

Court's ESG Ruling Puts Pressure on Managers of 401(k) Plans

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A lawsuit against American Airlines Group Inc. over its 401(k) plans may set the stage for a potential earthquake in the world of ESG investing.

US District Judge Reed O'Connor, a George W. Bush-appointed [popular](#) among right-wing groups seeking receptive court venues, ruled this month that the airline [violated](#) its fiduciary duty of loyalty when it allowed BlackRock Inc., the company's 401(k) manager, to consider environmental, social and governance factors when casting proxy votes on behalf of employees.

Reed wrote without citing a source that "ESG investments often underperform traditional investments by approximately 10%." He also used the ruling to criticize BlackRock, writing that the Wall Street giant exercises "an alarming degree of control and influence over the industry and, as a result, can effectively rig the process in a cartel-like manner." BlackRock isn't a defendant in the case.

While O'Connor has requested more information from American and the plaintiff, a senior pilot, before ruling on damages, his decision could certainly open the door to copycat cases, said [Marcia Wagner](#), founder and managing partner of Wagner Law Group, which specializes in the law at issue, the Employee Retirement Income Security Act, or ERISA.

Analysts at Bloomberg Intelligence said "anti-ESG sentiment will continue to drive litigation seeking to remove ESG considerations from investment decisions." Any appeal of O'Connor's ruling will likely go to the US Court of Appeals for the Fifth Circuit, the most conservative of all US appellate courts and the source of some of the most contentious cases decided by the Republican-appointed controlled US Supreme Court.

The lawsuit, filed as a class action, has big implications for 401(k) plans since almost every investment firm has incorporated ESG factors into their buy-and-sell decisions in recent years, said [Donald Calcagni](#), chief investment officer of Mercer Advisors. This case likely has "every business and every asset manager in the US looking at their ESG-related policies and asking themselves questions about how these policies impact shareholders," he said.

For its part, BlackRock said in response to O'Connor's ruling that it acts "independently and with a singular focus on what's in the best financial interests of our clients. Our only agenda is maximizing returns for our clients, consistent with their choices."

American Airlines hasn't said whether it plans to appeal, though the company noted it's never offered ESG investment options in its retirement plan. "In fact, the committee that considers investments for our 401(k) plan expressly rejected ESG investments," the carrier said in a statement. BlackRock's role is limited to offering index-tracking funds that mimic market benchmarks such as the S&P 500, American said, adding that O'Connor's ruling focuses on American's oversight of BlackRock's proxy voting. On this front, the company said it follows industry best practices, something O'Connor conceded when ruling against the defendant's claim that the carrier violated its duty of prudence.

But that was the only ground O'Connor would give. He rejected American's other arguments, saying the company breached its duty of loyalty in part "by failing to keep American's own corporate interests separate from their fiduciary responsibilities, resulting in impermissible cross-pollination of interests and influence on the management of the plan."

O'Connor asserted that American knew BlackRock was pursuing ESG initiatives through 2022 (when as he put it the firm "backed away from this

ESG activism”) through what he called “delegated proxy voting authority and related activism,” and that the airline took “no affirmative steps on its own to review, monitor and evaluate BlackRock.”

Wagner said a finding of a breach of duty of loyalty when there’s no breach of duty of prudence is unusual. When ERISA lawyers provide guidance to plan fiduciaries, the focus is more on the duty of prudence because that’s an objective factor focused upon process, she said. By contrast, the duty of loyalty is a subjective issue.