1 IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
2 DALLAS DIVISION

3 CHAMBER OF COMMERCE OF THE)
UNITED STATES OF AMERICA, ET AL.)
4)
Plaintiffs,)
5 v.)
) No. 3:16-CV-01476-M
6)
U. S. DEPARTMENT OF LABOR,)
7 ET AL.)
)
8 Defendants.)

9 TRANSCRIPT OF HEARING ON MOTIONS FOR SUMMARY JUDGMENT
BEFORE THE HONORABLE BARBARA M. G. LYNN,
10 UNITED STATES DISTRICT JUDGE
THURSDAY, NOVEMBER 17, 2016
11 DALLAS, TEXAS

12 APPEARANCES:

13 FOR THE PLAINTIFFS: MR. EUGENE SCALIA
GIBSON DUNN & CRUTCHER, LLP
14 1050 CONNECTICUT AVE. NW
WASHINGTON, D.C. 20036
15 (202) 955-8500
escalia@gibsondunn.com
16
MR. JASON J. MENDRO
17 GIBSON DUNN & CRUTCHER, LLP
1050 CONNECTICUT AVE. NW
18 WASHINGTON, D.C. 20036
(202) 955-8500
19 jmendro@gibsondunn.com

20 MS. RACHEL E. MONDL
GIBSON DUNN & CRUTCHER, LLP
21 1050 CONNECTICUT AVE. NW
WASHINGTON, D.C. 20036
22 (202) 955-8500
rmondl@gibsondunn.com
23

24

25

1 APPEARANCES (CONTD):
MR. JOSEPH ROBERT GUERRA
2 SIDLEY AUSTIN
1501 K. STREET NW
3 WASHINGTON, D.C. 20005
(202) 736-8000
4 jguerra@sidley.com

5 MR. DAVID OGDEN
WILMER CUTLER PICKERING HALE & DORR
6 1875 PENNSYLVANIA AVE NW
WASHINGTON, D.C. 20006
7 (202) 663-6000
david.ogden@wilmerhale.com
8
MR. KELLY PATRICK DUNBAR
9 WILMER CUTLER PICKERING HALE & DORR
1875 PENNSYLVANIA AVE NW
10 WASHINGTON, D.C. 20006
(202) 663-6000
11 kelly.dunbar@wilmerhale.com

12 MR. KEVIN LAMB
WILMER CUTLER PICKERING HALE & DORR
13 1875 PENNSYLVANIA AVE NW
WASHINGTON, D.C. 20006
14 (202) 663-6000
kevin.lamb@wilmerhale.com
15
FOR THE DEFENDANTS: MS. EMILY SUE NEWTON
16 U. S. DEPARTMENT OF JUSTICE
CIVIL DIVISION, FEDERAL PROGRAMS BRANCH
17 20 MASSACHUSETTS AVE NW
WASHINGTON, D.C. 20001
18 (202) 305-8356
emily.s.newton@usdoj.gov
19
MR. GALEN N. THORP
20 U. S. DEPARTMENT OF JUSTICE
CIVIL DIVISION, FEDERAL PROGRAMS BRANCH
21 20 MASSACHUSETTS AVE NW
WASHINGTON, D.C. 20001
22 (202) 514-4781
galen.thorp@usdoj.gov
23

24

25

1 APPEARANCES (CONTD):

MS. MEGAN HANSEN
2 U. S. DEPARTMENT OF LABOR
200 CONSTITUTION AVENUE
3 WASHINGTON, D.C. 20210
(866) 487-2365
4
MS. ELIZABETH HOPKINS
5 U. S. DEPARTMENT OF LABOR
200 CONSTITUTION AVENUE
6 WASHINGTON, D.C. 20210
(866) 487-2365

7

8

9

10

11

12

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16

17 D. KEITH JOHNSON, RDR, CRR
FEDERAL OFFICIAL COURT REPORTER
18 FOR THE HON. BARBARA M. G. LYNN
UNITED STATES DISTRICT COURT
19 NORTHERN DISTRICT OF TEXAS
1100 COMMERCE STREET, ROOM 1572
20 DALLAS, TEXAS 75242
(214) 753-2325
21 keith_johnson@txnd.uscourts.gov

22

23

24

25

1 P R O C E E D I N G S
2 (November 17, 2016)
3 THE COURT: Good morning.
4 All right. We have quite a tight schedule today,
5 so I'm going to forgo the usual formalities of everyone
6 introducing themselves. I'll have you introduce yourselves as
7 you argue.
8 Let me just take a moment to review what I
9 understand is our agreed schedule.
10 Y'all give me just a second here.
11 (Pause in proceedings.)
12 THE COURT: All right. We have 110 minutes to the
13 side. The chamber plaintiffs, 45 minutes; ACLI, 35 minutes;
14 IALC, 30 minutes; and the defendants, 110 minutes; 220, and we
15 will be done at noon. So I know we're getting a little bit of
16 a late start, but the Court doesn't have any flexibility about
17 the end time.
18 So that's a long time to be sitting here without a
19 break, but that may be what we have to do. We'll just see as
20 we go.
21 Okay. Anything else I need to cover preliminarily?
22 Okay. Let's go.
23 MR. SCALIA: Good morning, Your Honor. I'm Eugene
24 Scalia representing the Chamber of Commerce plaintiffs. I
25 have with me today my colleagues, Jason Mendro and Rachel

1 Mondl.
2 I'm going to address issues concerning the rules
3 generally. My co-counsel, Mr. Ogden, will address issues
4 associated with the First Amendment arguments and the
5 insurance industry generally. And then finally, Mr. Guerra
6 will address issues specific to equity index annuities.
7 Your Honor, I'd like to reserve 10 minutes for
8 rebuttal, if I could.
9 THE COURT: Okay. I'm not going to keep time.
10 It's hard for me to do that and pay attention. I'd rather be
11 paying attention. So you-all keep your own time in terms of
12 how much time you've been allotted. I'm expecting everyone to
13 honor the agreements made without me having to check you on
14 that.
15 MR. SCALIA: Understood.
16 Chief Judge Lynn, the cases before you today
17 concern the most sweeping changes to the retail financial
18 services industry since the Investment Advisers Act of 1940.
19 The regulation of the market for IRAs is being radically
20 transformed. And yet the things that are being done -- these
21 things are being done under a section of ERISA from which
22 Congress purposely omitted the duties and the private right of
23 action that the Labor Department is now adding. That's Title
24 II of ERISA, which concerns IRAs.
25 Moreover, Your Honor, these things are done being

1 done an agency that lacks regulatory oversight or enforcement
2 responsibility with respect to IRAs. The Labor Department's
3 responsibility is with respect to employer-sponsored ERISA
4 plans, not IRAs under Title II.
5 Third, Your Honor, these sweeping new requirements
6 have been crafted and imposed through an exemptive authority;
7 that is, an authority to reduce regulatory burdens. In all of
8 these ways, this rule conflicts with a fundamental principle
9 of administrative law, which has repeatedly been stated by the
10 Supreme Court, including as recently as 2014 in the Utility
11 Air Regulatory Group case, also known as UARG, where the Court
12 said as follows.
13 It said that scepticism is called for when an
14 agency, quote, "claims to discover in a long-existing statute
15 a hitherto unheralded power to regulate a significant portion
16 of the economy," end quote. That is what the Labor Department
17 has done here. The same scepticism is warranted.
18 And, Your Honor, to be clear, our complaint is not
19 merely that what the Labor Department has done is sweeping and
20 harmful to my clients' members and to retiring investors.
21 It's a point of administrative law, a presumption against
22 permitting agencies to make sweeping changes in the economy as
23 is being done here, based on the what the Supreme Court in
24 another case has called an ancillary or a modest statutory
25 provision.

1 This rule -- this package of rules fails the tests
2 set forth by the Supreme Court in the UARG case and others
3 that I'll be referring to today, and, therefore, all of these
4 rules should be vacated.
5 THE COURT: Well, you're not arguing that merely
6 because I might find that these changes are sweeping or big or
7 substantial -- are you arguing that in and of itself, based on
8 the presumption that you're arguing for, justify the Court in
9 invalidating them?
10 MR. SCALIA: I am arguing, Your Honor, that the
11 scope, the ambition, the consequence of this package of rules,
12 by itself, raises a presumption and concern, because it's such
13 an enormous change in a statute that has been existing for a
14 long time and an authority that never before had been claimed.
15 And so, for example, in the UARG case, the EPA gave
16 a statutory term an extremely broad definition that it
17 admitted was very hard to administer. It then essentially
18 exercised a sort of exemptive authority, adopted what it
19 called a tailoring rule. One of the reasons the Court
20 invalidated what was being done there is because of the scope
21 of the transformation was beyond what normally would delegate
22 to an agency.
23 Exactly the same, Your Honor, Brown & Williamson.
24 Exactly the same, the Whitman case, where in that case the --
25 and also exactly the same MCI Telecommunications case where

1 the FCC relied on its authority to modify certain things to
2 make very big changes in the regulation of telecommunications.
3 And the Supreme Court said Congress does not hide elephants in
4 mouse holes. Sweeping power --
5 THE COURT: Excuse me just a moment.
6 (Pause in proceedings.)
7 THE COURT: I'm sorry.
8 MR. SCALIA: So, Your Honor, in a nutshell, in each
9 one of these cases, the Supreme Court stepped back. It looked
10 at the forest, not just the trees, not just the specific
11 statutory word, but the broader framework and said, "Good
12 heavens. This is such a sweeping change. We would want
13 really powerful explicit authority to know Congress expected
14 the agency to do such a thing." But as I'll explain later
15 this morning, all indications are exactly to the contrary in
16 this case in a way even more powerful than these other
17 precedents we rely on.
18 But if I could begin with a fiduciary
19 interpretation that has been adopted. I'd like to be clear
20 factually on some of the activities that are picked up by this
21 interpretation. If an insurance sales agent comes to a
22 potential customer and says, you know, "I'm with Empire
23 Insurance, and Empire has a new proprietary product that I
24 think is very good and that you would like it," that person is
25 a fiduciary under this rule. Or if a broker-dealer sits down

1 with a potential customer and simply puts forward four
2 different potential investment options for that person to
3 select from, that makes that person a fiduciary.
4 In other words, Your Honor, the everyday activities
5 of sales people are suddenly being made fiduciary actions, and
6 yet few things are clearer that the common law recognizes a
7 fundamental distinction between somebody who's a fiduciary, on
8 the one hand, and somebody who is a salesperson, on the other
9 hand. They're distinct, they're antonyms, and they're
10 mutually exclusive. And any definition of fiduciary so broad
11 that it captures the most rudimentary acts of a salesperson
12 is, therefore, under the common law, by definition, an
13 overbroad interpretation.
14 To put it differently, Your Honor, there are
15 broker-dealers and insurance representatives throughout this
16 state, throughout the country, who for generations have been
17 making a living by coming to people and saying, "Here's a good
18 product; you will like this; you might want to consider these
19 four things."
20 And now, with respect to IRAs, that is being made
21 illegal. It is being made illegal. These people are -- at
22 the same time, for their sales activities --
23 THE COURT: Well, why is that being made illegal?
24 It's not a question of legality. It's a question of
25 regulation.

1 MR. SCALIA: Under the fiduciary interpretation
2 they've adopted, if those people are paid on a commission
3 basis, as they always have been --
4 THE COURT: Sure, of course. Part 2.
5 MR. SCALIA: -- it is now legal. And I apologize.
6 I wasn't clear enough on that last element. But that
7 commission payment is also how they've always been compensated
8 for these kinds of activities. So the very active -- being a
9 salesperson for these products is now first rendering you a
10 fiduciary, and second, rendering your ordinary business
11 activities illegal in a transformative way.
12 Now, the Labor Department argues a couple of
13 things. It says sales and advice, they're so inmeshed, we
14 can't distinguish them. It's a facile, artificial, unreal
15 distinction. They say the distinction doesn't exist in law
16 and it doesn't exist in reality. But they're wrong on both
17 counts. It exists in the law because it's been long
18 recognized in the common law and recognized in the Investment
19 Advisers Act. It's recognized in reality just as a matter of
20 common sense. Some people sell products, sell things. Other
21 people are there as your trustee, your adviser.
22 Critically, Your Honor, they themselves recognized
23 the sales advice distinction in this rule. And that's the
24 so-called seller carve-out for large plans. What they did was
25 they said for somebody who is selling financial products, and

1 in that context providing recommendations, which they define
2 as advice, to a large plan, that person is not a fiduciary as
3 long as their compensation is not for providing advice as
4 opposed to other services -- as long as they're not
5 compensated for advice as opposed to other services. That's
6 essentially a verbatim quote. So those other services, Your
7 Honor, are sales services, because it's the seller's
8 exemption.
9 So the Labor Department has told you time and again
10 this is a distinction that just can't be drawn. It's a
11 fiction. But, Your Honor, Congress drew it. It drew it in
12 the Advisers Act, and the Labor Department drew it in a
13 separate provision of this very rule. They cannot rest their
14 regulation of the IRA market on a claim that a distinction
15 doesn't exist when they themselves rely on it elsewhere.
16 THE COURT: Well, as Judge Moss pointed out in his
17 opinion, the Investment Advisers Act is different from ERISA.
18 You may be getting to that. If you want to answer that
19 question and comment on that later in your argument, you can.
20 But I understand the point he was making in his opinion, and
21 the Investment adviser Act approach is not the approach that
22 is taken by ERISA.
23 MR. SCALIA: Well, one difference, Your Honor, is
24 that ERISA refers explicitly to fiduciaries, which is not in
25 the Investment Advisers Act. So ERISA was even clearer that

1 it was talking about fiduciaries. I think that's an important
2 distinction.
3 Second, the distinction between a broker-dealer and
4 a fiduciary is fundamental to the common law. The Advisers
5 Act was merely recognizing that because of the broad sweep of
6 an act which didn't even use the word "fiduciary."
7 With respect to the significance of that word, the
8 Labor Department's position is essentially that you should act
9 as if that word is not in the statute; ignore it. Their claim
10 is that because Congress used the phrase "render investment
11 advice for a fee," you just set aside the word "fiduciary."
12 The problem with that argument is that the Supreme
13 Court cases that have been cited to you, Your Honor, that
14 determine who is a fiduciary under the Act do look at the word
15 fiduciary; they do consider the common law. And I'm speaking
16 specifically, Your Honor, of the Varity decision at Page 502,
17 where the what the Court says is we don't just look at a
18 dictionary to interpret the statutory definition of
19 "fiduciary," we look to the common law, because "fiduciary"
20 had common law meaning which brought meaning with it, and then
21 proceeded to consider the common law role of a fiduciary.
22 And the Varity -- the Pegram decision at Page 231
23 does exactly the same thing, Your Honor. It says, well, let's
24 look at who is a fiduciary in common law. So this important
25 part of our case, which Judge Moss did not think should be

1 given attention, is central to the two cases before you where
2 the holding concerned who was a fiduciary. The other thing I
3 would say about Judge Moss's decision, Your Honor, on this
4 point is that he, much like the Department of Labor,
5 approached the issue as if the statutory language were limited
6 to rendering investment advice or even giving investment
7 advice as opposed to the phrase "rendering investment advice
8 for a fee."
9 As the Supreme -- as the Labor Department -- I
10 apologize for confusing them, Your Honor. As the Labor
11 Department said in adopting its seller's carve-out, the
12 question is whether the essence of a relationship is advisory;
13 is that what the relationship is for, what the compensation is
14 for. They approached it in that manner when it came to the
15 seller's carve-out, but not otherwise.
16 Your Honor, the other point I would make with
17 respect to the meaning of fiduciary, it's certainly true that
18 in ERISA the Congress made a departure from the common law
19 approach in the terms of no longer requiring that you had to
20 be a so-called named fiduciary. But what it didn't do was
21 make the interpretation of who is a fiduciary boundless,
22 limitless, nor did it indicate that being a salesperson made
23 you a fiduciary, which is the approach the Labor Department
24 has taken.
25 Your Honor, the other way you know that their

1 interpretation of who is a fiduciary is overbroad is they've
2 told you so in their rule. They said that if they didn't
3 provide the exemptive relief that they were providing through
4 the so-called BIC exemption, that it would, quote, "have
5 seriously adverse consequences," end quote. In fact, they
6 even questioned whether it was, quote, "possible," quote, to
7 define fiduciary as broadly as they had without an exemption.
8 Your Honor, this brings you right back to that UARG
9 case, which I mentioned earlier. And in that case, the EPA
10 adopted an interpretation of the phrase "air pollutant" that
11 it admitted was so incredibly broad it would upset the
12 regulatory system if the EPA did not simultaneously adopt its
13 so-called tailoring rule. That's exactly what the Labor
14 Department has done here, adopted an impractical, unrealistic
15 interpretation of "fiduciary" that conflicts with common
16 practice and common law. And precisely because it did so, it
17 then adopted this so-called BIC exemption alongside it. An
18 interpretation that can't stand on its own but instead needs
19 this exemption to accompany it is not a reasonable
20 interpretation, nor does it comport with the plain statutory
21 language.
22 So, Your Honor, if I could then talk a bit about
23 the BIC exemption and the improper use by the Labor Department
24 of its authority. First, I think it's important to recognize
25 that the BIC exemption is the intent of this package of rules.

