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# Texas Federal Court Allows an ERISA Fiduciary Challenge Against Alleged "ESG Investing" Without Any ESG Funds

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On January 10, 2025, in *Spence v. American Airlines*[1], a federal district court in Texas ruled that American Airlines (the company) and the committee overseeing its 401(k) plans (the committee) breached their duty of loyalty under the Employee Retirement Income Security Act of 1974 (ERISA) owed to participants in the company's 401(k) plans, based primarily on conduct related to proxy voting of securities held in certain of the 401(k) plans' investment funds. The court held that the company's non-plan relationship with one of the 401(k) plans' investment managers led the company and the committee to turn a blind eye to the investment manager's allegedly ESG-driven proxy voting policies and activism, implemented in part (so the court found) using the assets of the company's 401(k) plans that the investment manager managed, thereby "sacrific[ing] investment return . . . to promote benefits or goals unrelated to the interests of participants."[2] At the same time, the court found that the company and the committee satisfied their ERISA duty of prudence with fiduciary oversight practices that not only met legal requirements, but "in many cases…exceeded the standards."[3]

The decision is remarkable and, if ultimately upheld, potentially opens a new avenue of ERISA fiduciary litigation against 401(k) plans, which focuses not on investment returns or administrative costs, but instead on the proxy voting activities of investment managers. In this article, we explore the details around the court's findings of fact and legal conclusions. We also look at the takeaways that 401(k) plan sponsors and their fiduciaries should consider in light of this decision.

## Court's Key Findings of Fact of the Case

The following summarizes key facts as found by the court and reported in the published decision.

The company sponsored and maintained two 401(k) plans at issue — the American Airlines, Inc. 401(k) Plan and the American Airlines, Inc. 401(k) Plan for Pilots (together, the plans) — which collectively held more than $26 billion in assets.[4] The governing plan documents for the plans established the committee as a "named fiduciary" and administrator for the plans.[5] The plans included an array of participant-directed investment choices, including a series of target date funds, a group of passively invested index funds, a group of actively managed funds, and a self-directed brokerage account alternative.[6]

The investment manager managed the passively invested index funds for the plans, which represented a significant portion of the total plan assets.[7] In addition, the court found that the investment manager owned more than 5% of the company and held about $400 million in corporate debt of the company.[8] The court highlighted

 

that the company's personnel notably described the company's relationship with the investment manager as "significant".[9] These findings of fact by the court will play an important role in the court's decisions discussed below.

The committee — staffed by experienced personnel from various business units (including human resources and finance), as appointed by the company — held the primary fiduciary responsibility for selecting and monitoring the plans' investment options, investment managers, and other vendors.[10] In alignment with the traditional practices of 401(k) plan fiduciaries, the committee met at least quarterly to review the performance of the investment options and maintained an investment policy statement to help guide that review.[11] The committee also engaged both internal and external investment professionals to assist in carrying out their duties.[12] The company's internal group, called the "Asset Management Group," was comprised of experienced financial analysts employed by the company, who regularly reviewed "detailed qualitative and quantitative information regarding the [Plans'] investment options" (including performance data and financial press regarding market developments) and met quarterly with current and prospective investment managers to "discuss any developments, changes in investment philosophy or the key personnel" to more comprehensively understand the manager's performance.[13] The committee also engaged a highly respected and established outside consultant (the fiduciary advisor) to advise the committee about the performance of the investment options including both quantitative analysis and a review of qualitative factors regarding the various investment managers for the investment options.[14] In addition to meeting with the fiduciary advisor quarterly to review investment options and make recommendations to the committee, the Asset Management Group also regularly met with the investment advisor for the pilots' union to get their additional feedback on the investment options and investment managers under the plans.[15] In other words, the committee, together with its advisors, conducted a rigorous process for selecting and monitoring the plans' investment options and underlying investment managers.

