

# Update on the Debate over Environmental, Social, and Corporate Governance Investing

by Kaitlyn Malkin on July 19, 2023

The debate over investment of retirement plan funds based on environmental, social, and corporate governance (“ESG”) factors continues to make waves. This post provides a high-level overview of the current state of play for plans that are subject to ERISA.

We last wrote about this topic in [October 2021](#) when the Department of Labor (“DOL”) under the Biden administration announced its proposed rule on prudence and loyalty in retirement plan investing, which included provisions permitting consideration of ESG factors. Since then, there has been increasingly intense debate as to whether the Biden administration’s 2022 final rule or the Trump administration’s 2020 final rule, which required fiduciaries selecting investments to consider only economic risk and return, should be the law. We discussed the back and forth between stances in our [April 2021](#) blog post, and this back and forth shows no signs of letting up. The debate has become increasingly political and polarized.

## 2022 Final Rule

The Biden administration’s rule was finalized in November 2022 and includes a key change from the 2021 proposed rule. Instead of noting that the projected return “may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action,”<sup>1</sup> the final rule provides that ESG risk and return factors “may, and often should depending on the investment under consideration,” be considered.<sup>2</sup>

The final rule gives fiduciaries discretion to consider ESG factors in making investment decisions by allowing them to determine the applicability and weight of any factors, which may include ESG factors, based on the specific facts and circumstances as well as the factors’ impact on the risk and return of the investment. This may be seen as reverting to the DOL’s neutral stance on specific investment considerations. The new rule authorizes tie-breaking, specifically noting that when two or more potential investments are equally beneficial for a plan and its participants, the fiduciary is not prohibited from selecting the investment based on collateral benefits, except that the

---

<sup>1</sup> 2021 DOL Proposed Regulation Section 2550.404a-1(b)(2)(ii)(C).

<sup>2</sup> DOL Regulation Section 2550.404a-1(d)(3).

fiduciary may not accept expected reduced returns or greater risks to secure those benefits.

## Legislative Challenges

In December 2022, Congressional Republicans sought to use the Congressional Review Act to overturn the 2022 final rule and reinstate the 2020 Trump administration rule. President Biden used the first veto of his administration to strike down this bill.

Earlier this month, the Ensuring Sound Guidance Act was reintroduced before Congress. This bill would require retirement plan fiduciaries to prioritize financial returns over non-pecuniary factors when making investment decisions and would essentially override the 2022 DOL final rule and revert to the requirements of the 2020 final rule through an amendment to ERISA.

## Recent Litigation

Multiple lawsuits have been filed that might affect the retirement plan rules on ESG investing. The first lawsuit noted below seeks to invalidate the 2022 final rule, and the second one seeks, among other things, to have retirement plan fiduciaries make good to the affected plans all losses resulting from the allegedly imprudent selection of ESG funds as available plan investments.

### *Utah v. Walsh*

In January 2023, twenty-five attorneys general and two energy companies filed suit in Texas federal court to invalidate the 2022 DOL final rule.<sup>3</sup> Among other things, the plaintiffs allege that ERISA requires fiduciaries to consider only financial benefits when making investment decisions, and that the 2022 final rule unlawfully eliminates this requirement. In June 2023, the DOL urged the court to grant summary judgment in its favor, arguing that the “[r]ule challenged here supports the goals of [ERISA] by clarifying that ERISA plan fiduciaries may consider any factor in selecting investments that they reasonably conclude is relevant to a risk and return analysis.”<sup>4</sup> The DOL explained that its 2022 rule rescinded earlier rules that “created a chilling effect on fiduciaries’ consideration of ESG factors – even when such factors were material to financial performance.”<sup>5</sup> This is the case to watch on whether the 2022 rule will remain in effect.

---

<sup>3</sup> *State of Utah et al. v. Walsh et al.*, case number 2:23-cv-00016, in the U.S. District Court for the Northern District of Texas.

<sup>4</sup> Memorandum in Support of Defendant’s Opposition to Plaintiffs’ Motion for Summary Judgment and Cross-Motion for Summary Judgment, [gov.uscourts.txnd.372476.96.0.pdf](https://gov.uscourts.txnd.372476.96.0.pdf) (courtlister.com).

<sup>5</sup> *Id.*

### ***Spence v. American Airlines Inc.***

In June 2023, a proposed class action lawsuit was brought in the same district court against American Airlines and the investment fiduciaries of its retirement plans, alleging that the inclusion of ESG funds in the plans violates ERISA's fiduciary duties of prudence and loyalty.<sup>6</sup> Of note, the lead plaintiff claims that ESG funds generally underperform and charge excessive fees, but the complaint provides no specific information about the performance and fees of the funds at issue or any comparison to other funds' performance and fees. Nor does the complaint allege that the lead plaintiff actually invested in any of the funds alleged to use ESG factors. Plan sponsors that have considered selecting ESG funds will be eager to see whether the complaint, in its current form, survives a motion to dismiss.

### **Current State of the Law**

Notwithstanding the volatile political environment and open lawsuits, the 2022 final rule is the current law and can be relied on at present. We will continue to monitor the status of the 2022 rule.

Please contact a member of Verrill's Employee Benefits & Executive Compensation Group if you have questions regarding ESG investing.

### **Kaitlyn Malkin**

Associate

T (617) 309 2600

[email](#)

---

<sup>6</sup> *Spence v. American Airlines Inc.*, case number 4:23-cv-00552, in the U.S. District Court for the Northern District of Texas.