1 It's to put people into this Best Interest Contract.
2 Throughout this regulatory package, the Labor Department touts
3 the fact that it is now importing a best interest standard
4 into the IRA market. That is what the rule says. That is
5 what all of the accompanying press buildup of this rule has
6 said.
7 It didn't do that by adopting the fiduciary
8 interpretation. They imposed a best interest standard
9 throughout this industry in one way, and that was adopting
10 that BIC exemption, which people are forced into because of
11 that impractical definition of -- or interpretation of
12 fiduciary, which again was the problem you had in the UARG
13 case.
14 So forcing reliance on this exemption was a -- it
15 was the goal, it was the centerpiece of this regulatory
16 package, or as the Department puts it on Page 2 and Page 6 of
17 the joint appendix, it is, quote, "the aim," quote, of what
18 they're doing.
19 In terms of the use of their exemptive authority,
20 Your Honor, the argument that the Labor Department makes to
21 you here is essentially the losing argument that was made in
22 UARG, that was made in the MCI Telecommunications case, and it
23 was made in Brown & Williamson. And for that matter, it was
24 made in the Burwell Healthcare case.
25 In all of those cases, the agency said we found

1 some ambiguity, you have to defer to us. And in all of those
2 cases, Your Honor, the Court stepped back in the manner that
3 you and I were discussing at the beginning of my presentation
4 this morning -- the Court stepped back and said, well, these
5 are immense changes, and we don't ordinarily expect that
6 there's a Congressional delegation of discretion to make
7 changes this big. That's what they said in Brown &
8 Williamson; that's what they said in UARG; that's what they
9 said in the Whitman case and MCI Telecommunications.
10 And very important, Your Honor, you mentioned the
11 NAFA decision. NAFA did not make the argument we are making
12 in Judge Moss' assessment. He was very clear about that. In
13 his view NAFA only made a so-called Chevron Step 1 argument.
14 We are also making so-called Chevron Step 2 argument, and
15 we're saying their use of exemptive authority was arbitrary
16 and capricious.
17 THE COURT: Well, I've read his opinion, and I've
18 read the transcript of the hearing. He addressed Chevron Step
19 2. Do you mean -- I just want to make sure I understand what
20 you're saying.
21 Are you saying at the argument that NAFA did not
22 make the argument under Chevron Step 2 that you are now
23 making? Is that what you meant? Because he addressed Chevron
24 Step 2 in his opinion.
25 MR. SCALIA: I believe he addressed it in the

1 context of the meaning of "fiduciary." When it came to the
2 use of exemptive authority, he was very clear that in his
3 judgment, NAFA had not made an argument based on the MCI
4 Telecommunications case, the UARG case. Those cases weren't
5 cited to Judge Moss. He never addressed them. He gave short
6 attention to the Brown & Williamson case and attempted to
7 distinguish it on limited grounds. But importantly, before he
8 did that, he made clear that he didn't view the kind of
9 argument we're making as even presented.
10 And so the Labor Department bears a heavy burden to
11 get you past these claims of deference and explain how such
12 sweeping changes can be permitted through what in Whitman the
13 Supreme Court called a modest and ancillary provision. This
14 is a provision meant to reduce regulatory burdens, this
15 exemptive provision. They have used it to revolutionize the
16 regulation -- the regulation of the market for IRAs.
17 And if I can emphasize these points as well. What
18 makes it so extraordinary is, again, first, this is an agency
19 that doesn't have the authority to establish standards,
20 conduct oversight or enforcement with respect to IRAs, and yet
21 it's doing it. That makes this worse than the other cases I
22 mentioned.
23 Second, the statute itself was quite careful --
24 Congress has said -- or the Supreme Court has said many times
25 how carefully Congress drew ERISA, very mindful of the rights

1 and remedies that were being established.
2 Well, in Title I, which is employer-sponsored
3 plans, Your Honor, Congress established clear fiduciary
4 responsibilities and duties and very carefully delineated
5 rights of actions. For IRAs that wasn't done. They said IRAs
6 will be enforced by the Treasury Department, won't be private
7 right of actions, except under the securities laws or under
8 the state insurance regulatory requirements.
9 What the Labor Department here has done, it has
10 stepped in and said, "That's just not right. We need more.
11 We need much more regulation in the IRA space, and we're going
12 to impose it." That is just extraordinary. When Congress has
13 made such a calculated conclusion that employer plans should
14 be regulated one way and IRA plans should be regulated
15 another --
16 THE COURT: Well, where does that conclusion come
17 from, Mr. Scalia? I understand the Title I/Title II
18 distinction. I understand that. But I think the conclusion
19 that Congress has decided that IRAs are not subject to
20 regulation is overstated.
21 The question here is, is it subject to this
22 regulation. I don't think it's accurate to say it's not
23 subject to regulation.
24 MR. SCALIA: I would not go that far, Your Honor.
25 What Congress said is there is no private right of

1 action under federal law with respect to IRAs. What it
2 concluded was, there will not be fiduciary duties of loyalty
3 or prudence with respect to IRAs. They put it in the first
4 title and not in the second title. And few inferences are
5 clearer than that that was a conscious, purposeful
6 Congressional decision. And again, they gave the authority
7 over the IRA space to the Treasury Department, not the Labor
8 Department, and yet the Labor Department has stepped in and
9 imposed all of these requirements.
10 Now, in terms of how radical this use of the
11 exemptive authority is, Your Honor, the Labor Department
12 relies on other exemptive rules that it's adopted. But what
13 it's done here is something very different. Ordinarily when
14 there's an exemptive rule with conditions and you don't meet
15 the condition, you don't get the exemption. The statutory
16 prohibitions snap back into place.
17 But here, the Labor Department concluded again,
18 "That just ain't good enough. We've got to have more. We've
19 got to have class actions. We've got to bar liquidated
20 damages." You know, that is unprecedented for their exemptive
21 rules, and it's not the proper role of an agency who --
22 particularly when it has no regulatory authority and when it's
23 using an authority to reduce regulatory burdens.
24 Another way to look at it, Your Honor, is if I were
25 a broker-dealer, and looking at this in a cynical manner, I

1 would conclude, you know what? I actually will suffer less
2 consequence if I continue to receive commission payments and
3 don't use the exemption than if I do use the exemption. If I
4 don't use the exemption, I am subject to the tax code
5 penalties. If I do use the BIC exemption, I'm still subject
6 to the tax code penalties. But I'm subject as well to all of
7 the extra things that the Labor Department has concluded
8 should be here.
9 But the Labor Department doesn't have a role in
10 determining that Congress' conclusion about the penalties for
11 a prohibited transaction were insufficient. Congress
12 determined what would happen if an IRA fiduciary engaged in a
13 prohibited transaction and yet now the Labor Department is
14 stepping in and saying, again, "Not good enough. We need
15 more. We need more regulatory tools in order to enforce
16 compliance." That is not the role of Department of Labor as
17 in long line --
18 THE COURT: Let me make sure I'm following that
19 argument. I didn't read your brief quite that way, and it's
20 an interesting position. Let me make sure I'm understanding
21 it.
22 So your position is the statute itself reflects a
23 conclusion by Congress that the only penalty that can apply
24 for a breach of fiduciary duty in the common law sense
25 involving an IRA is the excise tax?

1 MR. SCALIA: And disgorgement. That is the only
2 sanction under federal law.
3 And again, the inference is -- or rather under
4 ERISA, because there are SEC penalties.
5 And the inference is especially powerful because of
6 all of the Supreme Court decisions, including by the way
7 Mertens, which talks about what a carefully considered, highly
8 developed regulatory structure ERISA is, and particularly as
9 relates to employer plans where you have this sort of tower of
10 duties and penalties, but they're carefully drawn.
11 For example, damages remedies are limited even
12 under ERISA. And yet when it came to IRA -- IRAs, Title II,
13 it's sort of a level field. There's really little that
14 Congress thought was appropriate in ERISA.
15 THE COURT: All right. But there's not preemption
16 in Title II, so that -- let me go back to the point of the
17 question I was asking.
18 For the moment let's assume a definition of
19 "fiduciary" that's the common law defamation of "fiduciary."
20 If there is a breach of a fiduciary duty involving an IRA,
21 there are state private rights of action available, not -- not
22 under ERISA, but under state regulation and common law, right?
23 That's not preempted by Title II.
24 MR. SCALIA: Two responses. I think that those
25 actions more commonly just take the form of a suit for a

1 breach -- say a state law suitability standard alike; those
2 are the standards that are applicable, because --
3 THE COURT: Creative lawyers will come up with a
4 variety of theories. It doesn't matter to me what the theory,
5 but such claims are still available without regard to this
6 regulatory scheme under ERISA, because there's not preemption
7 under Title II.
8 MR. SCALIA: It's a little hard to fully answer,
9 because nobody except, until now, the Labor Department has
10 thought an insurance salesman was a fiduciary. So I don't
11 think it's accurate to say that an insurance sales agent could
12 be sued for breach of fiduciary duties under state law.
13 But what's more important, my second point, is the
14 question here is what can be imposed through ERISA, that is
15 through Title II, and that's --
16 THE COURT: Well, let me interrupt you just one
17 moment just to make sure my question is clear.
18 The focus of my question is preemption. I want to
19 make sure we're in agreement. There's no preemption under
20 Title II. Whatever the state causes of action that are
21 available are available, not -- and they're not preempted by
22 ERISA.
23 MR. SCALIA: There's not complete preemption in the
24 same manner as ERISA. Normal preemption rules would still
25 apply under Title II, Your Honor. So, for example, if there

1 were direct conflict, there would be preemption.
2 You know, the Labor Department's position on this
3 is very interesting. And Judge Moss, in his decision, placed
4 a lot of emphasis on what he regarded as NAFA's concession
5 that there was -- that state law would trump the Best Interest
6 Contract and that there wasn't preemption.
7 What's interesting about that is, when it first
8 came to lectern, the Labor Department took a different
9 position and said there is preemption. Then in the course of
10 argument, it began to appear that Judge Moss would take a more
11 favorable approach toward the rule if there weren't
12 preemption, so the Labor Department got back up, they said
13 state law would actually trump. NAFA agreed. We don't agree.
14 We think that there can be preemption here.
15 We think the BIC was premised on the idea that the
16 requirements of the BIC contract will be binding and
17 effective. If the Labor Department now wants to come before
18 you, Your Honor, and say that state law will override the BIC,
19 then here's my question to them: How can you base a rule on
20 the claim that the BIC will have all of these fabulous effects
21 if, in fact, you believe that states will override the BIC?
22 THE COURT: Well, I found that discussion confusing
23 in oral argument. I -- I wasn't clear who was arguing what.
24 Let's leave it at that.
25 It's -- let's go on. I'm -- I want everyone to be

1 focusing as we go -- and you are, Mr. Scalia; I'm not being
2 critical -- on the distinctions between Title I and Title II.
3 MR. SCALIA: Yes, yes. And just to sum up that
4 point, Congress made a conclusion about the rights and
5 remedies appropriate under the Tax Code. The Labor Department
6 has tried to radically change that, can't do so.
7 With respect to the private right of action, that
8 is part and parcel of our argument they've misused their
9 exemptive authority. The most important point to make here is
10 that what makes this rule so extraordinary is that that
11 enforceable private right of action was a very purposeful
12 centerpiece of what the Labor Department did here. And it
13 simply cannot compare what it did here to other exemptive
14 rules or to these Agriculture Department contracts.
15 Just to give one example, it relies on an
16 Agriculture Department rule. The Agriculture Department is
17 insuring certain contracts. It says you've got to set forth
18 the contract terms. Well, of course it does. If you're going
19 to ensure a contract, you want to know what you're insuring.
20 What there's no evidence of is that any of these other
21 contract references and other rules were for one purpose,
22 which is to establish an enforcement regime. That's the only
23 reason you have the contract.
24 THE COURT: What's the enforcement regime?
25 MR. SCALIA: This is, first, the standards that are

1 being imposed under the BIC, but second, class action
2 liability, for example. The --
3 THE COURT: Are you saying that class action
4 liability arises because of the BIC, whether or not it is a
5 matter of state law?
6 MR. SCALIA: Yes, I am. I'm saying that the BIC
7 requires that firms subject themselves to class action
8 liability, which they otherwise would have the ability to
9 arbitrate instead.
10 Alexander v. Sandoval was very clear that a federal
11 agency can't create a private right of action. But what the
12 Labor Department did here is 81 different times in the
13 preamble to the BIC rule, it said it was doing what it was
14 doing to establish enforceable rights.
15 There may be close cases where a rule refers to a
16 contract, and you're not sure whether the agency was actually
17 trying to bypass Alexander v. Sandoval and create a private
18 right of action. But here, Your Honor, they made it crystal
19 clear that they thought creating this right of action was a
20 centerpiece, an absolutely essential part of what they're
21 doing. And they haven't cited a rule that's remotely
22 comparable. And we've also cited cases such as Astra and
23 Grochowski which say that you can't bypass the Alexander v.
24 Sandoval prohibition on agencies creating private rights of
25 action by using contract theory, which is exactly what the

1 Labor Department has done.
2 So again, Your Honor, there may be close cases
3 here, but you know that unlike anything else the Labor
4 Department has cited you, what they did here was set about
5 creating a private right of action.
6 And one way I would put it is, in a sense it's not
7 really about the BIC contract, because what -- when we come to
8 the private right of action, our complaint is with the right
9 of action; it's not about contract law. The reason you know
10 that the reason for the BIC contract is enforcement is that
11 they didn't require it for ERISA plans.
12 For ERISA plans, there's no contract requirement.
13 And why is that? Because they looked at the ERISA enforcement
14 regime and they said, "That's a good enforcement regime." The
15 Labor Department then looked at the IRA enforcement regime and
16 said, "Not good. We need to improve upon what Congress
17 provided." And so they required the contract in order to
18 establish an enforcement regime. Their first aim was an
19 enforcement regime. The contract was just a way to get there,
20 which tells you crystal clear that this is a bypass around
21 Alexander v. Sandoval.
22 There's a lot of emphasis, Your Honor, in the
23 discussion before Judge Moss and Judge Moss' decision as to
24 whether this was a state law action or whether it was federal
25 law. Again, the NAFA conceded it was a state law claim. We

1 don't make that concession. But more importantly, it just
2 doesn't matter, just doesn't matter.
3 Alexander v. Sandoval and Astra could not be
4 clearer that it's not the job of federal agencies to establish
5 new rights and remedies. And yet the Labor Department set
6 about imposing these BIC requirements with a single objective,
7 and that single objective was to create private rights and
8 remedies. That is inconsistent with Alexander v. Sandoval,
9 and it's also arbitrary and capricious.
10 And on that point, again, Your Honor, because you
11 mentioned Judge Moss' decision, when you look at that
12 decision, there's several points where the Judge was quite
13 careful to note a difference that he saw between our case and
14 NAFA's case. And this was another one of them. He said that
15 standing alone, Alexander v. Sandoval didn't prohibit what was
16 being done. We're not relying only on Alexander v. Sandoval,
17 just as we're not just making a Chevron Step 1 argument. I
18 think that's what Judge Moss was trying to say in that part of
19 his decision, that NAFA hasn't brought to me certain arguments
20 that he recognizes we had made.
21 He also -- and it may be at Page 56 of his
22 decision. He says, "An interesting argument concerning
23 Sandoval would be whether the Justice Department, in trying to
24 enforce its disparate impact rule, could have just required a
25 contract." He said, "Maybe that would have been a problem,

1 but NAFA doesn't raise that argument."
2 But, Your Honor, we do make that argument. We do
3 make the argument that if the Labor Department is correct
4 about Alexander v. Sandoval, it follows -- if we're correct
5 about Alexander v. Sandoval, it follows you can't use a
6 contract to attempt to bypass what the Department of -- what
7 Congress provided in ERISA.
8 And, Your Honor, if I don't have that page number
9 correct, I'll be sure to have it correct for you on -- on
10 rebuttal where Judge Moss very plainly narrowed and confined
11 the Alexander v. Sandoval argument that he saw being made,
12 including in a very, very long footnote where he noted that
13 NAFA hadn't even brought to him some of the cases that we rely
14 upon in our principal briefs. They weren't even raised with
15 him until a supplemental submission after argument.
16 Your Honor, to conclude, the Department of Labor
17 has done two things here that are closely linked and each --
18 THE COURT: I've got it, Mr. Scalia.
19 MR. SCALIA: Okay. First adopted an unacceptable
20 interpretation of "fiduciary." But secondly, it did so for
21 the purpose of imposing a set of obligations and enforceable,
22 suable rights, including class action liability, that it
23 simply wasn't its authority to impose.
24 It claims that Chevron permits this. But that was
25 the losing argument every time in UARG, in Whitman, in MCI

1 Telecommunications, in Brown & Williamson. This case goes
2 even farther, because the changes that are being made are at
3 least as great as in some of those cases. And the toehold
4 that the Labor Department is relying upon is even weaker as it
5 adopts a regime inconsistent with what Congress established by
6 an agency that lacks oversight and enforcement in the area and
7 it does so based on an authority to reduce regulation.
8 All of these rules should be vacated together,
9 because they were all adopted as a piece. The private right
10 of action itself was so central to what they adopted that if
11 this Court determines that even the private right of action is
12 flawed, that invalidates the BIC. And invalidation of the BIC
13 invalidates the fiduciary interpretation, because they
14 admitted that there would be serious adverse consequences if
15 their fiduciary interpretation existed without the exemption
16 provided in the BIC.
17 THE COURT: All right. Thank you.
18 MR. SCALIA: Thank you, Your Honor.
19 MR. OGDEN: Good morning, Your Honor. I'm David
20 Ogden. I represent ACLI, the NAIFA and six North Texas
21 associations.
22 THE COURT: I know you, Mr. Ogden.
23 MR. OGDEN: You do indeed, Your Honor.
24 THE COURT: I haven't seen you in --
25 MR. OGDEN: It's been 15 years, I think.

1 THE COURT: -- a month of Sundays.
2 MR. OGDEN: Something like that. It's very nice to
3 see you this morning.
4 THE COURT: I've dyed my hair, and you obviously
5 haven't dyed yours.
6 MR. OGDEN: This is frosted, I'm sure, Your Honor.
7 THE COURT: Good to see you, Mr. Ogden.
8 MR. OGDEN: Thank you so much, Your Honor. It's a
9 pleasure to see you.
10 So my clients are the insurance companies and the
11 insurance agents who sell annuity products, both variable
12 annuities and fixed index annuities.
13 I want to start by saying we endorse Mr. Scalia's
14 arguments. We've divided the issues. We agree that they
15 require vacatur of the rule. We also endorse and agree with
16 Mr. Guerra, who will be arguing with respect to fixed index
17 annuities. Specifically we believe that his arguments require
18 vacatur of the rule.
19 THE COURT: I want to ask one question about that.
20 MR. OGDEN: Of course.
21 THE COURT: Is it the position of the plaintiffs
22 that my options are to set aside all the rules or none, or
23 does the Court have the prerogative to set aside some portions
24 of the rule but not all of them?
25 MR. OGDEN: It is our position, Your Honor, that

1 the normal and appropriate remedy under the APA is vacatur of
2 the rules as a whole if you find that the APA has been
3 violated.
4 As I'll -- we are in addition, the ACLI and the
5 NAIFA plaintiffs, are making an additional argument not under
6 the APA, a direct argument under the implied cause of action
7 under the First Amendment, which presents different remedial
8 issues, specifically the potential for declaratory relief and
9 injunctive relief that protects the First Amendment rights of
10 our members, as we can discuss. But that's a separate issue,
11 non-APA question. With respect to violations of APA, vacatur
12 is the appropriate remedy.
13 I want to address two reasons, in addition to those
14 that my colleagues will talk about, why the rule must be
15 vacated or its enforcement enjoined.
16 First, it is a content-based regulation of
17 commercial speech that violates the First Amendment. And
18 second, the heavy burdens it places on companies and
19 individuals, like the members of my clients, that sell
20 variable and fixed index annuities, violate the most basic
21 principles of reasoned decision-making under the APA.
22 Judge Moss did not consider either -- any of these
23 arguments. They were not presented before him, and therefore,
24 this will be the first opportunity for there to be rulings on
25 these particular claims.

