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Labor Dept. ESG Rule May Survive Chevron's Demise

By **Kellie Mejdrich**

Law360 (July 23, 2024, 6:41 PM EDT) -- The Fifth Circuit recently overturned a ruling that relied on the now-defunct doctrine of Chevron deference to uphold a U.S. Department of Labor rule covering socially conscious retirement plan investing, but some experts believe the rule has a good chance at surviving — even with the precedent off the books.

Attorneys said they weren't surprised by a three-judge panel's move on July 18 to vacate a Texas court's decision from September upholding the rule, given that the ruling relied on the test established by the U.S. Supreme Court in the landmark Chevron USA Inc. v. Natural Resources Defense Council Inc. In that case, the high court held that if Congress hadn't directly "spoken to the precise question at issue," courts must defer to a federal agency's interpretation of the law.

The appellate panel's remand in the wake of justices' Chevron doctrine repeal in late June via decisions in Loper Bright Enterprises v. Raimondo and Relentless Inc. v. Department of Commerce allows for more briefing and keeps the same panel intact for a more consequential merits decision down the road. Those Supreme Court decisions came down just 11 days before oral argument and dominated discussion during the proceedings on July 9.

The panel's action defers a merits ruling on the legitimacy of the so-called tiebreaker test in the DOL's rule, which describes how retirement managers can consider collateral issues like environment, social and governance, or ESG factors, when two options are theoretically otherwise equal.

That's a situation the Employee Retirement Income Security Act doesn't specifically address. But some attorneys expressed confidence that on remand the Texas court will again back the rule that allows, but doesn't require, consideration of ESG factors when selecting retirement plan investments, and find it complies with both ERISA and the Administrative Procedure Act.

Jason Levy, of counsel at Covington & Burling LLP, said he believes U.S. District Judge Matthew J. Kacsmaryk would reach the same conclusion "that the main body of the ESG investing rule is consistent with the law" if he revisited his earlier opinion.

Levy, who served as counsel on an amicus brief supporting the rule penned by retirement expert Mark Iwry during the appeal, said the judge would find that "in appropriate circumstances, ESG investments can be made consistent with the governing standard — which is that the investment decision needs to be made for the sole purpose of maximizing risk-adjusted return."

Iwry and other financial experts urged the Fifth Circuit to uphold the rule in multiple amicus briefs in March that argued the DOL's policy from November 2022 was entirely consistent with ERISA, the APA and investment professionals' obligations.

Morris DeFeo, partner and chair of the corporate department with New York law firm Herrick Feinstein LLP, said in an interview about the Fifth Circuit's decision that while he didn't like to "read tea leaves when it comes to situations like this," he was reassured by the limited remand aspect of the panel's decision.

DeFeo was one of multiple attorneys who pointed out that the panel distinguished its decision to vacate and remand the lower court by specifying the action was "for the limited purpose of reconsidering plaintiffs' challenge in light of the Supreme Court's decision in Loper Bright."

"I think it's really good when you see a court saying, we don't necessarily disagree with the underlying decision, but we think in light of the Supreme Court mandate now, we're basically saying go back and make sure that you can justify the decision based on the analysis that you made in a way that takes into consideration the fact that you can't give too much deference to the regulatory agencies," DeFeo said.

Conservative-led states and Texas-based energy interests appealed to the Fifth Circuit after a district court in September upheld the rule as in compliance with the APA as well as ERISA. The rule had reversed a 2020 policy from the Trump administration that most attorneys agreed was somewhat more restrictive on ERISA fiduciaries' ability to consider ESG, in part because the regulation contained a categorical ban on selecting an ESG-related fund as a default investment option in a 401(k) plan.

While Loper Bright repealed decades-old precedent that instructed judges when they could defer to a federal agency's interpretation of law, the decision also directed judges to exercise independent judgment when deciding if an agency's interpretation of a policy is within its statutory authority under the APA. Sensing that Chevron was on its way out in the courts, the DOL also told the panel during argument earlier in July and throughout briefing that the appellate court didn't need to rely on Chevron deference to uphold the rule as in compliance with both the APA and ERISA.

Portions of Judge Kacsmaryk's opinion from September also appear to support the argument that the DOL's 2022 policy it produced on the ESG rule is in line with its previous actions interpreting ERISA, even if federal benefits law doesn't explicitly mention the tiebreaker test in dispute. For example, Judge Kacsmaryk said he saw "little meaningful daylight" between how the Trump and Biden rules defined the conditions in which the so-called tiebreaker test would come into play.

Given how the arguments proceeded on appeal, Levy at Covington & Burling said he thinks the decision, if read properly "really will limit the rematch to simply the tiebreaker rule." He also said the tiebreaker rule rarely comes into play when fund managers are making investment decisions as a practical matter.

"In only rare circumstances do they have to resort to the tiebreaker rule, because they cannot reach a decision as to which of two competing investments are more reasonably likely to maximize financial return," Levy said.

DeFeo, at Herrick, said he was also skeptical that regulations from agencies interpreting laws were in overall jeopardy, just because justices in June took away a deference standard that courts previously employed.

"I don't see the court saying to regulatory agencies, we are not giving you any deference at all. I mean, that's not the way I understand how this is playing out, and it makes no sense," DeFeo said.

Ameena Majid, a partner at Seyfarth Shaw LLP who works in the firm's employee benefits and executive compensation department, and co-founded the firm's impact and sustainability practice, agreed that as a practical matter the tiebreaker test was rarely employed. She likened the panel's decision to "kicking the can" on the ultimate merits of the ESG rule.

Majid said the decision reflected how the courts are in a "new era" when it comes to analyzing rules in light of the Chevron deference repeal.

"But when [it comes] to investing, you still have tried and true principles of looking at how a fund is constructed … and what's the style, and what's the diversity of it, and what is the financial performance of those different holdings. And that is still a tried and true principle," including under ERISA, Majid said.

Charles Fowler, a principal with McKool Smith's Austin, Texas, office, said while he didn't think the remand decision "affects the ultimate merits" of a subsequent ruling from the panel on the DOL's ESG rule. But he also took note of the limited aspect of the appellate court's remand decision. He said the limited remand means the case "would go back to the district court for the limited purpose of a new legal ruling and would come back to the same panel who's already got familiarity — they've already read all the briefs once, they've already heard an oral argument in the case."

"I expect the proceedings to move fairly quickly from here," Fowler said.

Looking ahead, Fowler said he also took note of how U.S. Circuit Judge Catharina Haynes didn't join Judge Don R. Willett's opinion for the panel and only concurred in its judgment, in addition to appearing very supportive of the rule during argument.

"By virtue of repeating the appeal with the same panel, we already know at least one judge at least seemed to be leaning towards affirming in the first oral argument," Fowler said.

--Editing by Amy Rowe and Leah Bennett.
