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401(k) Rule Suit Echoes Past Legal Attack on Obama-Era Version

By Ben Miller and Jacklyn Wille

Deep Dive

- First suit challenging new fiduciary rule could undo DOL efforts
- DOL heeded precedent, 2018 decision that overturned standard

A trade association and insurance industry plaintiffs suing to overturn the Department of Labor's newest version of its fiduciary rule are following a similar playbook to litigants who successfully convinced an appeals court to vacate a previous iteration of the standard six years ago.

The DOL's newest fiduciary rule finalized in late April prompted a swift legal response from insurance industry stakeholders, who sued May 2 in the US District Court for the Eastern District of Texas to block and vacate it and an accompanying amended prohibited transaction exemption.

The rules package that is set to go into effect Sept. 23 would expand the scope of fiduciary duties to more retirement-related advice, including rollovers out of 401(k)s.

The Federation of Americans for Consumer Choice lawsuit could succeed if the Texas federal court is receptive to a similar Administrative Procedure Act argument to the one that got the rule killed in 2018 by the US Court of Appeals for the Fifth Circuit. In the years since, moves by federal judges to closely scrutinize agency rulemaking could work in FACC's favor, but the DOL has also crafted its latest fiduciary rule with its past court defeat in mind.

The DOL read the Fifth Circuit's decision to kill the 2016 version of its rule closely when writing its 2024 rule, which differs greatly from its predecessor, EBSA Principal Deputy Assistant Secretary Ali Khawar said in an interview.

"This is a very, very significantly different rule in very clear and measurable ways, no matter what the talking points say, there are very tangible and real differences," he said, citing an update that the DOL included in the final version of its 2024 rule that applies to compensation for independent insurance agents.

The DOL's finalized prohibited transaction exemption, called PTE 84-24, brings insurance brokers who aren't affiliated with a primary insurance company or don't serve as broker-dealer representatives under the umbrella of its new fiduciary definition, but still allows them to receive certain types of revenue sharing or fees.

The FACC complaint takes aim at the amended PTE 84-24. The plaintiffs argue that, regardless of the DOL's changes to the final rule, the rule's attempt to convert certain insurance sales agents into fiduciaries is still beyond the scope of the DOL's legal powers.

"What is entirely new are the challenges to the significant modifications to Prohibited Transaction Class Exemption 84-24, because the DOL has changed its view, particularly with respect to independent producers," said Marcia Wagner, founder and managing partner of Wagner Law Group.

Fifth Circuit Revisited

The FACC complaint draws numerous parallels between the 2024 standard and the 2016 standard that was vacated by the Fifth Circuit two years later.

"It's a lot like a musical that performs on Broadway that goes on national tour," said Kevin Walsh, partner at Groom Law Group. "You make some changes when you take a national tour, but the plot stays largely the same."

The Fifth Circuit ruled in 2018 that the Labor Department exceeded its authority under the APA by promulgating a standard that was inconsistent with the Employee Retirement Income Security Act and the Internal Revenue Code, as well as the common law meaning of "fiduciary," defined as a "special relationship of trust and confidence" with a client.

Judge Jeremy Kernodle, a Trump appointee in the Eastern District of Texas, has been assigned the case, according to the federal court docket.

Kernodle could adhere to the 2018 Fifth Circuit precedent from the Chamber of Commerce-led challenge of the past fiduciary rule, which would make the DOL's task of defending its new rule a difficult one, according to David Olstein, partner at Hogan Lovells.


"If the district court sticks very closely to the language and reasoning of the Fifth Circuit decision in the *Chamber of Commerce* litigation, I think that they would likely rule that the department did exceed their statutory authority," he said.

Judicial norms have also shifted more broadly, with more courts willing to scrutinize agency rulemaking than they were in 2018, according to Walsh and Samantha Chaifetz, partner at DLA Piper and former appellate attorney for the DOJ's Civil Division.

"The landscape has changed in various ways since 2018," she said. "There is more of a willingness today in the courts to stop and assess the premise for agency authority to act in the first instance."

The Fiduciary Rule's Long, Twisting History

The Biden Department of Labor's newly proposed rule is the fourth attempt at revising fiduciary regulations since they were first introduced during the Ford administration. Click on a bar for a more detailed overview of events.

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The Fifth Circuit and the district courts in its purview have been a hotbed for challenges to agency practices, for example in 2022 a panel of judges ruled that the Securities and Exchange Commission's use of in-house judges was unconstitutional.

The suit that ultimately overturned the Obama-era fiduciary rule in 2018 was brought in the Northern District of Texas, while the 2024 rule landed in that state's Eastern District, but their shared location within the Fifth Circuit isn't necessarily a death knell for the new standard, according to Joshua Lichtenstein, partner at Ropes & Gray LLP.

A Northern District of Texas judge recently declined to strike down the Labor Department's rule giving retirement plans more freedom to consider environmental, social, and corporate governance goals when making investment decisions.

"There are a lot of wildcards at play here, but if you take the simplest piece, which is this rule and this process, I think it has a chance of surviving," Lichtenstein said.

Plaintiffs in the FACC lawsuit also seek preliminary and permanent injunctions to prevent the DOL from enforcing its rule and PTE amendments, which courts have granted in past lawsuits challenging agency rulemaking, according to Walsh.

"Even if the preliminary injunction is not granted, there is a good case to be made, for looking at how this looks like 2016 and looking at the changes of administrative law, particularly if this drags out past June, when we've got two cases in the Supreme Court right now," Walsh said.

The question of agency deference itself hangs in the balance as the US Supreme Court prepares to rule on two cases that would decide the future of the *Chevron* doctrine, which instructs courts to defer to agencies' reasonable interpretations of laws where the statute is silent or ambiguous.

"DOL lost in 2018 with *Chevron* in place," Walsh said. "If we're operating in a world without *Chevron*, DOL faces a real mountainous challenge in terms of a pathway to having this rule take effect."

To contact the reporter on this story: Ben Miller in New York City at bmiller2@bloombergindustry.com

To contact the editor responsible for this story: Rebekah Mintzer at rmintzer@bloombergindustry.com

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