1 I'd like to start with -- with the First Amendment
2 issues, if I may, Your Honor. We think the rule is clearly
3 unconstitutional under the Supreme Court's analysis in the
4 Sorrell versus IMS Health case, which is a 2011 decision of
5 the Supreme Court, 564 U. S. 552.
6 The government has no answer for Sorrell, and
7 Sorrell really answers the points that the government has
8 tried to make. Just like the law struck down in Sorrell, the
9 rule is triggered by the content of commercial speech and
10 discriminates against commercial speech based on the content.
11 It's therefore subject to heightened scrutiny under the
12 analysis in Sorrell and many other Supreme Court decisions.
13 Sorrell was a case that involved private sales
14 pitches, just like those at issue here. And it demonstrates
15 that private sales pitches are protected by the First
16 Amendment, contrary to the government's first argument.
17 Just as in Sorrell, the rule's purposes and
18 assumptions are incompatible with the First Amendment, because
19 the whole point of the rule is to prevent listeners from being
20 persuaded by commercial speech.
21 And finally, as in Sorrell, the rule burdens more
22 protected speech than is justified, and it is not narrowly
23 tailored.
24 Moreover, because the rule raises serious First
25 Amendment questions, it must be rejected under the doctrine of

1 constitutional avoidance really at the threshold.
2 Now, let me go back and enumerate the reasons why
3 this is a content-based rule that is subject to the First
4 Amendment, for three independent reasons, Your Honor, under
5 the analyses that the Supreme Court has implemented over the
6 rules.
7 The regulation here is triggered by speech. It
8 applies purely to speech. The regulation is justified with
9 reference to attempting to ameliorate or affect the persuasive
10 value of speech. They're concerned about people being
11 persuaded, so its rationale is a justification based on the
12 effects of speech. And, third, it discriminates between types
13 of speech, recommendations of one product versus another,
14 which is discrimination based on the content of the speech
15 itself.
16 Now, in McCullen against Coakley in 2014, the
17 Supreme Court made clear, with respect to the triggering piece
18 of this, that a regulation is, quote, "content-based if it
19 requires enforcement authorities to examine the content of the
20 message that is conveyed to determine whether a violation has
21 occurred." That's 134 Supreme Court at 2531.
22 Well, in the rule's own words, it is triggered by a
23 recommendation which is defined as "a communication" -- and
24 this is a quote -- "a communication that based on its content
25 would reasonably be viewed as a suggestion that the advice

1 recipient engage in a refrain from taking a particular course
2 of action."
3 And further, the level of burden that's applied
4 depends upon whether that is a recommendation of a declared
5 rate annuity, in which case the burden is extremely low, or of
6 a variable or fixed index annuity, in which case the burden is
7 the BICE, which is extremely high.
8 And the Department of Labor has recognized --
9 THE COURT: Do you y'all want me to call this the
10 BIC or the BICE?
11 MR. OGDEN: It all depends whether it's the BIC
12 exemption or the BICE. I'm going to save myself a word, if
13 that's okay with you, and stick the E on the acronym. But
14 it's the same difference.
15 It applies to a communication based on its content.
16 That's the language of the rule. You're going to have to
17 search high and low for a regulation that makes it easier to
18 determine that it is a content-based regulation since it tells
19 you so.
20 Second, it is justified with respect to the content
21 of speech, which under the Reed decision, 135 Supreme Court at
22 227 (sic), and many other cases, is a second rubric, an
23 independent rubric for finding content basis.
24 As in Sorrell, Department of Labor's goal here is
25 to prevent salespeople from persuading purchases to buy things

1 that are in -- quote, in Sorrell's terms, "In conflict with
2 the goals of the state," close quote, because the state thinks
3 those transactions are not beneficial. That's the purpose,
4 the whole purpose of this regulation. It was the whole
5 purpose in Sorrell.
6 In Sorrell, what the state sought to do -- the
7 State of Vermont -- was to prevent the salespeople selling
8 brand name pharmaceuticals, in private conversations with
9 doctors, from persuading doctors to prescribe brand name
10 pharmaceuticals, because they're more expensive than generic
11 pharmaceuticals. And if they were persuaded by that private
12 commercial speech to prescribe the more expensive
13 pharmaceuticals, Vermont saw that as a bad thing for people
14 paying for them, the patients, and for the state, which was
15 also paying for them. That was something bad. They didn't
16 want them to be persuaded.
17 That was a content-based justification for the law
18 that required heightened scrutiny. This is obviously the same
19 thing. The concern that the Labor Department frankly has is
20 that salespeople who have an interest in the outcome of this
21 transaction will persuade buyers to buy their products,
22 exactly as the Sorrell case in Vermont was concerned about,
23 salespeople persuading doctors to prescribe products.
24 It's the --
25 THE COURT: Well, is your argument that the First

1 Amendment would be violated if there were an exemption
2 opportunity that did not have what you argue to be the
3 frailties of BIC?
4 MR. OGDEN: The threshold point, Your Honor, is
5 that the First Amendment, under Sorrell, requires heightened
6 scrutiny, which requires, first of all, that the rule directly
7 advance a substantial government objective and that it be
8 narrowly tailored.
9 The analysis of the BIC approach or an alternative
10 approach, if the alternative were triggered by speech in the
11 same way, would be a question whether that test was satisfied
12 by the particular alternative regime or by the BIC.
13 The BIC certainly doesn't satisfy it. As I'll
14 explain, its purpose is improper under the First Amendment,
15 because its purpose is to try to prevent even truthful
16 communications from persuading people to make decisions the
17 government thinks is bad.
18 In the Thompson case --
19 THE COURT: Let me back up for just a moment. I'm
20 not quite following that.
21 Do you mean by that, that the purpose of the
22 regulation is to prevent those who are now selling annuities
23 from selling them?
24 MR. OGDEN: The purpose of the regulation is to
25 prevent people from selling annuities if they have an

1 interest, a commercial interest, in doing so. They're
2 attempting to prevent people who are making typical sales
3 pitches, and not acting as fiduciary, from persuading people
4 to buy their products.
5 The regulation prohibits people from acting as a
6 normal salesperson and simply saying, as Mr. Scalia said, "Buy
7 my product; it's a good product; here's what it will do for
8 you." That's no longer good enough.
9 What you have to do is enter into a contract that
10 allows you to be sued, if it turns out that your
11 recommendation was not in best interest, if your
12 recommendation was -- if your compensation is unreasonable.
13 All of those are burdens that the statute place -- that the
14 regulation places on a truthful recommendation of a product.
15 You can't do it unless you comply with the BIC. So it's a
16 burden on truthful commercial expression.
17 And as Sorrell makes clear, the difference between
18 a ban and a burden is just a question of degree. And neither
19 one -- a content-based burden or a content-based ban, neither
20 one is constitutional, unless it satisfies the test. And here
21 it just clearly does not satisfy the test.
22 The third reason this is a content-based rule is,
23 again, was it discriminates between types of recommendations.
24 You get 8424 if you recommend a declared rate annuity. You
25 get much more regulation if you make a different

1 recommendation. Again, that's a recommendation of speech.
2 And the government could have directly regulated those
3 products, imposed restrictions on sales, on the contents of
4 those products. We're not quarreling with that. That's not a
5 speech-based restraint.
6 The problem here is that this is entirely aimed at
7 commercial speech, at solicitation, which in Edenfield, the
8 Supreme Court said is fully protected commercial speech. It's
9 triggered by speech. It's not about the content of the
10 product. It's about the content of speech. And, therefore,
11 it raises a huge First Amendment problem.
12 Now, the government makes a couple of arguments
13 that just don't withstand scrutiny as to why the First
14 Amendment doesn't apply, and I think the emptiness of their
15 arguments and the degree to which they're just readily
16 disposed of by existing precedent makes clear that they
17 recognize that if the First Amendment applies here, they can't
18 win the case.
19 Their first argument, they claim that the First
20 Amendment does not protect, quote, "a speaker providing
21 personalized advice in a private setting to a paying client."
22 That's their reply at 34. Well, yes, it does. The Sorrell
23 case and the Edenfield case -- the Edenfield case we rely
24 heavily on; they don't even cite in their reply brief. Both
25 of those cases clearly establish that private solicitation,

1 commercial speech, is fully protected by the commercial speech
2 doctrine. Both cases involve that. Sorrell, again, was
3 private detailing by pharmaceutical salespeople in private,
4 and Edenfield was a CPA soliciting business in private. In
5 both cases, the Court said that's fully protected speech.
6 There's reference to the professional speech
7 doctrine, the idea that this is somehow regulation of
8 professional speech. Well, first of all, the Supreme Court
9 has never recognized the existence of such a doctrine.
10 THE COURT: Well, but I'm in the Fifth Circuit.
11 I've got to follow Fifth Circuit doctrine.
12 MR. OGDEN: Well, the Fifth Circuit, in the
13 Serafine case, has said that it may permit regulation
14 incidental to a licensing scheme -- that was the 2016 Fifth
15 Circuit, 810 F 3d 354 -- but only insofar as the speech occurs
16 within the context of that -- what is being licensed, which is
17 their psychology relationship of trust and confidence, your
18 typical common law fiduciary relationship.
19 There's no licensing scheme here. DOL isn't
20 licensing anybody. What it's doing is directly regulating
21 speech. And it's doing so outside relationships of trust and
22 confidence.
23 Sure, if -- if I assume with my client a
24 relationship of trust and confidence, the state can ensure
25 that my speech to my client fulfills the obligations that I've

1 voluntarily undertaken pursuant to a licensing scheme.
2 But DOL specifically says here and recognizes, as
3 their brief says at 43, Note 40, and at 42, that this rule
4 specifically rejected the premise that the rule must limit
5 fiduciary status to those in relationships that have the
6 hallmarks of a trust relationship. They admit that the rule
7 does not limit fiduciary status to those already in
8 relationships of trust and confidence.
9 So what they're effectively claiming is we can --
10 the government can take any sales pitch, declare that the
11 person making it is a fiduciary, and then impose fiduciary
12 obligations on that speech. If that were true, there would be
13 no protection for commercial speech. Any sales speech could
14 be converted by fiat, artificially, the word they use, into
15 fiduciary speech.
16 But that's not how the First Amendment works. The
17 First Amendment says, sure, if there's a relationship of trust
18 and confidence, you can regulate consistent with that. But
19 the state can't create that and impose it on commercial
20 speech, because commercial speech, truthful commercial speech
21 is good; it has value.
22 In Sorrell, the Court says, "While the burdened
23 speech results from an economic motive, so too does a great
24 deal of vital expression." That's why commercial speech is
25 protected. And yet this rule is targeted at commercial

1 speech.
2 The second argument they make is that it's
3 justified as a regulation of misleading speech. Well, that
4 couldn't be more contrary to the doctrine. The Department
5 admits at AR 84, "The duties of loyalties and prudence in the
6 rule do not require proof of fraud or misrepresentation, and
7 full disclosure is not a defense to making an imprudent
8 recommendation."
9 Their problem is the taint of conflict, even of
10 truthful statements. They don't have to prove fraud; they
11 don't have to prove falsehood; they don't have to prove
12 anything is misleading. It's just if you have an interest,
13 represented by a commission or something, and you make certain
14 speech, you're regulated and you're in violation, as
15 Mr. Scalia said, unless you comply with all of this stuff.
16 That's not a concern about misleading speech. That
17 is a concern about commercial speech, because all commercial
18 speech is, quote, "tainted by the interest of the speaker."
19 And it still has value, and it's still protected.
20 Sorrell says, "While the burden speech results from
21 an economic motive, so does a great deal of vital speech." So
22 the mere possibility that commercial speech is misleading
23 doesn't justify regulation of it.
24 Under the Zaterer (phonetics) case, the government
25 has to prove it's misleading. It can't just say, "Oh,

1 commercial speech may be misleading." If that were enough,
2 all commercial speech could be regulated, could be banned.
3 So heightened scrutiny applies under Sorrell.
4 Clearly the statute can't -- the regulation can't withstand
5 that scrutiny.
6 The Department bears a heavy burden. It's entitled
7 to no deference under the Fifth Circuit's Porter decision.
8 The purpose here, the one we've talked about, is invalid.
9 What the Supreme Court said, as I mentioned, in Thompson, it
10 has rejected the notion that the government may regulate
11 truthful commercial expression to prevent people from making
12 bad decisions. That's a paternalistic justification that has
13 been rejected in the Virginia pharmacy case, in the Thompson
14 case, case after case. Sorrell, same difference.
15 Nor is it narrowly tailored. It has to be narrowly
16 tailored. First of all, as we've argued and is clear, they
17 have no basis for concluding that current regulation of
18 annuities in particular does not already address the problem.
19 All their studies that they looked at are studies of mutual
20 funds, performance before 2009, and a whole different
21 regulatory regime was put in place in 2010 that the SEC and
22 that the state insurance commissioners have said was robust
23 and different and would better protect consumers. They have
24 no study showing there's harm there. So they haven't even
25 shown that they need this rule, which flunks certainly the

1 directly advancing a substantial purpose. And it's not
2 narrowly tailored.
3 If they're concerned about role confusion -- and
4 there is a concern in the record that they say upwards of
5 60 percent of people who are buying products don't understand
6 whether the person is a fiduciary or not a fiduciary.
7 40 percent apparently, by their concession, do understand that
8 these aren't fiduciaries. But if that's a concern, role
9 confusion, that can obviously be addressed with a narrowly
10 tailored disclosure requirement.
11 To the extent the concern is about products, as I
12 said before, or unreasonable compensation, Congress could have
13 regulated those directly. Under Zaterer, Shapiro, those are
14 more narrowly tailored approaches that they were required to
15 take, and consequently the rule is invalidated.
16 Let me turn, if I may, unless you have questions on
17 the First Amendment issues, to the APA problems.
18 Now, the reasons, Your Honor, that the rule
19 violates the APA -- I want to turn to these two specific
20 things -- two specific arguments. We made a number. We think
21 all of them are important. I want to talk about two.
22 THE COURT: Let me -- I want ask one question about
23 the First Amendment.
24 MR. OGDEN: Of course.
25 THE COURT: And that's the waiver issue.

1 MR. OGDEN: Oh, sure.
2 THE COURT: This did not come up in the rulemaking
3 process, and I think there's support for the conclusion that
4 that argument was waived as a result. So I know it's in the
5 briefs, but that argument has my attention, so --
6 MR. OGDEN: I appreciate the opportunity to address
7 that, Your Honor.
8 First, we think the government is very -- basically
9 passing one sentence reference to it in each of their briefs
10 is probably itself a waiver of developing that argument. They
11 basically just asserted it. And under the Nola Spice Designs
12 case, we don't think they've preserved the objection.
13 But the first problem with the argument is, as I
14 said at the beginning, we are making this argument as -- not
15 under the APA. This isn't a backward-looking challenge to the
16 validity of the rulemaking process. This is a forward-looking
17 preenforcement challenge directly under the First Amendment
18 and the Declaratory Judgment Act, which doesn't depend on
19 having participated in the rulemaking at all.
20 The Sorrell case is an example of a preenforcement
21 challenge directly under the First Amendment.
22 THE COURT: Was waiver addressed in Sorrell?
23 MR. OGDEN: It doesn't arise, Your Honor, because
24 the issue is not the rulemaking. The issue is the regulation
25 and its impact on protected speech.

1 So a case, Minnesota Citizens Concerned for Life,
2 an Eighth Circuit decision, comes up in the context in which
3 there was a regulation, a federal regulation, that chilled or
4 affected speech, and they brought a preenforcement challenge
5 under it, and there was no even issue in the case as to
6 whether in the rulemaking there had been a challenge under the
7 First Amendment, because the question is simply whether you're
8 going to violate First Amendment rights by enforcing the rule.
9 And it would be a terrible thing if regulations
10 could adopted and enforced in violation of people's First
11 Amendment rights and they couldn't object on the ground that
12 they didn't participate in the rulemaking. And that's
13 obviously not the law. The First Amendment protects our
14 expression against violation by the government, and we can
15 bring a preenforcement challenge to that, even if -- even if
16 the rulemaking was long closed and we didn't even participate
17 in it. And so at the threshold, the argument is not
18 applicable, because we're entitled to be protected.
19 We also think we make the arguments -- and I think
20 they're certainly correct -- that constitutional claims are a
21 well-recognized exception to exhaustion requirements, even
22 with respect to the APA. The cases the government cites
23 involves OSHA and EPA rulemakings where there's an express
24 statutory or regulatory requirement of exhaustion not present
25 in DOL rulemakings. And the substance of the First Amendment

1 argument, without the label, was certainly in front of the DOL
2 for the reasons we've developed in our brief.
3 THE COURT: All right.
4 MR. OGDEN: So annuities are very important
5 products to retirees, uniquely among the products out there.
6 They address what is called longevity risk, which is the risk
7 of outliving your assets. And DOL doesn't dispute the value
8 of annuities. All annuities address longevity risk, because
9 they provide a guaranteed stream of income.
10 There are two other risks that drive the
11 choices that individuals make between annuity products.
12 There's inflation risk, which is the risk that inflation will
13 erode the value of your guaranteed income stream, and there is
14 investment risk, which is the risk that in an effort to
15 address inflation risk, by taking on the possibility of
16 investment growth, the investments will actually not grow and
17 they will lose value.
18 Declared rate annuities minimize investment risk
19 but expose the investor to inflation risk. Variable and fixed
20 annuities are designed to help address inflation risk by
21 having investments, but those obviously inject some degree of
22 investment risk. And the choice that consumers make is a
23 personal choice about how to balance those risks, given their
24 particular individual circumstances.
25 Customer satisfaction surveys and other evidence in

1 the record show that consumers who have these annuities are
2 very, very happy with them. But something very important
3 about annuities is that they are buy-and-hold products. You
4 buy them and you keep them, and they provide that stream of
5 income for life. And, therefore, they're not amenable to
6 being managed and having the people who provide them be
7 compensated on a basis of assets under management, because
8 very, very soon those one percent, two percent increments
9 would far exceed the value of one-time sale and there's not an
10 ongoing relationship. And so commissions are critical to the
11 sale of these products, uniquely, given how they are
12 buy-and-hold products.
13 And so when they sweep all of these products into
14 the fiduciary rule, simple sales speech, the way they -- the
15 way they do that, how they accommodate commissions becomes
16 critical.
17 Now, there are two ways in which they failed
18 utterly to fulfill their minimal obligations under the APA.
19 First, they admittedly failed to consider an obvious adverse
20 effect of the regulation on retirement savers, which
21 constitutes an important aspect of the problem under APA law.
22 And that is that because of regulatory incentives and
23 disincentives, not the merits of the products, consumers'
24 access to variable and fixed index annuities will be reduced.
25 They specifically say, "We didn't look at that. We recognize

1 we didn't look at that." And we'll talk about whether their
2 justifications for that hold up. We think they don't.
3 Second, they failed to meaningfully and reasonably
4 assess whether the robust existing regimes under federal
5 securities laws and state insurance laws sufficiently address
6 the concerns, and I'll try to address those both very briefly,
7 Your Honor.
8 DOL admits that it, quote, "Declined to quantify
9 reduction and access to these products," annuity products, as
10 a separate consideration. They say that in their opening
11 brief at 68. They had a legal obligation to do it, first of
12 all, because Michigan v. EPA says they must pay attention to
13 the advantages and disadvantages of agency decisions; second,
14 because the State Farm case says they must consider an
15 important aspect of the problem. And there's overwhelming
16 evidence in the record that they needed to address that the
17 burdens and the discrimination between products in the rule
18 would, for nonmerits reasons, prevent people who would benefit
19 from them from getting these products.
20 Now, DOL, their justification for not looking at
21 that issue is they just deny the problem exists. They argue
22 that marketshare of these products will decline only if the
23 products are not in the consumers' best interest. In other
24 words, only if they don't survive on the merits, they say in
25 their opening brief at 68.

