23-11097

United States Court of Appeals for the Fifth Circuit

STATE OF UTAH et al.,

Plaintiffs-Appellants,

v.

JULIE A. SU, Acting Secretary, U.S. Department of Labor; UNITED STATES DEPARTMENT OF LABOR,

Defendants-Appellees.

On Appeal from the U.S. District Court for the Northern District of Texas

BRIEF FOR THE STATES OF NEW YORK, ARIZONA, CALIFORNIA, COLORADO, CONNECTICUT, DELAWARE, HAWAIʻI, ILLINOIS, MAINE, MARYLAND, MASSACHUSETTS, MICHIGAN, MINNESOTA, NEVADA, OREGON, PENNSYLVANIA, RHODE ISLAND, VERMONT, AND WASHINGTON, AND THE DISTRICT OF COLUMBIA, AS AMICI CURIAE IN SUPPORT OF APPELLEES AND AFFIRMANCE

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INTRODUCTION AND INTERESTS OF AMICI

In 2022, defendant-appellee U.S. Department of Labor (DOL) clarified that employer-sponsored retirement plan fiduciaries subject to the Employee Retirement Income Security Act (ERISA) may consider environmental, social, and governance factors as needed to minimize investment risk and maximize returns. *See Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights*, 87 Fed. Reg. 73,822 (Dec. 1, 2022). Several states and private plaintiffs sued to challenge the rule under the Administrative Procedure Act (APA), and the U.S. District Court for the Northern District of Texas (Kacsmaryk, J.) denied plaintiffs' motion for summary judgment and granted defendants' cross-motion for summary judgment. Amici States submit this brief in support of defendants and affirmance.

Amici States have substantial interests in the economic well-being of millions of their residents who rely on employer-sponsored retirement plans to invest their savings and prepare for retirement. Amici States are home to approximately 141 million citizens, comprising more than 42% of the national population and a presumably similar percentage of employer-

sponsored retirement plan participants.[1] Allowing plan fiduciaries to effectively minimize risk and maximize returns through consideration of environmental, social, and governance factors where appropriate is critical to ensuring that amici's residents have sufficient resources to support their retirement without unduly burdening the public fisc.

Amici States' experience and ample data confirm that environmental, social, and governance factors are often relevant to risk and returns. For instance, amici—like all States and a host of other regulatory authorities—enforce a wide range of laws related to protecting the environment, workers, and consumers, and to corporate governance. Costs to resolve enforcement actions for failing to comply with such laws may be in the millions or even billions. Fiduciaries that assume the risk of such costs by ignoring environmental, social, and governance considerations do a major disservice to retirement plan participants—and may well be violating their fiduciary duties.

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[1] *See* U.S. Census Bureau, *2020 Population and Housing State Data* (Aug. 12, 2021). (For authorities available online, full URLs appear in the Table of Authorities. All URLs were last visited March 28, 2024.)

Moreover, the laws of nearly all States have long permitted the consideration of environmental, social, and governance factors that the challenged rule allows. These state laws are rooted in the same common-law fiduciary principles as ERISA. Therefore, just as state laws permit fiduciaries to consider environmental, social, and governance factors in evaluating investment risk and returns, so too does ERISA.

STATEMENT

ERISA was enacted in 1974 to protect the "well-being and security of millions of employees and their dependents" who rely on employer-sponsored retirement plans. *See* 29 U.S.C. § 1001(a). In such plans, plan sponsors (usually employers) choose investment options for employee participants. The plan sponsors and those the sponsors hire to assist in managing the plan investments are "fiduciaries" under ERISA. *See id.* § 1002(21)(A).

Drawing on longstanding principles of the common law of trusts, ERISA sets out a number of duties of plan fiduciaries. *See, e.g.*, *Tibble v. Edison Int'l*, 575 U.S. 523, 528 (2015). Among other things, ERISA requires a fiduciary to "discharge [] duties with respect to a plan solely in the interest of the participants and beneficiaries" and "for the exclusive

purpose of . . . providing benefits to participants and their beneficiaries." 29 U.S.C. § 1104(a)(1). A fiduciary is likewise obligated to act with "care, skill, prudence, and diligence." *Id.* § 1104(a)(1)(B). In further "determining the contours of an ERISA fiduciary's duty, courts often must look to the law of trusts." *Tibble*, 575 U.S. at 528-29.

