

Statement before the House Committee on Oversight and Accountability

Sean D. Reyes
Utah Attorney General

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Chairman Comer, Ranking Member Raskin, and Members of the Committee, thank you for inviting me to testify before you on the critically important issue of how Environmental Social and Governance (“ESG”) factors are distorting our financial system and harming consumers.

The “E” or environmental focus in ESG has become the predominant and overriding factor in nearly all ESG initiatives, often leaving observers from all sides to wonder if the “S” and “G” are merely window-dressing for green policy objectives. ESG involves some of the biggest and most powerful players in the global economy attempting to force costly operational changes on American companies in pursuit of the 2015 Paris Agreement, which has never been made the law of the land by our elected representatives in Congress.

The Paris Agreement—in particular, its stated goal of limiting global warming to 1.5° C above pre-industrial temperatures—contemplates changes to our way of life that are far reaching and fundamental. It would impact everything from how we grow our food and what we eat to how we power our homes and businesses and even what kind of cars we are allowed to purchase. These changes involve balancing multiple tradeoffs, including (1) financial costs and benefits, (2) how quickly or slowly the government imposes new technologies, (3) how reliable of a power grid we are going to have, and (4) how much we value our national security. My view is that we should trust consumers, promote American energy independence or dominance, and avoid as much regulation as possible. But answering these policy questions is the role of the people’s elected representatives in a democracy—including each of you in Congress, state elected officials, and local leaders—not unelected bureaucrats or foreign governments.

Since the signing of the Paris Agreement in 2015, however, there has been an open conspiracy to bypass Congress and instead impose costly changes on American consumers using the power of horizontal agreements by key players in our financial system. Some of these groups include Climate Action 100+ (“CA100+”), which was founded in 2017, and the Glasgow Alliance for Net Zero (“GFANZ”), which was founded in 2021. GFANZ is comprised of the Net Zero Asset Manager Initiative (“NZAM”), the Net Zero Banking Alliance (“NZBA”), and the Net Zero Insurance Alliance (“NZIA”). These horizontal organizations comprised of asset managers, banks, and insurance companies seek to use their collective market power over *trillions* in assets to force costly changes in what they term “the real economy.”

The “real economy” corporations that are the targets of these coordinated pressure campaigns would not adopt these changes on their own. These changes drive up the cost of goods. And they harm shareholders by reducing returns. In sum, ESG is an undemocratic tax on our economy and productivity.

While often not the focus of these policies, the “S” in ESG is equally problematic. I am particularly concerned about the attempt to add racial quotas into company hiring practices and also to require insurance companies to consider race in underwriting, as these proposals appear to violate state law including Utah’s laws. It is very disappointing that the SEC has failed to grant no action letters when such illegal, race-based proposals are introduced by shareholders. The SEC needs to fulfill its responsibility and properly review these proposals. But even when the SEC fails to grant no-action letters, proxy advisors cannot merely rely on the absence of a “no action” letter to conclude that a proposal is lawful and therefore can be supported.

ESG can also have the effect of de-prioritizing and diverting much-needed resources from laudable corporate social responsibility (“CSR”) efforts like eliminating supply chain human trafficking and supporting employee mental health.

Finally, ESG weakens America’s national security and that of our allies. While asset managers are telling American corporations that they must transition to renewable energy, China continues to build new coal plants at a rapid pace.¹ And many of the critical components for wind, solar, and electric vehicle batteries have rare earth elements and other supply chain needs that are dominated by China. Therefore, adopting these fundamental changes to our energy supply provides China huge leverage over our economy and security. Likewise, ESG has effects on national security issues like the border.²

I understand that the Committee is looking for a state attorney general perspective on ESG. As the elected Attorney General of Utah, I serve as the chief law enforcement officer of a State that is home to over three million people. My fellow state attorneys general and I are charged with enforcing antitrust and consumer protection laws to protect fair competition in our marketplace. Ultimately, our duty in this regard is to protect consumers, and ESG is a clear and present threat to them. I therefore welcome the Committee’s interest.

The various problems with ESG present a multi-faceted topic that is beyond the scope of any single hearing. In this testimony, I discuss several issues that bear directly on the harms to consumers from ESG, in which I have led with either legal filings or letters.³ I also selected these topics because these are areas where the Committee can and should investigate further. The first is the role of asset manager agreements on utility companies and whether the Federal Energy

¹ See Jessie Yeung, *China approved equivalent of two new coal plants a week in 2020, report finds*, CNN BUSINESS (Feb. 27, 2023), available at <https://www.cnn.com/2023/02/27/energy/china-new-coal-plants-climate-report-intl-hnk/index.html>.

² Rep. Paul Renner, *ESG Threatens our pocketbook, our national security, and our democracy*, Tallahassee Democrat (Sept. 9, 2022), <https://www.tallahassee.com/story/opinion/2022/09/09/esg-threatens-our-pocketbook-our-national-security-and-our-democracy-opinion/8016485001/>.

³ My testimony to the Committee draws from those documents. I provide full copies of the FERC filing as Exhibit A, the proxy advisor letter as Exhibit B, and the Motion for Preliminary Injunction in *Utah et al. v. Su et al.*, No. 23-cv-16 (N.D. Tex.) as Exhibit C.

Regulatory Commission (“FERC”) is doing its job to ensure that asset managers who collectively own significant percentages of utilities’ stock are improperly influencing the operations of those utilities. The second is the role of proxy advisory firms in making recommendations for share voting that are based on the goals of pressure groups like Climate Action 100+ rather than shareholders’ best interests. This includes proposals for racial quotas or injection of race into underwriting that violate applicable anti-discrimination laws and therefore should not be on proxy statements. The third is the recent Department of Labor rule that paves the way for ERISA fiduciaries to consider collateral factors in investments and shareholder voting. I applaud the bipartisan action of Congress to repeal this rule under the Congressional Review Act. As you know, it is only because of the President’s exercise of his first veto in his entire administration that this rule presently stands. I am proud to be leading a coalition of 26 states, along with private parties, challenging this rule in court. And I believe that actions by Congress such as attempting to repeal bad rules under the CRA draws much needed attention to these constitutional concerns. I urge you to keep up that work for future rules that are suspect on legal and policy grounds.

The Committee Should Investigate the Role of Horizontal Asset Manager Agreements on Utility Companies and FERC’s Responsibility Under the Federal Power Act

Asset managers that own at least 10% of a utility count as a “holding company” under the Federal Power Act (“FPA”). A holding company must obtain FERC authorization before acquiring more than \$10 million in voting securities in another utility.⁴ Under FERC’s policy, it will not approve an application unless it finds the transaction is consistent with the public interest considering competition, rates, and regulation.⁵ Holding companies may request advance “blanket authorizations” from FERC prior to acquiring such shares generally, and an entity that receives such authorization does not have to obtain approval for a particular transaction.⁶ FERC has rejected providing blanket authorization for a holding company comprised of asset managers that exceeds 20% ownership in a particular utility.⁷

CA100+ and NZAM, including their asset manager signatories, are “holding companies” under the FPA—in fact, they may be the largest holding companies to ever exist. An “association” and “any organized group of persons, whether incorporated or not,” can meet the definitions of “holding company.”⁸ CA100+ and NZAM fit this broad definition because they involve coordinated activities by their members to use ownership to influence utility operations. However, I am not aware that FERC has ever granted authorization with respect to utility transactions by asset managers in relation to their involvement in CA100+ or NZAM. This is problematic because as discussed below, these organizations are using tremendous power to harm the cost-effective provision of electricity to consumers.

⁴ 16 U.S.C. § 824b(a)(2); 18 C.F.R. § 33.1(c)(2)(ii).

⁵ 18 C.F.R. § 2.26(b); *see also* 16 U.S.C. § 824b(a)(4); *Inquiry Concerning the Commission’s Merger Policy Under the Federal Power Act; Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996).

⁶ *See, e.g., Cap. Rsch. & Mgmt. Co.*, 116 FERC ¶ 61,267 at P 28 (2006).

⁷ *See, e.g., Franklin Res., Inc.*, 126 FERC ¶ 61,250 at P 39–40 (2009), *order on reh’g*, 127 FERC ¶ 61,224 (2009).

⁸ 42 U.S.C. § 16451(4), (8).

CA100+ is a horizontal organization of asset managers and asset owners that has approximately **\$68 trillion** USD in assets under management.⁹ CA100+ “has established a common high-level agenda for company engagement to achieve clear commitments to cut emissions, improve governance and strengthen climate-related financial disclosures.”¹⁰ The second prong of CA100+’s “three asks” agenda is to push target company boards and senior management to “[t]ake action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement’s goal of limiting global average temperature increase to well below two degrees Celsius above pre-industrial levels, aiming for 1.5 degrees. Notably, this implies the need to move towards net-zero emissions by 2050 or sooner.”¹¹

CA100+ identifies on its website 166 “focus companies,” which are “key to driving the global net zero emissions transition.”¹² Signatories to CA100+ promise to evaluate whether the focus companies are “working to decarbonise [their] future capital expenditures,” which requires making “a commitment to ‘green revenues’ from low carbon products and services” and planning to cut future investment and production of traditional energy sources.¹³ Several U.S.-based utility companies are among CA100+’s targeted “focus companies,” including: Dominion Energy, Inc.; Duke Energy Corp.; FirstEnergy Corp.; NextEra Energy, Inc.; NRG Energy, Inc.; The Southern Company; Vistra Corp.; and Xcel Energy Inc.¹⁴ The “focus companies have been selected for engagement” because according to CA100+, they represent a significant portion of industrial greenhouse gas emissions.¹⁵

To satisfy CA100+’s goal, focus companies must “explicitly commit[] to align future capital expenditures with the Paris Agreement’s objective of limiting global warming to 1.5° Celsius.”¹⁶ As to utility companies specifically, CA100+ asset managers urge that “[b]oth coal and gas fired generation *must be phased out* to achieve global net-zero emissions by mid-century.”¹⁷ Accordingly, these asset managers have agreed to collectively compel utilities to publish a “coal

⁹ Climate Action 100+, *Investor Signatories*, available at <https://www.climateaction100.org/whos-involved/investors/>.

¹⁰ Climate Action 100+, *The Three Asks*, available at <https://www.climateaction100.org/approach/the-three-asks/>.

¹¹ *Id.*

¹² Climate Action 100+, *Companies* (“CA100+ Companies”), available at <https://www.climateaction100.org/whos-involved/companies/>

¹³ Climate Action 100+, *Climate Action 100+ Net-Zero Company Benchmark* 2-3 (Mar. 2021) (“CA100+ Net-Zero Company Benchmark”), available at <https://www.climateaction100.org/wp-content/uploads/2021/03/Climate-Action-100-Benchmark-Indicators-FINAL-3.12.pdf>.

¹⁴ See CA100+ Companies, *supra* note 12.

¹⁵ *Id.*

¹⁶ CA100+ Net-Zero Company Benchmark, *supra* note 13, at 3.

¹⁷ Climate Action 100+, *2020 Progress Report* 44 (2020) (emphasis added), available at <https://www.climateaction100.org/wp-content/uploads/2020/12/CA100-Progress-Report.pdf> (emphasis added).

and natural gas-generation retirement schedule consistent with a credible climate scenario” and a “retirement date assigned to each coal or gas unit.”¹⁸

NZAM is another horizontal association of asset managers that encompasses **\$59 trillion** USD in assets under management.¹⁹ Members of NZAM pledge to “[i]mplement a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with [NZAM’s] ambition for all assets under management to achieve net zero emissions by 2050 or sooner.”²⁰ This commitment, by its terms, applies to “**all assets under management.**”²¹ The NZAM FAQ says, “What is the reach of the Net Zero Asset Managers Initiative?”²² The response is: “Our 273 signatories to date [*i.e.*, at the time of the FAQ] manage over USD 61.3 trillion of assets. The transition to net zero will be the biggest transformation in economic history. The opportunities to allocate capital to this transition over the coming years cannot be underestimated. Our industry’s ability to drive the transition to net zero is extremely powerful. Without our industry on board, the goals set out in the Paris Agreement will be difficult to meet.”²³

CA100+ and NZAM’s agenda includes major changes in utility operations—reducing fossil fuel usage from 61% in 2020 to 26% by 2030 and to 2% by 2050. This is illustrated by the below chart from the International Energy Agency (“IEA”)’s Net-Zero Roadmap.²⁴

¹⁸ *Id.*

¹⁹ Net Zero Asset Managers Initiative, *The Net Zero Asset Managers Initiative*, available at <https://www.netzeroassetmanagers.org/>

²⁰ Net Zero Asset Managers Initiative, *Commitment*, available at <https://www.netzeroassetmanagers.org/commitment/>.

²¹ *Id.* (emphasis added).

²² The Net Zero Asset Managers Initiative, *FAQ*, available at <https://www.netzeroassetmanagers.org/faq/>.

²³ *Id.* (footnote omitted).

²⁴ Int’l Energy Agency, *Net Zero by 2050: A Roadmap for the Global Energy Sector* 198 (Oct. 2021), available at https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR.pdf.

Table A.3: Electricity

	Electricity Generation (TWh)					Shares (%)			CAAGR (%)	
	2019	2020	2030	2040	2050	2020	2030	2050	2020-2030	2020-2050
Total generation	26 922	26 778	37 316	56 553	71 164	100	100	100	3.4	3.3
Renewables	7 153	7 660	22 817	47 521	62 333	29	61	88	12	7.2
Solar PV	665	821	6 970	17 031	23 469	3	19	33	24	12
Wind	1 423	1 592	8 008	18 787	24 785	6	21	35	18	9.6
Hydro	4 294	4 418	5 870	7 445	8 461	17	16	12	2.9	2.2
Bioenergy	665	718	1 407	2 676	3 279	3	4	5	7.0	5.2
<i>of which BECCS</i>	-	-	129	673	842	-	0	1	<i>n.a.</i>	<i>n.a.</i>
CSP	14	14	204	880	1 386	0	1	2	31	17
Geothermal	92	94	330	625	821	0	1	1	13	7.5
Marine	1	2	27	77	132	0	0	0	28	14
Nuclear	2 792	2 698	3 777	4 855	5 497	10	10	8	3.4	2.4
Hydrogen-based	-	-	875	1 857	1 713	-	2	2	<i>n.a.</i>	<i>n.a.</i>
Fossil fuels with CCUS	1	4	459	1 659	1 332	0	1	2	61	21
Coal with CCUS	1	4	289	966	663	0	1	1	54	19
Natural gas with CCUS	-	-	170	694	669	-	0	1	<i>n.a.</i>	<i>n.a.</i>
Unabated fossil fuels	16 941	16 382	9 358	632	259	61	25	0	-5.4	-13
Coal	9 832	9 426	2 947	0	0	35	8	0	-11	-40
Natural gas	6 314	6 200	6 222	626	253	23	17	0	0.0	-10
Oil	795	756	189	6	6	3	1	0	-13	-15

CA100+ indicated last year that it wants to see “coal-fired power ... phased out in advanced economies by 2030.”²⁵ CA100+ also indicated that it wants “utility companies” to “add[] renewables and other low-carbon technologies fast enough to limit global warming to 1.5°C.”²⁶

Another report from last year that was endorsed by CA100+ and other horizontal organizations “brings forward the date by which power sector emissions need to reach net zero in advanced economies from 2040 to 2035.”²⁷ It then states, “[t]he report will now be used by

²⁵ Climate Action 100+, *Climate Action 100+ Net Zero Company Benchmark shows an increase in company net zero commitments, but much more urgent action is needed to align with a 1.5°C future* (Mar. 30, 2022) (“CA100+ Net Zero Company Benchmark Statement”), available at <https://www.climateaction100.org/news/climate-action-100-net-zero-company-benchmark-shows-an-increase-in-company-net-zero-commitments-but-much-more-urgent-action-is-needed-to-align-with-a-1-5c-future/>.

²⁶ *Id.*

²⁷ Inst’l Investors Grp. on Climate Change, *Global Sector Strategies: Investor Interventions to Accelerate Net Zero Electric Utilities 2* (Oct. 2021), available at <https://www.climateaction100.org/wp-content/uploads/2021/10/Global-Sector-Strategy-Electric->

investors that are engaging with power companies on the [CA100+] focus list, through sector-wide dialogue that encourages collaborative action and as part of individual engagements.”²⁸ Showing how central these goals are to CA100+’s members, the report states that “[p]ower is arguably the most important sector to decarbonise over the next decade.”²⁹ The report states, “[t]hese actions should include an immediate halt to the construction of coal-fired power plants, the phase out of coal in line with the timelines proposed by [the Powering Past Coal Alliance] and IEA NZE, and the scaling up of investments in clean energy sources and infrastructure. It is also vital to ensure full accountability of boards of directors to ensure that governance, targets and disclosures are provided, in line with the Climate Action 100+ Benchmark, to allow shareholders and stakeholders to track progress.”³⁰

Senior leadership of CA100+ has stated outright that the CA100+’s purpose is coordinated, horizontal action by shareholders across companies to force operational changes. The vice-chair of CA100+’s “global Steering Committee,” Stephanie Pfeifer, said that “[t]he Climate Action 100+ initiative has shown that investors can influence companies through meaningful engagement and good stewardship.”³¹ And Simiso Nzima, who is a member of the Steering Committee, said, “We will continue to use the power of collaborative engagements and proxy voting to drive action at our portfolio companies to align their climate ambitions with their long-term strategies and capital allocation decisions.”³² Ceres Investor Network CEO Mindy Lubber, who is also a member of the CA100+ global Steering Committee, stated, “Companies must ratchet up their climate ambition and action, and as we head into this year’s U.S. proxy season, investors will continue to use the results of the Climate Action 100+ Net Zero Company Benchmark to strengthen their own engagement and voting strategies.”³³

The above discussion shows that CA100+ and NZAM involve coordination by asset managers on voting and engagement to fundamentally change utility company operations. This appears to fit within the broad definition of a “holding company” under the FPA.³⁴ But FERC has never authorized the purchase, acquisition, or taking of securities in FPA covered utilities in relation to CA100+ or NZAM. Moreover, given their massive amount of assets under management, these holding companies exceed the 20% limit that FERC previously set in its decisions. The acquisition of utility company shares by members of CA100+ and NZAM is thus highly troubling and something that FERC should be investigating under its statutory duties.

In sum, there are two large associations of asset managers that each involve agreements to coordinate actions through the shares they control to force dramatic changes in utility company operations. I co-led a coalition of 13 state attorneys general in moving to intervene and protest the

[Utilities-IIGCC-Oct-21.pdf](#). “Advanced economies” are OECD countries, which includes the United States. *See id.* at 4.

²⁸ *Id.* at 2.

²⁹ *Id.* at 6.

³⁰ *Id.*

³¹ CA100+ Net Zero Company Benchmark Statement, *supra* note at 24.

³² *Id.*

³³ *Id.*

³⁴ 42 U.S.C. § 16451(4), (8).

blanket authorization that had been provided to Vanguard. Our filing (which is attached as Exhibit A) told FERC that it should not take Vanguard's representations at face value. After we filed this document with FERC in late November, 2020, Vanguard then announced only a few weeks later that it was leaving NZAM.

Vanguard's CEO thereafter commented, "We don't believe that we should dictate company strategy."³⁵ He also said, "It would be hubris to presume that we know the right strategy for the thousands of companies that Vanguard invests with. We just want to make sure that risks are being appropriately disclosed and that every company is playing by the rules."³⁶ He further stated, "We cannot state that [ESG] investing is better performance wise than broad index-based investing.... Our research indicates that ESG investing does not have any advantage over broad-based investing."³⁷

However, Vanguard is not the only large asset manager that has received blanket authorizations from FERC and then joined horizontal organizations such as CA100+ or NZAM. This Committee should make sure that FERC is properly carrying out its duties under the FPA to ensure that utility ownership is not being abused to harm consumers.

The Role of Proxy Advisors

There are important questions whether proxy advisors are carrying out their duties to provide objective voting advice on shares designed to maximize the value of the shares rather than pursue collateral environmental and social goals. Because proxy advisory firms have substantial power in swaying shareholder votes in public companies, the Committee should investigate their actions.

Proxy advisors are firms that provide advice to asset managers and institutional investors about how to vote shares. The market for proxy advisory firms is dominated by two players, Institutional Shareholder Services, Inc. ("ISS") and Glass Lewis & Co. ("Glass Lewis"). Proxy advisory firms are subject to federal and state laws and contractual obligations to their customers.

Under federal law, proxy advisor recommendations must be free from false or misleading material information.³⁸ Moreover, under the Investment Advisers Act, "an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting."³⁹ And states have consumer protection laws that

³⁵ Chris Flood et al., *Vanguard chief defends decision to pull asset manager out of climate alliance*, FIN. TIMES (Feb. 20, 2023), available at <https://www.ft.com/content/9dab65dd-64c8-40c0-ae6e-fac4689dcc77>.

³⁶ *Id.*

³⁷ *Id.*

³⁸ See 15 U.S.C. § 78n(a)(1); 17 C.F.R. § 240.14a-9(a) (Securities Exchange Act mandates that proxy solicitations, including voting advice, may not contain false or misleading material information).

³⁹ SEC, *Proxy Voting by Investment Advisers*, 68 FR 6585, 6586 & n.2 (Feb. 7, 2003) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963)).

prohibit unfair or deceptive trade practices, as well as securities laws that prohibit investment advisers from engaging in fraudulent or misleading practices.⁴⁰

The contractual agreements with proxy advisors may require that the proxy advisors “consider only those factors that relate to the economic value of [the] investment” and take action “in accordance with [the plan’s] economic best interest,” without subordination of the plan’s interests “to unrelated objectives” pertaining to social or environmental policy.⁴¹

Moreover, regarding conflicts of interest, ISS has generally warranted that “there are no relevant facts or circumstances that could give rise to any conflict of interest or appearance of impropriety,” and “that it shall not engage in any actions that could be perceived to be a conflict of interest.”⁴²

It is common sense that proxy advisory firms should focus on providing objective advice related to maximizing the value of the shares in the companies that are the subject of shareholder proposals and board of director elections. However, the proxy advisory firms have made several commitments that may interfere with their ability to honor their legal obligations, specifically as they relate to climate and diversity, equity, and inclusion priorities.

