C A D W A L A D E R

State AGs Challenge Department of Labor Rule on ESG Investing

January 31, 2023

By Timbre Shriver
Associate | Global Litigation

Twenty-five Republican state attorneys general, along with two energy companies, have commenced an action against the U.S. Department of Labor (DOL) seeking to "hold unlawful and set aside" rules governing how retirement plan mangers can consider climate change and other ESG factors. The **complaint**, filed last week in the U.S. District Court for the Northern District of Texas, challenges a **2022 rule issued by the DOL** that clarified previous regulations and afforded retirement plan fiduciaries the ability to consider ESG-related factors in their investment decisions and in exercising shareholder rights, consistent with their duties of prudence and loyalty. The complaint alleges that the rule conflicts with the scope of Employee Retirement Income Security Act (ERISA) fiduciary duties, is arbitrary and capricious in violation of the Administrative Procedure Act, and goes beyond the DOL's authority to regulate ERISA fiduciaries to consider nonpecuniary factors in administering plan assets. Among other things, the plaintiffs contend that the rule "will not only loosen the statutory and regulatory restraints on fiduciaries to consider ESG factors, it will allow fiduciaries and investment managers to potentially substitute their own ESG policy preferences under the guise [of] making a risk-return determination about an investment or investment course of action."

Taking the Temperature: At least in part, the DOL's rule reflects a view, frequently articulated by large institutional asset managers and others, that climate change and other ESG factors can be material to the companies in which they invest and therefore are properly considered as part of the investment process. While this legal challenge highlights the politicized nature of climate-related financial issues in the U.S., one interesting question it raises is whether, if the plaintiffs in this suit ultimately prevail on the theories articulated, the New York City pension funds that sent the shareholder proposals, discussed in another post today, could be argued to have violated their fiduciary duties in doing so, given the climate-related focus of the shareholder proposals. After all, a central premise of the lawsuit is that the DOL's rule "contravenes ERISA's clear command that fiduciaries act with the sole motive of promoting the financial interests of plan participants and their beneficiaries." Viewed from another

perspective, however, these shareholder proposals simply reflect a request for greater disclosure on what the shareholders likely consider an issue material to investment risk, which would seem to fit squarely within the permissible considerations for an ERISA fiduciary, even under the construction afforded by the plaintiffs in the state attorneys general suit. Whatever the outcome, as we have discussed, we expect climate-focused litigation to increase in prevalence and variety for the foreseeable future.