DOL, the agency that principally administers the ERISA statute, has recognized that, in exercising plan fiduciaries' duties, the fiduciaries "should appropriately consider factors that potentially influence risk and return," which may include "[e]nvironmental, social, and governance issues" that "may have a direct relationship to the economic value of the plan's investment." *Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments,* 80 Fed. Reg. 65,135, 65,136 (Oct. 26, 2015). In addition, DOL has recognized for three decades that ERISA's fiduciary duties permit consideration of collateral (i.e., not purely financial) investment benefits when selecting among investment options that equally serve the plan's financial interests; this is the so-called "tiebreaker" rule. 87 Fed. Reg. at 73,824.

In 2020, DOL issued a rule that required plan fiduciaries to choose investments based solely on consideration of "pecuniary factors"—a term that is not used in ERISA. *See Financial Factors in Selecting Plan Investments,* 85 Fed. Reg. 72,846, 72,884 (Nov. 13, 2020); *see also* 87 Fed. Reg. at 73,823. The new rule also stated that the tiebreaker rule was available only where fiduciaries were "unable to distinguish" among investments "on the basis of pecuniary factors alone." *See* 85 Fed. Reg. at 72,884.

The 2020 rule created substantial confusion among plan fiduciaries about whether, and, if so, when, environmental, social, and governance factors could be treated as "pecuniary" factors. *See* 87 Fed. Reg. at 73,856. The confusion chilled consideration of such factors, "even when those factors are financially material." *See id.* at 73,826. The 2022 rule at issue in this case was promulgated to remedy these concerns.

First, the 2022 rule removes the "pecuniary/non-pecuniary" terminology and clarifies—consistent with DOL's pre-2020 rules—that plan fiduciaries may consider environmental, social, and governance factors as "[r]isk and return factors," insofar as the fiduciary "reasonably determines" that the factors "are relevant to [the] risk and return

analysis." 29 C.F.R. § 2550.404a-1(b)(4); *see* 87 Fed. Reg. at 73,825-73,826, 73,856. As the 2022 rule's commentary makes clear, the rule does not establish "a mandate that ESG factors are relevant under every circumstance," or "an incentive for a fiduciary to put a thumb on the scale in favor of ESG factors," but rather merely establishes "appropriate regulatory neutrality" to ensure that a fiduciary "may exercise discretion" to consider whatever factors it deems relevant to risk and return—whether environmental, social, or governance-related, or otherwise. *See* 87 Fed. Reg. at 73,831 (emphasis omitted).

Second, the 2022 rule eliminates the "pecuniary factors" reference in the tiebreaker rule. *Id.* at 73,885. The revised tiebreaker rule simply confirms—as precursors of the 2022 rule had for decades, *see id.* at 73,822, 73,824—that, in the unusual circumstance where a fiduciary prudently concludes that competing investments equally serve the financial interests of the plan, the fiduciary is not prohibited from considering collateral benefits of a given investment. 29 C.F.R. § 2550.404a-1(c)(2). The tiebreaker provision is clear that "[a] fiduciary may not, however,

accept expected reduced returns or greater risks to secure such additional benefits." *Id.*[2]

Plaintiffs—a group of States and private plaintiffs—challenged the 2022 rule under the APA. In September 2023, the district court granted summary judgment in favor of defendants, holding that the 2022 rule is consistent with ERISA and is not arbitrary and capricious. As the district court explained, the 2022 rule simply confirms "that where a fiduciary reasonably determines that an investment strategy will maximize risk-adjusted returns, a fiduciary may pursue the strategy, whether pro-ESG, anti-ESG, or entirely unrelated to ESG," "[a]nd like prior rules, the 2022 Rule allows consideration of collateral factors to break a tie." *Utah v. Walsh*, No. 2:23-cv-016, 2023 WL 6205926, at *5 (N.D. Tex. Sept. 21, 2023) (quotation marks omitted).