With respect to climate, ISS announced that it will “generally vote against” relevant directors if the company does not implement “[a]ppropriate [greenhouse gas] emissions reduction targets.”⁴³ Likewise, Glass Lewis bases its recommendations in part on whether a company is adequately pursuing “broader goals,” defined as “net zero emissions goals.”⁴⁴ In a quintessential example of elevating non-financial considerations over financial ones, ISS argues that the finance industry “must play a central and catalytic role in the global transition to a low-carbon economy” because “[s]ignatories to the 2015 Paris Agreement are largely failing to deliver on their emissions reduction commitments.”⁴⁵ Glass Lewis recently recommended that shareholders reject the climate plan from Woodside Petroleum based on a concern that it did not do enough to reduce customers’

⁴⁰ See, e.g., Utah Code § 61-1-1 & -2.

⁴¹ See, e.g., Emps. Ret. Sys. of Tex., *Proxy Voting Policy* Add. VII at 1, 6 (Feb. 22, 2011), available at <https://ers.texas.gov/About-ERS/ERS-Investments-overview/Proxy-Voting/Proxy-Voting-Policy.pdf>.

⁴² See Second Amended and Restated Contractual Agreement between ISS and Employees Retirement System of Texas, §§ 14.1, 14.8.

⁴³ ISS, United States Proxy Voting Guidelines 17 (Dec. 13, 2022) (“ISS Proxy Voting Guidelines”), available at <https://www.issgovernance.com/file/policy/active/americas/US--Voting-Guidelines.pdf>. ISS defines the Climate Action 100+ focus group list as “significant GHG emitters.” *Id.* at 17 n.10.

⁴⁴ Glass Lewis, 2022 Policy Guidelines for ESG Initiatives 28 (2022), available at <https://www.glasslewis.com/wp-content/uploads/2021/11/ESG-Initiatives-Voting-Guidelines-GL-2022.pdf>.

⁴⁵ Emily Faithfull et al., ISS ESG, *Tackling Finance Emissions: Introducing Science-Based Targets for Financial Institutions* 3 (2020), available at <https://www.issgovernance.com/file/publications/ISS-ESG-Tackling-Financed-Emissions.pdf>.

emissions.⁴⁶ Put another way, Glass Lewis faulted the company for not having a good enough plan to get its customers to stop buying its own product. These are but some examples regarding proxy advisory firms that I and other state attorneys general outlined to ISS and Glass Lewis. I am attaching the full letter as Exhibit B to my written testimony.

The two large proxy advisory firms have also pledged to recommend votes against certain directors on boards that they view as having insufficient racial, ethnic, or sex-based diversity under arbitrary quotas. ISS recommends votes based on the number of “apparent racially or ethnically diverse members” and a “gender-diverse status.”⁴⁷ Glass Lewis recommends votes based on racial disclosures and the number of gender diverse directors.⁴⁸ Relatedly, ISS would support proposals that require companies to perform “racial equity ... audit[s],” particularly if a company has not issued sufficient “public statement[s] related to its racial justice efforts” or “engaged with” unidentified “civil rights experts.”⁴⁹ This pledge has led, for example, to ISS supporting proposals that would force insurance companies to gather and consider race data in apparent violation of state law.⁵⁰ In addition to potentially violating contractual and fiduciary duties, such actions may also violate state anti-discrimination laws. Nor is the connection between such policies and economic value sufficiently clear to justify such quotas, as a California court recently found in striking down a law that imposed similar mandates.⁵¹

ISS and Glass Lewis’s potential fiduciary breaches are particularly dangerous—the enormous influence these firms exercise in institutional shareholder voting cannot be overstated.

⁴⁶ Sonali Paul, *Glass Lewis recommends vote against Woodside Petroleum’s climate plan*, REUTERS (May 9, 2022), available at <https://www.reuters.com/business/energy/glass-lewis-recommends-vote-against-woodside-petroleum-climate-plan-2022-05-09/>.

⁴⁷ ISS Proxy Voting Guidelines, *supra* note 43 at 12.

⁴⁸ See Glass Lewis, *2022 Policy Guidelines for the United States* 40–42 (2022), available at <https://www.glasslewis.com/wp-content/uploads/2021/11/US-Voting-Guidelines-US-GL-2022.pdf>.

⁴⁹ ISS Proxy Voting Guidelines, *supra* note 43 at 69.

⁵⁰ Justin Danhof, *Is environmental, social and corporate governance (ESG) illegal?: The case of Travelers Insurance*, WASH. TIMES, Oct. 24, 2022, available at <https://www.washingtontimes.com/news/2022/oct/24/is-environmental-social-and-corporate-governance-e/>.

⁵¹ See *Crest v. Padilla*, No. 19STCV27561, 2022 WL 1565613 (Cal. Super. Ct. May 13, 2022) (“Crest – SB 826”) (striking down S.B. 826, which requires representation of women directors on boards of publicly held corporations based in California); *Crest v. Padilla*, No. 20 STCV 37513, 2022 WL 1073294 (Cal. Super. Ct. Apr. 1, 2022) (“Crest – AB 979”) (striking down A.B. 979, which required companies to have at least one board director who is a member of an “underrepresented community” by the end of 2021, and two or three such directors (depending on overall board size) by the end of 2022). In the latter case, the court faulted the legislature for “skip[ping] directly to mandating heterogenous boards” without attempting “to create neutral conditions under which qualified individuals from any group may succeed.” Crest – AB 979 at *1. And in Crest – SB 826, the court noted that the state was unable to find academic studies to support its contention that there is “a causal connection between women on corporate boards and corporate governance.” Crest – SB 826 at *6. Both cases have appeals pending.

As of April 2020, Glass Lewis clients manage \$35 trillion in assets.⁵² ISS does not provide the total assets under management but does report it covers approximately 48,000 shareholder meeting in 115 markets and “executes more than 12.8 million ballots representing 5.4 trillion shares.”⁵³ In 2020, a report concluded that 114 institutional investors voted in lockstep alignment with either ISS or Glass Lewis, and these investors managed \$5 trillion in assets.⁵⁴

A recent shareholder proposal before Travelers Insurance investors exemplified these dangers. Last year, the Trillium ESG Global Equity Fund managed by Trillium Asset Management introduced a shareholder proposal that sought a “racial justice audit” covering insurance products.⁵⁵ As support, Trillium noted that companies like Facebook, Starbucks, and BlackRock committed to such audits.⁵⁶ Notably absent were other insurance companies. This is because state law prohibits insurers from considering, and in some cases even collecting data, about race in their insurance business.⁵⁷ This proposal also targeted Travelers’ “law enforcement liability insurance” as “contributing to systemic racism.”⁵⁸ Even after the company aggressively campaigned to educate investors on the dangers of a proposal that would require Travelers to violate the law, the proposal received 47 percent of the vote at the shareholder meeting, in part because proxy advisors recommended voting for it.⁵⁹ Proxy advisors should not be supporting proposals that ask companies to act illegally.

Travelers is holding its 2023 annual meeting on May 24, 2023. The 2023 proxy statement discusses the 2022 racial equity audit proposal: “The [2022] proposal’s request [would have been] impossible to implement without violating the insurance laws of the vast majority of states.”⁶⁰

⁵² SEC, *Exemptions from the Proxy Rules for Proxy Voting Advice*, 85 Fed. Reg. 55082, 55126-27 (Sept. 3, 2020).

⁵³ ISS, *About ISS*, available at <https://www.issgovernance.com/about/about-iss/#1570776311994-db534a1e-7bb2>.

⁵⁴ See Paul Rose, *Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting*, MANHATTAN INSTITUTE, Apr. 2021, at 10, <https://media4.manhattan-institute.org/sites/default/files/proxy-advisors-market-power-review-investor-robovoting-PR.pdf>.

⁵⁵ See, e.g., Travelers Cos., Inc., 2022 Proxy Statement (DEF 14A), at Item 7 p. 79 (Apr. 8, 2022), available at https://s26.q4cdn.com/410417801/files/doc_financials/annual/2021/2022-Proxy-Statement-04-14-2022.pdf.

⁵⁶ *Id.*

⁵⁷ See, e.g., Danhof, *Is environmental, social and corporate governance (ESG) illegal?: The case of Travelers Insurance*, *supra* note 50 (“Maryland law provides the clearest example: “an insurer ... may not make an inquiry about race, creed, color, or national origin in an insurance form, questionnaire, or other manner of requesting general information that relates to an insurance application.” Other state laws are similar.”).

⁵⁸ Travelers Cos., Inc., 2022 Proxy Statement (DEF 14A), at Item 7 p. 79 (Apr. 8, 2022), available at https://s26.q4cdn.com/410417801/files/doc_financials/annual/2021/2022-Proxy-Statement-04-14-2022.pdf

⁵⁹ See Danhof, *Is environmental, social and corporate governance (ESG) illegal?: The case of Travelers Insurance*, *supra* note 50.

⁶⁰ See Travelers Cos., Inc., 2023 Proxy Statement (DEF 14A), at p. 10 (Apr. 7, 2023), available at https://s26.q4cdn.com/410417801/files/doc_financials/2022/ar/2023-Proxy-Statement.pdf.

Nonetheless, Trillium again offered a racial equity audit proposal, urging “a full racial equity audit to examine [Traveler’s] total impact and help dismantle systemic racism.”⁶¹

Importantly, this type of proposal should never reach a vote. Travelers sought a “no action” letter from the SEC, explaining that the proposal “would cause the Company to violate the insurance laws of the vast majority of states — specifically, those prohibiting the collection and use of race in insurers’ underwriting and rate-making decisions” and that “the Company lacks the power or authority to implement the Proposal given the constraints associated with the legal and regulatory environment in which the Company operates, and the fact that changes to existing insurance industry practice to take race into account or alter outcomes on the basis of race falls under the purview of legislators and regulators to determine rather than shareholders.”⁶² Disappointingly, SEC staff issued a conclusory statement that they were “unable to conclude that the Proposal, if implemented, would cause the Company to violate state law.”⁶³

While companies could consistently rely on the SEC to exclude such proposals in the past, there is a significant decrease in the number of shareholder proposals excluded based on a no-action request. The success rate for no-action requests has dropped from 70% in 2020 and 71% in 2021 to 38% in 2022.⁶⁴ Indeed, it is particularly problematic that, in the past, proxy advisors have relied on the absence of no action letters from SEC staff to conclude that a shareholder proposal is legal. This is so, even where on the face of the proposal it seeks to impose racial or sex-based quotas. The Committee should investigate whether the SEC’s no-action-letter process is functioning as intended, and whether these proxy advisory firms are acting lawfully in their recommendations.

The Department of Labor’s Rule Authorizing Consideration of Collateral-ESG Factors in ERISA Retirement Plans Is Unlawful

The final topic I would like to briefly discuss is the recent rulemaking issued by the Department of Labor that seeks to authorize consideration of collateral benefits in investing and proxy voting by ERISA beneficiaries. ERISA’s fiduciary duties are the highest known to law.⁶⁵

In 2020, the DOL promulgated critical protections under ERISA to deter fiduciary violations and protect participants in covered retirement plans after finding “shortcomings in the rigor of the prudence and loyalty analysis by some participating in the ESG investment

⁶¹ *Id.* at 98.

⁶² See Travelers Cos., Inc., Letter from Yafit Cohn to SEC (“Travelers Trillium Letter”) (Jan. 17, 2023), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2023/trilliumtravelers033023-14a8.pdf>.

⁶³ See SEC Ltr. to Travelers, Ins. (Mar. 30, 2023), available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2023/trilliumtravelers033023-14a8.pdf>

⁶⁴ Gibson Dunn, *Shareholder Proposal Developments During the 2022 Proxy Season*, available at <https://www.gibsondunn.com/shareholder-proposal-developments-during-the-2022-proxy-season/>.

⁶⁵ *Schweitzer v. Inv. Comm. of Phillips 66 Sav. Plan*, 960 F.3d 190, 194 (5th Cir. 2020).

marketplace.”⁶⁶ But under the Biden Administration, DOL has now subverted those protections and made it easier for fiduciaries to advance collateral agendas that are unrelated to the financial interests of participants.⁶⁷ This turns ERISA on its head. Whereas ERISA—like the 2020 rules—imposes various obligations on fiduciaries to benefit and protect plan participants, the new rule instead burdens participants while giving fiduciaries more discretion to make investment decisions based on “climate change and other ESG issues” that define the Biden Administration’s political agenda.⁶⁸

I applaud Congress for passing a bipartisan, joint resolution repealing this new rule under the Congressional Review Act.⁶⁹ While President Biden’s veto prevented this repeal from taking effect, I am proud to be leading a 26-state coalition challenging that rule as contrary to law, arbitrary and capricious, and in violation of the major questions doctrine.⁷⁰

Conclusion

I have outlined three issues where we attorneys general have filed legal briefs or sent letters to protect consumers. Consumer protection must remain a core focus of attorneys general. The actions of asset managers joining horizontal organizations to abuse their trillions in assets, proxy advisors in recommending votes for collateral purposes, and the Department of Labor in eliminating protections for ERISA plan participants harm consumers. This Committee should investigate these issues further.

⁶⁶ Financial Factors in Selecting Plan Investments, 85 F.R. 72846, 72847, 72850 (Nov. 13, 2020) (“2020 Investment Rule”); Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 F.R. 81658, 81678 (Dec. 16, 2020) (“2020 Proxy Voting Rule”).

⁶⁷ See Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 87 F.R. 73822 (Dec. 1, 2022) (“2022 Rule”).

⁶⁸ 87 F.R. at 73826.

⁶⁹ H.J. Res. 30 (March 1, 2023).

⁷⁰ A copy of the Plaintiffs’ motion for preliminary injunction is attached as Exhibit C.

Exhibit A, pages 15-31.

FERC Vanguard - EC19-57-002 Filing

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

The Vanguard Group, Inc.)	
Vanguard Global Advisors, LLC)	
Vanguard Asset Management, Ltd.)	Docket Nos. EC19-57-001;
Vanguard Investments Australia Ltd.)	EC-57-002
Vanguard Fiduciary Trust Company)	

**MOTION TO INTERVENE AND PROTEST
BY THE STATES AND ATTORNEYS GENERAL OF UTAH, INDIANA, ALABAMA,
ARKANSAS, KENTUCKY, LOUISIANA, MISSISSIPPI, MONTANA, NEBRASKA,
OHIO, SOUTH CAROLINA, SOUTH DAKOTA, AND TEXAS**

Pursuant to Rule 211 and Rule 214 of the Practice and Procedures of the Federal Energy Regulatory Commission (“FERC” or the “Commission”),¹ the States of Utah, Indiana, Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Montana, Nebraska, Ohio, South Carolina, South Dakota, and Texas, by and through their Attorneys General (collectively, the States) move to intervene and protest the application filed by The Vanguard Group, Inc. and its affiliated entities and subsidiaries (collectively, Vanguard), which requests a blanket authorization under Section 203 of the Federal Power Act (“FPA”) for acquisitions of voting securities of publicly traded utilities.² In particular, Vanguard asks the Commission for a three-year extension of the blanket authorization granted in 2019 (“2019 Authorization”)³ for Vanguard to acquire the voting securities of any utility, either up to 20% ownership in aggregate by Vanguard, its affiliates, and its subsidiaries or up to 10% ownership by any individual Vanguard fund. Vanguard also seeks approval to modify the terms of the 2019 Authorization by excluding from the 10% and 20%

¹ 18 C.F.R. §§ 385.211, 385.214.

² Joint Application for Authorization Under Section 203 of the Federal Power Act, *The Vanguard Group, Inc.*, Docket No. EC19-57-001 (Feb. 16, 2022) (“Application”).

³ *The Vanguard Group, Inc.*, 168 FERC ¶ 62,081 (2019) (“2019 Authorization”).

ownership limits the voting securities held in portfolios that Vanguard claims are managed by unaffiliated external advisors in externally advised funds.

We respectfully request that the Commission set a hearing in this proceeding to determine whether extending Vanguard's blanket authorization is in the public interest. The Commission granted the 2019 Authorization based on assurances from Vanguard that it would refrain from investing "for the purpose of managing" utility companies.⁴ Vanguard also guaranteed that it would not seek to "exercise any control over the day-to-day management" of utility companies nor take any action "affecting the prices at which power is transmitted or sold."⁵ Now, Vanguard's own public commitments and other statements have at the very least created the appearance that Vanguard has breached its promises to the Commission by engaging in environmental activism and using its financial influence to manipulate the activities of the utility companies in its portfolio. A hearing in this matter is warranted to determine the extent to which Vanguard has violated the 2019 Authorization and whether granting Vanguard a blanket authorization is contrary to the public interest.

I. Communications and Correspondence

All communications and correspondence regarding this proceeding should be sent to:

MELISSA A. HOLYOAK
Solicitor General
Office of the Utah Attorney General
350 N. State Street, Ste. 230
P.O. Box 142320
Salt Lake City, UT 84114
(801) 538-9600
melissaholyoak@agutah.gov

⁴ *Id.* ¶ 64,219.

⁵ *Id.* ¶ 64,220

THOMAS M. FISHER
Solicitor General
Office of the Indiana Attorney General
IGC-South, Fifth Floor
302 West Washington Street
Indianapolis, IN 46204-2770
(317) 232-6255
Tom.Fisher@atg.in.gov

EDMUND G. LACOUR JR.
Solicitor General
Office of the Attorney General
State of Alabama
501 Washington Avenue
P.O. Box 300152
Montgomery, Alabama 36130-0152
(334) 242-7300
(334) 353-8400 fax
Edmund.LaCour@AlabamaAG.gov

NICHOLAS J. BRONNI
Solicitor General
Dylan L. Jacobs
Deputy Solicitor General
Arkansas Attorney General's Office
323 Center Street, Suite 200
Little Rock, AR 72201
(501) 682-2007
Nicholas.Bronni@ArkansasAG.gov
Dylan.Jacobs@ArkansasAG.gov

MATTHEW F. KUHN
Solicitor General
Office of Kentucky Attorney General
700 Capital Avenue, Suite 118
Frankfort, Kentucky 40601
(502) 696-5400
Matt.Kuhn@ky.gov

ELIZABETH B. MURRILL
Solicitor General
Louisiana Department of Justice
1885 N. Third Street
Baton Rouge, Louisiana 70804
(225) 326-6766
murrille@ag.louisiana.gov
stjohnj@ag.louisiana.gov

JUSTIN L. MATHENY
Deputy Solicitor General
Office of the Mississippi Attorney General
P.O. Box 220
Jackson, MS 39205-0220
(601) 359-3680
justin.matheny@ago.ms.gov

CHRISTIAN CORRIGAN
Solicitor General
Montana Department of Justice
215 N Sanders St
Helena, MT 59601
(406) 444-2026
christian.corrigan@mt.gov

JAMES A. CAMPBELL
Solicitor General
Office of the Nebraska Attorney General
2115 State Capitol
Lincoln, NE 68509
(402) 471-2682
jim.campbell@nebraska.gov

BENJAMIN M. FLOWERS
Ohio Solicitor General
Office of Ohio Attorney General
30 East Broad Street, 17th Floor
Columbus, Ohio 43215
(614) 466-8980
(614) 466-5087 fax
benjamin.flowers@ohioago.gov

THOMAS T. HYDRICK
Assistant Deputy Solicitor General
Office of the South Carolina Attorney General
P.O. Box 11549
Columbia, SC 29211
thomashydrick@scag.gov
tel: (803) 734-4127

GRANT DORFMAN
Deputy First Assistant Attorney General
Office of the Attorney General
State of Texas
P.O. Box 12548 (MC 059)
Austin, Texas 78711-2548
(512) 936-1700
(512) 474-2697 fax
Grant.Dorfman@oag.texas.gov

II. Motion to Intervene

The Attorneys General seek to intervene in this proceeding to represent the interests of the States as well as of individuals and entities residing therein who consume electricity, or are otherwise affected by the Commission's decision on Vanguard's Application. Intervention is proper here because the State Attorneys General both "represent[] an interest which may be directly affected by the outcome of the proceeding" and because their participation would be in the public interest.⁶ The Attorneys General are public officers charged with various statutory duties related to representing their States.⁷ Resolution of this matter may directly affect the interests of everyday consumers and other ratepayers in the States whose rates or reliability of electricity supply may be adversely affected, as well as other participants in the States. There are multiple investor-owned utilities serving residents of the States that are joining this Motion. If these

⁶ 18 C.F.R. § 385.214(b)(2)(ii)–(iii).

⁷ See generally Ind. Code § 4-6-1-6; Utah Code Ann. § 67-5-1.

utilities' services became less reliable, or costs increased, then consumers in the States would necessarily be harmed.

For example, PacifiCorp, which serves Utah, is owned by Berkshire Hathaway Energy, which is owned by Berkshire Hathaway, Inc. (Berkshire). In 2022, Vanguard supported climate disclosure for certain of Berkshire's "carbon-intensive operating companies" and also noted that "[c]ertain of Berkshire's operating companies have also made net GHG emissions commitments."⁸ Berkshire Hathaway's website shows that currently 20% of PacifiCorp's energy comes from coal or natural gas generation.⁹ In Utah, this includes the Currant Creek, Hunter, and Huntington facilities.¹⁰ Consumers in Utah would be harmed if their costs went up because of closure of these facilities or substitution of more expensive energy sources.

Indiana is similarly served by multiple investor-owned utilities, whose ultimate parent companies are publicly traded.¹¹ These include Northern Indiana Public Service Company, (NIPSCO), which is a subsidiary of NiSource; Indiana-Michigan Power (I&M), which is a subsidiary of American Electric Power; Duke Energy, which is a subsidiary of Duke Energy Corporation; Indianapolis Power & Light (IPL), which is a subsidiary of AES Corporation; and Vectren, which is a subsidiary of CenterPoint Energy.¹² These companies presently supply consumers with energy generated from coal and natural gas.¹³ Consumers in Indiana would be

⁸ https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/Insights_Berkshire_final_05032022.pdf.

⁹ <https://brkenenergy.com/esg-sustainability/environmental>.

¹⁰ <https://www.pacificorp.com/energy/thermal.html>.

¹¹ <https://www.in.gov/oed/indianas-energy-landscape/electricity/investor-owned-utilities/>.

¹² *Id.*

¹³ *See, e.g.,* <https://www.duke-energy.com/energy-education/how-energy-works/energy-from-coal>; *see also* <https://www.duke-energy.com/our-company/about-us/power-plants>.

harm if their costs went up because of closure of these facilities or substitution to more expensive energy sources.

