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On Remand, District Court Again Upholds DOL Final Rule on ESG Investing and Proxy Voting, Ruling Against Group of States' Attorneys General

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Pension Committee
Pension Operations Advisory CommitteeSUBJECTS:ESG
PensionRE:On Remand, District Court Again Upholds DOL Final Rule on ESG Investing and Proxy Voting, Ruling Against Group of States' Attorneys General

On February 14, 2025, a judge for the US District Court in the Northern District of Texas issued its decision[1] in the case filed by attorneys general (AGs) from 26 states against the Department of Labor (DOL). The judge granted DOL's motion for summary judgment, refusing the state AGs' attempt to invalidate the final rule on "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" ("2022 Rule")[2], which addresses the consideration of environmental, social, and governance (ESG) factors in selecting plan investments and exercising shareholder rights.

This marks this judge's second decision upholding the rule, following the Fifth Circuit's remand of the lawsuit for the limited purpose of reconsidering Plaintiffs' challenge in light of the Supreme Court's decision in *Loper Bright* (which overturned the *Chevron* doctrine).[3]

2022 Rule

The 2022 Rule amends two rules finalized at the end of the Trump Administration, "Financial Factors in Selecting Plan Investments"[4] and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights"[5] (the "2020 Rules"). In issuing the 2022 Rule, DOL explained that the 2020 Rules "unnecessarily restrained plan fiduciaries' ability to weigh [ESG] factors when choosing investments, even when those factors would benefit plan participants financially."[6]

Although the 2022 Rule allows greater flexibility for fiduciaries to include ESG investments in plans, it retains the longstanding ERISA core principles, including that the duties of prudence and loyalty require ERISA plan fiduciaries to focus on relevant risk-return factors and not subordinate the interests of participants and beneficiaries (such as by sacrificing investment returns or taking on additional investment risk) to objectives unrelated to the provision of benefits under the plan.[7]

The 2022 Rule makes the following changes to the 2020 Rules:

- deleting the "pecuniary/non-pecuniary" terminology used in the 2020 Rules, based on concerns that the terminology caused confusion and a chilling effect to financially beneficial choices.
- clarifying that a fiduciary's determination with respect to an investment or investment course of action must be based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis and that such factors may include the economic effects of climate change and other ESG factors on the particular investment or investment course of action.
- removing the 2020 Rules' stricter rules for selecting qualified default investment alternatives (QDIAs), such that, under the 2022 Rule, the same standards apply to QDIAs as to selecting investments generally.
- amending the 2020 Rules' "tiebreaker" test, which imposed a requirement that competing investments be indistinguishable based on pecuniary factors alone before fiduciaries can turn to collateral factors to break a tie and imposed a special documentation requirement on the use of such factors. The 2022 Rule replaces those provisions with a standard that instead requires the fiduciary to conclude prudently that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon.

Prior Decisions

As a reminder, in September 2023, a judge for the US District Court in the Northern District of Texas issued its decision granting DOL's cross motion for summary judgment, refusing the state AGs' attempt to invalidate the final rule.[8]

The state AGs appealed the decision, and on July 18, 2024, the US Court of Appeals for the Fifth Circuit remanded the case to the district court "for the limited purpose of reconsidering Plaintiffs' challenge in light of the Supreme Court's decision in *Loper Bright* (which overturned the *Chevron* doctrine).

In October 2024, both parties again filed motions for summary judgment in district court. The state AGs reasserted their original challenges to the 2022 Rule, claiming that the 2022 Rule is contrary to law, is arbitrary and capricious, and is barred by the major questions doctrine.[9]

District Court's Decision on Remand

In the new decision, the district court explained that it had previously held that *Chevron* deference meant the 2022 Rules did not violate ERISA. Now, on limited remand, it must decide whether the 2022 Rule is contrary to ERISA under *Loper Bright*'s standard.

The court begins by dispensing with of two of plaintiffs' claims—that the 2022 Rule is arbitrary and capricious and violative of the major questions doctrine—holding that its previous reasoning on those standards stands. The court explains that this is because *Loper Bright* did not change how courts evaluate these standards. Rather it deals with statutory interpretation, providing that courts "must exercise their independent judgment in deciding whether an agency has acted within its statutory authority." The court therefore limits its analysis to whether the 2022 Rule is contrary to ERISA.

