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Interests of the Amici Curiae Brief

Ethan Halman Gonzalez is an environmental studies student who seeks to aid the Court in making an informed decision on the legal and business realities of Environmental, Social, and Governance investing.[1]

Summary of Argument

In a sentence: What is arbitrary and capricious?

To expand upon that, the State of Utah et al. wants to show the Department of Labor's "*Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights*" Rule proposed in December 2022, is arbitrary and capricious under the Administrative Procedure Act (APA) and Employment Retirement Income Security Act of 1974 (ERISA). The suit argues that the Department of Labor (DOL) oversteps the APA—as under the APA, the Court "shall… hold unlawful and set aside agency action, findings, and conclusions" that are "in excess of statutory jurisdiction, authority, or limitations," or "arbitrary capricious, an abuse of discretion, or otherwise not in accordance with law."[2]

The suit further cites *Luminant Generation Co. v. EPA, 675 F.3d 917, 925 (5th Cir. 2012)* which defines arbitrary and

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[1] No parties or legal counsel of parties finically supported this brief. All parties have consented to its filing.
[2] 5 U.S.C. § 706(2)(A), (C)–(D).

capricious as “if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.”[3]

Additionally, the suit argues that the rule oversteps the DOL’s authority under the ERISA. It argues that Congress rejected several proposals that encourage “socially responsible” investing. Therefore arguing that the rule should be thrown out because it violates the history and intention of the bill, making it arbitrary and capricious.

This may bring the major questions doctrine as a clear statement rule into play, as a large part of this new interpretation of the doctrine outlined by the Roberts Court states that Congress does not delegate any issues of major political or economic significance. The ERISA definitely covers the economic significance standard, with multiple executive orders being issued to define its provisions, and 141 million workers and beneficiaries being covered, amounting to over $7.6 trillion in assets.[4] So when

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[3] *Luminant Generation Co. v. EPA*, 675 F.3d 917, 925 (5th Cir. 2012).
[4] *Fact Sheet: What Is ERISA*, U.S. Department of Labor https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/what-is-erisa.

looking at the legality of the *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights* Rule, it may be needed to establish that Congress clearly authorized the DOL to allow for ERISA trustees to consider Environmental, Social, and Governance goals when creating their investment strategy.

Does this analysis of arbitrary and capricious fit?

The short answer is no. 5 U.S.C. § 706(2)(A) outlines that courts can strike down "agency action, findings, and conclusions found to be—arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law". However, the arbitrary and capricious standard is somewhat unclear, but *FCC v. Prometheus Radio Project*, 141 S. Ct. 1150, 1158 (2021) gives a universal standard—that the plaintiffs in this case agreed to—which outlines that in order to meet the arbitrary and capricious standard an agencies action must "be reasonable and reasonably explained."

The Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights Rule clearly meets this definition under the *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29 (1983) as an arbitrary action is defined as "a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n* also establishes in the case of an agency rescinding a rule—which the 2022 rule

does by rescinding the 2020 *Financial Factors in Selecting Plan Investments* and *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*—there must be "a justification for rescinding the regulation before engaging in a search for further evidence."

The *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights* Rule clearly meets this standard. This new rule was formulated to comply with Executive Order (E.O.) 13990—which prompted the DOL to review all existing regulations "promulgated, issued, or adopted between January 20, 2017, and January 20, 2021"[5]—and E.O. 14030—which directed the DOL to "suspend, revise, or rescind"[6] the two Trump era amendments to the Investment Duties regulations. In order to comply with E.O. 13990 and E.O. 14030 the DOL launched an informal discussion with stakeholders in the industry from asset managers, service providers, and plan sponsors—among others.

The prevailing sentiment among these stakeholders is that the amendments to Investment Duties regulations introduced in 2020 unfairly singles out ESG investing for higher scrutiny, like in the preamble to the *Financial Factors in Selecting Plan*

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[5] Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 87 F.R. 73822 (Dec. 1, 2022)

[6] Ibid.

