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TO:	Mayor and City Commissioners
FROM:	Daniel M. Nee, Interim City Attorney
DATE:	May 23, 2022
SUBJECT	Boards of Trustees' Fiduciary Duties Related to the City of Gainesville Employees Pension Plan and the City of Gainesville Retiree Health Insurance Program

The City of Gainesville has established and administers the City of Gainesville Employees Pension Plan and Fund, with the sole and exclusive purpose of providing pension benefits for members of the City of Gainesville Employees Pension Plan and their beneficiaries, and, “[n]either the city nor the board of trustees shall authorize or permit any part of the trust fund to be diverted for purposes other than for the exclusive benefit of members and their beneficiaries.” Ord. §2-522(c). Similarly, the City of Gainesville has established and administers the City of Gainesville Retiree Health Insurance Program and Trust Fund, with the sole and exclusive purpose of meeting the premium costs of providing health insurance to eligible retirees and their eligible dependents, in accordance with fiduciary duties such that, “[t]he board of trustees and retirement program officers shall, in the performance of program duties, discharge their duties with respect to the program solely in the interest of the participants and beneficiaries for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the program.” Ord. §2-648(n). The members of the City Commission serve as the Board of Trustees for both of the aforementioned plans. Ord. §§2-257(b) and 2-648(b).

The City of Gainesville Employees Pension Plan and the City of Gainesville Retiree Health Insurance Program are “Retirement Plans” as regulated by Florida Statutes, and their respective boards of trustees (the City Commission in both instances) are named fiduciaries. Fla. Stat. 112.625. In that role, the boards of trustees, “shall discharge [their] duties with respect to a plan solely in the interest of the participants and beneficiaries for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.” Fla. Stat. 112.656(1).

Generally, the fiduciary duty of loyalty comes in two distinct varieties. One is a “sole interest” rule under which a trustee must “administer the trust solely in the interest of the beneficiaries.” 3 Restatement (Third) of Trusts §78(1). The “sole interest” rule is sometimes also called the “sole benefit” or “exclusive benefit” rule. The other variety of the duty of loyalty is “best interest.” Under the “best interest” conception of loyalty -- which is typical of corporate law (including charities organized as corporations) and is applicable under trust law if the sole

interest rule is waived -- a fiduciary is not categorically prohibited from acting with a conflict of interest, but rather must act in the “best interest” of the principal notwithstanding the conflict. The best interest rule is typically implemented by way of an “entire fairness” test. The fiduciary duty set forth in the applicable ordinances and statutes for the City of Gainesville Employees Pension Plan and the City of Gainesville Retiree Health Insurance Program is the stricter “sole interest” rule.

Under the applicable “sole interest” rule, “the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust.” 3 Restatement (Third) of Trusts §78(1). “The trustee,” in other words, “is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person.” 1 Restatement (Second) of Trusts §170. Comparably, the sole interest rule is mandatory under ERISA plans, and is generally the default in trust law. “ERISA’s duty of loyalty is the ‘highest known to the law.’” Halperin v. Richards, 7 F.4th 534, 546 (7th Cir. 2021) *citing* Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982). Because the sole interest rule is prohibitory rather than regulatory, to prove a breach, a beneficiary need only prove the fact of a trustee’s mixed motives. Under the sole interest rule, a trustee violates the duty of loyalty -- even in the absence of self-dealing -- if the trustee has any motive or rationale for undertaking an action other than the “sole interest” or “exclusive benefit” of the beneficiary. Acting with mixed motives triggers, “an irrebuttable presumption of wrongdoing.” Langbein & Fischel, *ERISA’s Fundamental Contradiction: the Exclusive Benefit Rule*, 55 U. Chi. L. Rev. at 1114. A trustee who is influenced by his own or a third party’s interests is disloyal, because the trustee is no longer acting solely in the interest of the beneficiaries.

Directions to invest trust funds under ESG or SRI mandates seem to shift focus to the trustees’ ethics, rather than the sole interest of the beneficial owners of the funds. This Office joins in and supports the analysis and conclusions set forth by the Budget & Finance Department in the accompanying presentation “Investing Analysis, ESG-Environmental/Social/Governance, SRI-Socially Responsible Investing, for the Gainesville Operating Fund, General Employees Pension Plan, Retiree Health Insurance Fund.” To recap those operational conclusions, ESG and SRI mandates have negligible impacts on targeted companies (due to investments made in secondary markets), are difficult to maintain and implement (as seen in recent actions by some ESG managers to eliminate Tesla, but include Exxon investments), and give priority to considerations that are already baked-in to prudent risk profile parameters (as seen with typical aversion to investments in volatile and developing markets). Legally, the fiduciary duty of the trustees is also implicated. Arguably, ESG and SRI characteristics are, and may be, considered as part of a prudent “sole interest” portfolio. However, to the extent that ESG and SRI mandates subordinate the economic interests of the beneficial owners of the City of Gainesville Employees Pension Plan and the City of Gainesville Retiree Health Insurance Program, they would run counter to the sole interest rule, and, therefore, would violate the trustees’ fiduciary duty.

cc: Charter Officers
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Pension and Investment Officer