



DALLAS FEDERAL COURT TACKLES ERISA'S FIDUCIARY STANDARDS FOR FINANCIAL MANAGEMENT AND ESG INVESTMENT

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On January 10 , in *Spence v. American Airlines, Inc.*, the United States District Court for the Northern District of Texas, Dallas Division, addressed ERISA's fiduciary standards for appropriate retirement plan management in the context of the controversial topic of ESG investment.

The Role of ESG in Investment

Under ERISA, plan administrators are required to manage financial investments as a reasonably prudent business professional, balancing manageable risk with protection of plan assets, without self interest. This typically requires investment in established investments and investment vehicles with a history of performance. ESG is a recent investment phenomenon that prioritizes considerations in social, environmental and responsible corporate governance over traditional investment strategies, such as targeting dollars in investments focused solely on long-term or short-term growth, profits, emerging or foreign markets. Since the concept of ESG investing emerged in 2004, critics of ESG investment funds have pointed out the lack of reliable information on financial performance and the funds' focus on societal considerations as material components of the investment strategy.

How the Lawsuit Started

Spence was an American Airlines pilot and a participant in the retirement plan American Airlines Employee Retirement Plan. Spence filed the lawsuit on his own behalf, and on behalf of the other plan participants, alleging the plan mismanaged the plan assets by pursuing "non-pecuniary and non-financial" ESG goals through its proxy voting practices and "shareholder activism." Specifically, the class action plaintiffs claimed the plan breached its ERISA fiduciary duty by investing in passively managed index funds that invested exclusively in a collective investment trust overseen by a third-party manager

which pursued a “pervasive ESG agenda.” The class plaintiff claimed this practice breached both: (1) the fiduciary duty of exercising financial prudence; and (2) the duty of loyalty.

The Ruling in *Spence*

In *Spence*, the court concluded that American Airlines and the plan breached their ERISA fiduciary duty of loyalty, not by investing in ESG funds and, instead, by outsourcing the fund management to a non-party investment manager. This ruling is noteworthy due to the court's negative assessment of the common practice of delegating proxy voting authority to the retirement plan's external manager. By this ruling, the court signaled that benefit plan managers should reassess their third-party outsourcing of proxy voting. Changes would include: (i) conducting thorough due diligence of managers' voting records prior to their selection; and (ii) the possibility of passing the voting responsibilities directly to plan participants and their beneficiaries.

Ultimately, the Court did not conclude that investments in ESG funds were per se a violation of the duty of financial prudence. However, the court did conclude American Airlines and the plan breached their duty of loyalty by their “incestuous relationship” with the third-party manager, which unduly influence the manager's investment strategy to the benefit of the airline's corporate goals.

What this Means for Employers

Benefit plan sponsors should exercise constant vigilance to assess their plan management to confirm: (1) the plan manager is exercising financial prudence in managing plan assets through arm's length transactions; and (2) the plan manager is exercising the highest duty of loyalty to the plan and its participants, managing assets without any undue influence or conflict of interest.

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