Miller & Chevalier

The ERISA Edit: Investment Advice Fiduciary Regulation Faces First APA Challenge

Employee Benefits Alert
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Insurance Representatives File Lawsuit in Texas Seeking to Vacate DOL's New Fiduciary Rule

The expected legal challenges to the U.S. Department of Labor's (DOL) April 25, 2024, final rule redefining when a person is a fiduciary on the basis of rendering "investment advice for a fee or other compensation" (the Fiduciary Rule) have begun. On May 2, 2024, the trade association Federation of Americans for Consumer Choice (FACC), along with multiple individuals and companies engaged in the insurance industry, filed a complaint in the Eastern District of Texas under case caption *Fed'n of Americans for Consumer Choice Inc. v. DOL*, No. 6:24-cv-00163 (E.D. Tex. May 2, 2024). The plaintiffs ask the court to declare the Fiduciary Rule unlawful, to vacate it, and to issue preliminary and permanent injunctions preventing its implementation and enforcement.

The FACC complaint brings two causes of action against the Fiduciary Rule. First, the complaint alleges that the DOL exceeded its authority under ERISA and the Internal Revenue Code (Code) in promulgating the Fiduciary Rule and amendments to related prohibited transaction exemptions (PTEs). The FACC alleges that the Fiduciary Rule redefines the term "fiduciary" in a manner that is impermissibly broad in order "to assert new regulatory jurisdiction in the IRA market" that Congress did not confer to DOL under ERISA or the Code. Second, the complaint alleges that the Fiduciary Rule and PTE amendments are arbitrary and capricious in violation of the Administrative Procedure Act (APA) because the Rule defines "fiduciary" in a manner "fundamentally inconsistent with Congress' intent as expressed in the text of ERISA and the Code, as well as the historical and common law understanding of the term."

The FACC's complaint relies heavily on a 2018 Fifth Circuit case – binding in the Eastern District of Texas – that struck down a 2016 iteration of the Fiduciary Rule, arguing that the 2024 Fiduciary Rule is "effectively indistinguishable" from the 2016 rule that was vacated in full on grounds it was both contrary to law and arbitrary and capricious. In *Chamber of Commerce v. DOL*, 885 F.3d 360 (5th Cir. 2018), the Fifth Circuit found that the DOL's 2016 rule, which, like the 2024 Fiduciary Rule at issue, replaced the 1975 five-part test for defining when a person is a fiduciary on the basis of giving investment advice, conflicted with the statutory definition of "fiduciary" in ERISA. The Fifth Circuit opined that ERISA incorporated the common law understanding of "fiduciary" as someone with a "special relationship of trust and confidence" with an investor. Because the 2016 rule would encompass individuals engaged only in one-time sales of investment products, without any preexisting relationship with the investors to whom they marketed, the Fifth Circuit concluded it was contrary to ERISA, thus unlawful, and, further, that it was based on an unreasonable interpretation of fiduciary status, rendering it arbitrary and capricious under the APA.

The 2024 Fiduciary Rule, as we discussed when it was promulgated two weeks ago, defines two categories of "investment advice fiduciaries": (1) persons who make professional investment recommendations on a regular basis to retirement investors under circumstances indicating to a reasonable investor that the advice is based on the investor's particular needs or circumstances and may be relied upon to advance the investor's best interest and (2) persons who acknowledge their fiduciary status. Acknowledging the concerns implicated by the 2016 rule, the DOL states in its preamble to the 2024 Fiduciary Rule that such definition would not encompass sales activity that falls short of fiduciary advice, or persons only providing investment education, emphasizing that the new Fiduciary Rule "appropriately defines an investment advice fiduciary to comport with reasonable investor expectations of trust and confidence."

The FACC complaint rejects DOL's attempts to distinguish the Fiduciary Rule from its earlier iteration, calling the preamble's invocation of the "trust and confidence" standard "mere lip service." In support of its claim that the Fiduciary Rule is functionally indistinguishable from the 2016 rule, the complaint alleges that many one-time interactions between a broker or agent would still meet the Rule's definition of fiduciary advice, because the definition, by being pegged to "mak[ing] professional investment recommendations to investors on a regular basis as part of their business" is "coterminous with standard sales practices." The complaint also alleges that the speed with which DOL promulgated the Fiduciary Rule (providing a 60-day comment period that it refused to extend upon request) demonstrates both that the Rule is merely a "regurgitation" of the 2016 rule and DOL's "zeal to reach the desired result of turning every financial product salesperson who deals with a retirement investor into a fiduciary."

DOL will have the opportunity to respond to the complaint in the coming weeks and we expect this litigation and potentially additional legal challenges to the Fiduciary Rule to continue for some time.

Second Circuit Invalidates Arbitration Provision in ERISA Plan

On May 1, 2024, the Second Circuit joined the Third, Seventh, and Tenth Circuits in relying on the "effective vindication" doctrine and holding that when an ERISA plan's arbitration provision allows only individual relief, it is invalid because it prevents the "effective vindication" of participants' rights. *See Cedeno v. Sasson*, No. 21-2891, --- F.4th ---- (2d Cir. May 1, 2024).

