THE AMERICAN COLLEGE OF EMPLOYEE BENEFITS COUNSEL AND CATHOLIC UNIVERSITY OF AMERICA, COLUMBUS SCHOOL OF LAW

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2025 ELLEN A. (NELL) HENNESSY EMPLOYEE BENEFITS MOOT COURT COMPETITION

BENCH MEMORANDUM

OVERVIEW

This case involves claims under the Employee Retirement Security Act of 1974, as amended (ERISA). Specifically, Plaintiff, who is a participant in his employer's Section 401k defined contribution pension plan ("Plan"), alleges that both his employer and the Plan's investment manager breached their duties of loyalty and prudence under ERISA by pursuing "ESG" (Environmental, Social, and Governance) policies to the detriment of Plaintiff and other plan participants. Plaintiff claims that these policies have harmed the participants in two ways. First, he asserts that this has reduced the value of his employer's stock, which constitutes a portion of his and other participants' accounts in the Plan. Second, he alleges that the other investment options in the Plan, which were selected because of ESG factors, have yielded a lower return than similar other investments that do not take into account ESG factors.

Plaintiff alleges that defendants have breached their fiduciary duties and co-fiduciary duties under ERISA and seeks restoration to the Plan of all Plan losses as well as injunctive and other equitable relief requiring defendants to cease pursuing ESG strategies in selecting the Plan's investment options and seek pursuing ESG goals by means of proxy voting.

RELEVANT FACTS AND PROCEDURAL BACKGROUND

Plaintiff John Smith is a participant in a defined contribution 401(k) pension plan governed by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), 29 U.S.C. § 1001 *et seq.* The Plan is sponsored by his former employer, Hopscotch Corporation, a technology and social media company that is especially popular with teenagers and pre-teen children. Hopscotch is named as the Plan administrator for the Plan and, as such, is a Plan fiduciary.

Under the Plan, employees may choose to contribute up to 10% of their salary to the Plan to save for retirement. The company automatically contributes another 5% of salary and matches employee contributions up to 7%. The employees' own contributions vest immediately. Contributions from Hopscotch vest after an employee has worked for the company and participated in the Plan for five years. Because Mr. Smith worked for the company for seven years from 2016 until 2023, all of his own contributions to the Plan as well as the contributions Hopscotch made on his behalf were vested, meaning they cannot be taken away and he will receive them and any investment earnings on these contributions, less any applicable administrative expenses, when he retires.

The Plan has eight investment options, one of which is a fund consisting exclusively of Hopscotch stock and is referred to in the complaint as the employee stock ownership plan ("ESOP") option. The Plan's governing document provides

that this option must be one of the options. Also pursuant to the Plan's governing document, all matching contributions from Hopscotch automatically go into the ESOP option and must stay there until the employee has worked for the company for at least five years and these contributions have vested, at which point the employee may direct some or all of those funds to one or more of the other investment options if he or she so chooses.[1] All of the Plan's investment options are managed by the Plan's investment manager, Defendant Red Rock, which is also a Plan fiduciary by reason of its status as an Investment Manager under ERISA. As such, Red Rock had the right to exercise proxy voting rights as to all of the Plan's investments, including that in Hopscotch stock.

According to the complaint, both Red Rock and Hopscotch have embarked in recent years on a campaign of environmental, social and governance ("ESG") activism. Plaintiff alleges that Hopscotch's commitment to these kinds of goals, particularly with respect to the environment, is what led Hopscotch to pick Red Rock as the Plan's investment manager. And Plaintiff asserts that Red Rock has consistently used its proxy voting power associated with the investments it manages to vote in pro-environment individuals to boards of directors and to vote

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[1] Although neither the Complaint nor the district court's opinion mentions these provisions of the governing plan document, that document was referenced in the Complaint and was submitted to the district court as part of the record.

out those it considers less environmentally friendly. Moreover, Red Rock simply refuses to invest in many greenhouse-gas emitting energy companies.

Mr. Smith contends that the focus on ESG goals with respect to the Plan's investments is inconsistent with ERISA's fiduciary requirements which, according to Mr. Smith, require Plan fiduciaries to focus exclusively on investment returns in considering appropriate Plan investments. Mr. Smith contends that ESG investments have underperformed their non-ESG counterparts and that ESG proxy voting and activism by Red Rock has caused share prices at the targeted companies to go down. Mr. Smith further contends that this has caused financial injury to the Plan and its participants such as himself and endangers the retirement security of participants.

In support of these allegations of harm, the Complaint states as an example that in 2021 and 2022, the energy sector of the S&P 500 for large and mid-cap stocks returned over 55% more than non-Energy sectors, and that by foregoing most energy-sector investments, Red Rock has missed out on achieving these high returns for Plan participants. Plaintiff also asserts that Red Rock's proxy voting activism has had a measurable impact on the companies which it does invest in, each of which suffered a steep stock price decline following reports of Red Rock voting for a more pro-green energy Board of Directors. Recent papers, according to the complaint, including one from the Journal of Finance at the University of

Chicago, establish that ESG funds underperformed during the last five years by an average of 2.5% (returning an average of 6.3%) as compared to the broader market (which had an average return of 8.9% during the same five-year period).

