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Fiduciary Rule Survives Challenge in Texas

On February 8, 2017, Judge Barbara Lynn of the U.S. District Court for the Northern District of Texas issued a summary judgment ruling in *Chamber of Commerce of the United States, et al. v Hugler*. The Court granted summary judgment to the U.S. Department of Labor ("DOL"). This decision represents the final district court ruling in a series of cases bringing facial challenges to the DOL's recently finalized regulations (the "Fiduciary Rule") defining when someone acts as a fiduciary by providing investment advice under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") or the Internal Revenue Code of 1986, as amended (the "Code"), and related prohibited transaction exemptions. Notwithstanding DOL's string of district court successes, litigation is expected to continue in the appellate courts. In each of these cases, DOL has prevailed and the industry groups challenging the Fiduciary Rule have appealed or have indicated that they will appeal.

Chamber of Commerce was brought by a coalition including the U.S. Chamber of Commerce, Financial Services Institute, Inc., the Financial Services Roundtable, the Insured Retirement Institute, and four other organizations on June 1, 2016. The Plaintiffs challenged the Fiduciary Rule and related exemptions broadly The Plaintiffs offered substantive claims that the Fiduciary Rule's broad definition of "investment advice," and the requirement that financial institutions enter into contracts with certain prescribed provisions as part of the BIC Exemption violated DOL's regulatory authority under ERISA and the Code. Furthermore, the Plaintiffs argued DOL violated the Administrative Procedures Act by failing to properly consider the costs and benefits of the Fiduciary Rule and the related exemptions. Finally the Plaintiffs took a novel position and alleged that the Fiduciary Rule violated the First Amendment because it limited what agents and advisers could say to clients and potential clients.

In eighty-one pages of analysis, Judge Lynn methodically rejected each of the Plaintiffs' arguments concluding that the Fiduciary Rule was validly promulgated. In several instances, Judge Lynn observed that the Fiduciary Rule appeared more consistent with the statutory text than its predecessor:

- "[T]he [old] five-part test is the more difficult interpretation to reconcile with who is a fiduciary under ERISA… Under the five-part test [a rollover] would not trigger a fiduciary duty. This outcome is seemingly at odds with the statute's text and its broad remedial purpose, realities and the proliferation of participant-directed 401(k) plans, investments in IRAs, and rollovers of plan assets to IRAs. An interpretation covering such transactions better comports with the text, history, and purposes of ERISA."

- "The DOL's new rules comport with Congress' expressed intent in enacting ERISA."

In this regard, Judge Lynn's analysis appears consistent with the views expressed by the Court in the *National Association of Fixed Annuities v. Perez* last November.

The Court's decision in *Chamber of Commerce* comes at the same moment in time that the new Administration is reevaluating the Fiduciary Rule. On February 3, 2017, President Trump issued a memorandum (the "Memorandum") directing DOL to study the Fiduciary Rule and related exemptions, and, if warranted, to rescind or revise them. Under the Memorandum, DOL is directed to consider three economic and legal points in determining whether the Fiduciary Rule is consistent with the priority to empower Americans to make their own financial decisions and to facilitate the ability to save for retirement as well as other typical lifetime financial needs:

- Whether the anticipated applicability of the Fiduciary Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice;

- Whether the anticipated applicability of the Fiduciary Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and

- Whether the Fiduciary Rule is likely to cause an increase in litigation and an increase in the prices that investors and retirees must pay to gain access to retirement services.

In response to the Memorandum, Acting Secretary of Labor Edward Hugler announced that DOL would explore options for delaying the applicability date of the Fiduciary Rule, which is currently April 10, 2017.

Although the Memorandum was not explicitly discussed in Judge Lynn's opinion, her reasoning appears to have been framed with a view towards addressing many of the concerns expressed by the White House in the Memorandum. For example, Judge Lynn concluded that the Best Interest Contract Exemption is workable and not unduly burdensome:

- "Any exemption the DOL grants from the prohibited transaction rules reduces the industry's regulatory burden. Without PTE 84-24, BICE, or some other exemption … fiduciaries would be barred from engaging in prohibited transactions altogether."

- "Congress put a lock on prohibited transactions, and gave the DOL the key… [I]n ERISA Congress did speak clearly, and assigned the DOL the power to regulate a significant portion of the American economy."

- "[I]t is reasonable for the DOL to incentivize certain compensation models [asset based] over others [commissions] to protect plan participants and beneficiaries."

- "Although the industry will likely respond in different ways to BICE, BICE does not appear to be a 'Hobson's choice,' and the exemption's conditions have been deemed workable by many in the industry."

The long term impact of Judge Lynn's decision and those of the other district courts remain to be seen. However, these decisions affirm DOL's long-held position that it has broad authority to regulate the financial services industry, including advisers to IRAs. We should expect DOL to point to these decisions in future litigation and enforcement actions.

Just hours before the decision was issued, the DOL had filed a motion to stay with the Texas court arguing that "the outcome of [its] review may differ in relevant ways from the April 8, 2016 rulemaking challenged by Plaintiffs. For example, ... its cost-benefit analysis ...could be updated [or] the rulemaking may be 'revised or rescinded.'" While DOL's motion was denied, the decision to seek a stay could signal DOL's intent to delay the applicability date.

At this point, it is difficult to predict what is going to happen next. Will DOL seek a delay? We think so. If DOL seeks a delay, will it be pursuant to "notice and comment?" And will it be opposed in court by groups supporting the Fiduciary Rule? Also, notwithstanding the thoroughness of Judge Lynn's opinion, will the plaintiffs appeal this decision? If so, will the new Department of Justice ("DOJ") and DOL support the lower court decision or walk away? Will other groups seek to step in if DOJ and DOL do walk away? Finally, will all of this turbulence surrounding the Fiduciary Rule open the door for a new legislative solution – one that has some traction and perhaps White House support?