The case involved the claims of Ramon Dejesus Cedeno, a former employee of Strategic Financial Solutions. Cedeno, who participated in the company's ERISA-governed employee stock ownership plan (ESOP), brought suit against Argent Trust Company (Argent), the ESOP's trustee, alleging that Argent breached its fiduciary duties owed to the plan in connection with the plan's purchase of shares of company stock for more than fair market value. Cedeno relied on ERISA § 502(a)(2), which authorizes a plan participant to bring a civil action to obtain "restitution of the entirety of the loss to the plan."

Pointing to the plan's arbitration provisions — which explicitly limited any relief sought under § 502(a)(2) to the restoration of losses within the participant's individual account and prohibited any relief that would benefit any other employee, participant, or beneficiary, or otherwise bind the Plan, its trustee, or administrators — Argent moved to compel arbitration under the Federal Arbitration Act (FAA). The district court denied the motion and the Second Circuit affirmed in a split 2-1 decision, concluding that the contested arbitration provisions were unenforceable because "they amount to prospective waivers of participants' substantive rights and remedies under ERISA."

The Second Circuit observed that "[a] core concern of the FAA is protecting the enforceability of agreements to vindicate substantive rights through an arbitral *forum* using arbitral *procedures*." It held, however, that the FAA "does not purport to reach agreements to waive *substantive rights and remedies*." It relied on Supreme Court precedent that "made it clear that the policy favoring enforcement of agreements *to arbitrate* does not automatically extend to enforcement of *any* provision within an arbitration agreement." In this case, because the plan's arbitration provisions would nullify the only available statutory vehicle for vindicating Cedeno's rights (*i.e.*, a suit under § 502(a)(2) seeking remedies directed at the plan), those plan provisions could not be enforced.

The court bolstered its conclusion with the decisions of its sister circuits in "closely analogous cases" that involved provisions of arbitration agreements seeking to compel individualized arbitration of § 502(a)(2) claims and limiting the remedies available in such arbitrations. In two of those cases, the language in question was "nearly identical to the contested provisions" at the heart of Cedeno's case. Particularly persuasive was the Seventh Circuit's rationale in *Smith v. Board of Directors of Triad Manufacturing, Inc*., 13 F.4th 613 (7th Cir. 2021), where that court rejected the defendants' suggestion that it had to "harmonize" the FAA and ERISA in light of the strong federal policy favoring arbitration. The *Smith* court observed that "the conflict in need of harmonization is not between the FAA and ERISA; it is between ERISA and the plan's arbitration provision, which precludes certain remedies that [§ 502(a)(2)] expressly permit[s]."

Judge Steven J. Menashi dissented, stating that Cedeno's "tendentious reading of ERISA" created a "manufactured conflict" between ERISA and the plan's arbitration clause. Moreover, Judge Menashi called the legal status of the "effective vindication" doctrine into question, noting that although the Supreme Court has acknowledged the theoretical possibility of an effective vindication exception to the FAA, "it has always declined to apply the exception whenever litigants have asked it to do so."

Judge Menashi's dissent could provide grounds for rehearing *en banc*. Otherwise, given the lack of a circuit split on the issue of how to read the FAA and ERISA together, it seems very unlikely that the question will make its way to the Supreme Court any time soon.

Tri-Agencies Extend No Surprises Act Enforcement Relief

On May 1, 2024, DOL, along with the U.S. Departments of Health and Human Services (HHS) and the Treasury (collectively, the Departments) issued a new Frequently Asked Question (FAQ) extending the No Surprises Act (NSA) enforcement relief it previously announced in October 2023 in FAQ 62. *FAQ About Consolidated Appropriations Act, 2021 Implementation Part 67* (FAQ 67). In FAQ 62, the Departments responded to the August 24, 2023, decision in *Texas Medical Association et al. v. United States Department of Health and Human Services*, No. 6:22-cv-450-JDK (E.D. Tex.) (*TMA III*), which vacated portions of the Departments' NSA implementing regulations related to the methodology for calculating qualified payment amounts (QPAs), by stating that it would exercise enforcement discretion for any plan, issuer, or party to an NSA payment dispute that uses the regulations in effect prior to *TMA III* for calculating QPAs for items or services furnished before May 1, 2024. That enforcement policy expressly covered providers, facilities, and providers of air ambulance services with respect to collecting cost-sharing for NSA-covered items and services. In FAQ 67, the Departments extend those enforcement policies to claims for NSA-covered items and services furnished before November 1, 2024. According to the Departments, "despite taking reasonable steps to come into compliance, plans and issuers need additional time to complete the significant efforts associated with recalculating QPAs in a manner consistent with the statutes and regulations that remain in effect after the *TMA III* vacatur, as several of the changes to the QPA calculation methodology necessitate a manual process to locate data." The Departments encourage states to adopt a similar enforcement approach and say they do not anticipate further extensions of the enforcement relief. An appeal of *TMA III* remains pending before the Fifth Circuit.

Upcoming Speaking Engagements

Joanne will speak at the American Bar Association Joint Committee on Employee Benefits (JCEB) CLE program " ERISA: Beyond the Basics" on May 7 and at the American Staffing Association 2024 Staffing Law & Compliance conference on May 16. She will also co-present the Strafford webinar "ERISA Covered Health and Welfare Plan Administration: Compliance, Fiduciary Liability, DOL Enforcement Actions" on May 14.