Mississippi is served by investor-owned utilities, whose ultimate parent companies are publicly traded. These include Mississippi Power Company, a subsidiary of Southern Company which conducts its business through electric operating companies in three states, natural gas distribution companies in four states, a competitive generation company serving wholesale customers across America, and a leading distributed energy infrastructure company, (<https://www.southerncompany.com/sustainability/southern-company-overview.html>), and Entergy Mississippi, LLC, a subsidiary of Entergy Corporation which is an integrated energy company engaged in electric power production, transmission and retail distribution operations in four states, (<https://www.entergy.com/about-us/>). These companies presently supply consumers in Mississippi and elsewhere in the Southeastern United States with energy generated from fossil fuel sources, including coal and natural gas. (<https://www.southerncompany.com/about/our-business.html>); (<https://www.entergy.com/operations-information/>). Consumers in Mississippi would be harmed if their costs went up because of closure of these facilities or substitution to more expensive energy sources.

Arkansas, Louisiana, and Texas are similarly served by subsidiaries of Entergy Corporation. <https://www.entergy.com/residential/>. Arkansas is served by Entergy Arkansas LLC. Louisiana is served by Entergy Louisiana, LLC and Entergy New Orleans, LLC. Texas is Served by Entergy, Texas Inc.

American Electric Power Co., Inc. (“AEP”) serves 5.5 million customers in eleven states—Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia, and West Virginia. <https://www.aep.com/about/facts>. AEP is a Climate Action 100+ target

company, and in 2020 set an ambition to achieve Net zero GHG Emissions by 2050. <https://www.climateaction100.org/company/american-electric-power-company-inc/>. However, Climate Action 100+ has graded AEP in every category other than 2050 ambition as not meeting its criteria or only partially meeting its criteria. *Id.* AEP now reports that its strategy is to achieve “net zero carbon dioxide emissions by 2045, with an interim goal to cut emissions 80% from 2005 levels by 2030.” <https://www.aep.com/about/ourstory/cleanenergy>. Moreover, AEP reports that, as of 2022, 41% of its electricity generation came from coal, and 27% came from natural gas. <https://www.aep.com/about/businesses/generation>. It reports that it intends to cut its percentage of electricity generation from coal from 41% to 19% by 2032 and increase its percentage of generation from hydro, wind, solar & pumped storage from 23% to 53% during the same time period. *Id.* Consumers in the proposed intervenor States will be required to pay for this transition, pay any increased costs from these alternative sources of energy, and suffer the consequences of any loss of reliability in their power supply.

Alabama is served by the Alabama Power Company, which is a subsidiary of the Southern Company. <https://www.southerncompany.com/about/our-companies.html>. The Southern Company is a publicly traded company and a Climate Action 100+ focus company. <https://www.climateaction100.org/company/the-southern-company/>.

Montana is served by NorthWestern Energy, which is a publicly traded, investor-owned utility. <https://www.northwesternenergy.com/about-us>. For example, NorthWestern Energy has a 30% ownership interest in Colstrip Unit 4 in Montana, which uses sub-bituminous coal. <https://www.sec.gov/ix?doc=/Archives/edgar/data/73088/000007308822000019/nwe-20211231.htm> at 13. NorthWestern states that stricter carbon limitations by governmental bodies “has the potential to limit or curtail our operations, including the burning of fossil fuels at our coal-

fired power plants.” *Id.* at 21. Investors imposing this separate from government regulation would logically have the same effect.

South Carolina is served by several publicly traded utilities or subsidiaries of those utilities. Consumers in South Carolina would be harmed if their costs went up because of substitution to more expensive energy sources.

South Dakota and Nebraska are served by MidAmerican Energy Co., which is a subsidiary of Berkshire Hathaway Energy. <https://www.brkenenergy.com/our-businesses/midamerican-energy-company>. As discussed above, Vanguard supported climate disclosure for certain of Berkshire’s subsidiaries.

As discussed in Part III, below, the groups Vanguard joined (despite Vanguard’s specific commitments to the Commission) aim to shift global electricity production from natural gas and coal from approximately 67% of global electricity to approximately 0%. This will undoubtedly affect the cost and reliability of energy supplies.

In addition, the States that the Attorneys General represent are themselves consumers of energy, and decisions by utility companies can affect the reliable and affordable supply of energy that the States themselves consume, which creates a pecuniary interest in this matter.¹⁴ These direct and substantial interests will not be adequately protected without the intervention of the States through their Attorneys General. On top of this, participation by the States through their Attorneys General is in the public interest.¹⁵ Because the Attorneys General are elected officials who regularly take actions involving consumer protection and competition, they bring an important consumer-protection perspective. For these reasons, intervention is in the public interest, and the

¹⁴ See 18 C.F.R. § 385.214(b)(2)(ii)(A)–(B).

¹⁵ 18 C.F.R. § 385.214(b)(2)(iii).

Commission should grant the Attorneys General on behalf of the States leave to intervene in this proceeding with full rights as a party.

III. Protest

Vanguard is not entitled to a blanket authorization to acquire substantial equity and voting power in utility companies. Under Section 203 of the FPA, a holding company such as Vanguard cannot acquire a security worth more than ten million dollars in a utility without prior authorization from the Commission.¹⁶ By regulation, upon receipt of an application, the Commission must determine whether the proposed transaction is “consistent with the public interest” in light of its possible effects on competition, rates, and regulation.¹⁷ Additionally, the Commission considers “whether the proposed transaction will result in cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company, unless that cross-subsidization, pledge, or encumbrance will be consistent with the public interest.”¹⁸

Vanguard procured the 2019 Authorization by persuading the Commission that its contemplated transactions would not adversely affect competition, rates, and regulation. The Commission’s decision to grant a blanket authorization was premised in part on Vanguard’s assurance that it would neither seek to “exercise any control over the day-to-day management or operations of any U.S. Traded Utility” nor invest “for the purpose of managing, controlling, or entering into business transactions with portfolio companies.”¹⁹ At the time, Vanguard also represented that it would not “have any role in the setting of rates by utilities;” that it would not take “any other actions affecting the prices at which power is transmitted or sold;” and that “there

¹⁶ 16 U.S.C. § 824b(a)(2).

¹⁷ 18 C.F.R. § 2.26(b); *see also* 16 U.S.C. § 824b(a)(4) (setting forth general “consistent with the public interest” standard).

¹⁸ *Id.* § 2.26(f).

¹⁹ 2019 Authorization, 168 FERC at ¶ 64,219–20.

would be no discrete impact on the cost structures of the issuer that might affect the development or setting of cost-based rates.”²⁰ Based on these same promises, Vanguard now requests that the Commission extend its blanket authorization for another three years.²¹

The Commission should not take Vanguard’s representations at face value, particularly in light of the company’s recent commitments to environmental activism. In 2021, Vanguard joined the Net Zero Asset Managers Alliance (“NZAM”)—a group of nearly three hundred asset managers who work together to “accelerate the transition towards global net zero emissions.”²² NZAM asset managers in general agree to “[w]ork in partnership with asset owner clients on decarbonisation goals;” to “[p]rioritise the achievement of real economy emissions reductions within the sectors and companies in which [it] invest[s];” and to “[i]mplement a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with [its] ambition for all assets under management to achieve net zero emissions by 2050 or sooner.”²³ Similarly, as a member of the Ceres Investor Network, Vanguard “collaborate[s] with investors around the world to accelerate action on climate change.”²⁴ According to the International Energy Agency’s Net Zero pathway, achieving net zero requires shifting global electricity production from natural gas and coal from approximately 67% of global electricity to approximately 0%.²⁵

By making net zero commitments, Vanguard necessarily abandoned its status as a passive investor in public utilities and adopted a motive consistent with managing the utility. These commitments, on their face, further suggest that Vanguard has already undertaken and is currently

²⁰ *Id.* ¶ 64,220.

²¹ Application at 22–23.

²² The Net Zero Asset Managers Initiative, *Signatories*, <https://www.netzeroassetmanagers.org/signatories/>.

²³ The Net Zero Asset Managers Initiative, *Commitment*, <https://www.netzeroassetmanagers.org/commitment/>.

²⁴ Ceres, *Join the Ceres Investor Network*, <https://www.ceres.org/networks/ceres-investor-network/join-ceres-investor-network>.

²⁵ https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR.pdf (A very small percentage of coal and natural gas generation on the order of 2-3% of global supply may be permitted in a net zero scenario provided carbon capture is utilized).

undertaking corresponding activities that may constitute attempts to manage utilities—the precise actions Vanguard represented in its 2019 application and its pending application that it would not take. This in turn raises doubt as to whether the other statutorily and regulatorily required factors in FERC's inquiry are met. Only a fuller record, a hearing, and thorough briefing from all interested parties can determine whether Vanguard's representations are valid.

By committing to use its financial power to accelerate “the goal of net zero greenhouse gas emissions by 2050 or sooner,”²⁶ Vanguard may have already violated the terms and conditions of the 2019 Authorization. Vanguard agreed that it would not hold or purchase securities for the *purpose* of managing or controlling portfolio utility companies. Yet Vanguard has promised in a different context that it is, in effect, doing exactly that. As a member of NZAM and Ceres, Vanguard pledges to use its voting power to pressure utility companies towards decarbonization. How could it do that without intending to manage the companies in its portfolio? Even if it has not taken steps in line with these commitments, Vanguard appears to have potentially breached the conditions of the 2019 Authorization by investing “for the purpose of managing” utility companies.²⁷ The possibility of this breach should warrant greater scrutiny of Vanguard’s holdings and management of portfolio companies. Consequently, the Commission should deny Vanguard’s 2022 application for blanket reauthorization, which asks FERC to ignore the conduct of a company with over \$8.5 trillion under management. Whether and to what extent Vanguard has breached the 2019 Authorization are questions that could be aired and investigated at a hearing in this proceeding.²⁸

²⁶ *The Net Zero Asset Managers Initiative*, <https://www.netzeroassetmanagers.org/>.

²⁷ See 2019 Authorization, 168 FERC at ¶ 64,219

²⁸ Vanguard’s lack of forthrightness and transparency about its environmental purposes should be concerning to the Commission given its recent efforts to promote candor in communications by regulated entities. See Duty of Candor, 180 FERC ¶ 61,052 (2022).

Moreover, Vanguard, pursuant to its environmental commitments, has taken actions through its stewardship, engagement, and proxy-voting strategies to control the day-to-day operations of its portfolio utility companies in violation of the 2019 Authorization. For example, in its own publications, Vanguard warns its portfolio companies that it will support shareholder proposals that require the pursuit of climate risk mitigation targets and disclosure of greenhouse gas emissions or other climate-related metrics.²⁹ Vanguard also engages companies in carbon-intensive industries to have “risk mitigation targets that are aligned with the Paris Agreement[] and disclosure of progress against those risk-mitigation targets.”³⁰ In 2019 alone, Vanguard had over 250 engagements with companies “in the top carbon-producing and carbon-consuming sectors” on their climate-risk strategies.³¹ We urge the Commission to audit Vanguard’s voting records and engagements with utility companies to determine the extent to which Vanguard has breached its promise that it would not seek to “exercise any control over the day-to-day management or operations” of utility companies.³²

So too, we are concerned that Vanguard’s actions with respect to influencing environmental corporate policy—especially in combination with the stated motives of BlackRock and State Street Global Advisors³³—will inflate the rates consumers and our States pay for electrical service.³⁴ As Commissioners Danly and Christie recently pointed out, the Commission

²⁹ The Vanguard Group, Inc., *Vanguard Investment Stewardship Insights* 1 (June 2020), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/ISCLRG_062020.pdf.

³⁰ The Vanguard Group, Inc., *Vanguard’s Approach to Climate Change*, <https://corporate.vanguard.com/content/corporatesite/us/en/corp/climate-change.html>.

³¹ *Vanguard Investment Stewardship Insights*, *supra* note 19.

³² See 2019 Authorization, 168 FERC at ¶ 64,220.

³³ BlackRock, for many of the same reasons as set forth in this protest, has likely breached the terms and conditions of the various blanket authorizations that the Commission has granted to the company. See *BlackRock, Inc.*, 179 FERC ¶ 61,049. We therefore respectfully recommend that the Commission audit BlackRock to determine whether it is in compliance with the authorizing conditions.

³⁴ See, e.g., Jude Clemente, *ESG and The Dangerous Structural Increase in the Price of Oil*, FORBES (Feb. 13, 2022), <https://www.forbes.com/sites/judeclemente/2022/02/13/esg-and-the-dangerous-structural-increase-in-the-price-of-oil/?sh=728544b4757b>.

should not “rubber stamp requests for blanket authorizations”³⁵ where Vanguard cannot assure the Commission that its meddling in companies’ environmental agendas will not affect the “prices at which power is transmitted or sold” and/or “affect the development or setting of cost-based rates.”³⁶ Vanguard’s environmental mandates impose costs on its portfolio companies, and it is highly plausible that those costs are passed on to consumers directly or indirectly by hampering access to capital or foreclosing certain revenue-generating opportunities. A holding company of Vanguard’s size and influence should not be overlooked; to do so would be an abdication of the Commission’s statutory duty to safeguard the energy markets.

Finally, we note that in joining NZAM and Ceres, Vanguard has engaged (and promises to continue to engage) in organizations that coordinate conduct with other major financial institutions, including BlackRock and State Street, to impose net-zero requirements on publicly traded utilities. This group effort to control day-to-day operations of public utilities raises serious concerns about the continuing efficacy of the 10% and 20% ownership limits imposed by the 2019 Authorization and the Office of Energy Market Regulations’ nine-month extension order.³⁷ If these three companies can cause public companies regulated by FERC to act in tandem to achieve certain political goals (that do not promote the efficiency and fairness of the energy markets), then it appears the ownership limits are completely toothless. We ask the Commission to investigate this apparent circumvention, consider these factors in relation to Vanguard’s application, and initiate a hearing.

³⁵ Joint Statement of James P. Danly & Mark C. Christie, *The Vanguard Group, Inc.*, Docket No. EC19-57-001 (Aug. 11, 2022).

³⁶ See 2019 Authorization, 168 FERC at ¶ 64,220.

³⁷ *The Vanguard Group, Inc.*, 180 FERC ¶ 62,065 (2022).

IV. Conclusion

For the foregoing reasons, the Attorneys General of Indiana, Utah, Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Montana, Nebraska, Ohio, South Carolina, South Dakota, and Texas request that the Commission grant our motion to intervene for the purpose of protesting and permit the States to participate in this proceeding with full rights as parties thereto.

Respectfully submitted,

/s/ Melissa A. Holyoak
MELISSA A. HOLYOAK
Solicitor General
Office of the Attorney General
350 N. State Street, Ste. 230
P.O. Box 142320
Salt Lake City, UT 84114
(801) 538-9600
melissaholyoak@agutah.gov

THOMAS M. FISHER
Solicitor General
Office of the Indiana Attorney General
IGC-South, Fifth Floor
302 West Washington Street
Indianapolis, IN 46204-2770
(317) 232-6255
Tom.Fisher@atg.in.gov

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document on each person designated on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

Dated November 28, 2022.

/s/ Melissa A. Holyoak

Document Content(s)

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Exhibit B, pages 33 - 43.
Proxy Advisor Letter



January 17, 2023

Gary Retelny
President and CEO
Institutional Shareholder Services, Inc.
1177 Avenue of the Americas, 14th Floor
New York, New York 10036 USA

Kevin Cameron
Executive Chairman
Glass, Lewis & Co.
255 California Street, Suite 1100
San Francisco, CA 94111

Dear Mr. Retelny and Mr. Cameron:

Your companies, Institutional Shareholder Services, Inc. (“ISS”) and Glass Lewis & Co. (“Glass Lewis”), provide proxy voting advice to many of our States’ investment vehicles and citizens and businesses within our States. You are subject to both federal and state laws governing the advice and duties of proxy advisors. You are also subject to contractual obligations—including directly to some of our States’ investment vehicles.

It has come to our attention that you have made several commitments that may interfere with your ability to honor your legal obligations. In this letter, we provide evidence of these potential breaches, specifically as they relate to your climate and diversity, equity, and inclusion priorities. We seek written assurance that you will cease such violations and commit to following the law.

As Proxy Advisors, ISS and Glass Lewis Must Comply with Applicable Federal and State Laws

ISS and Glass Lewis must comply with federal law that applies to proxy advisors. Under federal law, proxy advisor recommendations must be free from false or misleading material information. *See* 15 U.S.C. § 78n(a)(1); 17 C.F.R. § 240.14a-9(a) (Securities Exchange Act mandates that proxy solicitations, including voting advice, may not contain false or misleading material information). Moreover, under the Investment Advisers Act, “an adviser is a fiduciary that owes each of its clients

duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting.”¹ Although Glass Lewis has contended that it is not an “investment adviser” subject to this Act,² ISS has represented in agreements that it *is* an “investment adviser,”³ and both of you appear to function as investment advisers.⁴ Finally, many States have prohibitions on unfair or deceptive trade practices, as well as securities laws that prohibit investment advisers from engaging in fraudulent or misleading practices.⁵

As Proxy Advisors, ISS and Glass Lewis Must Comply with Contracts with States' Investment Vehicles

Your agreements with States' investment vehicles to provide proxy voting services typically warrant that you will exercise duties of care and loyalty in providing advice. Your duties include acting with reasonable diligence and without conflicts of interest. These agreements also typically require that you consider only one goal: the economic value of the investments. As an example, one State's proxy policies require that proxy recommendations “consider only those factors that relate to the economic value of [the] investment” and be “in accordance with the [plan's] economic best interest,” without subordination of the plan's interests “to unrelated objectives” pertaining to social or environmental policy.⁶

Moreover, regarding conflicts of interest, ISS has generally warranted that “there are no relevant facts or circumstances that could give rise to any conflict of interest or appearance of impropriety,”⁷ and “that it shall not engage in any actions that could be perceived to be a conflict of interest.”⁸

¹ 68 Fed. Reg. 6585, 6586 (Feb. 7, 2003) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963)).

² Glass Lewis Statement to SEC Chairman Clayton regarding SEC Staff Roundtable on the Proxy Process – File Number 4-725 (Nov. 14, 2018) at 11, Attachment 1, <https://www.glasslewis.com/wp-content/uploads/2018/11/GL-SEC-Roundtable-Statement-111418.pdf>.

³ See Second Amended and Restated Contractual Agreement between ISS and Employees Retirement System of Texas (“ISS Agreement”), Section 5.5.

⁴ See 15 U.S.C. § 80b-2 (“Investment adviser” means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . .”). If you are not advisers under this provision, it is not apparent how you purport to legally offer advice concerning the voting of securities.

⁵ E.g., Utah Code § 61-1-1 & 2; Tex. Bus. & Com. Code Ann. § 17.46; Tex. Gov't Code Ann. § 4008.101;.

⁶ See Employees Retirement System of Texas, Proxy Voting Policy, <https://ers.texas.gov/About-ERS/ERS-Investments-overview/Proxy-Voting/Proxy-Voting-Policy.pdf> (Feb. 22, 2011).

⁷ See ISS Agreement, Section 14.8.

⁸ See ISS Agreement, Section 14.1.

ISS and Glass Lewis Have Potentially Violated Their Legal and Contractual Duties as Proxy Advisors

As explained below, the publicly available statements and actions of ISS and Glass Lewis in the performance of their duties as proxy advisors raise serious questions about whether both have violated their statutory and contractual duties. It appears that both have acted contrary to the financial interests of their clients and have promoted and relied upon false or misleading statements—and in so doing, have engaged in fraudulent and misleading practices.

1. Evidence of Potential Breaches by ISS and Glass Lewis with Respect to Advocating for and Acting in Alignment with Climate Change Goals

First, you have each pledged to recommend votes on company directors and proposals based on whether a company is implementing “net zero emissions” goals and related climate commitments that you have made. For companies that are on the Climate Action 100+ Focus Group list, ISS has announced that it will “generally vote against” relevant directors if the company does not implement “[a]ppropriate [greenhouse gas] emissions reduction targets” that must “increase over time.”⁹ Likewise, Glass Lewis bases its recommendations in part on whether a company is adequately pursuing “broader goals,” defined as “net zero emissions goals.”¹⁰ In a quintessential example of elevating non-financial considerations over financial ones, ISS argues that the finance industry “must play a central and catalytic role in the global transition to a low-carbon economy” because “[s]ignatories to the 2015 Paris Agreement are largely failing to deliver on their emissions reduction commitments.”¹¹ One of you (Glass Lewis) recently recommended that shareholders reject the climate plan from Woodside Petroleum based on a concern that it did not do enough to reduce *customers’* emissions.¹² Put another way, Glass Lewis faulted the company for not having a good enough plan to get its customers to stop buying its own product.

We question how such recommendations, and the policies that led to them, are based on the financial interests of the investment beneficiaries rather than other

⁹ See ISS, United States Proxy Voting Guidelines, at 16–17, <https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf> (“ISS Proxy Voting Guidelines”). ISS defines the Climate Action 100+ focus group list as “significant GHG emitters.” *Id.* at 16 n.10.

¹⁰ Glass Lewis, 2022 Policy Guidelines for ESG Initiatives, at 28–29, <https://www.glasslewis.com/wp-content/uploads/2021/11/ESG-Initiatives-Voting-Guidelines-GL-2022.pdf> (“Glass Lewis ESG Proxy Voting Guidelines”).

¹¹ Emily Faithfull et al., *Tackling Finance Emissions: Introducing Science-Based Targets for Financial Institutions*, ISS ESG (2020), <https://www.issgovernance.com/file/publications/ISS-ESG-Tackling-Financed-Emissions.pdf>.

¹² Sonali Paul, *Glass Lewis recommends vote against Woodside Petroleum’s climate plan*, REUTERS (May 9, 2022), <https://www.reuters.com/business/energy/glass-lewis-recommends-vote-against-woodside-petroleums-climate-plan-2022-05-09/>.

social goals, and if they are based on the latter, how that complies with your duties described above.

Even as you have agreed to provide advice focused on long-term economic value, informed by investigation and care, you have made conflicting pledges. For instance, you have pledged to require “[d]etailed disclosure of climate-related risks,”¹³ even though companies are already required to disclose “impacts related to climate change” that “have a material effect on a [company’s] business and operations.”¹⁴ Moreover, your attempts to force companies identified by Climate Action 100+ to achieve “net zero emissions” and “to set short- and medium-term targets in line with” the Paris Agreement¹⁵ appear unsupported by your duty to consider only the economic value of investments.