The court reasons that:

Under the rule, a fiduciary faced with choosing between investment options - that all equally serve the beneficiaries' financial interests - does not advance the interests of nonbeneficiaries nor act for a purpose other than their financial benefit when he chooses based on collateral factors. Plaintiffs' interpretation of ERISA would demand arbitrary randomness to choose between such investment options. It embodies the wooden textualism that courts should endeavor to avoid.

ERISA does not require such capriciousness. A fiduciary has acted in full accord with his ERISA duty of loyalty when he chooses between investment options that all are valid options because they each maximize the beneficiaries' financial benefits.[10]

The court walks through each of plaintiffs' arguments and ultimately finds that the 2022 Rule is not contrary to ERISA, applying the *Loper Bright* standard.

- Statutory Text. The opinion explains that the statutory text imposing ERISA's duty of loyalty requires a fiduciary to act "solely in the interest of participants and beneficiaries" and "for the exclusive purpose of … providing benefits to participants and beneficiaries." The plaintiffs argue that the "ordinary meaning" of "solely" and "exclusive" mean that a fiduciary cannot consider "any other considerations" when administering plans, and therefore, consideration of collateral benefits under the 2022 Rule's tiebreaker provision violates ERISA.[11] The court countered that the provision "never permits fiduciaries to deviate from exclusively achieving financial benefits for the beneficiaries alone" and that the statutory text means that "a fiduciary must act in the interest of the beneficiaries 'to the exclusion of all' other interests for the 'single,' 'limited' purpose of advancing their financial benefits."[12]
- Duty of Diversification. The plaintiffs argue that the tiebreaker provision is needless because ERISA's duty to diversify investment options means that, rather than apply the tiebreaker provision, the fiduciary should "choose both investments when possible."[13]
- The court agrees with the defendants' response that diversification is not required when "it is clearly prudent not to do so" and that it is clearly not prudent to do so when choosing both investments "entails additional costs (such as transaction or monitoring costs) that offset the benefits" of diversifying by choosing both options. The court finds that "ERISA's duty to diversify means the tiebreaker provision is textually narrow—but not needless."[14]
- ERISA's Exceptions to the Duty of Loyalty. The plaintiffs argue that ERISA provides statutory exceptions to its duty to loyalty, and therefore, DOL cannot add another exception with the tiebreaker provision. The court finds that the tiebreaker provision is not an exception to the duty of loyalty, but rather it "provides clarification on how to choose between several equal options - all of which would accord with a fiduciary's duties."[15]
- Common Law Interpretations. The plaintiffs argue that, applying the common law duty of loyalty's bar on a fiduciary acting in multiple roles, the "mixed motives" allowed by the tiebreaker rule are not permitted. The court disagreed with this analysis, finding that "[n]othing about that language permits dual loyalties, competing purposes, or conflicts."[16]
- Congressional Action and Inaction. The plaintiffs argue that because Congress considered and did not include several proposals that would allow fiduciaries to engage in "social investing," ERISA's text therefore forbids social investing. The court agrees that ERISA does not allow outright social investing but finds that the 2022 Rule does not permit it either.[17]

The court also points out that the 2020 Rule includes a tie-breaker provision that would also violate plaintiffs' interpretation of ERISA. While the court does express a preference for the 2020 Rule's articulation of the tiebreaker provision, it finds that ERISA does not invalidate the tiebreaker provision of either the 2020 Rule or the 2022 Rule. It adds that it is not the court's job "to decide the wisest outcome," but rather to interpret the law.[18]

Perhaps wanting to signal disapproval of ESG investing, the court cautions that "[f]iduciaries should strenuously guard against letting impermissible considerations taint their decisions."[19] The court expresses definitively that "ERISA prohibits outright social investing because then the fiduciary would be acting for a different purpose and on behalf of other interests."[20]

Future of the Rule and Letters from State Treasurers

We do not yet know whether the state AGs will appeal the decision to the Fifth Circuit. If they do not appeal, we expect that DOL would begin the process of notice and comment to amend the 2022 Rule to achieve the goals of the Trump Administration.