Investments final rule which asserts that ESG investing raises heightened concerns under ERISA, and implies that some ESG-themed funds fail the pecuniary interest standard. Because neither rule defines a bright-line rule where fiduciaries can determine if an ESG-themed asset is meeting the pecuniary sole interest standard prescribed under *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2468 (2014). This is more than enough of a reason to rescind the two 2020 policies for instigating a chill among ERISA fiduciaries, as industry stakeholders have outlined a clear need for further guidance on ESG-themed funds.

The plaintiffs then argue that since no specific entity was listed as being harmed in the final notice of rulemaking, the rule "thus proposes to fix a problem that does not exist by exacerbating a problem that does, but fails to weigh the benefits and burdens of doing so."' They argue that because of this inconsistency, the rule "cannot bchille adequately explained" and is a reason for holding the 2022 rule as an arbitrary and capricious change.[7]

However, there is a clear harm that has been done to the ESG investing market because of attacks on ESG investing. Despite the DOL putting a hold on the 2020 rules, ESG fund's assets fell around $163.2 billion globally during the first quarter of

[7] *AFGE, Loc. 2924 v. FLRA*, 470 F.3d 375, 380 (D.C. Cir. 2006)

2023 from 2022. This was despite ESG funds outperforming the 12-month average return for the market by 2.8 percent.[8] This major decline of ESG-related assets is at least partially explained by the recent GOP-led attacks on public money being used in ESG investing, with fourteen states—ten of which are plaintiffs on this case.[9] This shows a clear harm—as not only are stakeholders and ERISA stakeholders telling the DOL that the 2020 rules around ESG are creating a chill in the industry—there is empirical evidence that the uncertainty is causing a reduction in ESG assets currently on the market, despite the pecuniary returns being higher compared to non-ESG themed assets.

This all points to a connection between the facts found and the choice made being correct. The facts point to a multitude of industry stakeholders and ESG funds itself suffering from a chilling effect which has catered the industry.

Does the DOL exceed their authority?

The major argument in the plaintiff's suit is that the *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights* Rule oversteps the Department of Labor's authority given to them by Congress. This argument

[8] Goodkind N. (2023) "ESG investing is dying. That's not a bad thing" *CNN*
[9] Goodlett, B. et al. (2023) The "Anti-esg" movement: Balancing conflicting stakeholder concerns and inconsistent regulatory regimes, DLA Piper.

largely centers around the collateral benefits rule which the plaintiffs argue that "any nonpecuniary tiebreaker is not authorized by ERISA and violates its strict 'exclusive benefit' rule."

However, this argument is ahistorical at best and completely nonsensical at worst. In 1994, the DOL released Interpretive Bulletin 94-1 (IB 94-1), which was formulated to address economically targeted investments (ETIs) that used collateral benefits apart from the investment return to the plan investor. IB 94-1 explained that the requirements of sections 403 and 404 of ERISA do not prevent fiduciaries from investing plan assets in ETIs if the investment has an identical expected rate of return comparable to the rates of return of available alternative investments. The ETI must also have an "appropriate investment for the plan in terms of such factors as diversification and the investment policy of the plan." IB 94-1 further clarifies that when different investments serve the plan's economic interests "equally well", plan fiduciaries are allowed to use collateral considerations as the deciding factor for an investment decision.

This has been unchallenged department policy for over thirty years and reaffirmed through two different IBs that were released in 2008 and 2015. In Field Assistance Bulletin 2018-01 (FAB 2018-01), the DOL explicitly considered ESG investing and noted as long as the fiduciaries only consider financial factors that

have a material, pecuniary effect on the return and risk of an investment—a "prudently selected, well managed, and properly diversified" ESG investment may be considered. Again, this standard was unchallenged, and the 2022 rule just reaffirmed that language in the rule itself.