As is commonly known (and you have acknowledged), “[g]overnments are not implementing policies to require net zero.”¹⁶ In fact, “[n]one of the world’s biggest emitters—China, the United States, the European Union, and India—have reduced their emissions enough to meet Paris Agreement goals.”¹⁷ As of December 2021, the countries with legally binding net zero pledges represent merely 10% of global emissions.¹⁸ The lack of action should be no surprise based on the statements of net zero proponents. According to the International Energy Agency (“IEA”), the path to achieving net zero by 2050 is “narrow and requires an unprecedented transformation of how energy is produced, transported and used globally.”¹⁹ For example, net zero by 2050 would mean an 8% decrease in energy demand for a global economy projected to be twice as large.²⁰ The technology required to get to net zero by 2050 does not

¹³ ISS Proxy Voting Guidelines, at 17; *see also* Glass Lewis ESG Proxy Voting Guidelines, at 27 (requiring “enhanced disclosure on climate-related issues”).

¹⁴ Securities and Exchange Commission, Commission Guidance Regarding Disclosure Related to Climate Change (Feb. 8, 2010) (17 CFR Parts 211, 231 and 241; Release Nos. 33-9106; 34-61469; FR-82), at 6, <http://www.sec.gov/rules/interp/2010/33-9106.pdf>.

¹⁵ Sam Meredith, *Big Oil braces for shareholder revolt over climate plans in proxy voting season*, CNBC (May 11, 2022), <https://www.cnbc.com/2022/05/11/climate-big-oil-braces-for-shareholder-revolt-in-proxy-voting-season.html>.

¹⁶ Letter from 19 State Attorneys General to Laurence D. Fink (Aug. 4, 2022), at 4, <https://www.texasattorneygeneral.gov/sites/default/files/images/executive-management/BlackRock%20Letter.pdf> (“19-State Letter to Fink”).

¹⁷ Max Bearak et al., *The World is Falling Short of Its Climate Goals. Four Big Emitters Show Why.*, N.Y. TIMES (Nov. 8, 2022), <https://www.nytimes.com/interactive/2022/11/08/climate/cop27-emissions-country-compare.html>.

¹⁸ Renee Cho, *Net Zero Pledges: Can They Get Us Where We Need to Go?*, Columbia Climate School State of the Planet (Dec. 16, 2021), <https://news.climate.columbia.edu/2021/12/16/net-zero-pledges-can-they-get-us-where-we-need-to-go/>.

¹⁹ International Energy Agency, *Pathway to critical and formidable goal of net-zero emissions by 2050 is narrow but brings huge benefits, according to IEA special report* (May 18, 2021), <https://www.iea.org/news/pathway-to-critical-and-formidable-goal-of-net-zero-emissions-by-2050-is-narrow-but-brings-huge-benefits> (“IEA Pathway Report”).

²⁰ *Id.*

exist.²¹ Moreover, energy efficiency improvements must average “4% a year through 2030 – about three times the average over the past two decades.”²²

The IEA describes the pathway to net zero as “perhaps the greatest challenge humankind has ever faced.”²³ In other words, it is far from certain that any of this will occur. In one of your reports, you repeatedly cite the IEA pathway, yet ignore statements of the pathway’s improbability.²⁴ A rational company acting in the best interests of its shareholders would not voluntarily incur the massive expense estimated by the IEA pathway. The only way a rational actor would spend these funds is in response to a government-imposed mandate. But such mandates are not readily forthcoming, even from countries most eager to do so.

Rather than being based on a rational analysis of the effects that expected changes to government policy would have on any given company, your actions appear more like those of an activist forcing companies to comply with rules that governments will not otherwise institute. This would be consistent with your stated political belief that “[c]ountries with large fossil fuel reserves have a particular responsibility to leave those reserves in the ground,”²⁵ a responsibility you also ascribe to “large corporations.”²⁶ You note that “the needs of the environment and society come into conflict with established economic paradigms.”²⁷ Contrary to your duty to focus on a company’s financial interests, you appear to be acting based upon your opinion of society’s environmental needs.

Your apparent preference for environmental goals over financial ones is being put into practice. According to media reports, in 2021 Glass Lewis recommended against approving the Climate Action Transition Plan for BHP because it lacked third-party certification and was not aligned with the Paris Agreement.²⁸ But it is not apparent why third-party certification would affect the financial aspects of the plan or shareholder value. And it cannot be that alignment with the Paris Agreement provides 100% of the financial value of any climate transition plan, particularly given the problems with that Agreement outlined above. Only if the purpose of your recommendation is political rather than financial does urging shareholders to reject such a proposal make sense.

²¹ *Id.* (“[I]n 2050[] almost half the reductions come from technologies that are currently only at the demonstration or prototype phase.”).

²² *Id.*

²³ *Id.*

²⁴ Janina Magdanz et al., *Fighting Climate Change: A Battle of the Sovereigns*, ISS ESG (Sept. 9, 2021), at 3-5, <https://www.issgovernance.com/file/publications/iss-esg-fighting-climate-change.pdf>.

²⁵ *Id.* at 3.

²⁶ *Id.*

²⁷ *Id.*

²⁸ Evan Harp, *Glass Lewis Urges BHP Shareholders to Vote Against Emission Reduction Plan*, YAHOO! FINANCE (Sept. 30, 2021), <https://finance.yahoo.com/news/glass-lewis-urges-bhp-shareholders-154527612.html>.

You also appear intent to punish American companies for being out of step with net zero. Pressuring companies to disclose an emissions reduction target in line with net zero does not appear to be about transparency or maximizing shareholder value; instead, such pressure seems to be about changing behavior. Yet China's emissions increased last year at "the fastest pace in a decade," and the country emits more than the United States, Europe, and Japan combined.²⁹ Even John Kerry acknowledged that China's course of action "would undo the ability of the rest of the world to achieve a limit of 1.5 degrees."³⁰ Given your limited ability to affect Chinese emissions, your actions have the effect of strengthening an authoritarian regime while weakening companies within the United States, and punishing the American consumer. As you must be aware, China currently dominates the supply chain for "clean energy" metals.³¹ If China were to invade Taiwan,³² your actions to pressure companies to achieve net zero would have the effect of indirectly funding that regime while weakening American companies and critical infrastructure and inhibiting this country's response to such a crisis.

Your pursuit of net zero also potentially creates a conflict of interest between your company's interests and some of your clients' interests. Most obvious is that each of you offers a substantial number of services related to ESG investing. The value of these services would be undermined if you were to admit in your advisory services that ESG factors are not material to a firm's financial performance. Such a blatant conflict of interest calls into question every recommendation you make related to ESG issues.

But the conflicts are more subtle as well. Some of your clients have committed to jointly pressure you to act in a way that would harm other clients such as our state retirees. As part of joining the Net Zero Asset Managers Initiative, asset managers committed to "engage with . . . proxy advisers . . . to ensure that products and services . . . are consistent with the aim of achieving global net zero emissions by 2050 or sooner."³³ This suggests that your actions may be the product of pressure from some of your clients at the expense of others.

²⁹ Keith Bradsher et al., *China Is Burning More Coal, a Growing Climate Challenge*, N.Y. TIMES (Nov. 3, 2022), <https://www.nytimes.com/2022/11/03/business/energy-environment/china-coal-natural-gas.html>.

³⁰ *Id.*

³¹ Bruno Venditti, *Visualizing China's Dominance in Clean Energy Metals*, Visual Capitalist (Jan. 23, 2022), <https://www.visualcapitalist.com/chinas-dominance-in-clean-energy-metals/>.

³² John Culver, *How We Would Know When China is Preparing to Invade Taiwan*, Carnegie Endowment for International Peace (Oct. 3, 2022) ("U.S. intelligence community now assess that China could attack [Taiwan] as soon as 2024....").

³³ Net Zero Asset Managers Initiative, *Commitment* <https://www.netzeroassetmanagers.org/commitment/>.

All this evidence regarding climate change advocacy and goals suggests potential violations of your contractual obligations and legal duties.

2. Evidence of Potential Breaches by ISS and Glass Lewis with Respect to Advocating for and Acting in Alignment with Diversity, Equity, and Inclusion Quotas

Second, you have each pledged to recommend votes against certain directors on boards that you view as having insufficient racial, ethnic, or sex-based diversity under arbitrary quotas that you have announced. ISS recommends votes based on the number of “apparent racially or ethnically diverse members” and a “gender-diverse status.”³⁴ Glass Lewis recommends votes based on racial disclosures and the number of gender diverse directors.³⁵ Relatedly, you would support proposals that require companies to perform “racial equity ... audit[s],” particularly if a company has not issued sufficient “public statement[s] related to its racial justice efforts” or “engaged with” unidentified “civil rights experts.”³⁶ This pledge has led, for example, ISS to support proposals that would force insurance companies to gather race data in apparent violation of state law.³⁷ In addition to potentially violating your contractual and fiduciary duties, your actions in this area may violate state anti-discrimination laws as well.

You owe duties of reasonable investigation and care, yet you have advocated for quotas and racial equity audits of questionable efficacy and legality apparently without considering the legal issues posed by those policies. Nor is the connection between such policies and economic value sufficiently clear to justify such quotas, as a California court recently found in striking down a law that imposed similar

³⁴ ISS Proxy Voting Guidelines, at 11–12.

³⁵ Glass Lewis, 2022 Policy Guidelines, at 40–42, <https://www.glasslewis.com/wp-content/uploads/2021/11/US-Voting-Guidelines-US-GL-2022.pdf> (“Glass Lewis Proxy Voting Guidelines”).

³⁶ ISS Proxy Voting Guidelines, at 65.

³⁷ Justin Danhof, *Is environmental, social and corporate governance (ESG) illegal?: The case of Travelers Insurance*, THE WASHINGTON TIMES, Oct. 24, 2022, <https://www.washingtontimes.com/news/2022/oct/24/is-environmental-social-and-corporate-governance-e/>; see also Tex. Ins. Code § 560.002(3)(C) (rates are unfairly discriminatory if “based wholly or partly on the race, creed, color, ethnicity, or national origin of the policyholder or an insured”).

mandates.³⁸ You have not even explained how you measure what one of you calls “apparent” racial or sex diversity.³⁹

States generally have a constitutional obligation to treat individuals equally without regard to their race or sex. And companies are subject to many federal and state non-discrimination laws. Yet you appear to provide advice that, if taken, could expose both States and companies to significant legal liability for discriminating on prohibited bases. Leaving aside the fact that discriminating on the basis of race and sex is both morally repugnant and anti-American, legal liability would not be financially beneficial. For example, even as you acknowledge that California’s laws purporting to require racial and gender board diversity have been enjoined because they violate equal protection, you suggest that you will continue to advise clients, including State pension funds, to make official decisions (voting of shares) based on race and gender.⁴⁰ But as the Supreme Court has long held, “[i]ntentional discrimination” “on the basis of gender as well as on the basis of race” “by state actors violates the Equal Protection Clause.”⁴¹ Once again, your advice appears to focus on goals apart from economic value that raise the question of undeclared conflicts of interest.

States Request Assurance that ISS and Glass Lewis Will Cease Such Activity and Affirm Their Commitment to Uphold Their Legal Obligations as Proxy Advisors

Given our responsibilities to our States and their citizens, we request clarification on the following questions. Your actions may threaten the economic value of our States’ and citizens’ investments and pensions—interests that may not be subordinated to your social and environmental beliefs, or those of your other clients. In addition to working together, we will also work with any of our federal elected officials interested in conducting oversight of your activities with respect to federal law. Please respond by January 31, 2023.

³⁸ See *Crest v. Padilla*, No. 19STCV27561, 2022 WL 1565613 (Cal. Super. Ct. 2022) (“*Crest – SB 826*”) (striking down S.B. 826, which requires representation of women directors on boards of publicly held corporations based in California); *Crest v. Padilla*, No. 20 STCV 37513, 2022 WL 1073294 (Cal. Super. Apr. 1, 2022) (“*Crest - AB 979*”) (striking down A.B. 979, which required companies to have at least one board director who is a member of an “underrepresented community” by the end of 2021, and two or three such directors (depending on overall board size) by the end of 2022). In the latter case, the court faulted the legislature for “skip[ping] directly to mandating heterogenous boards” without attempting “to create neutral conditions under which qualified individuals from any group may succeed.” *Crest – AB 979* at 1. And in *Crest – SB 826*, the court noted that the state was unable to find academic studies to support its contention that there is “a causal connection between women on corporate boards and corporate governance.” 2022 WL 1565613 at 11. Both cases have appeals pending.

³⁹ ISS Proxy Voting Guidelines, at 12.

⁴⁰ Glass Lewis Proxy Voting Guidelines, at 40–41 & nn.39–40.

⁴¹ *J.E.B. v. Alabama ex rel. T.B.*, 511 U.S. 127, 130–31 (1994); see *Rogers v. Lodge*, 458 U.S. 613, 617 n.5 (1982) (“Purposeful racial discrimination invokes the strictest scrutiny of adverse differential treatment.”).

1. Do you agree that you have undertaken contractual duties of care and loyalty in providing advice, including to our States or their investment vehicles where you have contracted to provide services? And do you agree that these duties include acting with reasonable diligence and without conflicts of interest? Finally, do you agree that your agreements typically require you to consider only one goal: the economic value of the beneficiary's investments?
2. Explain your materiality analysis for requiring the disclosure of emissions reduction targets. Given that material information must already be disclosed, please explain whether you believe that either (i) companies are systematically failing to disclose material information, or (ii) companies should disclose non-material information.
3. Explain how you determine "appropriate" emissions reduction targets for each company and the financial basis for your determination. Please explain how you determine that a company should provide emissions reduction targets in the absence of any legal duty to do so. Please also address the following.
 - a. Explain your assumptions regarding the achievement of net zero, including the timeframe for achieving net zero within the United States, China, India, and globally; when you believe the United States, China, and India will mandate net zero compliance; and what you believe will be the economic impact of achieving net zero in the United States, China, and India both in terms of GDP and consumer gas and electricity prices. This explanation should include any political and/or legal developments in each country that you believe are necessary for achieving net zero.
 - b. Do you agree with the International Energy Agency that "in 2050, almost half the reductions come from technologies that are currently only at the demonstration or prototype phase?"⁴² If not, please explain. If yes, please explain the basis for your assumption that these technologies will be sufficiently widespread and economical to be deployed, such that companies must presently make assumptions based on their availability.
 - c. Do you agree with the International Energy Agency that achieving net zero by 2050 means an approximately 8% decrease in global energy demand for an economy that is estimated to be twice as large and serve 2 billion more people?⁴³ If not, please explain. If yes, please explain your assumptions about the impact on the American consumer regarding

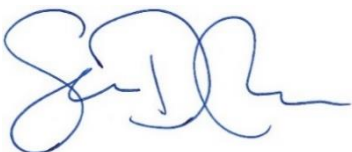
⁴² IEA Pathway Report.

⁴³ *Id.*

energy prices and the political impact energy price increases will have on net zero policy.

4. Please describe your assumptions about the odds of China invading Taiwan, the likely consequences for U.S. companies from supply chain disruption and otherwise, and why you require disclosures regarding emissions reduction targets, but not for exposure to China.
5. Do you agree that pressuring companies to adopt renewable energy means increasing dependance on China, given China's dominance of the renewable energy supply chain?
6. Please explain how adherence to net zero initiatives will impact American agriculture and/or food security including the use of fertilizer. Do you agree that net zero emissions policies may further increase American reliance on China and Chinese companies for food production?
7. Provide support for your apparent conclusion that no company that is a significant emitter of greenhouse gases may decide that it is in its financial interest not to reduce emissions and therefore not establish emissions reduction targets.
8. Please provide any analysis you conducted to determine that insurance companies' discrimination based on race and sex would not violate the law, and therefore that any recommendation you made did not constitute a recommendation for them to violate the law. Further, please explain how recommending actions that could subject companies to legal liabilities complies with your duty of care and was the product of focus on financial factors.
9. Please explain whether you consider yourselves subject to the federal Investment Advisers Act. If not, explain why not, and (for ISS) further explain why you have represented that you are an investment adviser subject to the Act in your agreements.
10. Please describe the extent of your coordination with Climate Action 100+, including your communications with Climate Action 100+ or any of its members.
11. Please identify which asset managers belonging to the Net Zero Asset Managers Initiative engaged with you on the issue of emissions reductions as it relates to your products or services, describe what they communicated to you, and describe any response that you provided.

Sincerely,



Sean D. Reyes
Utah Attorney General



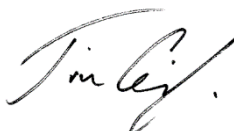
Ken Paxton
Texas Attorney General



Steve Marshall
Alabama Attorney General



Treg R. Taylor
Alaska Attorney General



Tim Griffin
Arkansas Attorney General



Christopher M. Carr
Georgia Attorney General



Raul Labrador
Idaho Attorney General



Todd Rokita
Indiana Attorney General



Brenna Bird
Iowa Attorney General



Kris Kobach
Kansas Attorney General



Daniel Cameron
Kentucky Attorney General



Jeff Landry
Louisiana Attorney General



Lynn Fitch
Mississippi Attorney General



Andrew Bailey
Missouri Attorney General



Austin Knudsen
Montana Attorney General



Mike Hilgers
Nebraska Attorney General



John M. Foremlla
New Hampshire
Attorney General



Dave Yost
Ohio Attorney General



Alan Wilson
South Carolina
Attorney General



Jason S. Miyares
Virginia Attorney General



Patrick Morrissey
West Virginia Attorney General

Exhibit C, pages 45-100.

MOTION FOR PRELIMINARY INJUNCTION AND MEMORANDUM IN SUPPORT
No. 2:23-CV-00016-Z

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
AMARILLO DIVISION**

STATE OF UTAH, *et al.*,

Plaintiffs,

v.

MARTY WALSH and
UNITED STATES DEPARTMENT OF LABOR,

Defendants.

No. 2:23-cv-00016-Z

MOTION FOR PRELIMINARY INJUNCTION AND MEMORANDUM IN SUPPORT

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INTRODUCTION

Pursuant to Rule of Civil Procedure 65(a), Plaintiffs move for a preliminary injunction of the new U.S. Department of Labor (“DOL”) rule that unlawfully subverts protections in the Employee Retirement Income Security Act of 1974 (“ERISA”). As its title states, ERISA safeguards the “retirement income” of 152 million workers, totaling more than \$12 trillion in assets. It provides that those assets “shall be held [in trust] for the *exclusive purposes* of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.” 29 U.S.C. § 1103(c)(1) (emphasis added). Plan fiduciaries must act “*solely* in the interest of the participants and beneficiaries and . . . for the *exclusive purpose* of . . . providing benefits to participants and their beneficiaries.” *Id.* § 1104(a)(1) (emphasis added). The Supreme Court has unanimously held that the term “benefits” “must be understood to refer to . . . *financial* benefits (such as retirement income)” and “does not cover nonpecuniary benefits.” *Fifth Third Bancorp v. Dudenboeffer*, 573 U.S. 409, 421 (2014).

Consistent with ERISA’s text and *Dudenboeffer*, DOL previously promulgated “Financial Factors in Selecting Plan Investments,” 85 F.R. 72846 (Nov. 13, 2020) (“2020 Investment Rule”), and “Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,” 85 F.R. 81658 (Dec. 16, 2020) (“2020 Proxy Voting Rule”). These rules amended 29 C.F.R. § 2550.404a-1 to reflect ERISA’s focus on *financial* benefits. DOL explained that “[p]roviding a secure retirement for American workers is the paramount, and eminently worthy, ‘social’ goal of ERISA plans.” 85 F.R. at 72848.

On December 1, 2022, however, DOL finalized a new regulation titled “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights,” 87 F.R. 73822 (“2022 Rule”), which took effect on January 30, 2023. The rule violates ERISA and unlawfully removes or undermines key regulatory protections to further the Biden Administration’s politically driven ESG objectives. First, the rule adopts a new standard for fiduciaries to pursue nonpecuniary considerations, authorizing a fiduciary to select an investment or investment

course of action “based on collateral benefits other than investment returns” whenever the fiduciary “prudently concludes that competing investments . . . equally serve the financial interests of the plan over the appropriate time horizon.” 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(c)(2)). Second, the rule removes a prohibition on exercising proxy rights to “promote non-pecuniary benefits or goals unrelated to those financial interests of the plan participants and beneficiaries.” 87 F.R. at 73847–48; *compare* 29 C.F.R. § 2550.404a-1(e)(2)(ii)(C) (2021), *with* 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(d)(2)(ii)(C)). These subtle but important changes free fiduciaries to pursue “collateral benefits” and nonpecuniary objectives, contrary to ERISA. Moreover, the loose “tiebreaker” standard will hinder participants and beneficiaries from challenging improper actions by fiduciaries.

The 2022 Rule also fails under the major questions doctrine. The rule applies to the retirement savings of over two-thirds of the U.S. adult population, totaling more than \$12 trillion in assets, and its objective is to promote the favored climate-change policy of the current administration. A rule of such “vast economic and political significance” requires clear authorization from Congress, *Nat’l Fed’n of Indep. Bus. v. DOL*, 142 S. Ct. 661, 665 (2022) (“*NFIB*”), which does not exist here.

Further, the 2022 Rule is arbitrary and capricious. Initially, there are two overarching problems. The rule fails to rebut DOL’s prior finding that strict regulations are necessary to protect participants from shortcomings that would otherwise result in the prudence and loyalty of some fiduciaries, and the alleged need for the rule is inadequate. Turning to specific provisions, the rule’s changes are unreasonable, internally inconsistent, and rely on impermissible considerations. This applies to expanding the tiebreaker, authorizing consideration of participants’ nonpecuniary preferences, authorizing nonpecuniary considerations in proxy voting and other exercises of shareholder rights, removing documentation requirements for fiduciaries acting for collateral purposes, and eliminating restrictions on the qualified default investment alternative (“QDIA”) for a plan. The rule also unreasonably declined to adopt a proposed collateral-benefit disclosure requirement in the

notice of proposed rulemaking, and it failed to consider the alternative of not amending § 2550.404a-1 and instead issuing sub-regulatory guidance. Finally, the rule is the product of prejudice.

BACKGROUND

I. STATUTORY BACKGROUND ON ERISA

Congressional concern about retirement plans traces back to the failure of automaker Studebaker, which left thousands of employees with little or none of their promised pension benefits. After nearly a decade of investigations and hearings into pension funds and diversions of those funds by fund managers, Congress enacted ERISA, Pub. L. 93-406, 88 Stat. 829.¹ ERISA protects two types of pension plans: 1) defined benefit plans, which are traditional pensions; and 2) defined contribution plans, also called “individual account plans.” 29 U.S.C. § 1002(34), (35).² For individual account plans, plan sponsors—who are typically the employer or a group of employers—are responsible for choosing the investment options offered to participants. *See id.* § 1002(16). Plan sponsors may manage the plans themselves or hire investment managers and others to perform various tasks.³ Plan administrators, investment managers, trustees, and advisors are fiduciaries under ERISA. *See id.* § 1002(21)(A).

