

March 28, 2024

ESG in 401(k) Plans in the Wake of *Spence v. American Airlines, Inc.*

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Whether investment decisions for pension, 401(k), and other plans covered by ERISA should be influenced by environmental, social, and governance (ESG) factors has become a flashpoint and, unlike most ERISA issues, the controversy extends into the political arena. The recent opinion of a federal district court denying a motion to dismiss claims that ESG factors were improperly applied for 401(k) plan investments shows that ESG can bring risk to fiduciaries, even if they are not pursuing ESG strategies.

Spence v. American Airlines, Inc.

In *Spence*, the plaintiffs brought a purported class action alleging that the committee responsible for investment decisions for 401(k) plans sponsored by American Airlines, Inc. (the “Committee”) had breached its fiduciary duties by including BlackRock funds that employed ESG strategies in the investment lineup.

While the complaint generally did not identify ESG strategies specific to the relevant BlackRock funds, it alleged that BlackRock and other firms “pursue a pervasive ESG agenda” that hurt participants by focusing on “socio-political outcomes” instead of investment returns. These allegations were based on statements made by BlackRock officials as well as reports of BlackRock’s shareholder activism on climate change initiatives.

The *Spence* court denied the defendants’ motion to dismiss these claims. The denial of a motion to dismiss does not mean that a court has concluded that there has been a breach of fiduciary duty. Rather, it means that the court has found that complaint makes a plausible case for fiduciary breach based on a review limited to the facts alleged in the complaint, and any other facts for which the court decides to take judicial notice. In particular, the *Spence* court found that the complaint made a plausible case for fiduciary breach based on the following allegations:

Funds managed by investment managers who employ ESG strategies underperform relative to similar funds in general (the court did not rely on specific allegations that the particular BlackRock funds actually underperformed); and

The Committee was influenced by the plan sponsor’s ESG policies to select a fund manager that employed ESG strategies.

Following denial of the motion to dismiss, the American Airlines defendants filed a motion for summary judgment. With a summary judgment motion, defendants can rely on evidence beyond what is set forth in the complaint, including other documents and testimony of witnesses and experts. Summary judgment can be

granted if the judge determines that there is no dispute regarding the material facts that would be necessary to establish defendants' liability, and so defendants are entitled to judgment as a matter of law.

In support of the motion for summary judgment, the American Airlines defendants offered evidence intending to show that the Committee followed a prudent fiduciary process in making investment decisions, which was not motivated by ESG considerations apart from the economic performance of investments, and that the plaintiffs could not establish any losses relating to the Committee's investment decisions.

Analysis

The denial of a motion to dismiss in the *Spence* case may be alarming for retirement plan fiduciaries because the court set a very low bar for plaintiffs to meet in alleging fiduciary breaches that relate to ESG investments. In particular, the *Spence* court did not find that the plaintiffs needed to allege any specific defects in the Committee's fiduciary process to survive a motion to dismiss. Based on the *Spence* court's position, there may be plausible allegations of a fiduciary breach that are sufficient to survive a motion to dismiss for any 401(k) plans that offer BlackRock funds.

But there are a couple of reasons that the 401(k) plan fiduciaries should temper their concerns. The *Spence* court's denial of a motion to dismiss does not set any precedents for other courts. While it is possible that other judges could apply similar reasoning, the *Spence* court's decision stands out because it set a particularly low bar by not requiring specific allegations of defects in the fiduciary process.

Further, the *Spence* court was willing to accept that the plan sponsor's support of sustainability initiatives created a reasonable inference that the Committee was influenced by these considerations. This holding undermines the fundamental principle that company officials can act exclusively in the interests of participants and beneficiaries when they are acting in their fiduciary capacity. Other courts may be reluctant to make such a departure from well-established principles.

The *Spence* court has not held that offering the BlackRock funds was a breach of fiduciary duty. ERISA fiduciary duties are process-based, and the motion to dismiss ruling did not involve any consideration of the Committee's fiduciary process. The American Airlines defendants have filed a motion for summary judgment supported by documentation and testimony regarding the Committee's fiduciary process.

Regulatory Backdrop

The Department of Labor [promulgated](#) a final regulation requiring retirement plan fiduciaries to consider ESG factors when selecting investments to the extent that ESG factors affect risk and return expectations. These regulations have been [upheld](#) by at least one federal court, although another lawsuit remains pending. The DOL regulations were not at issue for the *Spence* case. But fiduciaries should be mindful that these regulations require them to apply ESG factors to the extent that they are relevant to investment risk and return.

In addition, the SEC recently published [final regulations](#) requiring public companies to disclose certain climate-related risks and in 2022, [proposed rules](#) requiring mutual funds to disclose certain information regarding their ESG investment practices. These developments underscore that ESG will continue to be an important issue for fiduciaries to consider, even if they are not pursuing ESG strategies.

Evolving Landscape

Based on the *Spence* court's position, there may be plausible allegations of a fiduciary breach that are sufficient to survive a motion to dismiss for any 401(k) plans that offer BlackRock funds.

BlackRock has been a key target for critics of ESG investing. The Wall Street Journal recently [reported](#) that BlackRock is moving away from referring to the term "ESG", although it continues to support some sustainability initiatives. Fiduciaries who offer BlackRock funds have also been the target of some recent litigation unrelated to ESG investing, but [almost all](#) of these claims have been dismissed to date.