1 "There's no reason to expect that variable
2 annuities, FIAs, or any other class of products will lose
3 marketshare unless that class of products is disproportionally
4 recommended on unjustifiable bases." So that's kind of --
5 we're saying you can only recommend them justifiably, and the
6 only reason they won't be recommended is if they aren't
7 justifiable. It denies, in other words, that regulatory
8 disincentives, the huge burdens created by this rule and the
9 risk that it imposes on people selling these products and the
10 discrimination, will have a nonmerits impact. But that's
11 certainly wrong.
12 The record shows that consumer access to these
13 products will be diminished by nonmerits factors so that
14 people who would benefit from them will not purchase them.
15 DOL acknowledged repeatedly that regulatory
16 costs --
17 THE COURT: When you say "will not purchase them,"
18 do you mean because there will be less access to them? Is
19 that what you mean?
20 MR. OGDEN: Correct. Because they will not get
21 information, people won't -- the salespeople won't bring the
22 information to them, because, (a), doing so will expose them
23 to massive risks to -- the recommenders, the information
24 providers, to massive risks they don't face today; and,
25 second, was they face much less risk recommending other

1 products under this regulation.
2 So the pressure created by these high burdens on
3 certain products and lower burdens on other products, will be
4 to encourage recommendations of the favored products and
5 discourage recommendations of the disfavored products, without
6 regard to the merits. That's just basic economic sense. It's
7 basic economic sense that if you increase the cost of
8 providing information, you're going to reduce the supply of
9 information. It's basic economic sense that if there's
10 different levels of burden imposed on different products,
11 you're going to encourage the lower ones. And, in fact, they
12 say that's why they did it. They say specifically, declared
13 rate annuities are in 8424 because it will, quote, "promote
14 access" to those products.
15 Well, if putting it in 8424 promotes access to it,
16 putting it in the BICE obviously does opposite of promoting
17 access. It discourages access to it.
18 Why is robo advice, robotic advice, in -- not in
19 the BICE? They say because it would, quote, be "adversely
20 affected" -- it would have adversely affected the incentives
21 currently shaping the market for robo advice.
22 Well, putting anything in the BICE will adversely
23 affect the incentives currently shaping the market for that,
24 again without regard to the merits, because of the burdens of
25 these risks.

1 Why were fixed index annuities moved by the
2 Department from 8424 to the BICE? Well, because if they
3 didn't do it, it would have created a regulatory incentive to
4 preferentially recommend FIAs. So if FIAs are in 8424 and
5 variable annuities are in the BICE, the Department says, well,
6 that would have given a regulatory incentive to preferentially
7 recommend FIAs.
8 Well, so they understand there are nonmerits
9 reasons why their regulation will drive recommenders to the
10 easiest recommendations to make. They acknowledge that.
11 Except now, when declared rate annuities are in there and the
12 other annuities are in the BICE, they suddenly say magically
13 no, the only impact on those will be the merits. Well, that's
14 just obviously nonsense.
15 What does that mean in real terms? Does it mean
16 they couldn't draw a rule like this? No. What it means is
17 they had to squarely acknowledge that issue, they had to
18 consider and quantify the potential impact, and they had to
19 decide it was justified. But they didn't do that. They
20 failed to consider an important aspect of the problem, and so
21 the regulation needs to be set aside.
22 The other thing they didn't do that they need to --
23 that the rule needs to be set aside for is that their
24 assessment of whether you even -- this regulation is even
25 needed was badly irrational.

1 Under the American Equity Investment Life Insurance
2 case, the D.C. Circuit in 2010 made clear that before imposing
3 significant new regulations, an agency must consider whether
4 existing regulation is already sufficient. That principle is
5 obviously a very important one. And this agency did purport
6 to consider that question as it was required to do.
7 It said at AR 486, "The new rule and exemptions
8 have the potential to restore to IRA investors billions of
9 dollars over 20 years, even in spite of existing regulations
10 protecting investors."
11 So they made a finding that existing regulations
12 were incapable of protecting investors against these harms.
13 Under Chenery, they have to live up to that. That has to be a
14 reasonable finding. So American Equity Investments says they
15 need to do it anyway, but they did it, so they had to do it in
16 a reasonable way. And it was raised -- this issue was raised
17 extensively by lots of commenters saying you don't need to do
18 this; there's new regulations in place since 2010 and since
19 2012 -- 2010 for annuities, 2012 for mutual funds -- that
20 changed the game. They were put in place by SEC, by FINRA, by
21 state insurance commissioners. They beefed this up; the games
22 changed. That's in the record.
23 The sole basis on which the -- the principal basis,
24 the most relevant evidence that's cited by DOL for the
25 proposition that those regulations in place since 2010 and

1 2012 don't fix the problem, are nine studies, none of which --
2 none of which address the performance of any investments after
3 2009.
4 So the SEC and FINRA put in place regulations in
5 2010, with respect to annuities, robust regulations that
6 changed the substantive rules that require new supervision
7 requirements, that impose new documentation requirements, that
8 impose surveillance requirements on a book of business to
9 ensure compliance. Regulation is in 2010. None of the
10 studies that the Department of Labor relies on to find that
11 billions of dollars of damage assess that period specifically;
12 in fact, assess it at all, except for a study they throw in
13 after the fact that nobody got a chance to comment on, which
14 is another due process violation. But none of those studies
15 address that. But that's the most relevant evidence,
16 according to them.
17 You know, the SEC said that that FINRA rule was
18 expected to, quote, "Enhance firms' compliance and supervisory
19 systems and provide more comprehensive and targeted protection
20 to investors regarding fraud and manipulative tactics, promote
21 just and equitable principles of trade, and increase investor
22 protection." That's what the SEC said that FINRA's new rules
23 would do.
24 NAIC said similar ambitious things about the
25 protection of consumers by its new rules in 2010.

1 And these are real regulators. Their view that the
2 changes they made six years ago and four years ago address the
3 problem were entitled to be taken seriously by DOL, and many
4 commenters said that they had. But DOL's evidence that they
5 had not addressed the problem and that billions of dollars
6 would happen despite it, was based on things that happened
7 more than six years ago, more than four years ago.
8 Second, they didn't deal with mutual funds -- with
9 annuities at all. Those studies are only about mutual funds.
10 So they say nothing, obviously, about the regulation of
11 annuities, nothing that can be relied upon about regulation of
12 annuities since 2010.
13 Well, the government says, "Nevermind, we have this
14 study that we've thrown in after the fact." Well, if that
15 study is important, their reliance on it without allowing
16 notice and comment on it was a violation of due process. We'd
17 have had a lot of things to say about why that study doesn't
18 change the game. For one thing, it's studying the performance
19 of products that were bought before 2010. So the question
20 isn't how did products that were bought before 2010 perform
21 after 2010; the question is how do products bought after 2010
22 perform.
23 But more fundamentally, if it's a critical thing,
24 they had to expose it to notice and comment and allow comment
25 on it. It's a violation of due process under the Air

1 Transport Association case from the D.C. Circuit for them to
2 rely on it and not allow comment.
3 But they also rely on what they call
4 nonquantitative proof. This doesn't just doesn't pass the
5 laugh test. Media reports that there are problems with
6 annuities. Well, that doesn't tell you anything about whether
7 existing law addresses problems out there.
8 Lawsuits, they -- they point to allegations in
9 lawsuits; not proven outcomes of lawsuits, but allegations in
10 lawsuits which suggest only that some plaintiff's lawyer
11 thought existing law did address it, because that's why they
12 brought a lawsuit under existing law.
13 FINRA and investor alerts from the SEC or FINRA
14 staff guidance, again, shows only that the regulators who put
15 these new rules into place are focused on these problems.
16 They don't show that their regulations aren't up to snuff.
17 Opinion surveys from 2003 and before obviously don't address
18 regulations in place 2010 and after. And surveys of market
19 data in other countries, I mean, really, Chile, India and
20 Germany, tell us nothing about whether regulation in the
21 United States is sufficient.
22 So for all of those reasons, their consideration of
23 existing regulation was obviously inadequate, Your Honor, and
24 requires vacatur of the rule so that they can do it right.
25 If you have no further questions --

1 THE COURT: All right. Thank you, Mr. Ogden.
2 MR. OGDEN: Thank you.
3 THE COURT: Mr. Guerra, good morning.
4 MR. GUERRA: Good morning, Your Honor. Joe Guerra
5 for the IALC plaintiffs.
6 We obviously join in the broader arguments that
7 you've been hearing about from Mr. Scalia and Mr. Ogden. And
8 I'm going to focus on this morning is an elaboration of
9 several of the points that he was making at the end as they
10 pertain to fixed index annuities and the Department's flawed
11 decision in placing them in the BIC exemption.
12 As you know, and as Mr. Ogden just alluded to,
13 these products are subject to regulation by states, 35 of
14 which have adopted the robust new 2010 model suitability
15 regulations that are directly aimed at preventing the harms
16 that flow from commission-based sales of these products and
17 the conflicts that those commissions may create.
18 Congress, in the Harkin Amendment, concluded that
19 those protections were sufficiently robust, that they ought to
20 preclude SEC regulation of these very same products, as long
21 as issuers are complying with them on a nationwide basis.
22 And on top of that, Your Honor, the Department has,
23 with respect to the 8424 exemption, layered on a best interest
24 obligation on agents as well as restrictions on misleading
25 statements and limits on reasonable compensation.

1 So you have both robust state regulatory efforts
2 and enhanced federal regulatory efforts with respect to these
3 very products, and yet the Department said that's not enough;
4 we need to put FIAs in the BIC exemption.
5 THE COURT: Let me back up to the Harkin Amendment
6 for a moment. I'm not clear on what the argument about the
7 Harken Amendment is. It's not a clearly -- well, maybe I'm
8 wrong in saying this.
9 Is it your position that the Harkin Amendment
10 itself prohibits this regulation?
11 MR. GUERRA: No. And I think that's exactly what
12 Judge Moss understood the NAFA plaintiffs to be arguing, that
13 somehow this regulation under the BIC exemption was treating
14 them as securities, and that was prohibited by the Harkin
15 Amendment. That is not our position.
16 Our position is when Congress takes a look at a
17 product that is alleged to have particular downside consumer
18 harms, based on the compensation scheme, and the SEC is saying
19 we're going to regulate those to prevent those harms.
20 And then to be very clear, Your Honor, the harm in
21 particular that the SEC cited was unsuitable products, selling
22 these products to people, because they're buy-and-hold
23 products, and some people need their money sooner than that.
24 So seniors were being taken advantage of buying products in
25 their 70s where they would have to hold them for a long period

1 of time before they would get their money.
2 And the SEC is looking at that and saying we need
3 to step in and regulate these as securities. And Congress
4 says no. When these products were sold subject to the 2010
5 model suitability regulations, as set forth by the NAIC,
6 there's no need for that federal regulation. And so one of
7 the fundamental flaws here that the Department committed was,
8 at a bare minimum, it needed to say what was different about
9 its regulatory regime that justified basically saying that
10 Congress may have been right with respect to securities, but
11 this is different; we need --
12 THE COURT: Is there -- is there any effort
13 underway as we speak in Congress to the equivalent of the
14 Harkin Amendment with respect to this regulatory scheme? Is
15 there a piece of legislation floating around about that?
16 MR. GUERRA: Not to my knowledge at the moment,
17 Your Honor. I think there was a resolution disapproving the
18 rule, but I think it was vetoed under the Congressional Review
19 Act.
20 But our fundamental point is under the APA, if
21 you're going to engage in reasoned decision-making and
22 Congress has made a judgment about these very products and
23 they don't need federal regulation when they're subject, when
24 they're sold, to these suitability rules, you need to
25 explain -- you need to account for that in your rule. And

1 they didn't.
2 And to just be clear, Your Honor, here's the
3 Department's fundamental rationale. They say these products
4 are complicated, the purchasers are vulnerable, and it's
5 difficult to undo a sale because of surrender charges. All of
6 that means that the purchasers are vulnerable to being steered
7 to a product that is unsuitable for them.
8 And again, the unsuitability is a major theme. So
9 we're not just talking about products that are not
10 necessarily -- they're suitable, but not the best.
11 Unsuitability is a major theme in the Department's rationale.
12 It says that it relies -- in its regulatory impact analysis,
13 it relies on the Financial Planning Counsel Administrative
14 Record 448, which talks about unsuitable products. It relies
15 on comments made to the SEC in 2008 that talked about
16 unsuitable comments -- excuse me -- unsuitable product sales.
17 It talks about sales of insurance products in India that are
18 unsuitable at Page 465. And at Page 484, it says conflicts
19 can, quote, "result in unsuitable sales of annuity products."
20 So the Department is relying on the notion that
21 these commissions create incentives to push people into
22 unsuitable products, when you have a state regulatory regime
23 that directly addresses that precise concern by requiring the
24 agents and insurers to elicit information about the person's
25 financial situation, their liquidity needs, their age, their

1 tax situation, and ensure, based on that information, that the
2 product you sell them is suitable for them.
3 So the Department recognized that in light of this
4 regulation, it needed to come up with some evidence that the
5 rules, in fact, aren't working. And as Mr. Ogden mentioned,
6 they relied extensively on studies about mutual funds. And as
7 he pointed out, they relied on -- those studies were out of
8 date and couldn't reflect what was actually going on after the
9 adoption of the NAIC standards in 2010.
10 But we have a more fundamental objection to which
11 he alluded. The studies are about mutual funds, not fixed
12 index annuities.
13 And there's a fundamental reason why you would not
14 expect the phenomena identified in the fund such setting to
15 recur with the FIAs. Most of the studies attributed the
16 underperformance that was identified with the mutual funds to
17 the incentive that the sellers have to encourage excessive
18 trading, which can result in market timing errors, which can
19 reduce results. FIAs are buy-and-hold long-term products.
20 Nobody jumps in and out of them chasing market returns. So
21 that theory for underperformance wouldn't apply to these
22 products.
23 And in addition, one study said we think the reason
24 for the underperformance is because too much money is spent on
25 the sales force and not enough on the people who are actually

1 actively managing the investments to make sure that they get
2 superior returns. That doesn't happen with an FIA either. An
3 FIA, your money -- if I purchase an FIA, my money is not in
4 the stock market, it -- being actively managed by the insurer.
5 I have a contractual guarantee that I'm going to receive a
6 certain amount of money when I start receiving my payments.
7 It's tied to an index that the insurance company does not
8 influence.
9 So the two basic rationales for why
10 underperformance occurred in mutual funds don't apply to my
11 clients' products. And, in fact, the Department didn't
12 suggest otherwise, contrary to the claims of its counsel in
13 this case.
14 If you look at Page 474, under the section
15 "Magnitude of Harms," there's a paragraph in which they say,
16 "There's strong evidence that ties adviser conflicts --
17 adviser conflicts to underperformance in the mutual funds."
18 And they walk through the summary of those studies. And then
19 they say, "Other types of investments, such as insurance
20 products, are also likely to be subject to underperformance
21 due to conflicts. See Evans Fahlenbrach, 2012."
22 So their linchpin for extrapolating from the mutual
23 fund studies is this Evans and Fahlenbrach 2012 study that
24 doesn't say one word about fixed index annuities. So it
25 cannot possibly be probative, relevant evidence that

1 demonstrates that the suitability regulatory regime is failing
2 to prevent real world harms.
3 And the government has no real answer to this. In
4 their briefs, they don't talk about this study at all. And
5 they also try to run away from the studies that tie
6 underperformance to excessive trading. And they say what you
7 should look at is just one study -- they call it the CEM
8 study. They say look at that study, because it shows
9 underperformance and it doesn't attribute to anything. And,
10 therefore, the Department of Labor could assume then an
11 unexplained underperformance in a mutual fund could be
12 extrapolated to the fixed index annuities.
13 And that's a fundamentally flawed argument for two
14 reasons. The first is, as Mr. Ogden alluded to, the Chenery
15 principle, the agency's counsel can't come in here and offer
16 new rationales for the rule. The Department's rationale for
17 extrapolation from the mutual fund studies was Evans and
18 Fahlenbrach, not the CEM study. And on top of that, the
19 Department itself has said in various points in its decision,
20 at 467 to '68 and 489, in the regulatory impact statement, "We
21 think that the underperformance that we see in the mutual fund
22 studies is, in fact, the product of the active management
23 theory," which is, of course, one of the theories that doesn't
24 apply to our products.
25 So you've got a situation in which the Department

1 is relying on evidence to justify a crucial aspect of its
2 cost/benefit analysis, and it's evidence that the regulatory
3 regimes in place aren't working and that evidence just doesn't
4 bear any relationship to the problem that we're trying to --
5 to identify.
6 And on top of that, they then rely on a lot of the
7 evidence that Mr. Ogden mentioned. They talk about sales of
8 insurance products in other countries, without showing that
9 those are subject to suitability rules. They talk about sales
10 of products like commercial -- insurance for commercial
11 construction, which they don't demonstrate are subject to
12 suitability rules, and then they talk about surveys and
13 complaints that predate the adoption of the 2010 model
14 regulations, as well as the media reports, I believe, date
15 from 2009.
16 So all of that information can't shed any
17 meaningful light on whether the regulatory regime here is
18 actually working and if there's a real world problem that
19 needs to be addressed through the BIC exemption, or even, for
20 that matter, the 8424 exemption.
21 And, in fact, what is -- there is evidence in this
22 record showing that there are very, very small numbers of
23 complaints about FIAs. And there is -- their own study that
24 they embrace, the Schwartz study, about insurance agents in
25 the 21st Century, that says that, in fact, suitability rules

1 do meaningfully mitigate the risks of conflicts of interest.
2 So you've got the two pillars that they rely on to
3 show that there are actual real world harms going on that need
4 to be addressed by these regulations, and neither of those
5 pillars is relevant evidence that can possibly demonstrate the
6 existence of those harms.
7 And so this is a situation, Your Honor, that's
8 aptly described by the D.C. Circuit in National Fuel Gas
9 Supply where they say, quote, "Professing that a rule
10 ameliorates a real industry problem but then citing no
11 evidence demonstrating that there is, in fact, an industry
12 problem, is not reasoned decision-making."
13 So for that reason alone, we think, putting the
14 FIAs in the BIC is invalid and has to be -- renders that
15 aspect of the rule subject to vacatur.
16 In addition, they didn't provide any reasoned
17 explanation, as a theoretical matter, for why suitability
18 rules wouldn't suffice. They say, well, they're not uniform,
19 but they don't actually identify any distinctions among the 35
20 states that have adopted those rules that is in any way
21 meaningful. What they're really talking about is the fact
22 that 15 states haven't adopted the rules.
23 First of all, that would not be a justification for
24 regulating the products sold in the 35 states that have, in
25 fact, adopted the rules. But it's not a justification for