Sections 403(c) and 404(a) of ERISA require fiduciaries to act solely in the interests of a plan’s participants and beneficiaries, and for the exclusive purpose of providing benefits to them and defraying reasonable expenses of administering the plan. *Id.* §§ 1103(c)(1),

¹ *See, e.g.,* James G. McMillan III, *Misclassification and Employer Discretion Under ERISA*, 2 U. Pa. J. Lab. & Emp. L. 837, 840–42 (2000).

² *See also* Cong. Rsch. Serv. (“CRS”), R46366, Single-Employer Defined Benefit Pension Plans: Funding Relief and Modifications to Funding Rules 2 (2020), <https://crsreports.congress.gov/product/pdf/R/R46366>.

³ *See* CRS, R45957, Capital Markets: Asset Management and Related Policy Issues 1 (2019) (in defined benefit plans, investment managers may oversee capital allocation or provide investment advice), <https://crsreports.congress.gov/product/pdf/R/R45957>; CRS, R47152, Private-Sector Defined Contribution Pension Plans: An Introduction 1–2, 6–8 (2022) (in defined contribution plans, fiduciaries design and select the portfolio of investment options and have a duty to monitor), <https://crsreports.congress.gov/product/pdf/R/R47152>.

1104(a)(1). Section 404(a) also requires fiduciaries to act prudently and diversify investments. *Id.* § 1104(a)(1)(C). These duties can be enforced through private suits or by DOL. *Id.* § 1132.

II. PRIOR ADMINISTRATIVE GUIDANCE AND 2020 RULES

A. Pre-*Dudenhoeffer* Sub-Regulatory Guidance on Nonpecuniary Factors

ERISA confers rulemaking authority on DOL to carry out the statute. *Id.* § 1135. In 1979, DOL originally promulgated its “Investment Duties” regulation, now codified at 29 C.F.R. § 2550.404a-1, as amended. DOL then used letters and guidance documents to address how fiduciary duties apply to investments selected for reasons apart from their expected financial return, called “economically targeted investments” or “ETIs.” The first guidance document, Interpretive Bulletin 94-1 (“IB 94-1”), stated that “an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.” 59 F.R. 32606, 32607 (June 23, 1994). It explained that sections 403 and 404 “prohibit[] a fiduciary from subordinating” retirement-income interests “to unrelated objectives.” *Id.*

Interpretive Bulletin 94-2 (“IB 94-2”) added that voting proxies fell under ERISA’s fiduciary standard and required “the responsible fiduciary” to “consider those factors that may affect the value of the plan’s investment and not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives.” 59 F.R. 38860, 38863 (July 29, 1994). It approved of actions “intended to monitor or influence” corporate management decisions when motivated by a “reasonable expectation” such activities would “enhance the value of the plan’s investment.” *Id.*

In 2008, DOL replaced IB 94-1 and 94-2 with Interpretive Bulletins 2008-01 (“IB 2008-01”) and 2008-02 (“IB 2008-02”). IB 2008-01 emphasized that “fiduciaries may never subordinate the economic interests of the plan to unrelated objectives” and must first conclude that “alternative options are truly equal” before selecting an ETI. 73 F.R. 61734, 61735 (Oct.

17, 2008). DOL explained the problems with a “less rigid rule” and expressly rejected “a construction of ERISA that would render [its] tight limits on the use of plan assets illusory, and that would permit plan fiduciaries to expend ERISA trust assets to promote myriad public policy preferences.” *Id.* It further explained that “fiduciaries who rely on factors outside the economic interests of the plan . . . will rarely be able to demonstrate compliance with ERISA absent a written record demonstrating that a contemporaneous economic analysis showed that the investment alternatives were of equal value.” *Id.* at 61735–36.

IB 2008-2 reiterated ERISA’s pecuniary focus as related to proxy voting and explained that fiduciaries can only consider factors relevant to the plan’s economic interest when deciding to cast a proxy vote. 73 F.R. 61731, 61732 (Oct. 17, 2008). DOL added that “[p]lan fiduciaries risk violating the exclusive purpose rule when they exercise their fiduciary authority in an attempt to further legislative, regulatory, or public policy issues through the proxy process,” and attempting “to further policy or political issues . . . that have no connection to enhancing the economic value of the plan’s investments” is prohibited. *Id.* “The mere fact that plans are shareholders. . . does not itself provide a rationale for a fiduciary to spend plan assets to pursue, support, or oppose such proxy proposals.” *Id.*

B. *Dudenhoeffer* and Additional Sub-Regulatory Guidance

In 2014, the Supreme Court in *Dudenhoeffer* interpreted section 404(a)(1)(A)’s requirement that fiduciaries must act “for the exclusive purpose of . . . providing benefits to participants and their beneficiaries.” The Court unanimously held that the term “benefits” “must be understood to refer to . . . *financial* benefits (such as retirement income)” and “does not cover nonpecuniary benefits like those supposed to arise from employee ownership of employer stock.” 573 U.S. at 421.

DOL nonetheless replaced IB 2008-01 the next year with Interpretive Bulletin 2015-01 (“IB 2015-01”), which signaled openness to consideration of ESG factors by plan fiduciaries. 80 F.R. 65135 (Oct. 26, 2015). DOL was “concerned that the 2008 guidance may be dissuading

fiduciaries from (1) pursuing investment strategies that consider [ESG] factors, even where they are used solely to evaluate the economic benefits of investments and identify economically superior investments, and (2) investing in ETIs even where economically equivalent.” *Id.* at 65136. The guidance continued that “fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore, if the above requirements are met, the selection of an ETI . . . will not violate section 404(a)(1)(A) and (B) and . . . section 403.” *Id.* at 65137. Although purporting to limit ESG to financial considerations and economic equivalence, IB 2015-01 conspicuously lacked both warnings against pursuing nonpecuniary factors and failed to cite *Dudenboeff*.

DOL also replaced IB 2008-02 with Interpretive Bulletin 2016-01 (“IB 2016-01”) to again loosen restrictions on ESG considerations, this time in proxy voting. 81 F.R. 95882 (Dec. 29, 2016). DOL stated that “focusing on a ‘cost-benefit analysis’ demonstrating a ‘more likely than not’ enhancement in the economic value of the investment . . . may be read as discouraging fiduciaries from recognizing the long-term financial benefits that, although difficult to quantify, can result from thoughtful . . . engagement when voting proxies, establishing a proxy voting policy, or otherwise exercising rights as shareholders.” *Id.* at 95881. This included “engaging companies on ESG issues,” because DOL was concerned with being “out of step” with the actions of asset management organizations and “important domestic and international trends.” *Id.* at 95881–84. IB 2016-01 neither cited *Dudenboeff* nor had substantive analysis of the “exclusive purpose” requirement.

C. 2020 Regulations Regarding Pecuniary Factors

In 2020, recognizing the shortcomings of prior guidance, DOL replaced its sub-regulatory guidance by engaging in notice-and-comment rulemaking to amend the 1979 Investment Duties regulation codified at 29 C.F.R. § 2550.404a-1. These rules, the 2020 Investment Rule and 2020 Proxy Voting Rule, followed *Dudenboeff*’s focus on financial benefits and did not improperly single out ESG.

The 2020 Investment Rule adopted several changes to make clear that ERISA plan fiduciaries must evaluate investments “based only on pecuniary factors,” weighed according to “impact on risk-return.” 85 F.R. at 72846. The rule explained that “[p]roviding a secure retirement for American workers is the paramount, and eminently worthy, ‘social’ goal of ERISA plans.” *Id.* at 72848. It also stated that “the duty of loyalty—a bedrock principle of ERISA, with deep roots in the common law of trusts—requires those serving as fiduciaries to act with a single-minded focus on the interests of beneficiaries,” and “plan fiduciaries . . . must focus solely on the plan’s financial risks and returns.” *Id.* DOL found “sufficient reasons to justify the promulgation of the final rule, including the lack of precision and consistency in the marketplace with respect to defining ESG investments and strategies, shortcomings in the rigor of the prudence and loyalty analysis by some participating in the ESG investment marketplace, and perceived variation in some aspects of [DOL’s] past guidance on the extent a fiduciary may consider non-pecuniary factors in making investment decisions.” *Id.* at 72850.

The rule did not mention ESG factors in § 2550.404a-1’s text, instead providing that a “fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives,” and “may not sacrifice investment return or take on additional investment risk to promote non-pecuniary benefits or goals.” *Id.* at 72884 (previous 29 C.F.R. § 2550.404a-1(c)(1) (2021)). The rule included a narrow tiebreaker provision that applied only to “economically indistinguishable” investment alternatives. *Id.* at 72860–61, 72884 (previous 29 C.F.R. § 2550.404a-1(c)(2) (2021)). To protect beneficiaries, it required documentation “to prevent fiduciaries from improperly finding economic equivalence.” *Id.* at 72851; *see id.* at 72884 (previous 29 C.F.R. § 2550.404a-1(c)(2)(i)-(iii) (2021)). It also prohibited selecting a QDIA when its “investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors.” *Id.* at 72884 (previous 29 C.F.R. § 2550.404a-1(d)(2)(ii) (2021)). “Pecuniary factor” meant “a factor that a fiduciary prudently determines is expected to have a material effect on [the risk-return] of an investment based on appropriate investment

horizons” under the plan’s objectives and policy. *Id.* at 72884 (previous 29 C.F.R. § 2550.404a-1(f)(3) (2021)).

The 2020 Proxy Voting Rule aimed to clarify voting requirements, allaying concerns that fiduciaries must vote every proxy. This rule was also clear that plan fiduciaries must “not subordinate” participant or beneficiary financial interests or “promote non-pecuniary benefits or goals unrelated to th[e] financial interests of the plan’s participants and beneficiaries.” 85 F.R. at 81694 (previous 29 C.F.R. § 2550.404a-1(e)(2)(ii)(C) (2021)). In addition, the rule required fiduciaries to maintain records on proxy voting and other exercises of shareholder rights. *Id.* at 81694 (previous 29 C.F.R. § 2550.404a-1(e)(2)(ii)(E) (2021)).

III. 2021 EXECUTIVE ORDERS, NON-ENFORCEMENT OF 2020 RULES, AND 2022 RULE

A. 2021 Executive Orders and Non-Enforcement of 2020 Rules

On January 20, 2021, President Biden issued Executive Order (“E.O.”) 13990, directing agencies to consider suspending, revising, or rescinding regulations from the prior administration that were inconsistent with the E.O.’s new environmental policies. “Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis,” 86 F.R. 7037 (Jan. 25, 2021). DOL subsequently announced it would pause enforcing the 2020 rules. Emp. Benefits Sec. Admin., DOL, *Statement Regarding Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans* (Mar. 10, 2021), <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf>.

On May 20, 2021, President Biden issued E.O. 14030, titled “Executive Order on Climate-Related Financial Risk,” 86 F.R. 27967 (May 25, 2021). It included policies related to the alleged “intensifying impacts of climate change” and “failure of financial institutions to appropriately and adequately account for and measure these physical and transition risks.” *Id.* at 27967, sec. 1. It then directed DOL to consider superseding the 2020 rules. *Id.* at 27968–69, sec. 4(b).

A. 2021 Notice of Proposed Rulemaking

DOL subsequently published a notice of proposed rulemaking (“NPRM”) to amend 29 C.F.R. § 2550.404a-1, titled “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights,” 86 F.R. 57272 (Oct. 14, 2021). Notwithstanding ERISA’s clear focus on financial returns and the absence of any mention of ESG in § 2550.404a-1, DOL “intended to address uncertainties . . . regarding the consideration of climate change and other ESG issues by fiduciaries.” 86 F.R. at 57299.

The NPRM proposed multiple changes, including the addition of language that a fiduciary’s duty of prudence “may often require an evaluation of the economic effects of climate change and other ESG factors,” *id.* at 57276, expanding the narrow tiebreaker provision allowing consideration of “collateral factors,” *id.* at 57278, and deleting the term “pecuniary factor” that required fiduciaries to prioritize financial considerations over collateral goals, consistent with *Dudenhoeffer*. *Id.* at 57278 & n.37. It also proposed changes to proxy voting rules, *id.* at 57280, eliminating certain record-keeping requirements, *id.* at 57282, and requiring fiduciaries to identify investment options chosen for collateral-benefit characteristics. 86 F.R. at 57279, 57303.

ERISA investment advisors understood that the proposed rule “would remove barriers to plan fiduciaries’ ability to consider climate change and other ESG factors when selecting plan investments.” APP151-52, *Fingage Advisors and OWL Analytics Partner to Bring Custom ESG Solutions to the Retirement Space*, Newsroom, Fingage (Nov. 16, 2021), <https://www.fingage.com/newsroom/2021/11/16>.

B. 2022 Rule

The final 2022 Rule reflects many of the changes proposed in the NPRM, broadening the role that nonpecuniary factors may play in a fiduciary’s analysis and eliminating recordkeeping protections. It removes the pecuniary/nonpecuniary distinction that tracked *Dudenhoeffer*. *See* 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(c)(1), (e)). It removes the “economically indistinguishable” standard, replacing it with a tiebreaker threshold that allows

pursuit of collateral benefits if “competing investments . . . equally serve the financial interest of the plan over an appropriate time horizon.” *Id.* (new 29 C.F.R. § 2550.404a-1(c)(2)). It does not retain the disclosure requirement for when fiduciaries select investments for “collateral benefits,” adopting reasoning that such “collateral” factors have “no economic relevance” and “will not advance intelligent investment behavior.” *Id.* at 73840–41. It removes the limitation on QDIAs and authorizes consideration of “participants’ preferences.” *Id.* at 73885. And it deletes the express requirement that proxy voting and exercise of other shareholder rights not “promote non-pecuniary benefits or goals,” along with the requirement that fiduciaries must “[m]aintain records on proxy voting activities and other exercises of shareholder rights.” *Compare* 29 C.F.R. § 2550.404a-1(e)(2)(ii)(C), (E) (2021), *with* 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(e)(ii)(C), (E)). Most provisions became effective January 30, 2023. *Id.* at 73886.

ARGUMENT

PLAINTIFFS HAVE STANDING TO CHALLENGE THE 2022 RULE

A party satisfies Article III standing by “showing that it has suffered an injury that is concrete, particularized, and actual or imminent; fairly traceable to the challenged action; and redressable by a favorable ruling.” *Texas v. EEOC*, 933 F.3d 433, 446 (5th Cir. 2019) (cleaned up). “If, in a suit challenging the legality of government action, the plaintiff is himself an object of the action[,] there is ordinarily little question that the action or inaction has caused him injury, and that a [favorable] judgment will redress it. Whether someone is in fact an object of a regulation is a flexible inquiry rooted in common sense.” *Id.* (cleaned up) (quoting *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 561 (1992); *Contender Farms, L.L.P. v. U.S. Dep’t of Agric.*, 779 F.3d 258, 264–65 (5th Cir. 2015)). “An increased regulatory burden [also] typically satisfies” injury in fact. *Id.* The injury “need not measure more than an identifiable trifle.” *OCA-Greater Houston v. Texas*, 867 F.3d 604, 612 (5th Cir. 2017) (cleaned up). One party with standing is sufficient for the Court to address the merits of a rulemaking under the APA. *BST Holdings v. OSHA*, 17 F.4th 604, 610 n.6 (5th Cir. 2021).

A.Private Plaintiff Standing

1. Liberty and Liberty Services

Liberty Oilfield Services LLC (“Liberty Services”) is a subsidiary of Liberty Energy Inc. (“Liberty”), a publicly traded energy company. APP003, Stock Decl. ¶ 1. Liberty Services has operations throughout the United States, including in the Haynesville shale located in Eastern Texas and Western Louisiana, and it sponsors a defined contribution 401(k) plan for its employees, covered by ERISA. APP004, Stock Decl. ¶¶ 2-3. Liberty Services firmly wants its 401(k) plan to be managed for the sole purpose of maximizing financial benefits for its employees and not to pursue collateral goals, both because it believes this is the best outcome for its employees and because it offers the 401(k) plan to attract quality employees and help them retire with financial security. APP004, Stock Dec. ¶ 3; *see also* APP011, Poppel Decl. ¶ 3. Accordingly, Liberty Services expends resources to identify and hire quality investment advisors to help manage its 401(k) plan. APP004–05, Stock Decl. ¶ 4–7.

Liberty Services has standing, including on behalf of its investment committee, as an object of the regulation. *See EEOC*, 933 F.3d at 446. Under the 2022 Rule, Liberty Services (and its employees) will be forced to expend additional time and resources monitoring and reviewing recommendations from the plan’s investment advisors, without the benefit of recordkeeping requirements or strict regulations, to ensure the advisors are focusing only on pecuniary considerations and not collateral ESG factors. APP006, Stock Decl. ¶ 10–15; *see also* APP010–11, Poppel Decl. ¶¶ 3–8. Increased fiduciary discretion “renders ‘less solid’ the participants’ benefits by shifting the risk to the participant,” resulting in “an injury-in-fact.” *Johnson v. Allsteel, Inc.*, 259 F.3d 885, 888 (7th Cir. 2000) (citation omitted); *see also Bell v. Xerox Corp.*, 52 F. Supp. 3d 498, 505 (W.D.N.Y. 2014) (adding a reservation-of-rights clause to an employee benefit plan created injury for ERISA suit). In addition, ESG is undefined by the 2022 Rule, as is the time period over which the investments should be considered, which makes ESG value propositions difficult, if not impossible, to quantify. APP006, Stock Decl. ¶ 14. Considering ESG factors will greatly complicate management of the 401(k) plan, again

requiring additional resources. *Id.*

Liberty similarly has standing as an object of the regulation, which “is a flexible inquiry rooted in common sense.” *Contender Farms*, 779 F.3d at 265. This Court has held, for example, that the “practical impact” on family members of a regulated party, and the “interference as to their lives,” is sufficient for standing. *Id.* (quoting *Duarte ex rel. Duarte v. City of Lewisville*, 759 F.3d 514, 518 (5th Cir. 2014)). Regulation of a subsidiary likewise has practical impact on the parent company and interferes with its business operations.

Liberty will likely be further harmed by decreased interest from investors and access to investment capital. Liberty’s funding costs are determined, in large part, by its performance in public equity markets. APP007, Stock Decl. ¶ 21. With increased ability to consider ESG factors under ERISA, plan fiduciaries can and likely will steer investment away from oil and gas companies like Liberty to ESG-aligned funds, raising Liberty’s costs and placing it at a competitive disadvantage for funding. APP007–10, Stock Decl. ¶¶ 22–26; *see* APP055–59, Dismukes Decl. ¶¶ 16–20, 24–25.⁴ Plan fiduciaries also have increased latitude to engage Liberty on collateral ESG considerations and vote plan assets in support of such proposals (or otherwise make investments that will have the same result), inviting explicitly nonpecuniary activists to wage costly campaigns against Liberty and divert its focus from maximizing shareholder value. APP006–8, Stock Decl. ¶ 15–20. Given the dominance of ESG investment among institutional shareholders and proxy advisors, it is likely they will exercise their new discretion to prioritize ESG considerations. APP059, Dismukes Decl. ¶ 24.

Both increased costs and potential loss of funding, even if indirect, are sufficient injury to establish standing. *See Dep’t of Com. v. New York*, 139 S. Ct. 2551, 2565–66 (2019) (loss of funding); *BST Holdings*, 17 F.4th at 618 (compliance and monitoring costs); *Tex. Ass’n of Mfrs. v. U.S. Consumer Prod. Safety Comm’n*, 989 F.3d 368, 377 (5th Cir. 2021) (competitive

⁴ According to CSRHub, Liberty (formerly Liberty Oilfield Services Inc.) has an ESG score in the 25th percentile. *Liberty Oilfield Services Inc. ESG Rating*, CSRHub (last accessed Feb. 14, 2023), https://www.csrhub.com/CSR_and_sustainability_information/Liberty-Oilfield-Services-Inc.

disadvantage); *K.P. v. LeBlanc*, 627 F.3d 115, 122 (5th Cir. 2010) (being denied legal protections results in direct pecuniary injury).

These injuries are fairly traceable to the 2022 Rule. Traceability “requires no more than de facto causality,” *Dep’t of Com.*, 139 S. Ct. at 2565–66, and neither company would incur these injuries but for changes implemented by the new rule. It makes no difference that some of the injuries involve third parties, because injuries from even “unfounded” and “unlawful third-party action” provides standing if it is the “likely” and “predictable” consequence of government action. *Id.* This Court need look no further than DOL’s own flip-flopping for nearly 30 years, which demonstrates concern that plan fiduciaries were breaching their obligations and considering collateral factors in violation of the strict requirements of ERISA. *See supra* Background Parts II–III. DOL was even explicit that before the clear limitations articulated in the 2020 rules, it observed “shortcomings in the rigor of the prudence and loyalty analysis by some participating in the ESG investment marketplace.” 85 F.R. at 72850; 85 F.R. at 81678; *see also* 73 F.R. at 61735 (“A less rigid rule would allow fiduciaries to act on the basis of factors outside the economic interest of the plan.”).

These injuries are also redressable by this Court. “[C]ausal connection and redressability are two sides of the same coin.” *Ctr. for Biological Diversity v. Exp.-Imp. Bank of the U.S.*, 894 F.3d 1005, 1012 n.2 (9th Cir. 2018) (cleaned up). Plaintiffs “need only show that a favorable ruling could potentially lessen [the] injury, . . . not definitively demonstrate that a victory would completely remedy the harm.” *Sanchez v. R.G.L.*, 761 F.3d 495, 506 (5th Cir. 2014). The 2022 Rule loosens protections against unlawful fiduciary activity, removes reporting requirements to ensure compliance, and changes requirements for proxy voting, so enjoining the changes and vacating the 2022 Rule will logically halt the harms it threatens, restoring the more rigid 2020 rules.