Consistent with industry standards and the delegations set forth in the committee's investment policy statement, the investment management agreements with the plans' investment managers assigned the responsibility for proxy voting to each investment manager for any voting securities managed by that investment manager.[16] The investment managers were required to provide their applicable proxy voting guidelines to the Asset Management Group and to annually produce materials reporting on their proxy voting practices (including a summary report of how proxies were voted) to the committee each year.[17]

In that context, the investment manager's investment management agreement specified that it would vote any proxies consistent with its proxy-voting guidelines in the "best long-term economic interests of the assets it manages".[18] The court found that at some point, the investment manager's proxy-voting guidelines began to expressly incorporate certain ESG considerations.[19] Additionally, there was a quarterly process that required the investment manager to attest to its adherence to its voting guidelines, although in the court's view, this attestation process was seemingly not always followed.[20] Notably, while the fiduciary advisor's regular due diligence included reviewing the proxy voting policies and activities of the plans' investment managers as part of its qualitative review of such investment managers, the court found that such information rarely found its way into reports to, or discussions with, the committee.[21] As many 401(k) plan fiduciary committees are likely aware, a detailed investigation of proxy voting activities of plan investment managers is not a typical focus for fiduciary committees.

The court expressed in its findings of fact its deep skepticism that ESG investing is based on seeking improved

financial performance. The court cited certain studies showing that, over a select period, certain funds focused on ESG investing underperformed broader market indices.[22] The court highlighted that ESG investing's primary purpose is to effect societal change rather than achieve financial results.[23] While the court noted that "[i]nvesting that aims to reduce material risks or increase return for the exclusive purpose of obtaining financial benefit is *not* ESG investing," the court went on to state:

… ESG investing is a strategy that considers or pursues a non-pecuniary interest as an end itself rather than as a means to some financial end. This distinction is especially key in this case. Simply describing an ESG consideration as a material financial consideration is not enough. There must be a sound basis for characterizing something as a financial benefit. Otherwise, anything could qualify as a financial interest and can serve as pretext for non-pecuniary interests.[24]

The court also found that the investment manager had engaged in what the court classified as "ESG activism," with the court supporting this assertion with certain public statements and actions by the investment manager's CEO and its support of various shareholder initiatives in proxy voting campaigns.[25] As one example, the court noted a contested board election for a major, publicly traded oil and energy company, that ultimately resulted in the election of three dissident directors to that company's board. The court found that the investment manager's vote for the dissident directors was determinative of the vote's outcome.[26] The court observed that the oil and energy company's stock price dropped in the immediate aftermath of that vote.[27]

Meanwhile, the court also took note of the company's own ESG-based policies and positions, many of which the court found aligned with those for which the investment manager was supposedly advocating.[28] The court found that members of the Asset Management Group — one of whom, the court found, also oversaw the company's business relationships with the investment manager as a key owner and debt holder — were aware of what the court termed "ESG activism" by the investment manager and potential concerns related to such activism, but failed to raise the topic with the committee.[29]

**Who Is a Fiduciary?**

As an initial matter, the court decided that the company itself was an ERISA fiduciary with respect to the plans, despite the fact that the governing documents of the plans expressly listed the committee as the "named fiduciary" and plan administrator.[30] The court pointed to the following areas of responsibility held by the company that made it a "functional" fiduciary with respect to the plans under ERISA:

- The company held the power to appoint, retain, and remove plan fiduciaries, particularly, the members of the committee.
- The company held the duty to ensure that the committee members comply with their fiduciary duties.
- Finally, the company was "responsible for overseeing the [Plans'] investment managers, in addition to communicating with the [Plans'] advisors, preparing materials for [Committee] meetings, and raising any concerns or issues concerning the [Plans] with [Committee] members."[31]

Notably, the court also highlighted that both the committee and the company signed the consulting agreement with the fiduciary advisor, and the company was listed as the named fiduciary in such agreement's investment policy statement.[32]

