



## Fiduciary Update | February 2025

### **American Airlines Breached Duty of Loyalty, But Not Prudence, in ESG Case—On Unique Facts**

As [previously reported](#), American Airlines and its 401(k) plan fiduciaries were sued for inappropriately including investments with environmental, social, and governance (ESG) objectives in their plans. The plans offered BlackRock Index funds, which made up approximately \$11 billion of the plans' \$26 billion in assets in 2022. As the judge observed, BlackRock actively supported ESG efforts and social change by making investment decisions and voting proxies on this basis. American Airlines had also publicly endorsed ESG efforts as an important part of its long-term success. Additionally, BlackRock was a significant investor in American Airlines, holding more than 5 percent of American Airlines' stock and approximately \$400 million of its corporate debt. As detailed below, the judge found that American Airlines "incestuous relationship with BlackRock and its own corporate goals disloyally influenced administration of the plans." *Spence v. American Airlines, Inc.* (N.D. Tex.).

The lawsuit alleged that American Airlines and its plan fiduciaries had violated ERISA's prudence and loyalty rules. After reviewing the plan fiduciaries' processes, the judge decided there was no breach of fiduciary prudence. The plan fiduciaries had a robust process, which included an independent outside investment consultant, regular quarterly investment reviews, and quarterly meetings. The judge concluded that American Airlines' fiduciary process was in line with the industry norm. However, meeting industry norms, which, according to the judge, are effectively set by a few large players, does not safeguard against breaches of loyalty.

With respect to loyalty, the judge observed that ERISA "requires a fiduciary to always act solely for the plan and in the plan's best financial interests—not just some of the time." Plan fiduciaries must follow an "objective, analytically rigorous standard when it comes to a fiduciary exclusively pursuing the best financial interests of the plan."

Loyalty considers the reasons why a fiduciary acted, not the process of acting. ESG investing, by



definition, pursues a non-pecuniary interest as an end itself rather than as a means to achieve financial results. If there is a solid premise that ESG factors will advance a company's financial performance and could reasonably lead to positive financial outcomes for plan fiduciaries, the investment's objective is pecuniary.

The BlackRock investments in the American Airlines plans were all indexed investments. In indexed investments, the composition of the holdings is dictated by the index that is being tracked (e.g., the S&P 500 Index) and not by the investment manager's discretion (in this case, BlackRock). As a result, BlackRock had no discretion to pick and choose the companies whose stocks would be included. Noting its support for ESG, BlackRock's CEO explained that, for index fund holdings, it would use its proxy votes to drive social change.

The judge took particular note of a lapse in regular quarterly reporting of proxy voting by BlackRock to the American Airlines plan fiduciaries. The judge also noted the plan fiduciaries' failure to realize or call out the reporting failure. One individual at American Airlines was responsible for its corporate relationship with BlackRock and also had day-to-day oversight of the plans' investment managers. This person's failure to keep the roles separate and provide oversight of BlackRock's proxy voting was seen as evidence of subordinating the interests of plan participants and sacrificing investment returns to promote goals unrelated to the interests of the participants. The judge observed that most 401(k) fiduciary committees do not receive regular reporting on proxy votes, so this lapse demonstrated the fiduciaries "turning a blind eye" to proxy voting, but not a prudence failure.

In reaching his decision, the judge gave considerable weight to the compound factors indicating that American Airlines and the plan fiduciaries were motivated by ESG objectives and BlackRock's influence rather than being motivated to pursue the best financial results for plan participants. These factors included the similar corporate ESG positions of BlackRock and American Airlines, and the judge's belief that BlackRock's significant ongoing equity and fixed-income investment in American Airlines influenced American Airlines and its plan fiduciaries to support ESG objectives.

Key takeaways from this decision include:

- the critical importance of corporate executives being clear about their respective fiduciary and non-fiduciary roles—and keeping them separate;
- the complications and risks of having corporate service providers and investors who are also involved with retirement plans (there can be no corporate *quid pro quo* based on plan matters);
- the importance of plan fiduciaries understanding what their plan's investment managers seek to accomplish and whether they have any objectives other than participants' best financial interests; and
- the importance of plan fiduciaries' understanding how proxies are handled for the assets in their plans.

This decision is likely to be appealed, and, following the Supreme Court's elimination of Chevron deference, the Department of Labor will not be able to control courts' interpretations of ERISA. Therefore, varying district and appellate court opinions are likely. The legal environment for ESG

investing in retirement plans will continue to be uncertain and remain a likely target of legal challenges.

*Note on Proxies:* We can expect an increased focus on how plan fiduciaries handle proxies. Here is a quick refresher.

- Proxies issued on holdings in separate accounts and collective investment trusts must be voted in the best financial interests of plan participants. This voting is frequently delegated to the investment manager. If so, plan fiduciaries must monitor how proxies are voted. (This was the issue in the American Airlines case.)
- Proxies issued **by holdings in mutual funds** will be voted by the investment managers. Fiduciaries should understand the mutual fund's investment philosophy and whether non-financial interests are a goal.
- Proxies issued **by mutual funds** must be voted in the best financial interests of plan participants. These will include issues like the election of the mutual fund board and changes in the mutual fund investment policy.