1 regulating them at all, because the Harkin Amendment, which we
2 discussed a moment ago, creates a powerful incentive that says
3 if you don't want your FIAs subject to regulation under the
4 securities laws, you have to sell them on a nationwide basis
5 in compliance with the NAIC 2010 model suitability rules.
6 And there's evidence in this record that the
7 government quibbles with the wording of the assertions, but,
8 in fact, there's evidence saying that all of the -- virtually
9 all of these products are sold in conformity with those rules.
10 And the Department has made no contrary finding. In fact, it
11 notes in the RIA, in the Regulatory Impact Analysis, that most
12 are not registered with the SEC, which means that most are
13 not -- or are being sold in conformance with these rules.
14 So at the end of the day, what you have is the
15 government falling back on the idea that there is, indeed, a
16 real world problem. And they say this on page -- they quote
17 this very passage in the -- in their briefs from the
18 Regulatory Impact Analysis, which appears on Pages 426 to '27.
19 And this is the Department saying, "As elaborated
20 in Section 3.2.4 below, notwithstanding existing protections,
21 there is convincing evidence the device conflicts are
22 inflicting losses on IRA investors."
23 And where does Section 3.2.4 show up? That's the
24 page I just quoted to you earlier, 474, where their linchpin
25 for saying there's underperformance in FIAs, F-I-As, is the

1 Evans and Fahlenbrach study that doesn't talk about them at
2 all.
3 So you've got a complete evidentiary failure to
4 justify the BIC -- for putting FIAs in the BIC exemption. And
5 then you've got a failure to consider the cost of that
6 regulation.
7 Mr. Ogden has already alluded to the decreased
8 access to those products. That whole argument applies to our
9 FIA products as well as to variable annuities. We have the
10 additional argument with respect to FIAs that the Department
11 failed to consider the costs because this -- putting them in
12 the BIC disrupts, totally disrupts the distribution channel.
13 (Cellphone ringing.)
14 THE COURT: Just a second. I'm about to get a new
15 phone. Somebody's phone is ringing. Turn it off.
16 MR. GUERRA: They fail to consider the costs of
17 disrupting the existing distribution channel for FIAs, which
18 uses independent agents. And Department claims that it
19 understood this problem and that it addressed it, but, in
20 fact, it failed to consider the problem, and it's now trying
21 to pretend as though the problem doesn't exist.
22 And here is the essence of the problem. They say
23 there's no real -- you don't need to police sales of other
24 people's products by agents that you use; you only need to
25 police your own sales. That's a true statement that doesn't

1 address the issue.
2 The issue is if a company has an independent agent
3 selling one of its products and that agent is selling the
4 product of another carrier that offers what the Department of
5 Labor would deem a better product at a lower commission, and
6 the agent nevertheless recommends my suitable product at a
7 higher commission, that would run afoul of the BIC
8 requirements, because it would be, according to the
9 Department, recommending a less -- a product that was not
10 necessarily in the best interest --
11 THE COURT: I understand this argument. This is
12 what's the independent agent supposed to do and what are you
13 supposed to do, because you don't have control over the other
14 company's product.
15 MR. GUERRA: Correct.
16 THE COURT: And the agent is selling multiple
17 products from multiple sources.
18 MR. GUERRA: Right. And the Department now says
19 you don't have to worry about that because you can get market
20 information from these Wink's reports that show what the
21 commissions were on the other guy's products. But the problem
22 is, that's after-the-fact information. I can find out in
23 March, what the commission was on my competitor's product in
24 December, but that doesn't help me decide what to do in April
25 when I've got a new sale in front of me.

1 And Judge Moss did not agree with this argument,
2 Your Honor, but I think he did not have in front of him what
3 you have in front of you, which is Footnote 34 in the
4 government's reply brief, where they say in response to our
5 explaining the difficulty, they say, yes, that would violate
6 the BIC, and the insurer must have procedures and policies in
7 place that, quote, "make sure that doesn't happen."
8 And for the reasons I've described and we described
9 in our papers, you can't make sure that doesn't happen,
10 because --
11 THE COURT: So this -- this issue goes in the
12 bucket of administrative feasibility?
13 MR. GUERRA: No, Your Honor. Administrative
14 feasibility, the government argues, well, that's just a
15 standard about whether we can administer the rules we put in
16 place. This is an "APA failure to consider important aspect
17 of the problem" bucket.
18 And so you failed to consider this cost, which is a
19 very substantial cost, and you failed to consider the cost of
20 decreasing access. And yet you are touting this cost/benefit
21 analysis saying that all of these burdens are justified
22 because of the great benefits.
23 But if you look at Page 65 of their brief, their
24 opening brief, they have a chart that says cost of putting
25 FIAs in the BIC, $34 million. And as I've just explained, it

1 doesn't include these two major costs that we've identified.
2 And then it says hundreds of billions of dollars in benefits.
3 But there's no basis whatsoever for saying this hundreds of
4 billions of dollars, or any amount of benefits, attributable
5 to moving FIAs to the BIC. Because for the reasons I've
6 described and discussed earlier, they haven't demonstrated
7 that there are actual harms that are causing decreased
8 performance in the -- in these products that will be
9 alleviated by the -- the imposition of the BIC requirements.
10 So -- and the third -- the third defect under the
11 APA is that they drew an arbitrary and irrational distinction
12 between fixed index annuities and fixed rate annuities. They
13 say, "Well, we needed to keep a level playing field with
14 variables. Fixed rates" -- excuse me -- "Fixed index have
15 higher risks than fixed rates, and they're more complicated."
16 And at the end of the day, all of this boils down to a
17 complexity argument that doesn't suffice to explain the
18 distinction.
19 The variable annuities level playing field, that's
20 just another way of restating the distinction. Okay, so you
21 need to keep it level with the variable annuities, but why
22 does that justify creating an unlevel playing field with
23 respect to fixed rates? They don't answer that question.
24 Unless their theory is, well, because fixed index annuities
25 are as complicated as variables and not as complicated -- and

1 the fixed rates are less complicated, and that's just their
2 complexity theory.
3 With respect to the riskiness, Mr. Ogden has
4 described in a nutshell the flaw in that theory. The two
5 products are just mirror imagines of a risk/reward calculus.
6 And the Department had no basis for saying that it's always or
7 even most often the case that people should choose one risk
8 balance versus the other. So there's no reason for saying
9 that the fact that people -- some people decide to choose to
10 hedge against inflation risk but expose themselves to some
11 downside risk means that those products should be put in the
12 BIC exemption, particularly when the downside risk with
13 respect to the FIAs does not include the risk of losing your
14 principal.
15 So you're down to complexity. The theory is these
16 products are more complex. And there are two problems with
17 that. First, many of the things that they pointed to, to
18 identify the supposed increased complexity of FIAs, were
19 equally true of fixed rate annuities, surrender charges,
20 administrative fees, the right to change the terms and
21 conditions. You can't say that something is more complex than
22 something else by pointing to features that are common to
23 both.
24 But even putting that problem aside, Your Honor --
25 THE COURT: I think that says "stop."

1 MR. GUERRA: It tells me how much rebuttal time I'm
2 about to chew up.
3 THE COURT: Yeah, that's what I said.
4 MR. GUERRA: I am actually at my final observation
5 about this distinction, Your Honor.
6 And that is, what does complexity actually mean
7 here? Why is complexity a basis for saying we should heavily
8 regulate one product over another product because the one
9 product is more complicated? And at the end of the day,
10 complexity is actually just a fact that creates the risk of
11 potential harms to the consumer. Complexity means they may
12 not be able to appreciate that they're being steered to a
13 less -- an unsuitable product.
14 So that just poses the question, it doesn't answer
15 the question, about what's wrong with the existing regulatory
16 regime and whether it can address the risk that people will be
17 sold products they shouldn't purchase. And complexity doesn't
18 answer that question at all.
19 And if I can just illustrate it this way, Your
20 Honor. If, in fact, the regulatory regime was just a bunch of
21 disclosure requirements that said, "Before you sell an FIA,
22 you must tell the consumer about the following five features,"
23 then -- then the Department might have an argument where they
24 could say, you know, these products are so complicated, we
25 don't think that that regulatory mechanism is actually going

1 to solve the problem, because they will still be confused
2 after they hear those five things.
3 But that's not what the suitability rules do. The
4 suitability rules set a substantive standard and says you have
5 to look at all of this financial information and the
6 particulars of the purchaser's situation and determine
7 objectively that this is a suitable product for that person,
8 and that's enforceable and reviewable by insurance
9 commissions.
10 There's nothing about complexity that says that
11 that regulatory regime will not work. And so we're back to
12 the fundamental problem here, which is the Department decided
13 that it needed to regulate and subject fixed index annuities
14 to heavy regulation without determining that the existing
15 regulation was ineffective.
16 THE COURT: All right. Thank you.
17 Okay. Let's -- thanks very much, Mr. Guerra.
18 Let's take a five-minute break now.
19 If I let -- if I wait for everyone in this room to
20 go to the bathroom, I will resume on Monday. So I only care
21 about the people in front of the bar who are lawyers of record
22 who are speaking going to the bathroom. And you-all can go in
23 the jury room.
24 The rest of you, if you leave, be quiet when you
25 come back, please, because we're going to start in five

1 minutes, okay?

2 Thank you.

3 (Recess.)

4 THE COURT: All right. Okay.

5 MS. NEWTON: Good morning, Your Honor.

6 THE COURT: Good morning.

7 MS. NEWTON: Emily Newton for the government.

8 The government plans to --

9 THE COURT: I'm going to turn up your mic. for a

10 minute. It doesn't sound like -- give it a tap for me.

11 Okay.

12 MS. NEWTON: I understand Your Honor isn't keeping

13 time, and we will do so. But we plan to reserve 10 minutes

14 for rebuttal.

15 THE COURT: Okay.

16 MS. NEWTON: And with leave of the Court, I will

17 address the arguments made by Mr. Scalia and the First

18 Amendment argument made by Mr. Ogden, and my colleague,

19 Mr. Thorp, will address the remainder of the arguments.

20 THE COURT: Okay.

21 MS. NEWTON: Your Honor, plaintiffs' challenges to

22 the rules definition of fiduciary investment advice and the

23 exemption conditions have one commonality. They ignore the

24 statutory text that Congress adopted and the authority that

25 Congress gave to the Department to determine what conditions

1 would be appropriate in the case of transactions that are so
2 fraught with conflicts of interest that Congress prohibited
3 them altogether.
4 They seek to impose nontextual limitations where
5 Congress sought to apply fiduciary status broadly and where
6 Congress gave the Department broad authority to determine what
7 conditions are appropriate in the case of prohibited
8 transactions.
9 Plaintiffs' arguments cannot overcome the statutory
10 text. And they don't undermine the reasonableness of the
11 rulemaking, which accords with the text, the legislative
12 history, and the purpose of ERISA.
13 First, the rules definition of "fiduciary
14 investment advice" is a reasonable interpretation entitled to
15 deference. There is no dispute that the Department has the
16 authority to determine who qualifies as a fiduciary for
17 ERISA's purposes. And plaintiffs concede that Congress did
18 not provide a precise definition of what it means to render
19 investment advice.
20 Instead, as the Supreme Court has recognized,
21 Congress adopted a broad definition, quote, "commodiously
22 imposing fiduciary standards on those who actions can affect
23 the amount of benefits retirees will receive."
24 THE COURT: Let me -- I want to just ask you a
25 general question.

1 Is it your position that before this set of rules,
2 that the entities now affected by the new rule under Title II
3 were fiduciaries?
4 MS. NEWTON: They were only fiduciaries if they met
5 the five-part test that was set forth in the previous
6 regulation in 1975.
7 THE COURT: Okay. So the definition -- the effect
8 of the rules is to -- I want to -- this is the way I read the
9 briefs, but I want to make sure it's clear on the record. The
10 government concedes that the new -- that the rules expand the
11 definition of "fiduciary" that one would divine from the
12 five-part test?
13 MS. NEWTON: Yes, Your Honor.
14 The government concedes that the definition adopted
15 now in the rulemaking is broader than the five-part test. And
16 it's the government's position that the five-part test unduly
17 narrowed the definition of fiduciary investment advice. And
18 as the Department explained in great detail in the rulemaking,
19 it allowed those who are acting as fiduciaries to avoid
20 fiduciary duties and restrictions.
21 So, for example, when an investment adviser holding
22 him or herself out as an investment adviser, and not a
23 salesman, gives advice to an investor in regards to a
24 rollover, if that's one-time advice, it's not covered by the
25 fiduciary duties and restrictions, because the five-part test

1 had a requirement that advice be rendered on a, quote,
2 "regular basis."
3 The rulemaking seeks to remedy those -- the
4 narrowness of the five-part test so that those who are acting
5 as fiduciaries now have to abide by those duties --
6 THE COURT: Well, this product, generally speaking,
7 with some potential limited exceptions, would almost always be
8 a one-transaction business.
9 MS. NEWTON: A rollover recommendation?
10 THE COURT: Just say the annuity. I mean, there's
11 not going to be a continuing relationship with the person from
12 whom you purchased it.
13 MS. NEWTON: Not necessarily. Plaintiffs' members
14 actually do tout their services as, you know, developing a
15 relationship with investors. They often give advice on an
16 ongoing basis. They tout that as one of the merits of their
17 services, not just that they're selling a product, but they're
18 providing ongoing advice.
19 THE COURT: Well, is it the government's position
20 that a scenario such as the one that Mr. Scalia mentioned sort
21 of at the front of his argument, that if -- if the
22 conversation is simply, "I sell annuities, I have a number of
23 annuities to choose from, and I think a variable annuity is
24 the best for you" --
25 MS. NEWTON: Uh-huh.

1 THE COURT: -- or "I have a good variable annuity,"
2 are those covered by the rules?
3 MS. NEWTON: Yes, Your Honor. If it's based on the
4 particular investment needs of the investor or it's directed
5 at a particular investor. And importantly, they are holding
6 themselves out as investors, as the names of many of their
7 organizations show. They're not holding themselves out merely
8 as salesmen. And the rule doesn't --
9 THE COURT: You said investors. I think you meant
10 investment advisers.
11 MS. NEWTON: Investment advisers. I apologize.
12 Right.
13 And the rule does not provide a carve-out for
14 salesmen. The rule applies when a person renders investment
15 advice for a fee. And the fact is that in the course of
16 selling products, they are rendering investment advice.
17 So I think an important thing to note is, as a
18 threshold matter, if they're merely selling a product and
19 they're not rendering investment advice, the rule doesn't
20 apply, they don't qualify as fiduciaries.
21 But the rules definition applies where they make a
22 recommendation that's defined as call-to-action, to take a
23 particular action or to refrain from taking an action with
24 respect to investment property.
25 THE COURT: Well, if somebody just sets up a stand

1 outside a retirement home with a sign that says "annuities
2 here," is that covered?
3 MS. NEWTON: No, that's not investment advice.
4 THE COURT: Okay. "Good annuities here."
5 MS. NEWTON: No. That is advertising. And the
6 rule specifically states that it does not apply to general
7 advertising, marketing or education.
8 So when they are giving general information to the
9 masses or simply promoting that you should come talk to me,
10 that is not investment advice.
11 THE COURT: All right. Well, I want to use my
12 example one more time.
13 So a person shows up at the booth, and I'm the
14 person manning the booth, and I say, "I have these three
15 different kinds of annuities," is that covered?
16 MS. NEWTON: No. They would have to say, "I have
17 these three kinds of annuities, and based on your
18 circumstances, I think one of these three would be great for
19 you."
20 THE COURT: All right. "I have these three
21 annuities, but the one I personally like the best is this."
22 MS. NEWTON: Yes, that is investment advice.
23 THE COURT: Even though I know nothing and have
24 inquired about nothing involving the purchaser?
25 MS. NEWTON: Yes. Because it's directed toward a

1 particular advice recipient.
2 And the important thing is that Congress applied
3 fiduciary status broadly. It said anyone who renders
4 investment advice. And plaintiffs' own statements show that
5 they are rendering investment advice. They justify their
6 current compensation rates by the fact that they provide
7 investor information and a high level of services in the
8 course of selling their products. So it's not the case that
9 they're just selling a product. They are rendering investment
10 advice in the course of selling that product.
11 THE COURT: If -- in the context that you and I
12 just talked about, do you concede that that transaction, "I
13 have these three products, and the one I like the best is X,"
14 that that would not be considered a fiduciary relationship at
15 common law?
16 MS. NEWTON: I don't think -- it's the government's
17 position that the regulatory definition is broader than what
18 would be understood as a fiduciary relationship under the
19 common law, yes. And it's also the government's position that
20 that is perfectly acceptable under the statutory definition,
21 for multiple reasons.
22 First, the statutory text doesn't indicate that
23 there needs to be a relationship of trust and confidence
24 understood to be fiduciary under the common law.
25 And I think it's important to note, the plaintiffs

1 aren't just asking for there to be some evaluation of whether
2 they're in a trusted relationship. Plaintiffs go so far as to
3 argue that an investor can come to an investment adviser, put
4 their trust in that adviser, but so long as that adviser
5 doesn't accept that trust, they're not a fiduciary under the
6 rule. That's clear from ACLI's brief.
7 They cite a study that's cited in the rulemaking
8 that says that 60 percent of investors already believe that
9 they are to adhere to fiduciary duties. So they simply want
10 to be able to continue to disclaim fiduciary status because
11 they're salesmen or because there's no mutual understanding
12 that they are a fiduciary. And the rule -- and the statutory
13 language simply doesn't allow them to do that. And there's a
14 reason for that.
15 Congress determined that retirement savings
16 deserves special protection. They have tax-favored status,
17 and they're important to the well-being of Americans and their
18 dependents. So this isn't the sale of a normal product like a
19 car, as plaintiffs have suggested. This is investment advice
20 rendered during the course of a sale that Congress said is
21 important to protect.
22 In addition, again, they rely on the distinction in
23 the Investment Advisers Act that for the reasons that we have
24 explained and that the Court recognized in NAFA, just simply
25 are irrelevant here because the exclusion that's in the

1 Investment Advisers Act is not in ERISA.
2 And again, I just think where plaintiffs have
3 touted the fact that they're providing a high level of
4 services, and that's a reason that they're compensated for
5 those services, they should be held to a standard that allows
6 investors to do what they are already doing, which is rely on
7 them for trusted investment advice.
8 Plaintiffs' second claim is that the Department
9 doesn't have the authority to condition exemptions on
10 adherence to the impartial conduct standards that include the
11 duties of prudence and loyalty. But Congress gave the
12 Department broad authority to grant conditional or
13 unconditional exemptions to allow transactions to proceed only
14 if they are administratively feasible, in the interest of
15 retirement investors, and protective of their interests.
16 The Courts have said where Congress has delegated
17 that authority to not only grant the exemptions, but to make
18 the requisite findings in order to do so, those findings in
19 that grant are entitled to deference and can be overturned
20 only if they are arbitrary and capricious.
21 Here the Department determined that requiring
22 adherence to the impartial conduct standards in the case of
23 conflicted transactions was necessary so that advisers don't
24 rely on their own financial gain but are actually giving
25 advice because it's in the interest of the investor. That was