The court found that these functional roles caused the company to be a defendant not merely with respect to a duty to monitor the committee.[33] In making such determination, the court noted that, while some Fifth Circuit precedent might limit ERISA exposure for *individuals*, (*e.g.*, members of a board of directors) to the duty to monitor the members of a fiduciary committee, the court believed such limited liability does not apply to an entity, like the company.[34] As a result, the court considered the company to have equivalent fiduciary obligations of the committee, despite the fact that only the committee was named as a fiduciary under the terms of the plans' governing documents.[35]

**Duty of Prudence Satisfied**

The court first analyzed claims that the company and the committee failed to meet ERISA's duty of prudence, and ultimately concluded that the duty of prudence was satisfied.

ERISA's duty of prudence requires a fiduciary to perform its role with "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[36] After reviewing the various processes that the committee and the company followed, the court determined that "[f]atal to the prudence claim…[d]efendants' practices did not fall short of the prevailing industry standards"[37] and that "there is no evidence that a prudent fiduciary adhering to its monitoring processes would have taken some action that [the committee] did not."[38] In fact, the court found that the committee's practices may have exceeded prevailing standards, including the degree to which the committee and its fiduciary advisor monitored the proxy voting activities of the various investment managers under the plans, including the investment manager's ESG-motivated proxy voting actions.[39]

Although the court determined that the legal standards for measuring the duty of prudence mandated a finding in this case that the duty was satisfied, the court expressed criticism of what it characterized as the comparative standard nature for measuring compliance with the duty of prudence before turning to its analysis on the ERISA duty of loyalty.[40]

**Duty of Loyalty Failed**

The court then reviewed ERISA's duty of loyalty, which operates separately from the duty of prudence, and which can be violated even if the fiduciaries act prudently. Thus, even if the company's process for selecting plan investments reflected the care and diligence required of an ERISA fiduciary, an ERISA-recognized harm arises if the duty of loyalty is not separately met. As the court noted, ERISA's duty of loyalty is "the highest known to law" and requires fiduciaries to act "solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries."[41]

In a surprising turn, the court found that the committee and the company failed to satisfy their duty of loyalty. In making its determination, the court considered the significant non-plan role played by the investment manager as an owner and debt holder of the company and the company's ESG positions and policies, which the court found in combination influenced the company and the committee to turn a "blind eye" to the investment manager's alleged "ESG activism." The court also pointed to alleged quarterly proxy voting attestation reporting failures and the purported blurring of corporate and fiduciary roles of the individuals at the company who oversaw both the

performance of the plans' investments and the corporate relationship with the investment manager.[42] As the court stated:

It is this evidentiary combination – [d]efendants' undeniable corporate commitment to ESG *plus* endorsement of ESG goals by those responsible for overseeing the [plans] *plus* the influence of and conflicts of interests with [the investment manager] *plus* the lack of separation between corporate and fiduciary roles that reveals the [d]efendants' disloyalty.[43]

The court found that this combination of court-determined facts demonstrated that the committee and the company were "subordinat[ing] the interests of the participants … to other objectives" and "sacrific[ing] investment return … to promote benefits or goals unrelated to interests of the participants."[44] The court concluded that "the evidence made clear that [d]efendants' incestuous relationship with [the Investment Manager] and its own corporate goals disloyally influenced administration of the [Plans]."[45] This, despite the fact that none of the funds on the plan menu were themselves ESG funds.

In reaching its conclusion that the duty of loyalty was breached under these findings of fact, even in the face of clearly prudent fiduciary practices, the court took a broader swipe at the retirement savings industry as a whole, noting that:

In industries featuring oligopolist or cartel-like behavior — such as the retirement savings industry in which the largest investment managers own significant stakes in all of the relevant actors — industry norms are not enough to safeguard against breaches of loyalty. Otherwise, such a low bar would encourage collusion, cause rampant evasion of ERISA's stringent requirements, and wreak havoc for retirement plan beneficiaries.[46]

**Refresher on DOL Rulemaking About ESG Considerations for ERISA Plans**

The court's decision nowhere considers the recent rulemaking efforts of the Department of Labor (DOL) intended to address the permitted role (if any) of ESG factors for fiduciary actions related to ERISA-covered plan investments and proxy voting, other than to note a DOL warning in early 2020 about using ESG factors in such actions.