This standing analysis is confirmed by the common law of trusts. ERISA incorporates common law trust principles, *see Varity Corp. v. Howe*, 516 U.S. 489, 496–97 (1996); *Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc.*, 472 U.S. 559, 570 (1985); *infra* Argument Part

II.A.1.b, and those principles establish a traditional injury that supports standing, *TransUnion LLC v. Ramirez*, 141 S. Ct. 2190, 2200 (2021) (explaining injury is sufficient for standing if closely related to “harm traditionally recognized as providing basis for lawsuit in American courts”); *Perez v. McCreary, Veselka, Bragg & Allen P.C.*, 45 F.4th 816, 822 (5th Cir. 2022) (recognizing “harm . . . similar in kind to a type of harm that the common law has recognized as actionable”). Trustees have historically been authorized to sue to vindicate the interests of a trust and its beneficiaries, including to prevent a breach of trust. *See, e.g.*, Restatement (Third) of Trusts § 107(1). While “the policy of the trust law is to prefer (as a matter of default law) to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation,” *id.* § 78 cmt. b, the 2022 Rule loosens the restrictions and reporting requirements placed on fiduciaries, increasing fiduciary flexibility and the likelihood of mixed motives, imprudent investment options, and increased monitoring costs, to the detriment of Liberty Services, its 401(k) plan, and its participants and beneficiaries. This creates redressable injury for standing purposes. *See also Johnson*, 259 F.3d at 888.

2. Western Energy Alliance

Western Energy Alliance has standing for reasons similar to Liberty and Liberty Services. It sponsors a defined contribution 401(k) plan for its employees, hires an investment advisor to manage that plan, and will incur additional monitoring costs because of the 2022 Rule. APP015–17, Sgamma Decl. ¶ 11, 13–20. Alliance members also maintain 401(k) and other retirement plans covered by ERISA for their employees and will be further harmed when plan fiduciaries make investment decisions or recommendations that discriminate against oil and natural gas companies, or otherwise pursue objectives, based on nonpecuniary factors such as politicized ESG criteria. APP014–15, Sgamma Decl. ¶¶ 7–10; APP055–59, Dismukes Decl. ¶¶ 16–20, 24–25.

3. James R. Copland

James R. Copland is a plan participant in ERISA retirement plans and will be injured by the 2022 Rule because the ERISA statute and regulations are instrumental in establishing the basic requirements for a retirement plan trust and the standards of conduct for plan fiduciaries, impacting the rights of plan participants and beneficiaries. APP022–23, Copland Decl. ¶¶ 2, 11–12; *see also Contender Farms*, 779 F.3d at 265 (horse show participants had standing as objects of regulation to challenge rule that required amending rulebook). Copland is just “as much [an] object[] of the Regulation” as fiduciaries to challenge the 2022 Rule. *Id.*

Copland’s standing is further established by common law trust principles. *See supra* pp. 13–14 (citing cases). “A suit against a trustee of a private trust to enjoin or redress a breach of trust or otherwise to enforce the trust may be maintained only by a beneficiary or by a co-trustee, successor trustee, or other person acting on behalf of one or more beneficiaries.” Restatement (Third) of Trusts § 94(1); *see id.* cmt. b (“A suit to enforce a private trust ordinarily . . . may be maintained by any beneficiary whose rights are or may be adversely affected by the matter(s) at issue.”). ERISA incorporates this right of action by permitting suits “by a participant, beneficiary or fiduciary (A) to enjoin any act or practice which violates any provision of this title or the terms to enforce his rights under the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provision of this title or the terms of the plan.” 29 U.S.C. § 1132(a)(3).

The 2022 Rule loosens the restraints and recordkeeping requirements placed on plan fiduciaries, thereby allowing them more discretion than ordinarily permitted, and certainly more discretion than under the 2020 rules. *Johnson*, 259 F.3d at 888; *Bell*, 52 F. Supp.3d at 505. Hence, the 2022 Rule increases the burden on Copland to monitor and hold accountable plan fiduciaries for breaches of conduct. *See supra* p. 12 (cases on injury).

Just as with the other plaintiffs, Copland’s injuries are traceable to the regulation and redressable by favorable action by the Court because enjoining the 2022 Rule will restore the protections of the 2020 rules to him and other ERISA plan participants. *See supra* p. 13.

B. State Standing

Plaintiff States have standing to challenge the 2022 Rule because it harms their proprietary and *parens patriae* interests. And although the Plaintiff States have standing under the traditional analysis, their claim for standing is also entitled to “special solicitude.”

First, Plaintiff States suffer a proprietary injury in the form of diminished tax revenues. This is a cognizable proprietary injury conferring Article III standing, as long as a State can identify “a loss of specific tax revenues” as opposed to “a decline in general tax revenues.” *Wyoming v. Oklahoma*, 502 U.S. 437, 447–48 (1992). Here, many of the Plaintiff States treat retirement distributions as State taxable income to the extent they collect an income tax.⁵ The 2022 Rule, however, will likely result in a decrease in the amount of retirement distributions for State residents, and thus tax revenue from those distributions, by increasing ESG investing, which (1) does not perform as well as non-ESG investing, and (2) involves higher management fees. APP028–31, Bhagat Decl. ¶¶ 8–14. Further, Plaintiff States suffer a proprietary injury from the fact that the higher cost of capital will affect businesses in their States (such as Liberty and Liberty Services), *see supra* Argument Part I.A.1, which will result in lost tax revenue, investments, and jobs. *See* APP059-64, Dismukes Decl. ¶¶ 24–42; *see also Louisiana v. Becerra*, ___ F. Supp. 3d ___, 2022 WL 4370448, at *6 (W.D. La. Sept. 21, 2022) (standing based on “the alleged loss of jobs [and] businesses”).

Second, Plaintiff States have standing to challenge the 2022 Rule as *parens patriae* because the Rule will harm the economic well-being of their residents. *Parens patriae* standing allows a State to sue a defendant to protect the interests of its citizens at large. *See Alfred L. Snapp & Son, Inc. v. Puerto Rico*, 458 U.S. 592, 600–02 (1982). To invoke *parens patriae* standing, a State “must assert an injury that has been characterized as a *quasi-sovereign* interest.” *Becerra*, 2022 WL 4370448, at *5 (citing *Alfred L. Snapp*, 458 U.S. at 601). “[A] State has a quasi-sovereign interest

⁵ *See, e.g.*, Ala. Code § 40-18-13(a); Ga. Code Ann. § 48-7-27(a), (a)(4), (a)(5.1), (a)(7); Ind. Code § 6-3-1-8; Kan. Stat. Ann. §§ 79-32,116, 79-32,117; Mo. Rev. Stat. § 143.124; Ohio Rev. Code § 5747.01(A); Utah Code §§ 59-10-101(z), 59-10-103(1)(a), 59-10-104(2)(b); Va. Code § 58.1-322; W. Va. Code §§ 11-21-4e, 11-21-11, 11-21-12; *see also* 26 U.S.C. §§ 61, 62, 408(d)(1) (distributions from retirement plans generally included in federal gross income).

in the health and well-being—both physical and economic—of its residents in general.” *Alfred L. Snapp*, 458 U.S. at 607. Given that its citizens and businesses are injured by the 2022 Rule, *see* APP028–31, Bhagat Decl. at ¶¶8–14, the Plaintiff States have *parens patriae* standing to bring this action, *see, e.g., Louisiana v. Horseracing Integrity & Safety Auth., Inc.*, __ F. Supp. 3d __, 2022 WL 2960031, at *7 (W.D. La. July 26, 2022).⁶

Third, several of Plaintiff States have significant oil and gas deposits, and fossil fuel companies have a substantial presence in those States for the purpose of oil and gas exploration and extraction. Several Plaintiff States—including at least Louisiana, Texas, and Utah—also share in proceeds from oil and gas leasing on federal lands or adjoining federal waters under the Outer Continental Shelf Lands Act, the Gulf of Mexico Energy Security Act, and/or the Mineral Leasing Act. *See* APP062–64, Dismukes Decl. at ¶¶ 35–42. The 2022 Rule will result in reduced investment in the fossil fuel industry, which will reduce the revenue that accrues to the Plaintiff States through oil and gas extraction on State lands, federal property in those States, or federal waters adjoining those States. *Id.* at ¶¶ 33–34. Reduced investment in the fossil fuel industry will also decrease employment, adversely impact industries that support fossil fuel development, and decrease overall economic activity and tax revenue. *Id.* at ¶¶ 31–42.

Finally, Plaintiff States warrant special solicitude in the standing analysis. “‘States are not normal litigants for the purposes of invoking federal jurisdiction’ and may be ‘entitled to special solicitude.’” *Texas v. United States*, 50 F.4th 498, 514 (5th Cir. 2022) (citation omitted)). “When special solicitude is appropriate, a state can establish standing ‘without meeting all the

⁶ *Parens patriae* standing exists even though the Plaintiff States are suing the federal government. As a general matter, a State “does not have standing as *parens patriae* to bring an action against the Federal Government.” *Alfred L. Snapp*, 458 U.S. at 609 n.16 (citing *Massachusetts v. Mellon*, 262 U.S. 447, 485-85 (1923)). An important exception to that rule, however, is that “states have *parens patriae* standing where the state is bringing an action on behalf of citizens to enforce rights guaranteed by a federal statute,” including when “Plaintiff States allege the Agency Defendants violated the APA.” *Becerra*, 2022 WL 4370448, at *5 (citing *Texas v. United States*, 86 F. Supp. 3d 591, 626 (S.D. Tex. 2015)). Here, because the Plaintiff States’ claims concern how the DOL’s 2022 Rule violates ERISA and the APA, Plaintiff States can proceed on a *parens patriae* theory of standing against the federal defendants.

normal standards for redressability and immediacy.” *Id.* (citation omitted). Special solicitude has “two requirements”: “(1) the State must have a procedural right to challenge the action in question, and (2) the challenged action must affect one of the State’s quasi-sovereign interests.” *Id.* The Plaintiff States satisfy the first requirement because they are asserting “a procedural right under the APA to challenge agency action.” *Id.* They also satisfy the second because, as discussed above, the 2022 Rule affects the Plaintiff States’ quasi-sovereign interest in the economic well-being of their residents.

II. PLAINTIFFS ARE ENTITLED TO A PRELIMINARY INJUNCTION

To obtain a preliminary injunction, Plaintiffs “must show: (1) a substantial likelihood of success on the merits; (2) a substantial threat of irreparable harm if the injunction is not granted; (3) that the threatened injury outweighs any harm that the injunction might cause to the defendant; and (4) that the injunction will not disserve the public interest.” *Opulent Life Church v. City of Holly Springs*, 697 F.3d 279, 288 (5th Cir. 2012). Here, each factor weighs in the Plaintiffs’ favor.

A. The 2022 Rule Violates ERISA

The 2022 Rule violates ERISA because it permits fiduciaries to act with nonfinancial objectives even though the statute requires them to act exclusively for the purpose of obtaining financial benefits. DOL has authority to “carry out” the provisions of ERISA, 29 U.S.C. § 1135, but “[i]t is a fundamental precept of administrative law that an agency action, rule, or regulation ‘cannot overcome the plain text enacted by Congress.’” *Sierra Club, Inc. v. Sandy Creek Energy Assocs.*, 627 F.3d 134, 141 n.9 (5th Cir. 2010) (citation omitted). DOL thus “attempts to rewrite the law that is the sole source of its authority. This it cannot do.” *U.S. Chamber of Com. v. DOL*, 885 F.3d 360, 373 (5th Cir. 2018).

1. The Plain Language of ERISA Requires That Fiduciaries Act for the “Exclusive Purpose” of Providing Financial “Benefits”

ERISA requires that “the assets of a plan . . . shall be held [in trust] for the *exclusive purposes* of providing benefits to participants in the plan and their beneficiaries and defraying

reasonable expenses of administering the plan” 29 U.S.C. § 1103(a), (c)(1) (emphasis added). It also requires that fiduciaries act “*solely* in the interest of the participants and beneficiaries and . . . for the *exclusive purpose* of . . . providing benefits to participants and their beneficiaries.” *Id.* § 1104(a)(1) (emphasis added). Congress was clear in what it meant by “exclusive purpose,” “solely,” and “benefits.”

a. “Benefits” Means Exclusively Financial Benefits

In 2014, the Supreme Court unanimously concluded in *Dudenhoeffer* that ERISA requires fiduciaries to pursue “financial benefits,” not “nonpecuniary benefits.” The Court considered in that case whether it was presumptively prudent to use ERISA assets to purchase company stock as part of an employee stock ownership plan since Congress had elsewhere authorized these plans “to promote employee ownership of employer stock, a goal that Congress views as important.” 573 U.S. at 420. The Court rejected the presumption because the term “benefits” when used to describe ERISA’s fiduciary duties “refer[s] to the sort of *financial* benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust’s beneficiaries.” *Id.* at 421. The Court then cited ERISA’s definitions of “employee pension benefit plan” and “pension plan,” which focus on “retirement income” or other “deferral of income,” *id.* (citing 29 U.S.C. § 1002(2)(A)), thereby tying the term “benefits” to “income.” And the Court further stated that “benefits” “does not cover nonpecuniary benefits like those supposed to arise from employee ownership of employer stock.” *Id.*

Dudenhoeffer is particularly informative for analyzing the 2022 Rule and its explicit recognition of ESG investing. Like the goal of increasing “employee ownership of employer stock,” ESG considerations outside a risk-return analysis aim to achieve “collateral benefits,” such as preferred social policies and benefits to third parties. Pursuing these “nonpecuniary benefits” exceeds the plain language of ERISA. *Id.* at 421. Such ESG investing is even easier to classify as outside of ERISA’s approved purposes because employee ownership of employer

stock at least was tied to plan participants and associated statutes. *See id.* at 420–21.

a. “Exclusive Purpose” and “Solely” Mean Only Purpose

Dudenhoeffer also recognized that ERISA requires the “benefits” discussed above to be the “‘exclusive purpose’ to be pursued by all ERISA fiduciaries.” 573 U.S. at 421 (quoting 29 U.S.C. § 1104(a)(1)(a)(i), (ii)). By using “exclusive purpose” and “solely” in sections 403 and 404, Congress directly spoke to the purposes for which ERISA fiduciaries may act.

As discussed above, ERISA’s fiduciary duties derive from the common law of trusts. *See supra* pp. 13–14. ERISA requires undivided loyalty from fiduciaries in the form of the “sole interest” rule, also known as the “sole benefit” or “exclusive benefit” rule. *See* Restatement (Third) of Trusts § 78(1) cmt. a (the sole interest standard “states the trust law’s fundamental principle of undivided loyalty”); *see also* Restatement (Second) of Trusts § 170(1) (same).⁷ Under that rule, “ERISA requires that the fiduciary of a plan discharge his duties solely for the benefit of the plan participants and beneficiaries and that the assets of an employee benefit plan ‘shall never inure to the benefit of the employer.’” *Wash.-Balt. Newspaper Guild Local 35 v. Wash. Star Co.*, 555 F. Supp. 257, 259 (D.D.C. 1983) (citing 29 U.S.C. §§ 1104(a)(1)(A), 1103(c)(1)), *aff’d without opinion*, 729 F.2d 863 (D.C. Cir. 1984)); *see also Borst v. Chevron Corp.*, 36 F.3d 1308, 1320 (5th Cir. 1994) (“Both tax law and ERISA require the funds of a pension plan be used ‘for the exclusive benefit of the plan participants.’” (citing 26 U.S.C. § 401(a)(2); 29 U.S.C. § 1103(c)(1)). Fiduciaries must act with “complete and undivided loyalty to the beneficiaries,” *Donovan v. Mazzola*, 716 F.2d 1226, 1238 (9th Cir. 1983) (citation omitted), and with “single-minded devotion,” *Gregg v. Transp. Workers of Am. Intern.*, 343 F.3d 833, 840 (6th Cir. 2003) (citation omitted). The Fifth Circuit has described these fiduciary duties as “the highest known to the law.” *Schweitzer v. Inv. Comm. of Phillips 66 Sav. Plan*, 960 F.3d 190, 194 (5th Cir. 2020).

⁷ The Restatements of Trusts are authoritative in the ERISA context. *See Tibble v. Edison Int’l*, 575 U.S. 523, 530 (2015) (citing Restatement (Third) of Trusts § 90 cmt. b); *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 111-12, 115 (1989) (citing Restatement (Second) of Trust § 187 (1959)).

The “exclusive benefit” rule means that “the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust.” Restatement (Third) of Trusts § 78 cmt. f. This includes “advancing or expressing the trustee’s personal views concerning social or political issues or causes.” *Id.* § 90 cmt. c. The Supreme Court has long held that “[a] fiduciary cannot contend ‘that, although he had conflicting interests, he served his masters equally well or that his primary loyalty was not weakened by the pull of his secondary one.’” *NLRB v. Amax Coal Co.*, 453 U.S. 322, 330 (1981) (quoting *Woods v. City Nat’l Bank & Trust Co.*, 312 U.S. 262, 269 (1941)); see also *id.* at 332 (“ERISA essentially codified the strict fiduciary standards that a § 302(c)(5) trustee must meet.”). Mixed motives thus result in “an irrebuttable presumption of wrongdoing.” *Halperin v. Richards*, 7 F.4th 534, 546 (7th Cir. 2021) (quoting John H. Langbein & Daniel R. Fischel, *ERISA’s Fundamental Contradiction, The Exclusive Benefit Rule*, 55 U. Chi. L. Rev. 1105, 1114–15 (1988)); see *Amax Coal Co.*, 453 U.S. at 330; Op. Ky. Att’y Gen. 22-05, at 5 (May 26, 2022), <https://ag.ky.gov/Resources/Opinions/Opinions/OAG%2022-05.pdf>. Trust law “prefer[s] (as a matter of default law) to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation.” Restatement (Third) of Trusts § 78 cmt. b.

The structure of ERISA confirms that when Congress wanted to create exceptions to the exclusive benefit rule, it did so explicitly. ERISA expressly provides exceptions to the exclusive benefit rule for removal of trust assets. See *Bussian v. RJR Nabisco, Inc.*, 223 F.3d 286 (5th Cir. 2000). Section 403(c) similarly lists exceptions. 29 U.S.C. § 1103(c). In addition, section 406 forbids “prohibited transactions” and proscribes various types of self-dealing and other conflicts of interest, *id.* § 1106, again with enumerated exceptions in section 408, *id.* § 1108. The expression of these exceptions implies the exclusion of others. See, e.g., *Jennings v. Rodriguez*, 138 S. Ct. 830, 844 (2018).

Legislative history also confirms that the purpose of the “exclusive purpose” and “solely”

language was to enact an “exclusive benefit” rule into ERISA. *See* Langbein & Fischel, *supra*, at 1108 n.20; James D. Hutchinson & Charles G. Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 124 U. Pa. L. Rev. 1340, 1365–67 (1980) (cataloging rejected legislative proposals to show Congress’s intent to narrow the scope of a fiduciary’s discretion). Moreover, “ERISA’s exclusive benefit rule has a half-century of prehistory in other federal pension legislation” to support the same conclusion. Langbein & Fischel, *supra*, at 1109 (citing statutes).

In sum, Congress spoke clearly that financial “benefits” are the *only* purpose for which ERISA fiduciaries may act. ESG is treated as any other factor and is permissible only when the fiduciary reasonably concludes the factor will benefit the beneficiary directly by improving risk-adjusted return of a particular investment, *and* the fiduciary’s exclusive motive is to obtain this direct benefit.

2. The 2022 Rule Exceeds DOL’s Statutory Authority and Is Contrary to Law

Despite ERISA’s clear commands, the 2022 Rule expressly authorizes fiduciaries to act, or removes prohibitions on acting, for nonpecuniary purposes. DOL cannot adopt a rule that is contrary to ERISA. *See* 5 U.S.C. § 706(2)(A), (C); *Chamber of Com.*, 885 F.3d at 373.

First, the 2022 Rule purports to authorize a fiduciary to select an investment or investment course of action “based on collateral benefits other than investment returns” whenever the fiduciary “prudently concludes that competing investments . . . equally serve the financial interests of the plan over the appropriate time horizon.” 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(c)(2)). Any nonpecuniary tiebreaker is not authorized by ERISA and violates its strict “exclusive benefit” rule.

The new standard also falls short of requiring fiduciaries to select the best available investments for risk-adjusted return. This is particularly apparent when compared to the 2020 Investment Rule, which required a fiduciary to be “unable to distinguish on the basis of pecuniary factors alone” before he could consider a tiebreaker. 29 C.F.R. § 2550.404-1(c)(2)

(2021). Indeed, relaxing this standard was intentional in the 2022 Rule and exactly why some commenters requested the change. *See* 87 F.R. at 73835 (describing tiebreaker circumstances as “unrealistically difficult and prohibitively stringent” and “rare and unreasonably difficult to identify”); *id.* at 73836–37 (standard is “impractical”). This, too, violates ERISA. Only Congress can change its policy decision. *See Chamber of Com.*, 885 F.3d at 379.

This relaxed standard over an undefined “time horizon” will also be hard, if not impossible, to assess with any certainty, increasing the likelihood of suboptimal investments. And it creates a slippery slope that leads to false equivalence and abuse that will be equally difficult to disprove, especially with the elimination of recordkeeping requirements, discussed below.⁸ DOL has previously recognized the risk of loose tiebreaker standards. *See, e.g.*, 85 F.R. at 72850; 73 F.R. at 61735.

Second, the 2022 Rule deletes the prohibition on exercising proxy rights to “promote non-pecuniary benefits or goals unrelated to those financial interests of the plan participants and beneficiaries.” *Compare* 29 C.F.R. § 2550.404a-1(e)(2)(ii)(C) (2021), *with* 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(d)(2)(ii)(C)). The purpose of this deletion is to eliminate a clear regulatory command, but that command follows directly from the ERISA’s text and *Dudenboeff*.

Both of these changes in the 2022 Rule authorize fiduciaries to consider and promote “nonpecuniary benefits,” even though as explained in *Dudenboeff* and elsewhere, ERISA fiduciaries may *only* act with the motive to further the *financial* benefits of the plan assets. Contrary to ERISA and Congress’s clearly expressed intent, the changes make it easier for fiduciaries to act with mixed-motives and harder for beneficiaries to police such conduct.