The plaintiffs further argue that the 2022 rule's tiebreaker principle was not authorized by Congress. The 2022 rule modified the 2020 rules "tiebreaker" principle, which permits fiduciaries to consider collateral benefits as tiebreakers in some circumstances. As stated above, the 2020 rules had a requirement that competing investments that are similar enough to need a tiebreaker must be indistinguishable based on pecuniary factors alone before fiduciaries can turn to collateral factors to break a tie, while additionally imposing a requirement for special documentation when using these factors. The 2022 rule proposed replacing that standard with a new one that would require the fiduciary to prudently ensure that "competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon."[10]

There is a somewhat compelling argument that the tiebreaker principle violates the "sole interest" principle

[10] 29 CFR § 2550.404a-1 (c)(2)

established in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2468 (2014). The sole interest principle is defined under ERISA, where the Supreme Court has held that the "exclusive purpose" (or sole interest) to which a fiduciary must consider is the "financial benefits...for the trust's beneficiaries"[11]. However—as outlined above—the tiebreaker principle has been DOL policy for over three decades and was left unchanged through multiple changes in department policy pre and post-*Dudenhoeffer*. This may be a compelling argument, as established practices—are generally a solid defense—especially when as the plaintiffs state "if two assets (or funds) have returns that are less than perfectly correlated (correlation is less than 1.0), then financial economics teaches that the investor should invest in both to diversity the portfolio".[12]

Therefore, throwing out an entire rule based on an established practice that the plaintiffs admit is impossible to implement is completely incoherent. Even if the court finds that the tiebreaker principle violates the sole interest principle, the rest of the rule should be upheld, as the use of ESG factors is not limited to tiebreakers—and that guidance is invaluable to fiduciaries.

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[11] Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459, 2468 (2014)

[12] *Utah v. Walsh*, 2:23-CV-016-Z (N.D. Tex. Mar. 28, 2023)

As a part of this argument, the plaintiffs argue that the new rule constitutes a major easing of the tiebreaker principle, and such a major change in definition requires congressional approval, but the actual changes to ERISA are superficial at best. Rather than formulate an entirely new standard, the 2022 rule functionally just replaces the "pecuniary factors" mentioned in the 2020 rule, with the definition of said "pecuniary factors". The 2022 rule reaffirms the sole interest principle, stating that fiduciaries may only invest "based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis."[13] On the other hand, the 2020 rule required that an ERISA fiduciary must make investment decisions "based only on pecuniary factors." In the 2020 rule, a pecuniary factor is one "that a fiduciary prudently determines is expected to have a material effect on the risk and/or return of an investment."

Therefore, the changes within the 2022 rule are cosmetic: as the terms "prudently" was changed to "reasonably," and "material" to "relevant." So, in practice, the 2022 rule replaced the 2020 rule's use of the term "pecuniary factors" with its definition provided in the same rule. But—most importantly—both rules specify that a "fiduciary may not subordinate the interests of the participants and beneficiaries…under the plan to other objectives

[13] 29 CFR § 2550.404a-1 (b)(4)

and may not sacrifice investment return or take on additional investment risk to promote [other] benefits or goals."[14] To claim such a superficial change is outside of the DOL's scope of review is ludicrous and a fundamental misinterpretation of administrative law.

The judicial system and Supreme Court have consistently held that unless an agency's action clearly falls out of line from what Congress delegated them to do, agencies have the authority to act. ESG-informed investing is a relatively new, increasingly popular trend within the investing world, to not provide any guidance on when it is appropriate for fiduciaries to use the collateral benefits that many people (including several of the plaintiffs) believe entirely define ESG-themed funds is entirely inappropriate.

However, there is a somewhat compelling argument that the tiebreaker principle violates the "sole interest" rule established in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2468 (2014). The sole interest principle is defined under ERISA, where the Supreme Court has held that the "exclusive purpose" to which a fiduciary must consider is the "financial benefits...for the trust's beneficiaries"[15]. However—as outlined above—the tiebreaker

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[14] 29 CFR § 2550.404a-1 (c)(1)
[15] Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459, 2468 (2014)

principle has been DOL policy for over three decades and was left unchanged through multiple changes in department policy post-*Dudenhoeffer*. This may be a compelling argument, as established practices are generally a solid defense—especially when the plaintiffs state "if two assets (or funds) have returns that are less than perfectly correlated (correlation is less than 1.0), then financial economics teaches that the investor should invest in both to diversify the portfolio".[16]

Therefore, throwing out an entire rule based on an established practice that the plaintiffs admit is impossible to implement is completely incoherent. Even if the court finds that the tiebreaker principle violates the sole interest principle, the rest of the rule should be upheld, as the use of ESG factors is not limited to tiebreakers—and that guidance is invaluable to fiduciaries.