As a refresher, in 2020, the DOL under the first Trump administration issued two sets of rules that were targeted as attacks against so-called ESG investing (collectively, the 2020 rules). The first rule, titled "Financial Factors in Selecting Plan Investments," generally required plan fiduciaries to consider only "pecuniary factors" when selecting and monitoring 401(k) plan investment alternatives.[47] The second rule, titled "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," focused on ERISA's duties or prudence and loyalty in connection with voting shares of stock held in ERISA-covered plans.[48] While the 2020 rules themselves do not specifically reference ESG, based on the release accompanying each of the rules, a common view is that the 2020 rules were intended to reduce the use of ESG-friendly investment funds in ERISA-covered plans and to reduce or limit the ability to support ESG activism through proxy voting of shares held as ERISA plan assets.

Subsequently, in 2022, the DOL under the Biden administration finalized its rules on "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (the "2022 rules"), which supersede the 2020 rules described above.[49] The 2022 rules, like the 2020 rules, do not specifically reference ESG investing, but the

release accompanying the rules clearly indicates greater willingness to accept ESG investing as an economically prudent alternative. The 2022 rules — similar to the 2020 rules but with slightly different terminology — require fiduciaries to make investment decisions "based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis" (similar to the concept of "pecuniary interests" under the 2020 rules), but also that "such factors may include the economic effects of climate change and other ESG considerations on the particular investment or investment course of action."[50] The 2022 rules also added a so-called "tiebreaker" rule, which allows fiduciaries to consider collateral benefits, such as nonfinancial considerations related to ESG, in breaking the tie between two competing investment alternatives or courses of action (*e.g.*, proxy voting) that "equally serve the financial interests of a plan over the appropriate time horizon."[51]

The validity of the 2022 rules was subsequently challenged by the attorneys general of 26 red states and other interested parties. A district court in Texas initially rejected that challenge, largely based on an application of the *Chevron* doctrine deference to the rulemaking process.[52] However, the Fifth Circuit subsequently vacated that decision and remanded the case back to the district court to reconsider given that the *Chevron* doctrine was overruled in Summer 2024 by the Supreme Court's decision in *Loper Bright*.[53] While the district court reconsidered its analysis under the relevant standards after *Loper Bright*, it ultimately reached the same conclusion that the 2022 rules were validly issued.[54] This decision was announced in February 2025, after the *Spence* decision, and it is unclear if its outcome may impact any future decisions in *Spence*, whether on appeal or otherwise.

**What Comes Next**

The court directed the parties to present evidence as to whether the participants in the plans suffered any losses as a result of the court-determined duty of loyalty breach.[55] In particular, the court asked for direct evidence linking ESG investing to financial underperformance of the plans.[56] The court stated that the defendants bear the burden of proving the absence of any loss to the participants.[57] In particular, the court directed the parties to consider the impact of the drop in stock prices for the large oil and energy company that was the subject of the 2021 contested director vote discussed in the findings of fact, including given that immediate drop in those stock prices "quickly rebounded" not long after vote.[58]

It seems likely that, at some stage in the proceedings, the court's decision may be subject to appellate review. That review may also consider application of the 2022 rules to the findings of fact in the case, especially given the recent validation of the 2022 rules by the district court in *Su*.

**Takeaways**

Prior to *Spence,* much of recent prolific 401(k) fiduciary litigation has focused on issues related to fund performance and plan expenses — issues governed largely by the duty of prudence. The decision in *Spence*, however, highlights how an alleged failure by plan fiduciaries to fully consider proxy voting policies and activities of investment managers for 401(k) investment funds can lead to successful claims that the duty of loyalty has been breached, and at least partially opens another avenue for fiduciary attack on 401(k) plans. The decision may especially suggest a closer look at a plan's relationships and oversight of investment managers who also hold significant economic stakes in the plan sponsor.