It doesn’t matter that DOL insists fiduciaries must adhere to their duties and can never subordinate the financial interests of plan participants and beneficiaries. 87 F.R. at 73853 (claiming rule “emphatically addresses potential loyalty breaches”). Elsewhere DOL admits

⁸ This change transforms the 2020 Investment Rule’s strict tiebreaker into something that occurs regularly, and thus broadly authorizes acting for the purpose of collateral benefits.

that such hortatory language cannot compensate for the lack of strict regulation. 85 F.R. at 72847, 72850; 85 F.R. at 81678; 73 F.R. at 61735. And “the policy of the trust law is to prefer (as a matter of default law) to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation.” Restatement (Third) of Trusts § 78 cmt. b. Again, “a fiduciary cannot contend ‘that, although he had conflicting interests, he served his masters equally well or that his primary loyalty was not weakened by the pull of his secondary one.’” *Amax Coal*, 453 U.S. at 330 (quoting *Woods*, 312 U.S. at 269).

It likewise makes no difference that DOL has issued sub-regulatory guidance permitting the use of ESG (formerly ETI) factors in the past. The guidance has been far from consistent, never grappled with *Dudenhoeffer*; and, unlike the present regulation, was more often aimed at stating that ESG could be used as a financial factor rather than for its collateral benefits. *See supra* Background Part II. And it does not appear that a court has ever held that an exception for tiebreakers is lawful. In any event, DOL cannot change ERISA’s plain meaning. *See Chamber of Com.*, 885 F.3d at 373.

The idea of a generally applicable tiebreaker is also wrong because if two assets (or funds) have returns that are less than perfectly correlated (correlation is less than 1.0), then financial economics teaches that the investor should invest in both to diversity the portfolio, putting aside liquidity constraints and transaction costs. *See* APP031, Bhagat Decl. at ¶¶ 15–16.; *Schweitzer*, 960 F.3d at 197 n.36 (“By the Efficient Market Hypothesis and modern portfolio theory, stock prices in efficient markets do not reflect risks that an investor could eliminate through diversification. [And] ‘the market does not reward investors who fail to diversify [business-specific] risk down to zero.’” (quoting Jeffrey J. Haas, *Corporate Finance* 113 (2014))). DOL itself even undermines the need for a tiebreaker: “no two investments are the same in each and every respect.” 87 F.R. at 73837.

The “exclusive purpose” and “solely” language in ERISA shows Congress’s concern was to mandate prudent financial investment based on risk-return full stop, and it did not delegate

authority to DOL to permit fiduciaries to act for nonpecuniary purposes.

3. The 2022 Rule Also Fails Under the Major Questions Doctrine

The major questions doctrine confirms that DOL cannot authorize or allow ERISA fiduciaries to consider nonpecuniary factors. The key question is “whether Congress in fact meant to confer the power the agency has asserted.” *West Virginia v. EPA*, 142 S. Ct. 2587, 2608 (2022) (citing *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159 (2000)). In certain “extraordinary cases,” specifically those where the claimed authority carries substantial “economic and political significance,” courts should “hesitate before concluding that Congress meant to confer such authority.” *Id.* Nothing overcomes that hesitation here.

The 2022 Rule has vast economic significance. ERISA covers approximately 747,000 retirement plans, 2.5 million health plans, and 673,000 other welfare benefit plans. Emp. Benefits Sec. Admin., DOL, *Fact Sheet: EBSA Restores Over \$1.4 Billion to Employee Benefit Plans, Participants, and Beneficiaries* (2022), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/fact-sheets/ebsa-monetary-results-2022.pdf>. Employee benefit plans cover about 152 million workers and more than \$12 trillion in assets, equivalent to more than two-thirds of the U.S. adult population and half of the nation’s gross domestic product. *Id.* ESG and climate change are also issues of vast political significance. DOL promulgated the 2022 Rule to allow or encourage ERISA fiduciaries to manage plan assets consistent with the Biden Administration’s expressed priorities to address the “climate crisis.” 87 F.R. at 73823, 73825–26 (explaining 2022 Rule was drafted in response to E.O. 13990 and E.O. 14030). America’s climate change policy, and ESG more generally, is “the subject of an earnest and profound debate across the country.” *West Virginia*, 142 S. Ct. at 2614.

Two analogous cases demonstrate the applicability of the major-questions doctrine here. When the Occupational Safety and Health Administration, a DOL agency, claimed authority to require COVID-19 vaccination for 84 million Americans, the Court stayed the action because OSHA sought “to exercise powers of vast economic and political significance”

without clear authorization from Congress. *NFIB*, 142 S. Ct. at 665 (citing *Ala. Ass’n of Realtors*, 141 S. Ct. 2489 (2021)). The number of affected persons here is much greater, and the action no less controversial. Similarly, when DOL previously tried to reinterpret the reach of fiduciary duties under ERISA, a decision with “monumental significance to the financial services and insurance sectors of the economy,” the Fifth Circuit recognized the doctrine’s applicability to DOL’s “intent to transform the trillion-dollar market for IRA investments.” *See Chamber of Com.*, 885 F.3d at 366, 387–88.

The 2022 Rule thus requires clear authorization from Congress. *See NFIB*, 142 S. Ct. at 665. DOL based its authority on 29 U.S.C. § 1135, a general rulemaking provision that authorizes the Secretary to “prescribe such regulations as he finds necessary or appropriate to carry out the provisions of [ERISA]. Among other things, such regulations may define accounting, technical and trade terms used in such provisions; may prescribe forms; and may provide for the keeping of books and records, and for the inspection of such books and records.” *See* 87 F.R. at 73855. This general language is insufficient to support DOL’s claimed authority. *West Virginia*, 142 S. Ct. at 2609. Moreover, the included list of specific exercises of authority (*e.g.*, “defin[ing] accounting, technical, and trade terms”) shows that Congress did not intend this housekeeping provision to effect changes of vast economic and political significance. *See Yates v. United States*, 574 U.S. 528, 544 (2015) (discussing *noscitur a sociis*). In other words, Congress did not hide an elephant in this mousehole. *See id.*

B. The 2022 Rule Is Arbitrary and Capricious

The 2022 Rule also fails because it is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law” under the APA. 5 U.S.C. § 706(2)(A). “The APA’s arbitrary and capricious standard requires that agency action be reasonable and reasonably explained.” *FCC v. Prometheus Radio Project*, 141 S. Ct. 1150, 1158 (2021); *see also Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 50 (1983). Action is arbitrary and capricious “if the agency has relied on factors which Congress has not intended it to consider,

entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.” *Luminant Generation Co. v. EPA*, 675 F.3d 917, 925 (5th Cir. 2012) (cleaned up). “[S]ignificant and viable alternatives” to a proposed regulatory action must be considered, *10 Ring Precision, Inc. v. Jones*, 722 F.3d 711, 724 (5th Cir. 2013) (citation omitted), and the agency must articulate a “satisfactory explanation for its action including a rational connection between the facts found and the choice made.” *State Farm*, 463 U.S. at 43. If the agency fails to “cogently explain why it has exercised its discretion in a given manner,” its action will be invalidated. *Id.* at 48.

In addition, the agency must “provide a more detailed justification than what would suffice for a new policy created on a blank slate . . . when, for example, its new policy rests upon factual findings that contradict those which underlay its prior policy.” *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009); *see also Perez v. Mortg. Bankers Ass’n*, 135 S. Ct. 1199, 1209 (2015). An agency must consider a danger that is “within the ambit of the existing policy.” *DHS v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1913 (2020); *State Farm*, 463 U.S. at 51. If an agency does not do so, then it “fails to supply the requisite ‘reasoned analysis.’” *Regents*, 140 S. Ct. at 1899 (quoting *State Farm*, 463 U.S. at 57).

The 2022 Rule “bears hallmarks of ‘unreasonableness’ . . . and capricious exercises of administrative power,” *Chamber of Com.*, 885 F.3d at 388, for at least six reasons.

1. **The 2022 Rule Fails to Rebut DOL’s Prior Finding that Strict Regulations Are Necessary to Protect Participants and Prevent Fiduciary Violations**

The 2020 rules were adopted in part because, notwithstanding the general duties of prudence and loyalty, there were “shortcomings in the rigor of the prudence and loyalty analysis by some participating in the ESG investment marketplace.” 85 F.R. at 72847, 72850; 85 F.R. at 81678. The 2022 Rule fails to rebut this prior DOL finding that strict regulations are necessary to protect participants and beneficiaries from financial harm due to these

shortcomings.

As the comment to the NPRM from Senate ranking members made clear, APP071–72, Senators’ Letter 2–3, DOL needed to consider the 2022 Rule’s effect on this danger to participants and beneficiaries—a danger well “within the ambit of the existing policy” and, indeed, its purpose. *Regents*, 140 S. Ct. at 1913. And because DOL was departing from the 2020 rules’ factual finding, it was further required to provide “a more detailed justification” for its decision. *Fox*, 556 U.S. at 515.

Yet, as in the NPRM, the 2022 Rule does not repudiate the 2020 finding or even discuss it. Instead, the rule states that it “emphatically addresses potential loyalty breaches by forbidding subordination of participants’ financial benefits under the plan to ESG or any other goal.” 87 F.R. at 73853. But this general duty was the backdrop against which the 2020 rules were issued, and DOL nonetheless found it inadequate to protect participants, especially in the context of ESG. Critically, DOL does not call that finding into question. Nor does it dispute that the portions of the 2020 rules it rescinds were helpful and effective in protecting against this danger. Failure to consider and adequately explain departure from this finding renders the entire rulemaking arbitrary and capricious. *Fox*, 556 U.S. at 515. In fact, failure to consider the need to protect plan participants and beneficiaries is a common thread throughout the 2022 rulemaking.

1. The Alleged Need for the 2022 Rule is Inadequate

DOL justified the 2022 Rule because the 2020 rules allegedly created a “chill” or “confusion” about consideration of ESG factors under ERISA. But DOL never identified who specifically was confused, what the source of confusion was, or that any such confusion or negative perceptions reduced *financial* returns for participants and beneficiaries. *See, e.g.*, APP083, Berry Letter 8 (raising this issue). “The NPRM thus proposes to fix a problem that does not exist by exacerbating a problem that does, but fails to weigh the benefits and burdens of doing so.” APP108, Consumers’ Research (“CR”) Letter 9. The 2020 rules were clear that

ESG factors, just like any other factors, may and must be prudently considered insofar (and only insofar) as they affect the financial interests of participants and beneficiaries. Rather than include the term “ESG” or equivalents in the text, the 2020 rules included requirements of single-minded loyalty, exclusive focus on pecuniary factors, comparison among possible investments, and documentation of using the tiebreaker provision. APP109, CR Letter 10.

DOL also admits that its NPRM “created a misimpression” that it favored ESG factors. 87 F.R. at 73854. To cure that, the 2022 Rule deleted proposed text indicating that ERISA “may often require” consideration of ESG factors. *Id.* at 73830–31. But DOL left other references to ESG in the 2022 Rule, specifically countenancing those considerations. If the 2022 Rule’s partial deletion of ESG-references from the NPRM, combined with preamble assurances of equal treatment, is enough to assuage concerns about pro-ESG bias, then the 2020 rules, which also included assurances of equal treatment and went even further by eliminating *all* references to ESG in the regulatory text, must necessarily have been enough to assuage concerns and any “chilling effect” about anti-ESG bias. Either there was no actual “chill” from the 2020 rules, or the 2022 Rule is internally inconsistent.

The 2022 Rule thus “cannot be adequately explained” by its alleged justification and “reveal[s] a significant mismatch between the decision the Secretary made and the rationale he provided.” *Dep’t of Com.*, 139 S. Ct. at 2575; *see also Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 212 (2016) (“[A]n unexplained inconsistency in agency policy is a reason for holding an interpretation to be an arbitrary and capricious change.” (cleaned up)); *AFGE, Loc. 2924 v. FLRA*, 470 F.3d 375, 380 (D.C. Cir. 2006) (similar); *Engine Mfrs. Ass’n v. EPA*, 20 F.3d 1177, 1182 (D.C. Cir. 1994) (similar); *Gen. Chem. Corp. v. United States*, 817 F.2d 844, 846 (D.C. Cir. 1987) (similar). This also exposes the real motivation of the 2022 Rule—to allow use of ERISA funds to push President Biden’s climate agenda.

2. The 2022 Rule’s Changes Are Unreasonable, Internally Inconsistent, and Rely on Impermissible Considerations

The 2022 Rule is further arbitrary and capricious because many of its provisions are

unreasonable, internally inconsistent, fail to consider relevant factors, and “rel[y] on factors which Congress has not intended it to consider.” *State Farm*, 463 U.S. at 43. This includes expansion of the tiebreaker that existed under the 2020 rules, express authorization to consider participants’ preferences in selecting investments for participant-directed individual account plans, implicit authorization to pursue nonpecuniary factors in proxy voting and other exercises of shareholder rights, removal of documentation requirements, and elimination of protections for QDIAs.

a. Expanding the Tiebreaker Provision

The 2022 Rule substantially expands the tiebreaker test. Even if collateral considerations were permissible under ERISA in tiebreaker situations—which they’re not, *see supra* Argument Part II.A.2—the 2022 Rule fails to give any permissible reason for broadening that exception, 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(c)(2)). As *Dudenhoeffer* emphasizes, ERISA imposes strict fiduciary duties to protect the *financial* interests of plan participants. 573 U.S. at 421. Congress rejected proposals that would have allowed consideration of collateral factors in investing and expressed zero interest in allowing fiduciaries to achieve social or political objectives. *See, e.g.*, Hutchinson & Cole, *supra*, at 1365–67 (rejected legislative proposals).

DOL justified the tiebreaker provision in the 2022 Rule because there has been a tiebreaker provision in previous iterations of DOL guidance, including IB 94-1, and the tiebreaker provision in the 2020 rules was “impractical,” 87 F.R. at 73836, citing comments that it set an “unrealistically difficult and prohibitively stringent standard” that was “rare and unreasonably difficult to identify,” *id.* at 73835. But neither of these is a financial reason. Instead, DOL’s reasons are circular and do not explain how the need for an expanded tiebreaker is based on participants’ financial interests rather than desire to incorporate collateral considerations. Because, even on DOL’s telling, the tiebreaker rule comes into play only as between options that are equally beneficial for participants’ financial well-being, its use cannot advance Congress’s purpose in enacting ERISA. Even if there were no reason to

believe the tiebreaker harmed participants' interests, it would be arbitrary to include and expand it, because the only reason to do so is to advance a factor Congress did not intend for consideration. *See, e.g., State Farm*, 463 U.S. at 43; *Luminant*, 675 F.3d at 925–26, 930–32.

Further, the tiebreaker rule *does* harm participants from a financial perspective. The expanded, vague tiebreaker plays right into the “shortcomings in the rigor” of fiduciaries’ prudence and loyalty analyses that DOL found in 2020, but DOL never analyzes this problem. *See also supra* Argument Part II.B.1. It also harms participants by failing to consider that “the possibility of pursuing collateral benefits gives fiduciaries an incentive to conclude that an investment that furthers such benefits is equivalent to an investment that does not, even when a candid review would find the latter investment superior.” APP121–22, CR Letter 22–23; *see also supra* pp. 22–23.

Moreover, a fiduciary confronted with two equally beneficial investment options typically advances the participants’ financial interests if he diversifies by investing in both options. *See supra* p. 24; APP031, Bhagat Decl. at ¶¶ 15–16; APP074, Senators’ Letter 5; APP141, Utah Letter 3. In contrast, the tiebreaker rule would allow the fiduciary to make a single (more concentrated and thus riskier) investment. DOL attempts to rebut this critique by pointing to scenarios involving illiquid assets or high transaction costs. *See* 87 F.R. at 73836. But these scenarios do not support allowing a nonpecuniary tiebreaker for *all* situations—let alone show that the benefits of allowing the tiebreaker outweigh the harm to participants. Instead, DOL could have expressly limited its tiebreaker to when investments have identical risk-return *and* diversification is not possible or is prohibitively expensive. Retaining the tiebreaker rule for more than this rare scenario is based on a nonfinancial consideration.⁹

a. Authorizing Consideration of Participants’ Preferences

The 2022 Rule authorizes ERISA fiduciaries managing a participant-directed

⁹ Proposed § 2550.404a-1(c)(2), which states, “[a] fiduciary may not, however, accept expected reduced returns or greater risk to secure such additional benefits,” flips the burden to the participants and beneficiaries to prove there were actually “expected reduced returns or greater risk.” Flipping the burden in this manner is arbitrary because DOL lacks a permissible basis for doing so.

individual account plan to select investment alternatives by considering “participants’ preferences.” 87 F.R. at 73841–42. This is a euphemism for considering nonpecuniary factors such as climate change and other ESG factors. *See id.* at 73860 (discussing studies suggesting some workers “would increase their overall contribution rate if an ESG option was offered”); *id.* at 73885 (new 29 C.F.R. § 2550.404a-1(c)(3)). Indeed, the 2022 Rule does not even provide a uniform approach for how fiduciaries are supposed to determine plan participants’ preferences. There is no permissible justification for this change. *Cf. Hughes v. Nw. Univ.*, 142 S. Ct. 737, 742 (2022) (“[E]ven in a defined-contribution plan . . . plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan’s menu of options.”).

b. Authorizing Nonpecuniary Factors in Proxy Voting and Other Exercises of Shareholder Rights

The 2022 Rule’s implicit authorization to pursue nonpecuniary factors in proxy voting and other exercises of shareholder rights is similarly unlawful because it is not based on financial factors. The rule deletes the prohibition, which tracked the language in *Dudenhoffer*, on exercising proxy rights to “promote non-pecuniary benefits or goals unrelated to those financial interests of the plan participants and beneficiaries.” *Compare* 29 C.F.R. § 2550.404a-1(c)(2)(ii)(C) (2021), *with* 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(d)(2)(ii)(C)).

The deletion eliminates a clear regulatory command designed to promote ERISA’s focus on financial benefits for participants and beneficiaries. DOL claimed that it was based on its conclusion that the clause serves “no independent function.” 87 F.R. at 73847–48. Yet the commenters were concerned that it did serve a function—it forced fiduciaries to ensure that their actions were based on financial factors. *Id.* DOL never explained how it reached its contrary conclusion, and later it contradicted itself by suggesting this straightforward requirement “impose[s] additional duties and costs and potential for litigation.” *Id.* Ultimately, as it did for the tiebreaker, DOL then reverts back to the circular argument that prior guidance was more relaxed than the 2020 rules. The 2022 Rule thus did not rely on any permissible

factors in eliminating the clear command from 29 C.F.R. § 2550.404a-1(e)(2)(ii)(C), especially when weighed against the increased risk of harm to plan participants and beneficiaries. Failure to provide adequate justification, and the accompanying internal inconsistency, renders the change arbitrary and capricious. *See, e.g., Encino Motorcars*, 579 U.S. at 212; *State Farm*, 463 U.S. at 43.

c. Removing Documentation Requirements for Fiduciaries Acting for Collateral Purposes

The 2022 Rule is arbitrary and capricious for jettisoning the 2020 rules' documentation requirements and failing to replace them with new ones. The 2022 Rule eliminated the specific documentation requirement for the tiebreaker rule on the ground that it might unduly burden use of collateral benefits to break ties. *See* 87 F.R. at 73838. But as noted above, there is no cognizable interest in using the tiebreaker rule, because it definitionally does not promote the financial interests of participants. So, any burden on using that rule is also not a cognizable factor, and rescinding the documentation requirement—meant to protect the financial interests of participants and beneficiaries, which ERISA actually recognizes—is arbitrary and capricious. *Luminant*, 675 F.3d at 925.

The 2022 Rule opines that the documentation requirement “can lead to conduct contrary to the plan’s interests,” including the risk that creating documentation “would result in increased transaction costs for no particular benefit to plan participants,” estimated at half a million dollars in paperwork costs per year. 87 F.R. at 73838, 73871. But in a scenario where documentation would create net costs to participants, fiduciaries would simply be required by their duties of prudence and loyalty not to use the tiebreaker rule (*i.e.*, to forego the consideration of collateral benefits). The specter invoked by DOL could not arise and therefore cannot save the elimination of the documentation requirement from arbitrariness.

The 2022 Rule also abandons the 2020 rules' requirement to retain records of proxy votes. The rule does not take issue with the policy underlying that requirement, but rather worries it may somehow chill the exercise of proxy voting rights. *See* 87 F.R. at 73846. But the

APA requires more than the identification of myriad benefits for an action to be rational. Elimination of the documentation requirement imposes real costs on participants because it impedes their ability to monitor when their fiduciaries make investment and shareholder decisions that are concededly not designed to further the participants' financial interests—precisely the moment of greatest risk. APP097–98, Berry Letter at 22–23. DOL has not shown, or attempted to show, that these costs are worth the benefits it claims eliminating the requirement would achieve.

While the rule does explain that ERISA already requires certain documentation of proxy voting, *see* 87 F.R. at 73846, it never concludes that this pre-existing requirement renders the record retention requirements of the 2020 rules irrelevant. As far as DOL is concerned, the 2020 rules achieved an important objective, but it has nevertheless decided to abandon that objective in favor of another without weighing the two objectives against each other. Failure to do so here was arbitrary and capricious. *See, e.g., Luminant*, 675 F.3d at 925. If DOL were truly worried about cost efficiency, it would not allow any consideration of collateral factors.

d. Eliminating Specific Restrictions on QDIAs

The rule is arbitrary and capricious for eliminating the specific restrictions on QDIAs and allowing plan fiduciaries to select funds that expressly prioritize nonpecuniary benefits, like ESG considerations, as the default investment for plan participants. *See* 29 C.F.R. § 2550.404a-1(d)(2)(ii). The rule admits that “QDIAs warrant special treatment because plan participants have not affirmatively directed the investments of their assets into the QDIA but are nevertheless dependent on the investments for long-run financial security.” 87 F.R. at 73843. But the rule declines to afford special protection here, instead rescinding their special treatment under the 2020 rules. DOL also worries that the “chill” from the 2020 rules would infect the selection of QDIAs. *See* 87 F.R. at 73843. But this is no reason to abandon entirely the special treatment that DOL concedes QDIAs merit. Removing the restrictions was thus

internally inconsistent and unreasonable. *See, e.g., Encino Motorcars*, 579 U.S. at 212; *State Farm*, 463 U.S. at 43.

3. The 2022 Rule Unreasonably Removed the Collateral Benefit Disclosure Requirement Included in the NPRM

The 2022 Rule declined to adopt a disclosure requirement proposed in the NPRM that would apply whenever a fiduciary considered a collateral benefit in selecting an investment for a participant-driven individual account plan. DOL initially proposed that the fiduciary “must ensure that the collateral-benefit characteristic of the fund, product, or model portfolio is prominently displayed in disclosure materials provided to participants and beneficiaries.” 86 F.R. at 57303. The 2022 Rule eliminated this provision but remarkably does not clearly state why. Instead, it spells out the concerns of commenters, both in favor and opposed, and then states: “Based on the foregoing concerns, and reasons similar to those underlying the decision to remove the documentation requirements from the current regulation, the final rule does not adopt the proposed” requirement. *Id.* at 73841.

