits, DC plan costs, retirement industry says

By ROBERT STEYER



Getty Images/iStockphoto

Lady Justice statue in front of the U.S. Supreme Court building.

The retirement industry assailed a recent ruling by the Supreme Court on the vexatious legal issue of prohibited transactions, saying the pro-participant decision will encourage more lawsuits, raise retirement plan costs and discourage innovation in plan design.

Led by prominent trade groups, critics of the 9-0 Supreme Court decision in *Cunningham et al. vs. Cornell University et al.* said only Congress can provide relief by changing the federal law — ERISA — that identifies prohibited transactions in one section and exemptions to the prohibitions in another section, they said.

"This ruling effectively invites a new wave of litigation that could burden plan fiduciaries for doing what ERISA expressly permits — engaging necessary service providers at reasonable fees," said Tim Rouse, executive director of the SPARK Institute, whose members serve more than 110 million savers in employer-sponsored retirement plans.

"The decision rewards legal technicalities over practical realities and will ultimately harm plan participants by increasing costs and discouraging plan innovation," said Rouse, whose membership includes record keepers, mutual fund companies, banks, consultants, investment advisers and insurance companies.

ERISA contains a series of prohibited transactions, including self-dealing by fiduciaries, improper contracts and transactions, that carry a high risk to retirement plan assets due to contracts that transfer to third parties the responsibilities reserved for fiduciaries.

ERISA also contains a list of exemptions that include providing investment advice, loans to plan participants, loans to employee stock ownership plans, and contracts for life insurance or annuities.

The Supreme Court **ruled** sponsors must prove to judges that their transactions with third parties qualify as exemptions under ERISA rather than judges requiring participants to disprove the exemptions.

The Supreme Court "came to a frankly horrible decision, creating enormous litigation exposure for the private retirement plan system, including every single ERISA-covered defined contribution plan regardless of how well managed it is," said Kent A. Mason, a partner in the Davis & Harman law firm and outside counsel for the American Benefits Council.

"The opinion generally recognizes that this decision could lead to an avalanche of litigation, but effectively blames Congress for that," Mason said. "Without (legislative) reform, the cost of maintaining a plan will certainly rise very materially and much of the good that has been achieved in recent bipartisan legislation could be undermined."

Congressional action

Mason said it will be challenging to get congressional action. "Legislation to fix this will require 60 votes in the Senate, which in turn will require Democratic votes," he said. "Democrats have been very protective of participants' ability to sue in the past."

Without a change in the law, retirement plan sponsors “will have to come up with a process that in some way justifies every step” in their transactions with providers, said Lynn Dudley, senior vice president for global retirement and compensation policy for the American Benefits Council, which represents private employee retirement and health benefits programs covering more than 100 million Americans.

“Rather than bundle the services, they will have to break it apart,” she said.

The bottom line for defined contribution plans: “People will get less,” she said.” I fear far fewer services.”

Dudley added that plans will emphasize cost, such as adding more index funds, resulting in “far less innovation.”

Differing opinions

The Supreme Court took the Cornell case in part because different federal appeals courts had issued differing opinions on the responsibilities of participant-plaintiffs vs. defendant-sponsors in convincing judges about prohibited transaction complaints.

Sponsors want standards that place the burden on participants, a higher bar for plaintiffs that could lead to lawsuits being dismissed — the first and cheapest line of defense in litigation.

A federal District Court in New York and the 2nd Circuit Court of Appeals, New York, endorsed this approach in the Cornell case, which was originally filed in 2016 by participants in two Cornell 403(b) plans.

Retirement plan members say the burden should fall to the sponsors, who must prove that their transactions with third parties such as record keepers are exempt from ERISA's prohibited transaction rules.

The Supreme Court, in an opinion written by Justice Sonia Sotomayor, backed the participants, reversed the appeals court ruling and sent the case back to the trial court, which will review the participants' original complaint about excessive fees.

“It is defendant fiduciaries who bear the burden of pleading and proving that (an ERISA) exemption applies to an otherwise prohibited transaction,” Sotomayor wrote.

"Plaintiffs seeking to state a (prohibited transaction) claim must plausibly allege that a plan fiduciary engaged in a transaction proscribed therein, no more, no less," Sotomayor wrote. "Plaintiffs are not required to plead and prove that the myriad (ERISA) exemptions pose no barrier to ultimate relief."