Major Questions Doctrine

One of the most potentially impactful arguments in the entire case is a relatively minor part of the plaintiff's argument. While there is not much in the way of case law on the major question doctrine, it is potentially one of the most powerful legal analyses in administrative law. The standard for when and how the

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[16] *Utah v. Walsh*, 2:23-CV-016-Z (N.D. Tex. Mar. 28, 2023)

major doctrine is still unclear—and therefore it is worth mentioning, despite the plaintiffs barely arguing it.

The plaintiffs first cite *West Virginia v. EPA*, 142 S. Ct. 2587, 2608 (2022) which asks, "whether Congress in fact meant to confer the power the agency has asserted.". They argue that in certain "extraordinary cases," especially those where the subject matter carries substantial "economic and political significance," the court should "hesitate before concluding that Congress meant to confer such authority." They argue that nothing in the case overcomes the hesitation, and therefore Congress has not conferred the power to issue the *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights* Rule to the DOL.

The plaintiffs first aim to show that the 2022 rule is of "vast economic significance". It may seem like an easy answer at the start, as ERISA covers approximately 747,000 retirement plans, 2.5 million health plans, and 673,000 other welfare benefit plans. Additionally, these employee benefit plans cover about 152 million workers and more than $12 trillion in assets, equivalent to more than two-thirds of the U.S. adult population and half of the nation's gross domestic product.[17]

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[17] Emp. Benefits Sec. Admin., DOL*, Fact Sheet: EBSA Restores Over $1.4 Billion to Employee Benefit Plans, Participants, and Beneficiaries* (2022)

The plaintiffs argue that this qualifies as economically significant, but their own argument counteracts this narrative, as by their own argument "the idea of a generally applicable tiebreaker is also wrong". If the tiebreaker principle is impossible to implement because—as the DOL and plaintiffs admit— "no two investments are the same in each and every respect"[18][19] then there is no actual issue of economic importance—as none of the above statistics are actually affected.

In order to sidestep this, the plaintiffs argue that DOL created the 2022 Rule to encourage the use of ESG investing. They argue that climate change policy, and ESG more generally, is "'the subject of an earnest and profound debate across the country.'"[20] However, this case is not about the legality of ESG-led investing—even if the 2022 rule is overturned, ESG factors and funds would still be permissible. This is because the 2022 Rule does not affect ERISA fiduciaries that are currently engaging in risk-and-return ESG investing in a prudent process, without taking into account the collateral benefits.

The plaintiffs try and further argue that in order to issue the 2022 Rule the DOL needed clear authorization from Congress. The DOL derives its statutory authority for the 2022 Rule from 29

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[18] 87 F.R. at 73837
[19] *Utah v. Walsh*, 2:23-CV-016-Z (2023)

[20] *West Virginia v. EPA*, 142 S. Ct. (2022)

U.S.C. § 1135, a general rulemaking provision that allows the Secretary to "prescribe such regulations as he finds necessary or appropriate to carry out the provisions of [ERISA]. Among other things, such regulations may define accounting, technical and trade terms used in such provisions; may prescribe forms; and may provide for the keeping of books and records, and for the inspection of such books and records."

The plaintiffs then argue that none of the terms listed above were meant to allow for the 2022 Rule, especially focusing on the DOL's ability to "define accounting, technical, and trade terms". While the plaintiffs do not define the term "define", Blacks Law Dictionary defines "define" as "to settle, make clear, establish boundaries."[21] This rule clearly set out to "settle, make clear [and] establish boundaries" the murky waters around ERISA fiduciaries investing in ESG-theme funds and is well within the DOL statutory authority to rule upon.

Conclusion

For these reasons, the United States District Court for the Northern District of Texas should find in favor of the defendants Walsh and the Department of Labor.

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[21] *Define definition & meaning - black's law dictionary* (2011) *The Law Dictionary*. Available at: https://thelawdictionary.org/define/.

May 8, 2023 Respectfully submitted,

Ethan Halman Gonzalez