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[2] The 2022 rule also adjusts certain other provisions from the 2020 rule (and another rule issued that same year, *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,* 85 Fed. Reg. 81,658 (Dec. 16, 2020)) that had discouraged fiduciaries' application of their own best judgment in considering environmental, social, or governance investment factors and qualified designated investment alternatives, and exercising proxy voting rights. *See generally* 87 Fed. Reg. at 73,822. Amici States agree with DOL and the district court that those other adjustments were appropriate, but do not principally address them in this brief.

ARGUMENT

THE 2022 RULE SUPPORTS AMICI'S INTERESTS BY ENSURING THAT PLAN FIDUCIARIES MAY CONSIDER ALL RELEVANT FACTORS TO MINIMIZE RISK AND MAXIMIZE RETURNS

Plaintiffs and their amici fundamentally misunderstand the 2022 rule. As explained above, the challenged rule permits consideration of environmental, social, and governance factors only as "[r]isk and return factors" and not for any other purpose, 29 C.F.R. § 2550.404a-1(b)(4), such as the purportedly improper collateral purposes suggested by plaintiffs and their amici. The district court was therefore correct to find the 2022 rule to be consistent with ERISA's requirement that fiduciaries act "solely in the interest of the [plan] participants," and "for the exclusive purpose" of providing benefits to those participants. *See* 29 U.S.C. § 1104(a)(1)(A). Indeed, the rule's clarification that fiduciaries may consider environmental, social, and governance factors when relevant to risk and return—but need not consider any such factors and may not consider them when doing so would increase risk or reduce returns—is precisely the sort of clarification that serves the interests of plan participants and benefits them. The rule properly recognizes that fiduciaries

can make better investment decisions when they can consider all factors that may be relevant to risk and returns.

A. Environmental, Social, and Governance Factors Are Often Relevant to Risk and Returns.

Ample evidence demonstrates that environmental, social, and governance factors often do affect investments' risk and returns, and thus should be considered by a prudent fiduciary. Even the 2020 rules (which were supported by plaintiffs) acknowledged that "the economic literature and fiduciary investment experience" demonstrate that environmental, social, and governance factors "may present issues of material business risk or opportunities." *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, 85 Fed. Reg. 81,658, 81,662 n.30 (Dec. 16, 2020); *see also* 85 Fed. Reg. at 72,848 ("For example, a company's improper disposal of hazardous waste would likely implicate business risks and opportunities, litigation exposure, and regulatory obligations.").

As noted by many, varied commenters on the 2022 rule—from asset managers and financial institutions to NGOs and States—and as appropriately considered by DOL, *see* 87 Fed. Reg. at 73,862-73,863, 73,865, empirical studies and meta-analyses have repeatedly found positive

relationships between consideration of environmental, social, and governance factors and financial performance. For instance, one meta-analysis of numerous studies found important financial benefits of environmental, social, and governance investing considerations, especially for long-term investors and downside protection. *See* Tensie Whelan et al., NYU Stern Ctr. for Sustainable Bus., *ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published Between 2015-2020* (2021). Another meta-study found that companies with strong environmental, social, and governance practices tend to achieve competitive risk-adjusted returns, lower costs of capital, and improved profitability. *See* Prashant Debnath et al., *An In-Depth Systematic Literature Review on ESG and Sustainable Investment: Current Perspectives and Future Directions*, 10 Int'l J. Socio-Econ. & Env't Outlook 9, 19 (July 2023). And an analysis of nearly 11,000 mutual funds showed no financial trade-off, and lower downside risk, from sustainable funds. *See* Morgan Stanley Inst. for Sustainable Investing, *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds* (2019). Other studies are in accord. *See, e.g.*, Rui Coelho et al., *The Impact of Social Responsibility on Corporate Financial Performance: A Systematic*

Literature Review, 30 Corp. Soc. Resp. & Env't Mgmt. 1535, 1535, 1556 (2022) (meta-analysis finding that ESG indicators positively impact financial performance). There is no reason plan fiduciaries should be precluded or discouraged from considering investment factors with such a demonstrated degree of relevance.

