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Biden ESG Rule Shows Some Staying Power

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On September 21, 2023, the District Court for the Northern District of Texas rejected a challenge brought by 26 states that argued that the Department of Labor's ("DOL") 2022 Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights rule ("2022 ESG Rule") was "arbitrary and capricious." *Utah v. Walsh*, No. 2:23-cv-00016-Z, slip op. (N.D. Tex. Sept. 21, 2023).

The court not only concluded that the DOL had complied with the Administrative Procedure Act ("APA") in crafting the 2022 ESG Rule, but also highlighted that the 2022 ESG Rule "changes little in substance" from the DOL's previous rulemakings. Under both the 2022 and 2020 ESG-related rules, a fiduciary's "determination with respect to an investment … must be [made] based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis," which, therefore, permits a fiduciary to consider ESG factors so long as they are expected to have an economic impact on an investment. While the 26 states may appeal and there is also a second challenge to the 2022 ESG Rule pending in Wisconsin, this decision provides some clarity to plan fiduciaries on when and how ESG factors may be considered.

A Closer Look

Twenty-six states and other private parties sued the Secretary of Labor ("Secretary") over the 2022 ESG Rule and alleged that it violated the APA, arguing that its provisions violated the plain text of the fiduciary duties imposed by Congress in the Employee Retirement Income Security Act ("ERISA"). To assess this allegation, the court relied on the Supreme Court's 1984, two-part framework for determining whether a court must defer to an agency's action, developed in *Chevron USA Inc. v. Nat. Res. Def. Council., Inc.*, 467 U.S. 837.[1] *Chevron* established that an agency must give effect to the plain language of Congress (known as *Chevron* step 1), but when the plain language is ambiguous, the court must then analyze an agency's interpretation of the statute and defer to an agency's reasonable interpretation (known as *Chevron* step 2).

Applying this framework, the court first concluded that ERISA's plain language is ambiguous, because Congress did not directly address what factors may be considered when there is a tie between two financially equivalent investments. In assessing whether the DOL's interpretation in the 2022 ESG

Rule was reasonable, the court concluded that the DOL's interpretation was not "manifestly contrary to the statute" and as a result, held that the DOL was entitled to *Chevron* deference.

Specifically, the court emphasized that "for nearly three decades" the DOL has opined, though with varying terminology, that ERISA does not prohibit the consideration of collateral benefits when alternative financial investments are equal. Furthermore, the court noted that "'[t]he fact that the agency has from time to time changed its interpretation' does not mean that 'no deference should be accorded [to] the agency's interpretation of the statute.'" In its assessment of the 2022 ESG Rule, the court noted that there is "little meaningful daylight" between the 2022 ESG Rule and 2020 ESG Rule and even cited to scholars suggesting the changes were "cosmetic" in nature, rather than substantive. Please see the following links for more information on the 2022 ESG Rule and the 2020 ESG Rule.

Even if an agency's action is entitled to *Chevron* deference, a rule that is arbitrary and capricious must still be held unlawful. 5 U.S.C. § 706(2)(A). An agency action may be arbitrary and capricious if the agency: (i) failed to assess all of the important aspects of the question, (ii) opined in a way not supported by or contrary to the evidence before it, and (iii) ignored its earlier findings without detailing what led to a change in position. The court concluded that the DOL (i) assessed the concerns regarding the 2020 ESG Rule's "chilling effect" on the reliance interests regarding the ability to consider collateral benefits when financially relevant, (ii) in a manner consistent with evidence, including the public comments submitted, and (iii) did not significantly and substantively depart its longstanding prior positions. As such, the 2022 ESG Rule was not arbitrary and capricious and did not violate the APA.

The 2022 ESG Rule May Still Be In Jeopardy

ESG investing has been, and remains, a partisan issue. In the decision, the judge expressed skepticism toward ESG investing and stated that it is not "unsympathetic to Plaintiffs' concerns over ESG investing trends." That being said, the court was evaluating whether the rulemaking was contrary to law and not whether it thought the 2022 ESG Rule represents the optimal policy outcome. Regardless, the court's reliance on *Chevron* in particular may make the rule vulnerable to a challenge should the states appeal to the 5th Circuit.

The 2022 ESG Rule is currently also being challenged in the District Court for the Eastern District of Wisconsin. *Braun v. Walsh*, No. 2:23-cv-00234. In *Braun*, the plaintiffs brought similar allegations against the Secretary, and specifically accused the Secretary of overstepping his authority in promulgating the 2022 ESG Rule and "unlawfully politiciz[ing] the retirement system." A key issue in the Wisconsin case will be whether the plaintiffs have Article III standing – that is, have they been harmed by the rulemaking in a way such that courts are allowed to intervene?

Additionally, plan fiduciaries have also been sued where plaintiffs have alleged that the defendants breached their fiduciary duties by making retirement plan investment decisions that prioritized goals unrelated to the maximization of economic return. Even with the 2022 ESG Rule, it is important for plan fiduciaries to understand their responsibilities with regard to plan investments.

For more information on the impact of the *Utah* decision, please contact the authors or any of our Groom attorneys.