Notably, *Spence* also reminds us about the importance of not only maintaining but documenting excellent fiduciary practices and documentation in selecting and monitoring a 401(k) plan's investment choices. Some of those best practices noted in the case include:

- Having a plan committee that is staffed with individuals who have appropriate expertise;
- Ensuring the committee meets regularly (*e.g.*, quarterly) to review performance of investment managers;
- Maintaining a written investment policy statement to guide investment performance reviews and acting in accordance with such policy;
- Engaging third parties with appropriate financial and investment expertise to assist in the investment performance review process and appropriately monitoring such third parties; and
- Maintaining good written records of meeting discussions and the information reviewed.

Finally, *Spence* reminds us that the parties who may be held accountable as plan fiduciaries may extend beyond those named as the plan fiduciary under the terms of the relevant plan documents. Even though the plan sponsor is not named as a fiduciary, it may nonetheless be considered a functional fiduciary. It's important for plan sponsors to know who the plan fiduciaries are (named and functional alike) and to ensure that such fiduciaries are aware of their responsibilities and duties to the plan and its participants.

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[1] *Spence v. Am. Airlines, Inc*., No. 4:23-CV-00552-O, 2025 WL 225127, at *2 (N.D. Tex. Jan. 10, 2025).

[2] *Id.*, at *27.

[3] *Id.*, at *23.

[4] *Id.*, at *6.

[5] *Id.*, at *8.

[6] *Id.*, at *7.

[7] *Id.*, at *13.

[8] *Id.*

[9] *Id.*, at *26.

[10] *Id.*, at *8.

[11] *Id.*, at *8.

[12] *Id.*, at *8-9.

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*, at *10.

[17] *Id.*

[18] *Id.*, at *11.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*, at *11.

[23] *Id.*

[24] *Id.*, at *12.

[25] *Id.*, at *13.

[26] *Id.*, at *15.

[27] *Id.*

[28] *Id.*, at *17.

[29] *Id.* at *16.

[30] *Id.*, at *19-20.

[31] *Id.*, at *20.

[32] *Id.*

[33] *Id.*, at *19.

[34] *Id.*

[35] *Id.*, at *20.

[36] *Id.*, at *20 (citing 29 U.S.C. § 1104(a)(1)(B)).

[37] *Id.*, at *21. *See also Id.*, at *11 (stating that ". . . the [Committee's] processes for addressing the voting of proxies during the Class Period were consistent with and, in many respects exceeded, the processes of other fiduciaries.").

[38] *Id.*, at *24.

[39] *Id*., at *22-24.

[40] *Id.*, at *24.

[41] *Id.*, at *25.

[42] *Id*., at *25-31.

[43] *Id.*, at *31.

[44] *Id.*, at *27 (citing 29 C.F.R. § 2550.404a-1(c)(1)).

[45] *Id.*, at *31.

[46] *Id*.

[47] 85 Fed. Reg. 72846.

[48] 85 Fed. Reg. 81658.

[49] 87 Fed. Reg. 73822.

[50] *See* Employee Benefits Security Administration Fact Sheet, Final Rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, available here.

[51] *Id.*

[52] *See Utah v. Walsh*, 2:23-CV-016-Z, 2023 WL 6205926 (N.D. Tex., Sept. 21, 2023). *See also Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc*., 467 U. S. 837 (1984).

[53] *See Utah v. Su*, 109 F.4th 313 (5th Cir. 2024). *See also Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024).

[54] *See Utah v. Su*, N.D. Tex., No. 2:23-cv-00016, opinion and order issued 2/14/25.

[55] *Spence*, at *31-32.

[56] *Id.*

[57] *Id.,* at *19.

[58] *Id.*, at *31.

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