DISTRICT COURT DECISION

Defendants advanced several arguments in favor of dismissing Plaintiff's claim. First, they argued on several grounds that Plaintiff failed to allege a cognizable claim that they breached their fiduciary duties. The court concluded that Plaintiff had sufficiently alleged such breaches, although it failed to specifically address several of Defendant's arguments in this regard.

Nevertheless, the Court dismissed the complaint because it found that Plaintiff had failed to adequately allege that the Plan suffered losses as a result of the breaches in that Plaintiff did not specify comparator investments that earned better returns than those in the Plan. Because Plaintiff stated that he would not amend his complaint, the Court entered judgment for Defendants and dismissed the case.

ISSUES ON APPEAL

1. Whether the district court erred in holding that Plaintiff failed to adequately state a claim that Defendants' alleged fiduciary breaches caused loss to the Plan.

2. Whether, even if Plaintiff adequately alleged harm, the district court should nonetheless have dismissed the complaint because Plaintiff failed to adequately allege that one or both of the Defendants breached their fiduciary duty.

EXPECTED ARGUMENTS

On the first issue, I would expect the plaintiff to argue that he adequately alleged that Defendants' breaches caused harm to the Plan through his allegations that (1) the Plan missed out on investment returns by foregoing most energy sector investments, (2) the share prices of companies included in the Plan's investment options steeply declined following Red Rock's announcement of its proxy voting policies, and (3) according to an academic study, ESG investments underperformed other investments. I would expect his attorneys to argue that the level of detail required by *Matousek v. Mid-American Energy Co.*, 51 F.4th 274, 281 (8th Cir. 2022), and similar cases is inapplicable to this case which alleges breaches of the duties of prudence and loyalty and that this is not simply a case alleging 401k plan fiduciaries' chose poorly performing and/or higher fee investment options among otherwise comparable investment funds. On this issue, I would expect the attorneys for the defendants to argue that there is no good reason to distinguish *Matousek* and the many other similar cases regarding loss allegations, and that even if there is some basis to at least distinguish them in part,

Plaintiff could have, but did not allege any of the following: (1) any specific amount by which the value of Hopscotch's stock declined as the result of the company's ESG policies or as a result of Red Rock's exercise or failure to exercise proxy voting rights with regard to the Plan's investment in Hopscotch stock; (2) the performance of investment funds comparable to the Plan's other (non-ESOP) investment options during the time period when the Plan's investments allegedly declined following Red Rock's announcement of its ESG policy.

With regard to the second issue – whether the Complaint sufficiently alleged a breach of fiduciary duty – I would expect attorneys for the defendants to advance several arguments. First, I would expect the attorneys for Hopscotch to argue that it acted as in its role as settlor, rather than fiduciary, in drafting the governing Plan document to require investment of company contributions in Hopscotch stock, (*see*, *e.g., Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996)), and for the attorneys for Red Rock to argue that they were obligated to follow this language pursuant to 29 U.S.C. § 1104(a)(1)(D). As to the Plan's other investment options, I would expect Hopscotch to argue that because Red Rock was an investment manager as defined by 29 U.S.C. § 1102(c)(3), Red Rock rather than Hopscotch was responsible for selecting the non-ESOP investment options.

In response, I would expect Plaintiffs' attorney to argue that under *Fifth Third Bancorp. v. Dudenhoffer*, 573 U.S. 409 (2014), Red Rock was not obligated

to follow the governing plan document if it would be imprudent to do so. With regard to Hopscotch, Plaintiff's attorneys might argue along the following lines. First, although Hopscotch was not a fiduciary with regard to the selection of the Plan's investment options by Red Rock other than company stock, it nonetheless had the duty to prudently select the Plan's investment manager and that it imprudently selected (and retained) Red Rock in light of Red Rock's ESG policies. Plaintiff might also argue that in so doing, Hopscotch violated one or more of the co-fiduciary standards in 29 U.S.C. § 1105.

Hopscotch's attorneys can also be expected to argue that its decisions to follow ESG standards as a corporation are not fiduciary, but corporate, decisions and not subject to ERISA. Moreover, Hopscotch may argue, as they did below, that an ESG investment strategy was prudent in that was popular with and expected to grow the business with the company's young users and therefore actually increase the value of Plan assets, 40% of which were invested in company stock. Plaintiff's attorneys may argue in response that, even if Hopscotch was not acting as a fiduciary in setting ESG investing goals for itself, Red Rock breached its fiduciary duties, as follows: As fiduciary of the Plan, which was a major Hopscotch shareholder, Redrock breached its fiduciary duty by failing to even attempt to influence Hopscotch to abandon its ESG policies through proxy voting or other shareholder activism.