1 entirely reasonable, where the statutory requirements are that
2 any exemption be in the interest and protect the rights of
3 retirement investors.
4 Now, Plaintiffs' principal argument is that because
5 Congress imposed certain standards on fiduciaries to ERISA
6 plans, but not on fiduciaries to IRAs, that the Department is
7 somehow precluded from doing so. But as the government has
8 argued and as the Court recently found in NAFA, plaintiffs
9 aren't comparing apples to apples.
10 In the case of a conflicted transaction, Congress
11 didn't impose any standards; it prohibited the transaction
12 altogether and then it delegated to the Department the
13 authority to determine what standards would be appropriate in
14 order to protect the investors.
15 THE COURT: So your position -- I think this is
16 inherent in your position. But your position is that if you
17 get past the objection about the definition that you're
18 applying to a fiduciary, that you don't have to have any
19 exemptions at all. So if you have an exemption, you can have
20 any exemption that you want?
21 MS. NEWTON: Yes, Your Honor. The Department is
22 obliged to grant exemptions, based on the proposal that it
23 proposed in 2010 and received feedback from the industry that
24 they wanted more exemptive relief, and the Department
25 recognized that certain customary forms of compensation, under

1 the new definition, would be prohibited under the prohibited
2 transaction provisions in ERISA. And for that reason, it
3 provided the exemptive relief that it did through various
4 amendments to exemptions and through the BIC exemption and
5 Principal Transactions Exemption.
6 And it was entirely reasonable for the Department
7 to borrow the longstanding duties of prudence and loyalty that
8 Congress itself found was sufficient to protect retirement
9 investors in ERISA plans.
10 Plaintiffs' position would basically be that the
11 Department couldn't use any provisions or any requirements in
12 Title I and use those to protect investors in Title II plans.
13 But that would be unreasonable itself, because it would mean
14 that the Department couldn't, in order to serve and protect
15 retirement investors, use the same duties of prudence and
16 loyalty that Congress itself found protected investors in
17 ERISA plans.
18 There's simply no basis for limiting the
19 Department's discretion in this way, given the broad authority
20 that was delegated to it to determine how to best protect
21 retirement investors, and the plaintiffs can't explain why
22 requiring advice that's in the best interest of an investor
23 somehow does not meet the statutory requirement that any
24 exemption serve the interest and protect the rights --
25 THE COURT: Well, their argument is that Congress

1 expressed its intent with respect to ERISA plans but did not
2 express the intent to impose that duty in the context of IRAs.
3 MS. NEWTON: I think that argument would require
4 the Court to read Congressional silence to overcome the
5 express statutory authority that Congress did give to the
6 Department through its exemptive authority. And I think it's
7 just simply incorrect that the Department is limited to
8 relieving financial institutions from regulation.
9 Congress expressly allowed for conditional or
10 unconditional exemptions. The Department has required
11 substantive conditions to take advantage of an exemption in
12 the past, and plaintiffs can't point to any case questioning
13 the Department's authority to do so.
14 Turning to plaintiffs' third claim, it's premised
15 on their assertion that the Department created a new private
16 right of action in violation of Alexander versus Sandoval.
17 The Department did not create a federal cause of
18 action. Under the rulemaking, no IRA-holder can go into
19 federal court and enforce the prohibited transactions
20 provisions or the terms of the BIC. And plaintiffs don't
21 explain how Congress, much less Department, could have created
22 a state cause of action. Instead, what the Department did was
23 merely required that specified terms go into contracts that
24 are already being entered into between IRA fiduciaries and
25 investors.

1 I think it's important to note what those terms
2 are. The BIC exemption requires that they acknowledge that
3 they are a fiduciary, they disclose their conflicts of
4 interest and the fees that they are collecting, that they give
5 advice in the best interest of retirement investors and they
6 not adopt policies -- or they have policies in place to ensure
7 adherence to those impartial conduct standards and not adopt
8 incentives that would lead their advisers to violate the
9 impartial conduct standards.
10 These aren't sweeping changes for onerous
11 requirements. These are fundamental duties of fair dealing
12 that have applied to fiduciaries for decades, if not
13 centuries.
14 THE COURT: Well, I want to go back to the question
15 I was asking you at the beginning.
16 I mean, you -- are you meaning by your argument
17 that each of those duties applies to those involved in these
18 IRA transactions without BIC?
19 MS. NEWTON: No. No, Your Honor.
20 THE COURT: Okay.
21 MS. NEWTON: So if a financial institution
22 qualifies as a fiduciary under the regulatory definition of a
23 fiduciary, he or she is subject to the prohibited transaction
24 provisions under the code. They are only required to adhere
25 to the impartial conduct standards and enter into a written

1 agreement containing the terms that I just noted if they are
2 seeking to rely on the BIC exemption.
3 So it's only when they are seeking to engage in a
4 transaction that Congress otherwise prohibited, because it's
5 so fraught with conflicts of interest, that they would need to
6 agree in a written document to these specified duties and
7 restrictions.
8 THE COURT: All right. So I understand the
9 argument of the plaintiffs to be -- I understand the briefs
10 are full of there's creation of private right of action.
11 That's not literally true, because, for the reasons you've
12 just said, there's no federal private right of action here.
13 But their argument essentially is that you are
14 imposing regulation on them that you're not entitled to impose
15 by making it impossible for them to operate without claiming
16 the exemption, and therefore it is a backhanded way of
17 imposing that regulation. That's -- that's the way I
18 summarize the argument.
19 I've read this repeatedly, this private right of
20 action. I'm having a hard time figuring out what it means,
21 because there's not literally that. But I think the argument
22 reduced to its essential is what I just said. It's framed
23 differently in the briefing.
24 MS. NEWTON: Right. And so I'd like to address
25 that. I think you're right. There is no creation of a

1 private right of action. And that's what Sandoval stands for,
2 unless there is no Sandoval problem. And so I think the
3 question is then whether the Department has the authority to
4 require these written agreements contain certain contract
5 terms.
6 And I think there are two --
7 THE COURT: Well, let me just put a little tail on
8 that. And because the plaintiffs would have to invoke the BIC
9 exemption to operate, they would thereby be subject to claims
10 that they would not otherwise be subject to. That -- that's
11 the rest of the argument.
12 MS. NEWTON: Right. So I think there are a few
13 points for that.
14 So first of all, financial institutions are already
15 subject to breach of contract claims for the contracts they
16 enter into with investors.
17 Second of all, my colleague will discuss the
18 workability of the exemption. But there are -- Morgan
19 Stanley, for example, has said that it will retain its current
20 forms of compensation and it will use the BIC exemption. So
21 it will reform its policies to do so. So it's simply not the
22 case that this is unworkable. The Department cited numerous
23 ways in which the industry can either reform its compensation
24 practices so that it doesn't have to engage in a conflicted
25 transaction, or it can take advantage of the BIC exemption to

1 get exemptive relief.
2 But I also think you mentioned that they argued
3 that the Department doesn't have the jurisdiction or the
4 authority to do so. That's simply incorrect. It is
5 indisputable that the Department has the authority to define
6 fiduciary for purposes of the code for IRA transactions and
7 that it has the authority to grant exemptions that are
8 conditional or unconditional in the case of IRA transactions
9 when they are conflicted.
10 They cite extensively Whitman and MCI
11 Telecommunications, and there are key differences between
12 those cases and what is done here. Not only is it not the
13 sweeping change that they characterize it as, but it's
14 incorrect to characterize the Department's authority as modest
15 or ancillary.
16 As the Court recently recognized in NAFA, Congress
17 unambiguously granted the Department broad authority, end
18 quote, to grant administrative exemptions, subject only to, as
19 plaintiffs concede, quote, "broadly worded statutory
20 requirements that they" be in the best interest -- "that they
21 serve the interests and protect the rights of retirement
22 investors."
23 Again, their position that they can only relieve
24 entities of regulation is simply at odds with the statutory
25 text that allows the Department to grant conditional

1 exemptions. And unlike in Whitman and MCI Telecommunications,
2 where the Court found that the agency's interpretations were
3 at odds with the statutory text, here as we have explained,
4 the Department's requirements to enter into an enforceable
5 agreement agreeing to give advice that is in the best interest
6 of retirement investors, perfectly accords with the statutory
7 requirements.
8 In regards to the contract provision in particular,
9 they raise Astra and a number of other cases. And as the
10 Court in NAFA recognized, those cases are distinguishable from
11 what we have here. In those cases, claims were brought by
12 individuals claiming to be third-party beneficiaries of a
13 contract. And at bottom, the Court said that they sought
14 through the guise of a contract claim to enforce statutory
15 provisions for which Congress had not provided a private cause
16 of action.
17 Importantly, here investors would not be attempting
18 to enforce any statutory provision. It's actually the exact
19 opposite of Astra. There the Court found significant that the
20 plaintiff was bringing the claim based on a violation of a
21 federal statute and not based on any independent legal
22 obligation under the contract. Here the legal obligation
23 arises only from the contract and not from any statutory
24 provision. I think plaintiffs try to confuse enforcement of
25 the prohibited transaction provision and enforcement of the

1 contract terms.
2 THE COURT: Well, to -- I think their argument is
3 this contract is being forced upon them. There would not be a
4 contract. And the only reason they have a contract is because
5 to operate, they have to claim the exemption and the exemption
6 requires a contract, and once they have the contract, then
7 they're subject to state law that would establish a potential
8 claim for breach of contract, breach of fiduciary duty, and
9 all of the other --
10 MS. NEWTON: Yeah. Well, that's simply incorrect.
11 All of these transactions that they're engage to already
12 involve contracts with investors.
13 THE COURT: But not with these terms.
14 MS. NEWTON: Not with these specified terms, but
15 they're already subject to state law breach of contract
16 claims. And that is important, because it makes what happened
17 here distinguishable from all of the cases that they cite.
18 For example, Mertens and Russell basically stands
19 for the proposition that the Courts won't read into ERISA new
20 remedies to enforce statutory terms. But again, this is not
21 enforcing the statutory terms. This isn't a new remedy. IRA
22 contracts are already enforceable in state courts. And
23 importantly, in Astra, the Court noted that the agency might
24 have authority to require -- to allow for third-party claims.
25 Here the Department is not acting pursuant to a

1 general grant of authority, as was the case in Sandoval, for
2 example. Here the Department is acting pursuant to a broad
3 authority to determine what safeguards are appropriate if
4 these transactions are to move forward at all.
5 The fact that the Department simply required
6 minimum contract terms to be put in contracts that they're
7 already entering into simply just isn't beyond the pale, and
8 it doesn't meet the standard to show that that is arbitrary
9 and capricious in light of the statutory requirements that any
10 exemptions need to be in the interest and protect the rights
11 of retirement investors.
12 Your Honor, I'm happy to address any other
13 questions you had on that point.
14 And I would want to emphasize, you noted the
15 preemption issue. And if that was a bit confusing, we
16 apologize. But want to make clear that in the case of IRA
17 transactions, ERISA's preemption provision does not apply.
18 And so when claims are brought in state court, the remedy and
19 enforcement of that contract will be governed by state law
20 contracts.
21 THE COURT: That's what I understood you -- you to
22 be saying in your argument.
23 MS. NEWTON: Then turning to Plaintiffs' First
24 Amendment claim, we think there's no merit to this claim for
25 various reasons.

1 Your Honor noted waiver of the claim. It is the
2 general rule that absent exceptional circumstances, Courts
3 will not consider questions of law that were not presented to
4 the agency during the notice and comment period.
5 Plaintiffs did not present their First Amendment
6 claim. They referred to traditional legal principles, and
7 that's what they're saying was sufficient to alert the agency
8 of their claim. That's simply not the case. They must allege
9 their claim with sufficient specificity to alert the
10 government of what their claim is, and they simply didn't do
11 so. They don't argue that exceptional circumstances are
12 present here. And there is no merit to their other two
13 reasons for being allowed to present their claim here.
14 First they argue that because they're bringing a
15 claim under the Declaratory Judgment Act, waiver doesn't
16 apply. First of all, Sorrell wasn't -- didn't involve a
17 rulemaking, so there was no opportunity for notice and
18 comment.
19 And they also cite Weaver versus U. S. Information
20 Agency. The challenge there was to a prepublication review
21 process, and that case merely stands for the proposition that
22 exhaustion isn't required where there's no administrative
23 process to exhaust. There simply wasn't an administrative
24 process to exhaust. Here there was nearly a six-year notice
25 and comment rulemaking process in which they had every

1 opportunity to present their claim and they didn't.
2 This is confirmed by a case that plaintiffs cite,
3 Ramirez versus CBP, 709 F Supp 2d 74, which says that, "Weaver
4 stands for the proposition that exhaustion is required for
5 constitutional claims for equitable relief when administrative
6 process is available," end quote.
7 That case, as well as several others in the Fifth
8 Circuit, Trinity Industries, which we cite in our brief, and
9 BCCA Appeal Group both involved constitutional claims and in
10 both cases the Fifth Circuit said that they were waived, so
11 it's simply not the fact that because they're bringing a
12 constitutional claim --
13 THE COURT: What case were you citing for that?
14 MS. NEWTON: I apologize. Trinity Industries is --
15 THE COURT: I have that. I thought that's what you
16 were --
17 MS. NEWTON: Okay. Thank you.
18 THE COURT: Thank you.
19 MS. NEWTON: They cite two cases, Dawson Farms and
20 Ramirez, for the opposite proposition. But Dawson simply
21 stands for the proposition that administrative exhaustion is
22 not required where the claimant challenges the
23 constitutionality of a statute, not the constitutionality of a
24 regulation, which is what we have here.
25 And Ramirez confirms that exhaustion is generally

1 required, but the Court allowed the claim to proceed there
2 because exceptional circumstances had been shown, because
3 plaintiffs have shown that there would be irreparable harm if
4 they were not allowed to proceed with their constitutional
5 claim.
6 But in addition, even if the Court were to reach
7 the merits of plaintiffs' First Amendment claim, we think it
8 fails for several reasons. First, the rulemaking is a
9 regulation of professional conduct, not a regulation of
10 speech. And the Fifth Circuit, as well as the Third, Fourth,
11 Ninth and Eleventh, have expressly recognized the doctrine and
12 said that where a regulation of conduct has an incidental
13 effect on speech, it doesn't violate the First Amendment. And
14 there is no dispute that the rulemaking here applies to
15 personalized advice to a paying client in a private setting.
16 So the professional speech doctrine would apply here.
17 Now, plaintiffs argue that the problem is that the
18 rule impermissibly defines "fiduciary," and so the imposition
19 of fiduciary duties, that no Court has held violates the First
20 Amendment, is impermissible because the regulation simply
21 applies those duties to individuals who are not fiduciaries.
22 I think there are two problems with that argument.
23 First, as we've argued, the rules definition comports with the
24 statutory definition. Plaintiffs don't dispute that the rules
25 definition comports with an ordinary understanding of what it

1 means to render investment advice. They don't even analyze
2 those terms. And ERISA applies fiduciary status us to those
3 who render investment advice for a fee. And so to the extent
4 plaintiffs are challenging the application of fiduciary status
5 and duties on First Amendment grounds, they would have to be
6 challenging ERISA as well as numerous other -- as I'll get
7 into in a later component of this argument, numerous other
8 regulatory regimes that do apply to certain individuals or
9 industries.
10 But more importantly, for the First Amendment
11 argument, is that even if the rulemaking applied certain
12 duties to individuals who are not understood to be
13 fiduciaries, it's irrelevant for First Amendment purposes
14 because the relevant inquiry is whether they're giving
15 personalized advice in a private setting to a paying client.
16 And there's no dispute here that they are, and that's where
17 the professional speech doctrine applies.
18 Now, plaintiffs have said that the Supreme Court
19 majority has never recognized the doctrine. While it's true
20 that they have never expressly recognized the doctrine, it is
21 implicit in several Supreme Court opinions. For example, in
22 Arolik, the Court upheld an Ohio ban on a lawyer's in-person
23 solicitation of employment as, quote, within the proper sphere
24 of economic and professional regulation."
25 In addition, in Planned Parenthood versus Casey,

1 there was a Pennsylvania provision at issue that required
2 doctors to provide certain information to women if they were
3 considering an abortion. And the Court said because First
4 Amendment rights are implicated only as part of the practice
5 of medicine, which is licensed and regulated by the
6 government, there was no First Amendment problem.
7 So the doctrine is certainly recognized in several
8 Supreme Court opinions and provides a basis where we're not
9 saying it's entirely free from First Amendment scrutiny, but
10 it would require a very low level of rational basis review.
11 And even if the Court were to analyze plaintiffs'
12 First Amendment claim as regulation of commercial speech, the
13 rulemaking easily satisfies First Amendment scrutiny here
14 because it only regulates -- if it regulates speech at all, it
15 only regulates misleading advice and misleading statements.
16 I listened carefully today, hoping that I would
17 better understand exactly which part of the rulemaking
18 plaintiffs are challenging on First Amendment grounds. But
19 the only speech that it arguably regulates is misleading
20 advice. Investment advisers can't give advice that is not in
21 the best interest of an investor. And plaintiffs don't
22 explain how recommending a product that is not in the
23 investor's best interest, when the investor thinks that
24 they're giving advice that is in their best interest, is not
25 inherently misleading. And the Department has also shown that

1 that conflicting advice is -- has, in fact, been deceptive.
2 The Department has shown that because of conflicts, and as my
3 colleague will get into further, investors are losing
4 retirement savings and they stand to lose over $95 billion
5 over the next ten years if this rule doesn't go into effect.
6 So because it only regulates misleading advice and
7 misleading speech, to the extent it regulates them at all, the
8 Supreme Court has said that it doesn't deserve First Amendment
9 protection at all.
10 THE COURT: Well, let me pursue that, because I'm
11 not following that.
12 I mean, it regulates more than misleading speech;
13 it just punishing misleading speech, doesn't it? I mean, if
14 you're subject to the regulation, you're subject to the
15 regulation. You may be subject to the regulation and not get
16 in any trouble because you're not doing anything that's
17 improper.
18 I guess your position is, well, it's a prohibited
19 transaction, unless there's an exemption, and if there's an
20 exemption, then ipso facto, it's not misleading speech.
21 MS. NEWTON: No, Your Honor. Our position is that
22 it's a prohibited transaction, and Congress can prohibit the
23 transaction altogether, despite the fact that that transaction
24 obviously entails speech, because it is misleading.
25 THE COURT: So your position is it's innately