As commenters also noted and DOL appropriately considered, *see* 87 Fed. Reg. at 73,863, the benefits of considering environmental, social, and governance factors may be especially pronounced during periods of instability. For instance, in 2020 during the COVID-19 pandemic, U.S. sustainable equity funds outperformed other funds by more than four percent, and downside deviation was more than three percent less than for other funds. *See* Morgan Stanley Inst. for Sustainable Investing, *Sustainable Funds Outperform Peers in 2020 During Coronavirus* (Feb. 24, 2021); *see also* Jon Hale, Morningstar Manager Research, *Sustainable Funds U.S. Landscape Report: More Funds, More Flows, and Impressive Returns in 2020* (Feb. 10, 2021). Such strong performance in times of unexpected instability is particularly important for those at or near retirement age, who may not have time to await longer-term market correction.

Considering environmental, social, and governance factors can minimize business risk and maximize returns in a variety of ways, including top-line growth (e.g., from sustainable practices that appeal to customers and other stakeholders); cost reductions (e.g., from lower resource consumption); productivity gains (e.g., from ability to attract and retain talent); investment and asset optimization (e.g., from making assets more sustainable); and avoiding legal problems (e.g., from enforcement actions, fines, and penalties). *See* Witold Henisz et al., McKinsey & Co., *Five Ways That ESG Creates Value*, McKinsey Quarterly (Nov. 2019).

Amici States are especially familiar with the latter benefits of considering environmental, social, and governance factors, i.e., the ability to avoid expensive legal problems. Amici States—like all States and many other regulatory authorities—enforce a wide range of laws requiring businesses to avoid environmental harms, protect workers and consumers, and ensure that their officers and directors govern businesses appropriately. Costs to comply with such laws can be substantial—and particularly so for businesses that have not prioritized sustainable practices or good governance standards. Moreover, Amici States and others frequently take enforcement action when businesses fail to comply with these

laws—and such enforcement action often results in multi-million-dollar settlements or judgments against offending businesses. A recent McKinsey analysis found that one-third of corporate profits are at risk from adverse government action, and that fraction rises as high as 60% in certain highly regulated industries. *See* Henisz et al., *supra*, Ex. 3. In addition, company lawyers now identify governmental and other disputes arising from environmental, social, and governance factors as the top litigation risk to their organizations. *See* Baker McKenzie, *The Year Ahead: Global Disputes Forecast 2024*, at 7 (2024).

As one example, following evidence of emissions cheating by Volkswagen, a coalition of over forty state attorneys general investigated the company under state consumer protection and environmental laws, which resulted in the company paying over $600 million to the States—and billions more to the U.S. government and private plaintiffs. *See* Jeffrey Rothfeder, *The Volkswagen Settlement: How Bad Management Leads to Big Punishment*, The New Yorker (July 1, 2016); N.Y. State Att'y Gen., *A.G. Schneiderman Announces Partial Multistate and Federal Settlements of Up to $15 Billion with Volkswagen, Audi and Porsche, Including Unprecedented Relief for Defrauded New Yorkers* (June 28,

2016); Nat'l Ass'n of Att'ys Gen., *Rules and Regulations of the VW Settlement Fund* (n.d.). Moreover, Volkswagen's stock fell over 30% within days of the scandal becoming public. *See* Paul R. La Monica, *Volkswagen Has Plunged 50%. Will It Ever Recover?* CNN Business (Sept. 25, 2015). By ensuring that fiduciaries may consider the sorts of environmental regulatory risks and governance problems—e.g., poor monitoring and compliance protocols—that resulted in this massive loss of shareholder value, the 2022 rule provides critical protection to retirees.

Further, the benefits of integrating environmental, social, and governance factors into businesses are likely to increase in the longer term—when retirement funds often will need to be accessed—because sustainability concerns inherently extend over the long term. States and other regulators, too, are looking to the longer term by implementing long-term sustainability plans. And whatever one may think of the best way to address sustainability concerns such as climate change, a fiduciary would be disserving plan participants by ignoring rapidly increasing regulatory efforts requiring or incentivizing moves away from unsustainable business practices. For example, already, forty-five States (and many

localities) have released climate action plans to incentivize sustainability—and this number is likely to continue to grow. Such plans create material risks for unsustainable businesses and material benefits for businesses pursuing sustainability efforts. *See* U.S. Environmental Protection Agency, *45 States, Large Metro Areas Submit Climate Action Plans Under President Biden's Inflation Reduction Act* (Mar. 11, 2024).

