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Airline 401k Decision Illustrates Continued Takeoff of ESG Litigation

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A Texas federal judge recently permitted an environmental, social, and governance- (ESG) related Employee Retirement Income Security Act (ERISA) case filed by an airline pilot against his employer and its benefits plan to proceed into discovery.

Below, we break down what is in the decision, outline how the case fits into the larger ESG-focused policy debate, and provide three lessons for the regulated community.

The Texas Decision

In *Spence v. American Airlines* (decision here), an American Airlines pilot brought claims alleging that his employer breached its fiduciary duties of prudence and loyalty in its management of its 401(k) plan. Specifically, the pilot alleged that the plan includes funds "that are managed by investment managers that pursue non-financial and nonpecuniary ESG policy goals through proxy voting and shareholder activism" rather than focusing exclusively on financial returns.

In reviewing the defendants' motion to dismiss the complaint, a Texas federal judge determined that the plaintiff's allegations of the defendants failing to properly adjust two ESG-focused funds that were continually underperforming other similarly situated funds were sufficient to infer that the defendants' conduct was imprudent. This result came despite the defendants arguing that the plaintiff provided neither any benchmark by which to determine underperformance nor any evidence of a connection between any proxy voting and the alleged underperformance, both of which the court deemed unnecessary at this stage. The court also found that the plaintiff's allegation that the defendants were motivated by a company-wide commitment to ESG rather than pure financial gain articulated a “plausible story” over the defendants, contending a lack of supporting facts showing any specific alternative non-financial motivations.

In denying the defendants’ motion, the court did not make any declarative statements about the strength of the plaintiffs’ claims, but it did make clear that it believed those claims plausible. The allegations focused largely on the stated value placed on ESG by American Airlines, as well as an imputed underperformance from ESG-focused funds.

Takeaways from *Spence*

Tensions Over the Meaning of “ESG” Play Out in Corporate Governance Disputes

A few weeks ago in a piece focused on ESG-related claims involving the government, we noted that the last year has seen “’ESG’ factors recast from being perceived as technocratic tools wielded by accountants and policy optimists into villainous tools employed by bureaucrats to limit freedom and harm businesses.”

Spence forces us to switch from government to governance, a topic we write about less frequently given our perspective as grizzled veterans of environmental policy campaigns. (See here.) “ESG” is given different meanings by different actors. Some of these meanings bear the hallmarks of investment professionals, others are more closely tied to policy advocates, while still others attribute the meaning of ESG to their unique stakeholder communities. A paper by Elizabeth Pollman, University of Pennsylvania Law School Professor of Law and Institute for Law & Economics co-director, entitled “The Making and Meaning of ESG” ? providing four usages — provides a jumping-off point for this discussion. ESG can mean:

- Factors used by investors for managing risk and identifying opportunities.
- Broad principles which can be themselves implemented as risk-management tools or used to create opportunities.
- A description of factors relating to corporate social responsibility or corporate sustainability.
- A concept which incorporates a policy preference (at least somewhat removed from risk management) or taste guiding investment decisions.

The long-term fate of the *Spence* case in essence requires that the plaintiffs demonstrate that social values or policy preferences were inappropriately factored into the airlines’ investment decisions. Through discovery, the plaintiffs will seek to establish whether this is – in actuality – true. But here, at the motion to dismiss phase of litigation, courts accept the plaintiffs’ factual averments as true and allow the case to proceed into discovery.

ESG Fights Are Likely to Play Out in Unexpected Terrain

A second point worth noting is that *Spence* was filed in the Northern District of Texas, a court not particularly known for its track record for managing major corporate legal disputes. Instead, as we have discussed elsewhere, it is frequent forum for political policy disputes. As ESG has come into vogue, Spence joins two other ESG-related cases – State of Utah v. Walsh (involving a US Department of Labor (DOL) regulations on decisions by investment managers) and *Exxon Mobil Corporation v. Arjuna Capital, LLC* (action by oil company challenging an activist investor’s use of a shareholder proposal process to present climate proposals).

Standing Up Defensible ESG Programs Takes Work

Finally, a major takeaway from cases like *Spence* is that the defensible use of ESG tools in guiding decisions takes work. We've written repeatedly about a New York state case styled *Wong v. New York City Employees' Retirement System*. (See here and here.) *Wong* is a New York state breach of fiduciary duty case alleging that teachers' retirement system plan administrators breached their duty to plan participants by divesting from fossil-fuel related businesses. The Wong complaint ties political pressure on pension plan managers to the loss in opportunities on pension plan participants as many fossil-fuel tied companies in the energy industry have had record profits in recent years. *Spence* substitutes ideological pressure for the political pressure which drove the allegedly bad decisions at issue in *Wong*.

While it's too soon to tell what will come of cases like *Spence* and *Wong*, a preliminary takeaway is that ESG-related considerations need to be evaluated and analyzed to understand how they impact overall financial performance and in what timeframe. Even if this happens, because the plaintiffs' averments that ESG-related investment decisions underperform other investments are accepted as true at the motion to dismiss phase of litigation, it is likely that more cases like this will come.

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