Setting the bar for complaints

Industry representatives said the ruling makes it easier for participants to sue and to overcome a motion to dismiss.

"Considering the large — and increasing — number of suits being filed ... one might well wish for better legal guardrails to thwart them," Nevin Adams, an attorney and former chief content officer for the American Retirement Association, wrote in an analysis of the decision for ARA.

"But this result seems unlikely to slow the current pace — and might well accelerate it," he wrote.

Jerome Schlichter, the participants' attorney, disputed the industry's comments.

"Floodgates will not open," said Schlichter, founding and managing partner of Schlichter Bogard.

The ruling "was based on a strict interpretation of ERISA," he said. "It's a classic case of a conservative interpretation of what the statute says. This isn't legislating from the bench."

The court placed the burden on sponsors to show their actions were exempt under ERISA, he said, "a straightforward and clear decision," said Schlichter. "I don't see any ambiguity."

This is Schlichter's third ERISA victory at the Supreme Court, all by unanimous votes. In 2015, it was **Tibble et al vs. Edison International Inc.** et al., establishing the requirement that DC plans have a "continuing duty" to monitor investments and remove imprudent ones. **In 2022,** it was Hughes vs. **Northwestern University**, in which the justices said DC plan fiduciaries must monitor every investment in a plan's lineup.

The latest 9-0 ruling is "eclipsed by the court's statements regarding how its interpretation of the relevant provisions of ERISA raises 'serious concerns,' namely that the relaxed pleading standards will open the floodgates to meritless cases that will survive motions to dismiss," said Tom Christina, executive director of the ERISA Industry Committee's Legal Center. "The court clearly has misgivings about that result."

Those misgivings showed up in **Sotomayor's opinion** as well as a concurring opinion by Justice Samuel A. Alito Jr., who was joined by Justices Brett Kavanaugh and Clarence Thomas.

"The unanimous decision, and even more so the concurrence, expressed concern that these results could result in litigation going deeper into the process, resulting in delay and expense," said Andrew

L. Oringer, partner and general counsel for the Wagner Law Group.

The justices "took the unusual step of suggesting the use of special federal rules that could allow a district court to dismiss claims where an affirmative defense is plainly available and the claims are essentially spurious," Oringer said. "The court, however, was stuck with the statute's structure, and therefore could not do more."

The unanimity of the justices' ruling may have been a surprise to some retirement industry members based on the **oral arguments** in January.

"That seems nuts," Kavanaugh said at the time, referring to the plaintiffs' argument.

"All you need to do is plead something that seems to be on the surface completely innocuous," Alito said. "That's enough to get you beyond the motion to dismiss."

In his concurring opinion, Alito wrote he joined the majority because he was following the strict construction of ERISA. The law contains a list of affirmative defenses — the exemptions — and ERISA says plaintiffs aren't required to challenge such defenses, Alito wrote.

"It would make no sense to require a complaint to anticipate and attempt to refute all the affirmative defenses that a defendant might raise," he wrote.

"Unfortunately, this straightforward application of established rules has the potential to cause — and, indeed, I expect it will cause — untoward practical results," he wrote.

The justices “were trying to give the best answer given the statute,” said Stephanie L. Gutwein, a partner at Faegre Drinker Biddle & Reath.

For now, the best defendants can do is tell judges “their response is consistent” with the some suggestions in Sotomayor's opinion, she said.

Sotomayor acknowledged the concerns expressed by Cornell University's lawyers about plaintiffs being able to hurdle a motion to dismiss, pushing a complaint into the expensive discovery process.

"These are serious concerns, but they cannot overcome the statutory text and structure," she wrote. "District courts … have available a variety of means to address the concerns raised by respondents."

That's not good enough for some industry representatives.

“I am skeptical that these steps will be taken sufficiently often to control meritless prohibited transaction claims,” said Carol Buckmann, founding partner of Cohen & Buckmann.

Such rules would be subject to interpretation by individual trial judges, who "often have inconsistent approaches to the same fact patterns," she said.

RELATED ARTICLES

Supreme Court rules for retirement plan plaintiffs in suit against Cornell University

Supreme Court hearing to pit DOL against big names in retirement, employment