In response to the recent district court decision in *Spence v. American Airlines, Inc.* which found that American and the American Airlines Employee Benefits Committee breached their duty of loyalty in connection with the (in the court's view) ESG-influenced proxy voting practices of BlackRock,[21] both Republican and Democratic state treasurers have weighed in on these issues.

Republican state treasurers from 18 states sent a letter to the SEC and DOL in late January, urging them to:

- issue new guidance codifying the court's ruling that ESG activism is incompatible with ERISA's financial interest standard.
- bar fiduciaries from using plan assets to advance political or social agendas under the guise of long-term risk.
- require disclosures from asset managers on the financial risks and legal liabilities of ESG and diversity, equity and inclusion (DEI) initiatives.

In mid-February, Democratic state treasurers from 15 states wrote a counter-letter, arguing that the ruling is misguided and politicizes risk assessment, warning that limiting fiduciary discretion could harm investor confidence and financial security. Both letters are attached at the end of this memo.

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Notes

[1] The decision is available at https://www.ici.org/system/files/2025-02/utah-micone-0225.pdf.

[2] For a summary of the final 2022 Rule, see ICI Memorandum No. 34506, dated December 5, 2022, available at https://www.ici.org/memo34506. The 2022 Rule became effective on January 30, 2023, and all but two provisions also became applicable on that date. Two proxy voting provisions (both unchanged from the final 2020 Rule) have a delayed

applicability date of December 1, 2023 to allow fiduciaries and investment managers time to make any necessary changes to proxy voting policies and guidelines.

[3] *Loper Bright Enterprises v. Raimondo*, 144 S.Ct. 2244 (2024), available at https://www.ca5.uscourts.gov/opinions/pub/23/23-11097-CV0.pdf. In overturning the *Chevron* deference standard, the *Loper Bright* held that courts "must exercise their independent judgment in deciding whether an agency has acted within its statutory authority."

[4] For a summary, see ICI Memorandum No. 32888, dated November 3, 2020, available at https://www.ici.org/my_ici/memorandum/memo32888.

[5] For a summary, see ICI Memorandum No. 32984, dated December 15, 2020, available at https://www.ici.org/my_ici/memorandum/memo32984.

[6] See DOL press release dated November 22, 2022, available at https://www.dol.gov/newsroom/releases/ebsa/ebsa20221122.

[7] Note that the court also holds this position, stating:

Since ERISA's passage, DOL regulations have never allowed fiduciaries to overpower financial-benefit considerations with nonfinancial-benefit considerations - even though the details and strength of the regulatory language have waxed and waned. ...Even so, DOL never once forbade consideration of nonfinancial benefits when selecting between investment options that served financial benefits equally.

Page 3-4 of opinion.

[8] For a summary of the decision, see ICI Memorandum No. 35447, dated September 25, 2023, available at https://www.ici.org/memo35447.

[9] For a summary of plaintiffs' complaint, filed on January 26, 2023, see ICI Memorandum No. 34935, dated February 9, 2023, available at https://www.ici.org/memo34935.

[10] Page 1-2 of opinion.

[11] Page 11 of opinion.

[12] The court helpfully explains,

ERISA instead defines whose *interest* the fiduciary must protect and what the fiduciary's *purpose* is. It says nothing of what they may consider... Other considerations can come into play, but they must be oriented toward the interests of the beneficiary alone and not for another purpose than financial benefit... He does not contradict ERISA' s duty of loyalty when discharging his duties when all actions are in the interests of the beneficiary and for the purpose of reaping financial benefits. Other considerations may be utilized if they do not alter or add to the interests the fiduciary represents or his purpose.

Pages 12-13 of opinion.

[13] Page 15 of opinion.

[14] Id.

[15] Page 16 of opinion.

[16] Page 20 of opinion.

[17] "[The tiebreaker provision in the 2022 Rule] permits, in full accord with the fiduciary's duties, a fiduciary to look to collateral factors to break a tie when investment options would equally serve the plan, and prudence would disallow investing in both." Page 21 of opinion.

[18] Page 23-24 of opinion.

[19] Page 23 of opinion.

[20] Page 20 of opinion.

[21] See ICI Memorandum No. 35993, dated January 23, 2025, available at https://www.ici.org/memo35993.