B. State Law Nationwide Has Long Permitted Consideration of Environmental, Social, and Governance Factors.

Consistent with the evidence demonstrating the relevance environmental, social, and governance factors may have to investment risk and returns, state and local laws across the country—including but not limited to Amici States' laws—have long permitted fiduciaries to consider such factors. State law also has long implemented tiebreaker rules similar to the challenged rule's tiebreaker provision. Those facts are particularly significant because the state and local laws are typically derived from the same common law of trusts from which the federal ERISA statute is derived, and the laws typically share similar or identical language to ERISA's language requiring fiduciaries to act "solely in the interest of" plan participants and "for the exclusive purpose" of providing

benefits to them. *See* 29 U.S.C. § 1104(a)(1)(A); David H. Webber, *The Use & Abuse of Labor's Capital*, 89 N.Y.U. L. Rev. 2106, Appendix (Dec. 2014) (state-by-state survey of relevant state laws). And the States and localities have long found this exclusive-purpose requirement consistent both with fiduciaries' consideration of environmental, social, and governance factors, and with tiebreaker rules.

First, States have long approved fiduciaries' consideration of environmental, social, and governance factors, and found that consideration consistent with fiduciaries' duty to act for the exclusive purpose of benefiting plan participants. For instance, Maryland's highest state court rejected an argument that a fiduciary violates a duty to act for the exclusive purpose of providing benefits to plan participants by considering social implications of an investment decision. As that court explained, fiduciaries "may well believe that, by investing in businesses with a proper sense of social obligation, they will in the long run best serve the beneficiaries' interests and most effectively secure the provision of future benefits." *Board of Trs. of Emps.' Ret. Sys. of City of Balt. v. Mayor & City Council of Balt. City*, 317 Md. 72, 109-10 (1989) (quotation marks omitted).

In recent years, as the evidence of the effects of environmental, social, and governance factors on risk and returns has grown in volume and strength, some States, including several Amici States, have enacted new laws to encourage their public pension funds to consider such factors.[3] While some other States, including some of the plaintiff States in this case, have recently taken different legislative steps to ensure that risk and returns are not subordinated to environmental, social, and governance factors, even these States have often continued to permit consideration of such factors insofar as they are relevant to risk and

[3] *See, e.g.*, Conn. Gen. Stat. § 3-13d(a) ("Among the factors to be considered by the Treasurer with respect to all securities may be the social, economic and environmental implications of investments"); 30 Ill. Comp. Stat. 238/20 ("A public agency shall prudently integrate sustainability factors into its investment decision-making" "to maximize anticipated financial returns, minimize projected risk, and more effectively execute its fiduciary duty"); Md. Code Ann., State Pers. & Pens. § 21-116(e)(1) (state pension board "shall include policies in the investment policy manual" regarding the management of environmental risk). Again, these States have found such laws consistent with fiduciaries' longstanding duties, including to act for the exclusive purpose of benefiting plan participants. *See*, *e.g.*, Conn. Gen. Stat. § 5-155a(c); 40 Ill. Comp. Stat. 5/1-109(a); Md. Code Ann., State Pers. & Pens. § 21-203.

returns—recognizing that the factors are properly considered by fiduciaries in that context.[4]

Moreover, when some jurisdictions have tried to go further in prohibiting consideration of environmental, social, or governance factors, there have generally been strong objections—and many such proposals have been rejected or curtailed. For instance, state lawmakers in several States voted down proposals to prohibit state governments or pension funds from doing business with financial institutions that have adopted environmental, social, and/or governance policies. In North Dakota, such a proposal was defeated by a 90-3 margin. *See* Steven Mufson, *The Conservative Battle Against 'Woke' Banks Is Backfiring*, Wash. Post (Feb. 28, 2023). That overwhelming rejection is understandable in light of evidence that, in Texas, which approved a similar proposal, municipalities will now face $300 to $500 million in additional borrowing costs as a result of the change. *See* Daniel G. Garrett & Ivan T. Ivanov, Hutchins Ctr. on

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[4] *See, e.g.*, Idaho Code Ann. § 67-2345 (no consideration of environmental, social, or governance factors "in a manner that could override the prudent investor rule"); N.D. Cent. Code § 21-10-08.1 (no investment considering "socially responsible criteria," unless investment "would provide an equivalent or superior rate of return compared to a similar investment").