1 misleading. Every transaction of the type that the rules
2 purport -- well, intend to regulate is inherently misleading
3 unless the exemption is activated?
4 MS. NEWTON: No, Your Honor.
5 THE COURT: Okay.
6 MS. NEWTON: I apologize.
7 So our position is that every transaction that
8 would fall within the prohibited transaction provisions does
9 have the potential to mislead, because, as Congress has
10 recognized, those transactions are fraught with conflicts of
11 interest.
12 But our position is that under the rulemaking,
13 plaintiffs can say whatever they like. They can recommend
14 whatever products they like, as long as they're not
15 recommending products that aren't in the investor's best
16 interest. And the standard is that the government can
17 regulate speech that is inherently misleading or has, in fact,
18 been deceptive. And plaintiffs can't show why recommendation
19 to buy a product, that's not actually in the investor's
20 interest, is not inherently misleading.
21 So if I were to go in and say, "What would you
22 recommend?" and an investment adviser were to say to me, "This
23 product would be good for you; I recommend buying this
24 product," I'm going to believe that that is the best product
25 for me, the product that I should buy. Relying on that, that

1 is inherently misleading, if, in fact, it's not the best
2 product for me, but it's the product that makes the most money
3 for the financial institution or the adviser recommending it.
4 And that is the only speech that the rulemaking even arguably
5 regulates. So it's not truthful speech, it's not speech
6 that's not misleading; it's only recommendations --
7 THE COURT: Well, let's go back to my example. You
8 said it would be covered by the rules if I said to the person
9 that comes by my booth, "I like this one." How is that
10 inherently misleading?
11 MS. NEWTON: I don't think "I like this one" -- so
12 the determination of whether or not someone is providing a
13 recommendation is an -- under the rule, it's an objective
14 determination based on the context of the transaction. So
15 someone would look at the recommendation and say were they
16 actually providing a call to action to buy an investment
17 product. And if it doesn't meet that threshold, it's not a
18 recommendation. So "I like this product," "I generally sell
19 great products," that's not investment advice until it is
20 recommended to the specific person that they should buy that
21 product.
22 And I think even if the Court were to determine
23 that the rulemaking has some effect -- and I should note that
24 plaintiffs don't challenge the disclosure provisions of the
25 rulemaking. They don't -- on First Amendment grounds. They

1 don't challenge the contract requirement on First Amendment
2 grounds, and they don't do so because the Supreme Court in
3 Milovich made it clear that those requirements would be
4 subject only to rational basis review. So I understand their
5 challenge to be to the fact that they have to adhere to
6 fiduciary duties under the impartial conduct standards.
7 And lastly, even if the Court were to determine
8 that the rulemaking regulates nonmisleading speech that is
9 content based, strict scrutiny still does not apply. It's
10 well established that commercial speech is afforded less First
11 Amendment protection. And the Supreme Court confirmed in
12 Central Hudson and Sorrell that the content -- that content
13 regulation of commercial speech is permissible if the
14 government has a neutral justification for the regulation.
15 Plaintiffs cite cases like Reed, Brown and Playboy.
16 None of those involved commercial speech. There's no dispute
17 that there are different standards that apply to traditional
18 speech and commercial speech and that the latter gets better
19 protection under the First Amendment. So those cases are
20 simply inapplicable.
21 The only case that they cite that does involve
22 commercial speech is Sorrell. And in that case, as plaintiffs
23 note in their opening, the Court determined that the
24 regulation should be subject to, quote, higher -- "heightened
25 scrutiny." That was not strict scrutiny. They went out of

1 their way not to use that term. And circuit courts
2 interpreting Sorrell have determined that the scrutiny
3 necessary is something akin to the intermediate scrutiny test
4 that was applied in Central Hudson. If Sorrell were to have
5 held otherwise, it would be overruling decades of Supreme
6 Court precedent that has said commercial speech necessitates
7 lesser First Amendment protections.
8 And importantly, in Sorrell the Court applied
9 heightened scrutiny, because the law at issue was based on the
10 government's disagreement with the message conveyed and not,
11 as is the case here, on a neutral justification provided by
12 the government.
13 So the Supreme Court has repeatedly said that even
14 where there are distinctions between a speaker or a listener
15 or based on the subject matter -- for example, "Laws which
16 favor one set of speakers over another are subject to strict
17 scrutiny under the First Amendment only if the law reflects
18 the government's preference for substance of what favored
19 speakers have to say." That's Turner Broadcasting Systems
20 versus FCC, 512 U.S. 622. So it's just not the case that
21 strict scrutiny would apply here.
22 And as we noted in our brief, strict scrutiny would
23 also not apply here, because the reason that there are any
24 distinctions between speakers and listeners and subject
25 matters in the rulemaking, it's for the very reason that the

1 speech could be prohibited altogether, because of the
2 different levels -- degrees to which the speech would be
3 misleading or more conflicted and likely to harm investors.
4 So finally, the rulemaking easily satisfies even
5 the highest level of scrutiny that could possibly apply to it,
6 which would be internet -- intermediate scrutiny under Central
7 Hudson. The rulemaking directly advances of the government's
8 substantial interest to protect retirement investors from
9 conflicted investment advice. Plaintiffs don't dispute that
10 the government has a substantial interest here.
11 The rulemaking provided extensive analysis of how
12 it will mitigate or eliminate conflicts of interest and save
13 investment advisers over $30 billion over ten years in one
14 segment of the market alone.
15 And the rulemaking is also no more extensive than
16 necessary. The Department evaluated numerous alternatives,
17 including a disclosure-based regime that plaintiffs advocate
18 for, and found that none would protect investors as
19 efficiently and effectively as the rulemaking.
20 It made numerous changes to the rulemaking in
21 response to comments from the industry to reduce costs and
22 make it more easily complied with. That includes providing
23 additional exemptive relief at the behest of the industry.
24 And it ultimately adopted a flexible, principle-based approach
25 that allows the industry to determine how best to come into

1 compliance with the standards set forth.
2 So for all of these reasons, we think there is no
3 merit to the plaintiffs' First Amendment claim, and the
4 government is entitled to summary judgment.
5 Thank you, Your Honor.
6 THE COURT: I'm just going to caution everyone with
7 the obvious, but I know there are some reporters here. I have
8 in the past read about something I was thinking because of a
9 question I was asking. That is a dangerous proposition.
10 You'll know what I'm thinking when I issue my opinion. My
11 questions are questions, and they don't convey anything but
12 I'd like an answer to my question. So if you read in the
13 press tomorrow that I've tipped my hand on how I'm coming out,
14 that would be wrong. If I'm going to, I will say "I'm tipping
15 my hand now."
16 Good morning.
17 MR. THORP: Good morning, Your Honor. Galen Thorp
18 for Department of Labor.
19 My colleague primarily addressed the agency's
20 authority, and I'll address questions that largely involve the
21 sufficiency of the evidence.
22 It's important to emphasize the Court's narrow role
23 under the APA's arbitrary and capricious clause, which in the
24 context of plaintiffs' arguments, as they've essentially
25 conceded, boils down to whether the agency entirely failed to

1 consider an important aspect of the problem.
2 The APA standards are amply satisfied here, as
3 demonstrated by the Department's thorough analysis, reasoned
4 explanation for its choices. The Department has established
5 in many different ways that despite existing federal and state
6 regulatory -- regulations, advisers' conflicts of interests
7 are substantially harming retirement investors. To mitigate
8 that harm and serve the public interest, it conducted an
9 exemplary rulemaking. It proposed principle-based standards
10 that can flexibly apply to many different circumstances and
11 types of products, it sought and weighed the public input
12 regarding those proposals, and it revised its proposals in
13 light of the recommendations of the industry and the public.
14 I'll focus first on the cost/benefit analysis that
15 has been -- has been challenged here. Plaintiffs cannot
16 overcome the presumption of validity that inheres in
17 administrative action or show that the Department's thorough
18 analysis fell below what this Circuit and the Court has termed
19 "minimum standards of rationality."
20 Plaintiffs would like the Court to apply a more
21 searching -- sort of cost/benefit requirement, but that's in
22 excess of what the APA requires. Michigan versus EPA, the
23 Supreme Court earlier this term, said that a formal
24 cost/benefit analysis is not required by the APA but that some
25 consideration of cost is generally appropriate, and the agency

1 does have discretion in regard to, quote, "How to account for
2 costs."
3 There's no doubt the agency considered costs and
4 benefits in this rulemaking. It's not the case like some
5 other cases that have come up occasionally where an agency
6 takes action and says, "Oh, we didn't have to analyze
7 cost/benefit." They thoroughly -- the extensive record here
8 shows that that was thoroughly addressed.
9 And the Department concluded, after weighing the
10 pros and cons, that it expected the investor gains under the
11 rulemaking to be very large relative to the compliance costs
12 making the rule, quote, "economically justified and sound."
13 That's 484 of the administrative record.
14 So let's talk about the evidence that the
15 Department looked at. It found all of the evidence pointing
16 in the same direction, overwhelmingly, that in the various
17 types of quantitative and qualitative evidence, whenever you
18 have a professional adviser and an inexperienced client and
19 the adviser has a conflict of interest, it ends badly for the
20 consumer. Uniformly found that.
21 So this wide body of evidence led them to
22 reasonably conclude that conflicted advise about mutual funds,
23 annuities, other retirement investments, inflict significant
24 harm on the --
25 THE COURT: Where's the evidence in the record

1 about annuities? There's a lot of evidence about mutual
2 funds. But for the reasons that Mr. Guerra mentioned, they
3 seem different than the typical annuity transaction. Where is
4 the study on annuities in the record that was considered
5 before the rules were adopted?
6 MR. THORP: Yes, Your Honor.
7 So I was point to the Schwartz and Seligman article
8 that was published in 2015. The quote I have is on Page 31682
9 of the administrative record, which surveyed regulation of
10 insurance agents.
11 THE COURT: When was that published in 2015?
12 MR. THORP: It was a -- selected for publication in
13 2015. I think plaintiffs have actually attached the published
14 version of it.
15 THE COURT: When?
16 MR. THORP: When in 2015?
17 THE COURT: My question was: What was in the
18 record before the rule was adopted?
19 MR. THORP: Oh, the rule was adopted in 2016, Your
20 Honor. So this is in the record.
21 THE COURT: Okay. I'm sorry. I stand corrected.
22 And the rule was issued for comment April of 2015,
23 adopted April 2016?
24 MR. THORP: Yes, Your Honor.
25 THE COURT: And this study -- is it a study? This

1 is the short --
2 MR. THORP: It's a survey of -- kind of a
3 metanalysis of a lot of studies.
4 THE COURT: Of annuity transactions?
5 MR. THORP: Of actions by insurance agents,
6 including annuities and other types of insurance --
7 THE COURT: Okay. Give me that record citing.
8 MR. THORP: So 31682 is -- is a pincite within the
9 article.
10 THE COURT: What's the -- I'm asking you for the
11 cite in the record. What's the cite in the record?
12 MR. THORP: Yeah, I'm sorry. That's --
13 administrative record 31682 is the page number in the
14 administrative record in that study.
15 Are you looking for -- do you want a document
16 number?
17 THE COURT: Yes, because I have a lot of documents,
18 but I don't think I have 31,632. If I do, I haven't read
19 everything.
20 MR. THORP: Yes, Your Honor. Sorry.
21 To be clear, the Supplemental Joint Appendix the
22 parties filed, Document 115, in the administrative record,
23 includes throughout the table on the left side of the page a
24 document number, and on the right side the administrative
25 number page ranges.

1 THE COURT: Okay.
2 MR. THORP: Sorry. I was citing the page range.
3 The document I'm talking about is 28, Document 28.
4 THE COURT: Okay. Thank you.
5 MR. THORP: Sorry for the confusion.
6 And on the page I indicated, it states that neither
7 regulation nor competition is stronger for insurance agents
8 and that -- and that it expected that on net, that conflicts
9 of interest -- that all of the evidence points to the fact
10 that conflicts of interest are a problem for insurance sales.
11 So the Department's reasoning is -- the plaintiff
12 sort of focused on the fact that there's no quantified study
13 of the effect of conflicts in the insurance space. And
14 there's a simple reason for that. The insurance company holds
15 on to this data very closely, and it's not provided to
16 researchers, is the short answer.
17 Mutual fund studies can be done, because a lot of
18 that data is -- is publicly disclosed under SEC regulations,
19 sold by broker-dealers or registered insurance advisers,
20 and -- I'm sorry -- investment advisers. And that data is
21 publicly available and can be analyzed.
22 So plaintiffs would have the Court rule that
23 because they close-hold their data and there's no quantified
24 studies out there, therefore the government can't regulate.
25 And that's simply not the case.

1 This Circuit in 2010 in ConocoPhillips said, "An
2 agency doesn't need to await development of information in the
3 future. It must make do with the available information."
4 And so what the Department did here is looked at a
5 variety of studies, the quantified studies in the mutual fund
6 context, and other measure on the qualitative side. For
7 example, there is a -- an analysis of continued commissions in
8 casualty insurance. It's not the same annuity sort of product
9 here, but it's insurance agents selling and found substantial
10 conflicts of interest there in the incentives that were
11 provided. That's discussed in the Regulatory Impact Analysis
12 on Page 438 of the record.
13 Also, field experiments of life insurance sales.
14 This again is discussed in the Schwartz and Seligman article.
15 It's discussed by the agency on Pages 464 to 465 of the
16 record. Insurance agent surveys that show that they
17 themselves are aware of the conflicts of interest, the
18 problematic incentives, again discussed on the same page we
19 just cited. And other regulators' observations about the
20 abuses in the system. For example, the National -- the North
21 American Securities Administrators Association, which is on
22 Page 413 -- I'm sorry -- 41538 of the administrative record.
23 So all of the evidence points in the same
24 direction. And plaintiffs argue that the mutual fund studies
25 cannot be analogized to the insurance context, and the

1 Department simply concluded otherwise, and the Department's
2 conclusion is reasonable. So if I may, I'd like to talk about
3 the mutual fund studies and why they can be extended to the
4 insurance context.
5 So first, the Department, to put a finer point on
6 its general finding of problematic conflicts in this whole
7 arena, analyzed nine studies that look at broker-sold mutual
8 funds. And these nine studies, it used these to estimate the
9 degree to which the conflicts decreased investor returns as
10 compared to direct-sold mutual funds. And it found that the
11 conflict decreased investor gains by about half a percent to
12 one percent a year.
13 It then did a more narrowly tailored analysis,
14 relying on what has been called the CEM study -- the lead
15 author was Kristofferson, so I'll call it Kristofferson
16 here -- that looked at -- to determine the effect of the
17 rulemaking on the front-end-load mutual funds. So
18 front-end-load mutual funds are mutual funds that are sold and
19 the broker immediately gets a share of that -- of that load
20 fee, basically essentially a commission.
21 So when the broker receives a commission that's
22 comparable to the insurance agent -- receives a load share,
23 that's comparable to the insurance agent getting a commission.
24 And what the study found, it looked only at the difference in
25 those with load shares and those with no load shares and the

1 comparison between the degree of the commission. Basically
2 the result of the study was that the higher the commission
3 that the broker received, the worse the investor did on the
4 product.
5 THE COURT: Okay. But I'm still questioning
6 whether it is reasonable to draw the conclusion from those
7 studies. One could think through why that would likely be so.
8 Why does that necessarily follow with respect to annuity
9 transactions, which are just descriptively different than the
10 purchase of a mutual fund or stock or a variety of similar
11 financial products?
12 MR. THORP: Because what this study isolates is one
13 type of conflict, the incentive of the broker at the front end
14 of the transaction to sell things that are in the broker's
15 interest rather than the investor's interest. And given the
16 actual comparability between -- fundamental comparability
17 between the FINRA regulation of broker-dealer selling mutual
18 funds and the regulation of insurance agents selling
19 annuities, they're fundamentally similar.
20 For example, both laws have suitability
21 requirements. And both laws are fundamentally based on
22 disclosure regimes. And neither set of -- neither set of laws
23 in any way addresses the loyalty question.
24 If any -- under both regulations, if any product is
25 minimally suitable, satisfied that provision, the agent

1 selling the product can sell what maximizes the benefits to
2 the agent. And that is the fundamental difference between
3 this rulemaking and those regulatory regimes.
4 The improvements in 2010 and 2012 in the state
5 regulations and the FINRA rule don't change -- they say
6 they're fundamental shifts. They improve the suitability
7 requirements perhaps and some supervision of that suitability
8 requirement, but they don't change the nature of the regime.
9 And there's no reason to expect that the conflicts will
10 substantially go away.
11 Indeed, the Department did a supplemental analysis
12 that's laid out in detail in Appendix A of the Regulatory
13 Impact Analysis that looked at data through 2015 and found
14 that the results remain the same.
15 So because they're the same sorts of regimes, and
16 this study in particular does not deal with timing issues
17 or -- or other aspects that would apply more to mutual funds
18 that are turned over more frequently and just isolates the
19 nature of the incentive conflict, it's reasonable for the
20 Department to extend it.
21 It perhaps wouldn't be reasonable for the
22 Department to extend the quantification and say because we
23 quantified this effect here, we can quantify exactly the same
24 monetary value on the other side. That's not what the
25 Department did. Because the Department found that

1 market-wide, the quantified gains to investors in this one
2 corner of the investment market outweighed the entire
3 compliance cost for the whole industry.
4 That suggests that even if the insurer -- the
5 insurer gains in the annuity market were perhaps lower than
6 these gains, that wouldn't undermine the -- the nature of the
7 rulemaking, because that would just be adding benefit that the
8 Department wasn't able to quantify.
9 Does that make sense, Your Honor?
10 THE COURT: Well, I guess what troubles me is that
11 there are a variety of kinds of financial arrangements between
12 brokers and customers, just a variety of different
13 transactions. Don't need to summarize all of those.
14 My understanding is that in this space, all of the
15 insurance agents who are selling these are compensated on a
16 commission. They might get a different commission for
17 different products, but it's only a commission, unless this
18 rule or something else in the marketplace prompts a change in
19 that.
20 So in the mutual fund space, there's different
21 kinds of transactions. So one could analyze are people who
22 are paying a fixed fee getting better investment advice than
23 people who are compensating with their broker based on a
24 commission, which in and of itself -- I know enough to be
25 dangerous, because I wrote my article in 1975 on the

1 suitability standard. So there is an incentive, just a
2 general incentive, nonspecific to a person, to churn and gin
3 up activity. That doesn't necessarily translate to a
4 different space where everyone is compensated on a commission
5 basis.
6 MR. THORP: Your Honor, the ability to study it
7 doesn't transfer the same way.
8 THE COURT: Okay. Well --
9 MR. THORP: But the nature of the conflict wouldn't
10 inherently change.
11 THE COURT: Okay. Well, I want to follow up on
12 that, and I really am just asking this because I don't know.
13 In the context of rulemaking like this, do you have
14 the authority to get information other than to just ask nicely
15 and say --
16 MR. THORP: No, Your Honor. We don't have subpoena
17 power. Congress does, but we don't.
18 THE COURT: Okay. All right.
19 MR. THORP: And the Department -- we laid in out in
20 our briefs that we did ask for the information from plaintiffs
21 after the first -- after we withdrew the first rulemaking and
22 followed up with letters, I think in preparation for this
23 rulemaking, and they said we either don't have it or we won't
24 turn it over or it will be just too burdensome for us to
25 provide it to you.