This decision was arbitrary and capricious because DOL fails to clearly explain it. *See, Airlines Co. v. Fed. Energy Regul. Comm’n*, 926 F.3d 851, 856 (D.C. Cir. 2019) (“A full and rational explanation becomes especially important when, as here, an agency elects to shift its policy or depart from its typical manner of administering a program.” (quotation omitted)). DOL does not assert that the provision would fail to achieve the benefits some commenters (and DOL itself in the proposal) claimed it would achieve. Nor does DOL assert that the provision would have caused any harm. While it describes concerns of some commenters, it makes no findings as to whether any of those concerns are justified (and if so, which). Nor does it assert that any harms the provision would create would exceed its benefits. Failure to explain its decision and weigh the relationship of benefits to costs was arbitrary and capricious. *Michigan v. EPA*, 576

U.S. 743, 750–51 (2015); *State Farm*, 463 U.S. at 48.¹⁰

DOL itself characterizes the benefits of this disclosure requirement as “appreciable,” 87 F.R. at 73839, and has not shown that any harm the provision potentially imposes would exceed those benefits. Therefore, on DOL’s own reasoning, the documentation provision it eliminates would achieve benefits, and nothing in the rule calls those benefits into question. Yet the rule does not explain why those benefits are outweighed by any costs.

Further, the rule itself admits that “giving consideration to whether an investment option aligns with participants’ preferences can be relevant to furthering the purposes of the plan,” because it may “lead to greater participation and higher deferral rates.” 87 F.R. at 73828. The final rule cites this consideration as justification for another provision “clarifying that fiduciaries do not violate their duty of loyalty solely because they take participants’ preferences into account when constructing a menu of prudent investment options for participant-directed individual account plans.” *Id.* But the same rationale would apply equally to disclosing the consideration of collateral benefits, unless, of course, the point of the rule is to allow fiduciaries to quietly pursue collateral benefits unbeknownst to everyone else, including plan participants and beneficiaries. An agency cannot adopt reasoning that is “internally inconsistent,” *Gen. Chem. Corp.*, 817 F.2d at 846, or “illogical on its own terms,” *AFGE, Loc. 2924*, 470 F.3d at 380 (cleaned up); *see also Encino Motorcars*, 579 U.S. at 212; *Engine Mfrs. Ass’n*, 20 F.3d at 1182 (“unexplained inconsistency” in final rule is “not reasonable”).

4. The 2022 Rule Fails to Consider Issuing Sub-Regulatory Guidance Instead of Amending the Regulation Itself

Rather than amend the Code of Federal Regulations to replace the 2020 rules, DOL could

¹⁰ Assuming DOL meant to adopt all commenters’ relevant concerns, the provision is still arbitrary and capricious. The only comments that DOL cites regarding a lack of benefits for participants argue that participants do not need to know about collateral benefits because they (definitionally) do not affect risks and returns. But this rationale, to the extent DOL has adopted it, highlights a fatal flaw in DOL’s reasoning. For if *participants* have no reason to care about policy or social preferences that do not affect risks and returns, what valid reason could fiduciaries have for caring about them without violating their duty of loyalty? Yet one of the rule’s main objectives is to allow fiduciaries to act on the basis of these preferences. If it is valuable for fiduciaries, it is (even more) valuable for participants.

have issued sub-regulatory guidance. The 2022 Rule failed to consider this obvious alternative of leaving 29 C.F.R. § 2550.404a-1 unchanged from its 2020 amendments, and simply issuing sub-regulatory guidance to cure any alleged chill or confusion. APP117, CR Letter 18.

“When an agency rescinds or alters a prior policy[,] its reasoned analysis must consider the alternatives that are within the ambit of the existing policy.” *Regents*, 140 S. Ct. at 1913 (quotation omitted). DOL claims to have considered returning to the pre-2020 regulatory regime, in which the application of its 1979 Investment Duties regulation to ESG investing was clarified by guidance. 87 F.R. at 73879. There was nothing in § 2550.404a-1, even after 2020, that mentioned “climate change and other environmental, social, or governance factors.” DOL therefore could have supplemented § 2550.404a-1 with guidance. But the 2022 Rule instead rescinded the 2020 rules and expressly added ESG into the regulation itself. *See* 87 F.R. at 73885 (new 29 C.F.R. § 2550.404a-1(b)(4)).

The alternative of simply adding guidance would have had many advantages, among them lower transaction costs as entities would stay with a framework with which they are familiar. The *only* reason the rule gives for embedding ESG into the regulation itself is that DOL’s “prior non-regulatory guidance on ESG investing and proxy voting was removed from the [C.F.R.]” by the 2020 rules. 87 F.R. at 73879. The rule does not consider the obvious alternative of reinstating that guidance or issuing new guidance, or cite the comment that suggested doing so. APP117, CR Letter 18. This improperly fails to consider reasonable alternatives and respond to comments. *See, e.g., Perez*, 575 U.S. at 96; *10 Ring Precision*, 722 F.3d at 724.

5. The 2022 Rule is the Product of Prejudgment

The 2022 Rule is also unlawful on account of prejudgment in violation of the APA and Due Process Clause. *See Miss. Comm’n on Env’t Quality v. EPA*, 790 F.3d 138, 183 (D.C. Cir. 2015); U.S. Const. amd. V. The APA “is designed to ensure that affected parties have an opportunity to participate in and influence agency decision making at an early stage, when the

agency is more likely to give real consideration to alternative ideas.” *U.S. Steel Corp. v. EPA*, 595 F.2d 207, 214 (5th Cir. 1979). Interested parties must be presented with an opportunity to “influence the rule making process in a meaningful way.” *Id.*; see also *Perez*, 575 U.S. at 96 (“An agency must *consider* and respond to significant comments received during the period for public comment.” (emphasis added)).

The 2022 Rule does not meaningfully rebut the strong evidence that DOL had already decided what to do in this rulemaking before it reviewed the public comments. APP135–37, CR Letter 36–38. Indeed, the rule echoes DOL’s earlier description of its stakeholder outreach, announced before its review of comments, as designed “to determine how to craft rules that better recognize the role that ESG integration can play in the evaluation and management of plan investments in ways that further fundamental fiduciary obligations.” 87 F.R. at 73823. To determine *how*, not *whether*. It also cites the Executive Orders that directed DOL to reconsider the 2020 rules. *Id.*

DOL’s sole effort to rebut the charge of prejudgment is to point to changes in the final versus proposed rule. But none of the cited changes go to the fundamental question of whether to rescind the 2020 rules and replace them with rules more favorable to ESG investing. See 87 F.R. at 73854.

C. Plaintiffs Will Suffer Irreparable Harm Without an Injunction

“To show irreparable injury if threatened action is not enjoined, it is not necessary to demonstrate that harm is inevitable and irreparable.” *Humana, Inc. v. Avram A. Jacobson, M.D., P.A.*, 804 F.2d 1390, 1394 (5th Cir. 1986). Instead, Plaintiffs must show that they are “likely to suffer irreparable harm in the absence of preliminary relief” and “need only show [its injury] ‘cannot be undone through monetary remedies.’” *Texas v. United States*, 524 F. Supp. 3d 598, 662–63 (S.D. Tex. 2021) (citations omitted). In *BST Holdings*, the Fifth Circuit found that “compliance and monitoring costs” for businesses covered by a regulation constituted irreparable injury. 17 F.4th at 618. “[C]omplying with a regulation later held invalid almost

always produces the irreparable harm of nonrecoverable compliance costs.” *Id.* (quoting *Texas v. EPA*, 829 F.3d 405, 433 (5th Cir. 2016)).

For Liberty Services and Western Energy Alliance, additional monitoring costs they or their employees incur to protect against improper collateral considerations is irreparable injury because those costs are irrecoverable. *See* APP005-7, Stock Decl. ¶¶ 10–15, 17; APP016–17, Sgamma Decl. ¶ 13–20; *see also* APP010–11, Poppel Decl. ¶¶ 3–8. For Liberty, any reduction in interest from investors and access to capital, and the associated competitive disadvantage, also qualifies as irreparable injury because it too is irrecoverable. Given the difficulties in recovering monetary damages, especially from the federal government, the loss of funds here constitutes irreparable harm. *See BST Holdings*, 17 F.4th at 618; *Texas v. United States*, 809 F.3d 134, 186 (5th Cir. 2015); *Texas*, 524 F. Supp. 3d at 663.

Copland is harmed because the 2022 Rule is contrary to the clear intent of the exclusive benefit rule. Copland seeks faithful adherence to ERISA and the statutory duties of loyalty and prudence incorporated therein. Hence, monetary damages would not remedy this harm. *See Burgess v. FDIC*, 871 F.3d 297, 304 (5th Cir. 2017) (injury is irreparable if monetary damages are unavailable or inadequate).

Moreover, “one of the expressed purposes of ERISA is to ensure the protection of millions of employees covered by pension plans: ‘Congress finds . . . that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest.’” *Gould v. Lambert Excavating Inc.*, 870 F.2d 1214, 1221 (7th Cir. 1989) (quoting 29 U.S.C. § 1001(a)). Consequently, “the probability of irreparable harm is strong” when a private litigant seeks to enforce rights under the ERISA statute. *Id.*; *see also Herman v. S.C. Nat’l Bank*, 140 F.3d 1413, 1423 (11th Cir. 1998) (“It remains the intent of Congress that the courts use their power to fashion legal and equitable remedies that not only protect participants and beneficiaries but deter violations of the law as well.” (quoting H.R. Rep. No. 101-386, at 433 (1989) (conf. rep.))). The 2022 Rule loosens the statutory restraints of sections 403 and 404 and removes the monitoring and

accountability provisions that were in the 2020 rules. The result is irreparable harm because the 2022 Rule “excessively insulates [fiduciaries] from effective oversight by [plan] beneficiaries and participants.” *Partenza v. Brown*, 14 F. Supp.2d 493, 495 (S.D.N.Y. 1998).

In addition, Plaintiff States have submitted substantial evidence of loss of tax revenues and harms to their economies and citizens’ jobs. *See supra* pp. 16–18. These economic harms are also irreparable as they are not recoverable from the federal government. *See, e.g., Texas*, 829 F.3d at 433.

D. An Injunction Will Not Harm Defendants or Disserve the Public Interest

“Any interest [the government] may claim in enforcing an unlawful” regulation “is illegitimate.” *BST Holdings*, 17 F.4th at 618. Because the 2022 Rule is an unlawful attempt to rewrite ERISA’s plain text and is arbitrary and capricious, Defendants lack a legitimate interest in its implementation and would not suffer if it is enjoined.

By contrast, the public is “served when the law is followed.” *Daniels Health Scis., L.L.C. v. Vascular Health Scis., L.L.C.*, 710 F.3d 579, 585 (5th Cir. 2013); *see also League of Women Voters of U.S. v. Newby*, 838 F.3d 1, 12 (D.C. Cir. 2016). The Supreme Court also recognizes a strong public interest in the proper functioning of retirement plans, including maximizing financial returns and members of the public saving for their future security. *Boggs v. Boggs*, 520 U.S. 833, 840–41 (1997); *see also Gould*, 870 F.2d at 1221.

The balance of harms in this case is thus straightforward. Plaintiffs seek an injunction to preserve the careful management of employee benefits and retirement plans in compliance with ERISA, while Defendants seek to perpetuate an abdication of congressionally imposed statutory duties. Enjoining the Defendants would stop an illegal agency action and compel the Defendants to follow the law. Such relief harms neither the government nor the public.

CONCLUSION

For the foregoing reasons, this Court should grant a preliminary injunction.

Dated February 21, 2023.

/s/ Leif A. Olson

KEN PAXTON
Attorney General
AARON REITZ
Texas Bar No. 24105704
Deputy Attorney General for Legal Strategy
LEIF A. OLSON
Chief, Special Litigation Division
Texas Bar No. 24032801

Office of the Attorney General
P.O. Box 12548
Austin, TX 78711-2548
aaron.reitz@oag.texas.gov
leif.olson@oag.texas.gov

Counsel for Plaintiff State of Texas

/s/ Jonathan Berry

C. BOYDEN GRAY
JONATHAN BERRY
R. TRENT MCCOTTER
MICHAEL BUSCHBACHER
JARED M. KELSON

Boyden Gray & Associates
801 17th Street NW, Ste. 350
Washington, DC 20006
(202) 955-0620
berry@boydengrayassociates.com
kelson@boydengrayassociates.com

*Counsel for Plaintiffs Liberty Energy Inc., Liberty
Oilfield Services LLC, and Western Energy
Alliance*

Respectfully submitted,

/s/ Melissa Holyoak

SEAN REYES
Attorney General
MELISSA HOLYOAK*
Solicitor General

Utah Attorney General's Office
350 N. State Street, Suite 230
P.O. Box 142320
Salt Lake City, UT 84114-2320
(801) 538-9600
melissaholyoak@agutah.gov

BRUNN (BEAU) ROYSDEN*
Fusion Law, PLLC
7600 N. 15th St., Suite 150
Phoenix, AZ 85020
(602) 315-7545
beau@fusion.law

JOHN SULLIVAN, Of Counsel
Texas Bar Number: 24083920
610 Uptown Boulevard, Suite 2000
Cedar Hill, Texas 75104
(469) 523-1351
john.sullivan@the-sl-lawfirm.com

Counsel for Plaintiff State of Utah

/s/ Andrew Ferguson

JASON MIYARES
Attorney General
ANDREW N. FERGUSON*
Solicitor General
KEVIN M. GALLAGHER*
Deputy Solicitor General

Virginia Attorney General's Office
202 North 9th Street
Richmond, VA 23219
(804) 786-2071
aferguson@oag.state.va.us
kgallagher@oag.state.va.us

Counsel for Plaintiff Commonwealth of Virginia

/s/ Neville Hedley

NEVILLE HEDLEY*
Hamilton Lincoln Law Institute
1440 W. Taylor Street, #1487
Chicago, IL 60607
(312) 342-6008
ned.hedley@hlli.org

ANNA ST. JOHN
Hamilton Lincoln Law Institute
1629 K Street NW, Suite 300
Washington, DC 20006
(917) 327-2392
anna.stjohn@hlli.org

Counsel for Plaintiff James R. Copland

STEVE MARSHALL
Attorney General
EDMUND LACOUR
Solicitor General

Alabama Attorney General's Office
501 Washington Ave.
Montgomery, AL 36014
(334) 353-2196
edmund.lacour@alabamaag.gov

Counsel for Plaintiff State of Alabama

/s/ Joseph S. St. John

JEFF LANDRY
Attorney General
ELIZABETH B. MURRILL*
Solicitor General
JOSEPH S. ST. JOHN
Deputy Solicitor General
TRACY SHORT
Assistant Attorney General

Louisiana Department of Justice
1885 N. Third Street
Baton Rouge, LA 70804
Tel: (225) 326-6766
murrille@ag.louisiana.gov
stjohnj@ag.louisiana.gov
shortt@ag.louisiana.gov

Counsel for Plaintiff State of Louisiana

TREG TAYLOR
Attorney General
JEFFREY G. PICKETT
Senior Assistant Attorney General
BENJAMIN HOFMEISTER*
Assistant Attorney General

Alaska Department of Law
123 4th Street
Juneau, AK 99801
(907) 269-5275
jeff.pickett@alaska.gov
ben.hofmeister@alaska.gov

Counsel for Plaintiff State of Alaska

TIM GRIFFIN
Attorney General
NICHOLAS J. BRONNI*
Solicitor General

Arkansas Attorney General's Office
323 Center Street, Suite 200
Little Rock, AR 72201
(501) 682-2007
Nicholas.Bronni@arkansasag.gov

Counsel for Plaintiff State of Arkansas

CHRISTOPHER M. CARR
Attorney General
STEPHEN J. PETRANY*
Solicitor General

Georgia Department of Law
40 Capitol Square, SW
Atlanta, GA 30334
(404) 458-3408
spetrany@law.ga.gov

Counsel for Plaintiff State of Georgia

THEODORE E. ROKITA
Attorney General
THOMAS FISHER*
Solicitor General

Indiana Attorney General's Office
IGC South, Fifth Floor
302 W. Washington St.
Indianapolis, IN 46204
(317) 232-6255
tom.fisher@atg.in.gov

Counsel for Plaintiff State of Indiana

ASHLEY MOODY
Attorney General
JOSEPH E. HART*
Assistant Attorney General of Legal Policy

Florida Attorney General's Office
The Capitol, PI-01
Tallahassee, FL 32399-1050
Phone: (850) 414-3300
joseph.hart@myfloridalegal.com

Counsel for Plaintiff State of Florida

RAÚL R. LABRADOR
Attorney General
DAVID M.S. DEWHIRST*
Chief Deputy Attorney General

Idaho Attorney General's Office
700 W. Jefferson Street, Ste. 210
P.O. Box 83720
Boise, ID 83720-0010
(208) 334-2400
david.dewhirst@ag.idaho.gov

Counsel for Plaintiff State of Idaho

BRENNA BIRD
Attorney General
ERIC H. WESSAN*
Solicitor General

Iowa Attorney General's Office
1305 E. Walnut Street
Des Moines, IA 50319
(515) 281-5164
eric.wessan@ag.iowa.gov.

Counsel for Plaintiff State of Iowa

KRIS KOBACH
Attorney General
JESSE A. BURRIS*
Assistant Attorney General

Kansas Attorney General's Office
120 SW 10th Ave, 2nd Floor
Topeka, KS 66612
(785) 368-8197
jesse.burris@ag.ks.gov

Counsel for Plaintiff State of Kansas

LYNN FITCH
Attorney General
JUSTIN L. MATHENY
Deputy Solicitor General

Mississippi Attorney General's Office
P.O. Box 220
Jackson, MS 39205-0220
(601) 359-3680
justin.matheny@ago.ms.gov

Counsel for Plaintiff State of Mississippi

AUSTIN KNUDSEN
Attorney General
CHRISTIAN B. CORRIGAN*
Solicitor General

Montana Department of Justice
215 N Sanders St.
Helena, MT 59601
(406) 444-2707
Christian.Corrigan@mt.gov

Counsel for Plaintiff State of Montana

DANIEL CAMERON
Attorney General
LINDSEY KEISER*
Assistant Attorney General

Kentucky Attorney General's Office
700 Capital Avenue, Suite 118
Frankfort, KY
Tel: (502) 696-5478
lindsey.keiser@ky.gov

Counsel for Plaintiff Commonwealth of Kentucky

ANDREW BAILEY
Attorney General
JOSHUA M. DIVINE*
Solicitor General
MARIA A. LANAHAN*
Deputy Solicitor General

Missouri Attorney General's Office
Post Office Box 899
Jefferson City, MO 65102
Tel: (573) 751-3321
josh.divine@ago.mo.gov
maria.lanahan@ago.mo.gov

Counsel for Plaintiff State of Missouri

MICHAEL T. HILGERS
Attorney General
ERIC J. HAMILTON*
Deputy Solicitor General

Nebraska Attorney General's Office
2115 State Capitol
Lincoln, NE 68509
(402) 471-2682
eric.hamilton@nebraska.gov

Counsel for Plaintiff State of Nebraska

JOHN FORMELLA
Attorney General
MARK W. DELL'ORFANO*
Attorney

New Hampshire Department of Justice
33 Capitol Street
Concord, NH 03301
anthony.j.galdieri@doj.nh.gov
(603) 271-1214

Counsel for Plaintiff State of New Hampshire

DAVE YOST
Attorney General
BENJAMIN FLOWERS*
Solicitor General

Ohio Attorney General's office
30 E. Broad St., 17th Fl.
Columbus, OH 43215
(614) 728-7511
benjamin.flowers@ohioattorneygeneral.gov

Counsel for Plaintiff State of Ohio

JONATHAN SKRMETTI
Attorney General and Reporter
BRANDON SMITH*
Chief of Staff

Office of the Attorney General and Reporter
of Tennessee
P.O. Box 20207
Nashville, TN 37202-0207
(615) 741-3491
brandon.smith@ag.tn.gov

Counsel for Plaintiff State of Tennessee

DREW H. WRIGLEY
Attorney General
COURTNEY TITUS*
Deputy Solicitor General

North Dakota Attorney General's Office
600 E Boulevard Avenue, Dept. 125
Bismarck, ND 58505
(701) 328-3644
ctitus@nd.gov

Counsel for Plaintiff State of North Dakota

ALAN WILSON
Attorney General
THOMAS T. HYDRICK*
Assistant Deputy Solicitor General

South Carolina Attorney General's Office
Post Office Box 11549
Columbia, SC 29211
(803) 734-4127
thomashydrick@scag.gov

Counsel for Plaintiff State of South Carolina

PATRICK MORRISEY
Attorney General
LINDSAY S. SEE*
Solicitor General
MICHAEL R. WILLIAMS*
Senior Deputy Solicitor General

West Virginia Attorney General's Office
State Capitol Complex, Bldg. 1, Rm E-26
1900 Kanawha Blvd. E
Charleston, WV 25305
(681) 313-4550
lindsay.s.see@wvago.gov
michael.r.williams@wvago.gov

Counsel for Plaintiff State of West Virginia

BRIDGET HILL
Attorney General
RYAN SCHELHAAS*
Chief Deputy Attorney General

**motion for admission pending or forthcoming*

Office of the Wyoming Attorney General
200 W. 24th Street
Cheyenne, WY 82002
(307) 777-7841
ryan.schelhaas@wyo.gov

Counsel for Plaintiff State of Wyoming

In association with local counsel:

F. Scott Flow
FLOW LAW FIRM, PLLC
800 SW 9th Avenue
Amarillo, Texas 79101-3206
(806) 372-2010
fsflow@flowlaw.com

Co-Counsel for Plaintiffs other than State of Texas

CERTIFICATE OF CONFERENCE

I certify that on February 9, 2023, counsel for the State Plaintiffs conferred with Defendants' counsel, Leslie Cooper Viegen and Cassandra M. Snyder, who stated that the Defendants oppose this motion.

/s/ Leif A. Olson

CERTIFICATE OF SERVICE

On February 21, 2023, I filed this brief through the Court's CM/ECF service, which served it upon all counsel of record.

/s/ Leif A. Olson