### **UnitedHealth Group Settles Target-Date-Fund Challenge for \$69 Million Settlement Amid Conflict-of-Interest Allegations**

As [previously reported](#), fiduciaries of the UnitedHealth Group 401(k) plan were sued challenging their retention of underperforming target-date funds. The complaint alleges that the company's retirement plan continued to offer Wells Fargo target-date funds from 2015 to 2021, even though these funds consistently and significantly underperformed. *Snyder v. UnitedHealth Group* (D. Minn., filed 2021).

Through the litigation discovery process, the plaintiffs claim to have found evidence that, even though the UnitedHealth fiduciary committee had decided to remove the Wells Fargo target-date funds, UnitedHealth's chief financial officer (CFO) interceded to keep the funds in place. After discovering the CFO's intervention, the participants' claims were expanded to add the CFO as an individually named defendant.

The amended complaint alleges that the CFO directed an evaluation of UnitedHealth's business relationships with Wells Fargo and the other firms whose funds were candidates to replace the Wells Fargo target-date funds. Upon determining that Wells Fargo was a significant business partner, the decision to replace the Wells Fargo funds was reversed. Soon after, the plan's fiduciary committee was restructured to include the CFO, who had not previously been a member. The complaint contends that UnitedHealth's plan fiduciaries put the plan sponsor's business interests and profits ahead of plan participants' interests, thereby violating ERISA's exclusive benefit rule and causing losses for plan participants.

Against this backdrop of alleged conflicts of interest, the case has reportedly been settled for \$69 million, which appears to be a record amount in a suit alleging the improper retention of underperforming investments.



Like the American Airlines case, this one is a reminder that, under ERISA, plan fiduciaries and sponsors may not make plan-related decisions that benefit corporate interest and compromise plan participants' interests, and that even perceived conflicts of interest should be avoided.

## **Pension Settlements: Legal Challenges Continue**

In recent years, many pension plan sponsors have fully or partially closed out their obligations to plan participants by purchasing annuities to fund participants' earned benefits. The applicable fiduciary rules do not permit plan fiduciaries to seek the least expensive annuities. Rather, they must select the "safest available" annuity provider, and there can be more than one "safest" provider at any given time.

We have recently reported on several lawsuits challenging the selection of Athene as an annuity provider, most of which allege that it did not meet the safest-available-provider requirement. In those cases, Athene has been characterized by the plaintiffs as a "highly risky private-equity-controlled insurance company with a complex and opaque structure."

In a recent suit, Verizon and its independent fiduciary, State Street Global Advisors, were challenged for entering a pension settlement of \$5.7 billion and covering 56,000 pension plan participants. Prudential and RGA Reinsurance took on the pension liabilities. Prudential is a frequent party in these transactions.

The suit alleges that Prudential and RGA were not the safest available providers. Importantly, the case goes on to claim that State Street was motivated in its selection of Prudential and RGA by its own self-interest, due to its investments in Prudential, RGA, and Verizon. *Dempsey v. Verizon Communications, Inc.* (S.D. N.Y., filed 12.30.2024).

This case is in the early stages of litigation. Some commentators have expressed surprise at seeing a case like this involving Prudential, which is frequently selected as the "safest available" provider. One commentator observed that, if this case survives a motion to dismiss, the plaintiffs will have the leverage to force a settlement. And if that happens, similar cases are likely to follow.

## **Supreme Court Hears Case on What's Needed in a Viable ERISA Complaint, Oral Argument Did Not Suggest an Outcome**

Due to conflicting decisions in U.S. courts of appeal, the Supreme Court accepted a case to decide what must be included in a lawsuit alleging an ERISA-prohibited transaction violation. The law in this area is not clear. Some federal appellate courts consider many common day-to-day relationships to be prohibited transactions. In this situation, a suit can be brought forward with minimal facts, then the plan fiduciaries must prove there was no loss to plan participants. Other federal appellate courts require an allegation that fiduciaries overpaid for a service or purchased an unnecessary service. In this situation, the plan participants who are suing must prove there was a loss.



Frequently, comments and questions from Supreme Court justices during oral argument offer an indication of how a case will be decided. Not so in this case. Justice Barrett asked, “Why on earth” did Congress structure this part of ERISA the way it did? And Justice Sotomayor said, “This isn’t that easy a case in my mind.” *Cunningham v. Cornell University* (S. Ct., argued January 2025).

If the Supreme Court decides that plaintiffs who bring suit are not required to allege and show damages, the volume of plan-related lawsuits based on ERISA-prohibited transactions can be expected to grow significantly. A decision is expected by the middle of the year.

## **Vanguard Settles Target-Date-Fund Claim for \$40 Million—Along with a \$106 Million Penalty**

In 2021, Vanguard lowered the minimum investment required to use the institutional share class of its target-date funds from \$100 million to \$5 million. This offered investors a significant fee reduction. As a result, a large amount of money left the retail share class to move into the less expensive institutional share class, which is a separate fund structure. To accommodate the movement of these assets, the retail share class investment managers sold significant amounts of holdings. For retail investors in taxable accounts, this triggered capital gains taxes. Tax-exempt accounts, like 401(k) plans, did not have this issue.

Retail investors in taxable accounts sued Vanguard for repayment of the capital gains taxes incurred because of the retail share class sell-off. *In re: Vanguard Chester Funds Litigation* (E.D. Penn. 2024).

Settlement of this case for \$40 million was recently reported. In addition, the Securities and Exchange Commission has assessed a \$106 million penalty for misleading statements related to capital gains and tax consequences of the sell-off.

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