Fiscal & Monetary Pol'y at Brookings, *Gas, Guns, and Governments: Financial Costs of Anti-ESG Policies* (Apr. 2023). Meanwhile, in Indiana, a state fiscal impact analysis determined that a similar proposal could have resulted in reduced returns of $6.7 *billion* over ten years. *See* Ross Kerber, *Anti-ESG Bill Could Cut Indiana Pension Returns by $6.7 Bln – Analysis*, Reuters (Feb. 7, 2023). In response, the final legislation was amended to focus on maximizing financial benefits to plan participants. *See* Ind. Code § 5-10.2-14-1 et seq.; Brenna Goth, *States Dilute Anti-ESG Investing Efforts to Avoid Pension Losses*, Bloomberg Law (May 1, 2023).

Second, States—including some of the plaintiff States in this case—have found tiebreaker rules similar to the tiebreaker provision at issue in this case consistent with fiduciaries' duty to act for the exclusive purpose of benefiting plan participants. For example, an Ohio law that requires fiduciaries to act "for the exclusive purpose of providing benefits" to plan participants also provides that, where investments with certain social benefits "offer quality, return, and safety comparable to other investments currently available," fiduciaries should give special consideration to the investments with social benefits. Ohio Rev. Code Ann.

§ 3307.15(A)-(B). Specifically, in such tiebreaker circumstances, fiduciaries should "give consideration to investments that enhance the general welfare of the state and its citizens," including by investing in "minority owned and controlled firms and firms owned and controlled by women." *Id.* Other States with exclusive-purpose-type rules have similar tiebreaker provisions. *See, e.g.*, Mich. Comp. Laws § 38.1133(3)(c), (e) (fiduciary shall "give appropriate consideration to investments that would enhance the general welfare of this state and its citizens if those investments offer the safety and rate of return comparable to other investments"); Mo. Rev. Stat. § 105.688(3), (5) (fiduciary shall "[g]ive appropriate consideration to investments which would enhance the general welfare of this state and its citizens if those investments offer the safety and rate of return comparable to other investments").

Some other States have similar statutory provisions that require consideration of investment options that enhance the welfare of the State, wherever consistent with fiduciary responsibilities, without expressly limiting that consideration to tiebreaker circumstances. *See, e.g.*, Ky. Rev. Stat. Ann. §§ 61.650(3), 78.790(3), 161.430(1)(c) ("wherever consistent with its fiduciary responsibilities," fiduciary "shall give priority to

the investment[s]" that "enhance the economic welfare of the Commonwealth"); Fla. Stat. § 215.47(7) ("consistent with its fiduciary duties," fiduciary may invest a percentage of assets "in technology and growth investments of businesses domiciled in this state").

Such provisions function much like the tiebreaker provision in the challenged rule: they recognize that a fiduciary may in some circumstances find that multiple investments equally serve plan participants' financial interests, and that collateral investment considerations, e.g., related to social welfare, are consistent with fiduciary duties, including the exclusive-purpose rule, in such circumstances. The challenged rule's tiebreaker provision is equally consistent with ERISA's fiduciary duties and exclusive-purpose rule and is therefore lawful, as the district court correctly concluded.

CONCLUSION

This Court should affirm the district court's order on appeal.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a) of the Federal Rules of Appellate Procedure, Emily Paule, an employee in the Office of the Attorney General of the State of New York, hereby certifies that according to the word count feature of the word processing program used to prepare this brief, the brief contains 3,892 words and complies with the typeface requirements and length limits of Rules 29 and 32(a)(5)-(7) and the corresponding local rules.

/s/ *Emily Paule*

CERTIFICATE OF SERVICE

I hereby certify that on March 28, 2024, the foregoing brief for amici curiae was filed electronically. Notice of this filing will be sent to all parties for whom counsel has entered an appearance by operation of the Court's electronic filing system. Parties may access this filing through the Court's system.

Dated: New York, New York
March 28, 2024

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