1 But it can't be that federal agency's regulation of
2 a space depends upon the industry turning over data from which
3 sort of specific quantifiable studies can be done. It remains
4 true that plaintiff can point to no evidence that -- that
5 there are not substantial conflicts of interest in this -- in
6 this space, whether the industry generally or with insurance
7 in particular.
8 Now, I would note that Your Honor's concerns about
9 the applicability of the evidence really only goes to the
10 indexed annuity sort of side of it. Because variable
11 annuities compete with mutual funds and are regulated under
12 the FINRA rules as well. So the notation that the regulatory
13 regimes are substantially different doesn't really hold up.
14 The real teeth -- the teeth of the regime that
15 applies to the variable annuities is the FINRA rule. And
16 while -- and while the insurance rules also apply to variable
17 annuities and exclusively apply to indexed annuities, the fact
18 is, the nature of the regime isn't fundamentally different.
19 What plaintiffs pointed to in their reply brief is,
20 well, the difference is that there has to be a supervisory
21 sign-off on the suitability ground for insurance. That's not
22 true for mutual funds. That doesn't -- that could protect
23 against suitability errors, but it doesn't change the
24 conflicted incentive problem.
25 And so when a study isolates the conflicted

1 incentive problem for the seller, there's reason -- and that's
2 consistent with all of the other data available to the
3 Department, it's reasonable to extend the observation that
4 serious conflicts are expected in the annuity space.
5 In the annuity space, the commissions are
6 substantially higher than broker -- than the mutual fund
7 commissions. The compensation is more opaque, and the
8 investor is less aware of what actually is being paid.
9 For example, the -- the sales pitch for -- for
10 annuities is often, "Don't worry about paying me. I'm paid by
11 the company." And the reality is that that commission they're
12 being paid by the company is -- the company covers it out of
13 the gains on the product, so their return. So you're paying
14 for the service out of the reduced returns on your product.
15 I would note that for -- apart from the annuity
16 applicability of this, plaintiffs also challenge these studies
17 straight up. But all of the grounds upon which they challenge
18 them were raised and addressed in the rulemaking by the
19 agency. And the Fifth Circuit in Associated Builders said,
20 "It's not the role of the Court to weigh the evidence pro and
21 con." Again, also Alamo Express, the Fifth Circuit in 1982,
22 saying, "It's not the function of the Court to reweigh the
23 evidence." So when the Department has done a reasonable job
24 of assessing plaintiffs' critiques of these various studies
25 and weighed the issues, it's not for the Court to -- to

1 reweigh it. The agency hasn't gone out of bounds.
2 Plaintiffs also suggest that somehow there are
3 costs that should be added that weren't appropriately
4 considered. For example, they say that consumers will be
5 deprived of assistance. They colloquially refer to the
6 Department's response to this as conceding that we didn't look
7 at that. That's fundamentally untrue. What wasn't done is a
8 quantification of a harm to consumers, because the Department,
9 looking at all the evidence, including some somewhat
10 comparable regulatory actions in the U.K., concluded that
11 consumers would not lose any -- not meaningfully lose access
12 to investment advice, whether they were small investors or
13 large investors.
14 THE COURT: Well, I understand my task here is not
15 to just engage in a flurry of second-guessing here about,
16 well, if I were okaying this, this is what I would have looked
17 at. The question is whether the conclusions are justified by
18 what was done and whether there were things that the
19 regulatory scheme mandates be done that were not done. It
20 doesn't have to be perfect. There's plenty of cases that say
21 that.
22 MR. THORP: Yes, Your Honor.
23 THE COURT: So I take that. I understand that.
24 MR. THORP: Thank you.
25 But the point as far as whether there should be

1 additional -- so what I was talking about a bit ago is sort of
2 whether the Department has appropriately concluded that there
3 are substantial conflicts of interest that harm investors.
4 And I think the Department has shown that.
5 The plaintiffs' second critique on the cost/benefit
6 analysis is that somehow there were costs that should have
7 been quantified or considered that weren't. And the one
8 they've talked about this morning is -- is that consumers are
9 going to lose access to products. In the annuity space, they
10 said that there's going to be reduced access.
11 THE COURT: Well, because -- let me just finish the
12 thought on that. I understood that to mean because sellers
13 will leave the space --
14 MR. THORP: Yes, Your Honor.
15 THE COURT: -- because the regulatory cost -- I'm
16 using that in a different sense now --
17 MR. THORP: Yes.
18 THE COURT: -- is too great for them to incur.
19 MR. THORP: Yes, Your Honor. And the Department --
20 what's relevant here under the APA standards, the Department
21 considered this question, so it's not something the Department
22 entirely failed to consider. And the Department concluded
23 that investors would retain access to products.
24 Plaintiffs are confusing two different things.
25 They're saying because some -- in this dynamic marketplace,

1 where people choose how to respond differently, some market
2 actors may choose to leave the space. But that doesn't mean
3 that consumer access will be diminished. Reduced
4 recommendations of a product is not reduced consumer access,
5 unless plaintiffs are saying that the only reason plaintiffs
6 buy product is because they're strongly recommended by certain
7 advisers.
8 As long as consumers have the options available,
9 even if some market participants choose to sort of reallocate
10 their resources, that doesn't fundamentally mean that
11 consumers lose, particularly if the -- if the actors that
12 leave are ones for which the -- the cost of complying, of
13 bringing their products into line with the impartial conduct
14 standards, outweighs the benefit to the consumer.
15 So the point is, the Department agrees that
16 annuities have value. It cites this on Page 324 of the
17 record. And it specifically considered that the regulation
18 will not meaningfully diminish access to these products. And
19 the plaintiffs' only way to sort of challenge that is to say
20 that, well, some of our participants will -- might leave the
21 space.
22 I would note with regard to variable annuities,
23 back in July, Mass Mutual and Lincoln National, two of the
24 leading sellers of variable annuities, have said that they
25 fully intend to use the BIC exemption. And more recently, as

1 my colleague mentioned, Morgan Stanley, Ameriprise, Raymond
2 James, which are on the broker-dealer side of things, have
3 said that they intend to allow their agents to use the BIC
4 exemption.
5 Some other firms have concluded that because of the
6 nature of -- of what they sell, they will realign to
7 exclusively sell things that don't have a conflict of
8 interest. So they're changing their compensation structure so
9 that -- so that the conflict won't even come into play.
10 We think that all of these changes serve the
11 consumer and are consistent with the rulemaking.
12 So again, the fact -- so plaintiffs say that you
13 should have added the cost to consumers as a cost. But on the
14 Department's reasonable conclusion that it actually won't
15 diminish access, there's no need to characterize it as a cost.
16 Davis Mountain, in the Fifth Circuit in 2004,
17 basically said that adding a cost is irrelevant if the -- that
18 case, limited discussion of an adverse effect the agency
19 determined was unlikely.
20 If I may, I'd like to spend a moment on the Federal
21 Arbitration Act as a bit of a sort of step aside. So one
22 condition of the BIC exemption and the Principal Transaction
23 Exemption is that contracts, while they may require individual
24 arbitration, may not prohibit class actions. And this is
25 expressly parallel to the FINRA rule that governs

1 broker-dealers.
2 The Federal Arbitration Act states that a written
3 provision in a contract to settle by arbitration shall be
4 valid, irrevocable and enforceable, save upon such grounds as
5 exist in law or equity for the revocation of any contract.
6 THE COURT: So you're saying it's still valid, it's
7 just you don't get the benefit of the exemption?
8 MR. THORP: Yes, Your Honor. When you're comparing
9 two federal laws, the -- the terms of the statute should be --
10 should control whether there's conflict of law. And here
11 there is no -- is no conflict of law. What -- of the
12 statutory terms.
13 What plaintiffs want you to do is take some of the
14 broad language about the purposes of the statute that the
15 Supreme Court has applied, particularly in determining the
16 preemptive effect on state law as with regard to the savings
17 clause, and say therefore you should apply the FAA as this
18 broad principle that limits other federal law and regulation
19 pursuit to other federal law. And we submit that that would
20 simply be inappropriate and is, in fact, exactly what was
21 rejected in EEOC versus Waffle House, Supreme Court case in
22 2002.
23 In that case, the Fourth Circuit had attempted
24 to -- had attempted to balance the policy goals of the FAA
25 against the clear language of Title VII, and that's where the

1 dissent in that case said that should have been done.
2 But on Page 297 of that opinion, the Supreme Court
3 majority said, "The text of the relevant statutes do not
4 authorize the courts to balance the competing policies of the
5 ADA and the FAA." And on a few pages earlier, on Page 294,
6 said the pro-arbitration policy goals of the FAA do not
7 require the agency to relinquish its statutory authority."
8 So here where there's no question as to the
9 enforceability of the agreement, all plaintiffs can hang their
10 hat on is some notion that the agency's regulation discourages
11 people from entering into the agreements in the first place.
12 That sort of disgorgement theory is expressly what EEOC versus
13 Waffle House rejected as a sufficient ground to limit the
14 application of other federal law.
15 And, in fact, the Department exercised its
16 statutory discretion in a reasonable way. It provided for
17 individual arbitration and it recognized the Supreme Court's
18 observations in Concepcion that class arbitration, it has
19 limits and that -- and is not superior to class actions.
20 Concepcion, most recent Supreme Court case on the FAA, dealt
21 with the question of whether California law could require
22 class arbitration to be inferred after the fact in agreements
23 that only provided for individual arbitration.
24 So plaintiffs' fallback position is that somehow
25 the provisions of this regulation are coercive and that this

1 changes the question. But in the Federal Arbitration Act
2 analysis, there's no -- no place for that question to really
3 come up. Because, for example, with regard -- in EEOC versus
4 Waffle House, in the Title VII context, of course federal law
5 can have directly coercive application upon regulated
6 entities. So with -- the role of coercion for the arbitration
7 analysis I think is simply misplaced.
8 But regardless, the regulation here does not coerce
9 agency action. I mean -- sorry -- the industry action. It
10 simply gives them choices. As Judge Moss said in the NAFA
11 decision, they may not like the choices, but they are not --
12 as is indicated by different firms choosing different
13 approaches to respond to this, they are not coerced.
14 Turning to the various other arguments about
15 annuities. The Department sufficiently explained its reason
16 for putting variable annuities and indexed annuities in the
17 Best Interest Contract Exemption. Those include complexity,
18 risk, the opaque compensation, inconsistent regulation and
19 leveling the playing field.
20 Let's just start with leveling the playing field.
21 What plaintiffs are asking for is that variable annuities and
22 indexed annuities, which directly compete for investment
23 dollars with mutual funds in the retirement space, be given
24 preferential treatment as opposed to all other products. This
25 isn't just security products. Real estate investment trusts,

1 bank CDs, are all in the Best Interest Contract Exemption. So
2 it's not targeting or discrimination against these annuities
3 to include them in the regulation.
4 Just to note, plaintiffs have sort of pushed in the
5 first half of the argument for the notion that these are just
6 sales; sales are different. In plaintiffs making that claim,
7 they're going against not only this rulemaking but against the
8 entire interpretation of ERISA, all the way back in exemption
9 77-9, back in 1977, when -- with regard, which created the
10 predecessor to Exemption 8424, which at that time was focused
11 on insurance products with regard to the plan space, the
12 employee benefit plans.
13 The insurance -- the insurance company said give us
14 a seller's exemption. We're just salesmen. And in that
15 rulemaking, the Department expressly rejected that conclusion.
16 To the extent this broadens the scope of renders investment
17 advice for a fee applies, there no sales exemption. And so
18 that's why 8424 existed, even under the more limited five-part
19 test, because if insurance agents are selling a product and
20 making recommendations involved, they are -- come within the
21 scope of the statute. So plaintiffs want you to go far beyond
22 this rulemaking to challenge -- to undermine the scope of
23 ERISA entirely.
24 Let's talk about the complexity with regard to
25 distinguishing indexed annuities from traditional fixed

1 annuities. Plaintiffs cannot dispute that the crediting
2 mechanisms make them a far more complex product. And the
3 Department has shown in the rulemaking, and we've argued in
4 our briefs, that that has a fundamental -- is a sufficient
5 difference to make the Department's actions not arbitrary and
6 capricious.
7 Let's talk about the nature of the difference
8 between the products. First you have to choose an index.
9 Almost half choose the S & P 500, but there are now dozens and
10 hundreds of other indexes, including hybrid ones that allow
11 you to try to weigh the effect of gold and others things.
12 Second, you have to choose a formula to measure gains from the
13 index. And there are three or four ways of doing so that have
14 cascading consequences.
15 And finally, the -- each contract has methods to
16 limit how much of those gains are credited. So even if you
17 have an index, have a benchmark of how it's going to be
18 measured, you're never going to see all of the gains that that
19 index reaches. Instead, what you're going to be left with is
20 the insurance industry capping those gains so they can sort of
21 balance out boom and bust times and also so they can make
22 money.
23 All of those choices are things that most consumers
24 are not in a position to assess on their own. And within
25 those choices, particularly the last one, is opaque

1 compensation. The consumer often does not know or understand
2 the extent to which the insurance company is -- how the
3 insurance company is making money, how those incentives affect
4 the consumer, and therefore is not in a position to -- what
5 the Department said, they become acutely dependent upon the
6 adviser.
7 This is in contrast to traditional fixed annuities,
8 which are relevantly simple products, that consumers are
9 better able to understand and are less beholden to the
10 investor. There are some comparabilities, but on a slide --
11 all the Department did was apply a sliding scale and decide
12 that because these are sufficiently more complex, we'll treat
13 them with the other products with which they're competing.
14 That is a reasonable assessment.
15 Plaintiffs also try to play this game of because
16 the Department was doing two things, it was deciding whether
17 indexed annuities belonged in the Best Interest Contracts
18 Exemption and it was also deciding whether they were
19 sufficiently distinct from traditional fixed annuities, to say
20 the Department is being irrational because it talked about
21 some things that are comparable between the two.
22 But the Department, as shown in its tables laying
23 out the comparability of the products, was under no illusions
24 that some things were different between the products when they
25 were actually the same. Instead applying a totality of the

1 circumstances for treatment of indexed annuities, it looked at
2 all of the issues, including some of the ones that overlapped
3 with traditional fixed. And when looking at whether to
4 distinguish between the two, we submit that the complexity
5 question is sufficient standing alone.
6 So even if some other thing it looked at,
7 plaintiffs' challenge looking at risk is not sufficiently
8 related to conflict of interest -- we submit that it is. But
9 even if somehow it wasn't, PDK Laboratories, a D.C. Circuit
10 case from 2004, suggests that if the mistake didn't affect
11 the -- if that was somehow a mistake, it wouldn't have
12 affected the outcome and therefore it's not a basis for
13 reversal.
14 Plaintiffs also say that we didn't take annuity
15 regulations into account. They haven't pointed to anything
16 about annuity regulations that isn't laid out in the
17 rulemaking. So it's not that the Department was ignorant;
18 they just say that the Department should have weighed those
19 existing regulations differently than it did.
20 But here, it was, as we discussed, it was
21 reasonable to extrapolate from mutual funds studies, which
22 have at least as great a regulation as the regulation
23 governing insurance, to conclude that -- that the conflicts
24 could be expected in this space as well and that the existing
25 regulations, like FINRA's regulations, weren't enough to deal

1 especially with that incentive from variable compensation.
2 They also said that the 2010 and 2012 changes to
3 the NAIC and FINRA improvements means the game is changed.
4 They cite nothing in the rulemaking that suggests that the
5 game is fundamentally changed. There were incremental
6 improvements on the existing regulations. And the Department
7 doesn't have to wait around for new studies to be done. It
8 is, as ConocoPhillips said, it can make do with the available
9 information.
10 THE COURT: Well, okay, let's pursue that a bit.
11 I took the argument to be there was a sea change in
12 2010, 2012, and it's unreasonable per se not to look at that
13 because inevitably it must -- it is changing the regulatory
14 environment. So --
15 MR. THORP: Yeah.
16 THE COURT: -- it would be --
17 MR. THORP: If that's their argument --
18 THE COURT: Just a minute.
19 MR. THORP: Sorry.
20 THE COURT: It would be wrong to draw the
21 conclusion that this rule is necessary without analyzing how
22 the rest of the regulatory scheme is working.
23 MR. THORP: Yes, Your Honor. If that's their
24 argument, then there's a simple answer. The Department wasn't
25 oblivious to those changes and did discuss them. And in

1 response to comments in making these points, actually did a
2 supplemental study that updated basically on the same
3 methodology as the Kristofferson study -- and this is laid out
4 in Appendix A of the Regulatory Impact Analysis -- that
5 supplemented the data through 2015 and found that from 2008 to
6 2015, the data was not dissimilar to the prior data.
7 Again, this was the mutual fund context, so it goes
8 to the FINRA rule. And regulators continued to express
9 concern after 2012 about annuities and -- and so the
10 Department concluded that these incremental improvements, not
11 the -- were not the game is changed and that they didn't
12 change the -- fundamentally change the scope of the problem.
13 Plaintiffs suggested -- the only datapoint that
14 plaintiffs have to point the Court to is complaint data. And
15 they try to look at complaint data through sort of a
16 roundabout way of a comment that cited a news article that
17 cited data.
18 The data at issue is the NAIC's centralized
19 complaint database. We've pointed the Court to the most
20 recent data there that shows that complaints have only been
21 growing with regards to these products. And complaint data is
22 a very under-inclusive way to look at conflicts of interest in
23 this space, because complaint data requires -- the complaints
24 require people to complain about the product. But if the
25 problem is conflicted compensation, and you never know you

1 were given this product because it paid the agent the most,
2 you may not even be aware that you have a problem and that
3 your gains are -- that you have -- that you're harmed.
4 So complaint data is also under I under-inclusive
5 because it's voluntarily reported by states and there are also
6 various coding issues with the way it's done, so it doesn't
7 really tell us anything fundamentally. And it certainly
8 doesn't overwhelm all of the structural and overwhelming
9 evidence that when you have incentives for the agent to sell
10 based on what they're making themselves and you have an
11 unsophisticated client, it's going to turn out badly.
12 Plaintiffs also suggest that it's impossible for
13 them to supervise independent agents and that this was
14 something that the Department failed to consider. Remember,
15 of course, that what we're talking about is the application of
16 longstanding standards, such as prudence, loyalty and
17 reasonable compensation, that have always applied on the plan
18 side of the ERISA space, including to the sale of insurance
19 products to these plans, annuity products to these plans.
20 Most of the sales to plans are variable annuities or
21 traditional fixed annuities, but there are some indexed
22 annuities that are sold to plans.
23 Plaintiffs' theory that it's impossible for them to
24 supervise agents with regard to prudence and loyalty suggest
25 that they can't actually do what they're obligated to do under

1 current law. The NAIC rules require the supervision of the
2 suitability standards.
3 THE COURT: Well, there may be this argument as
4 well. But the point I was making and that I'm interested in
5 is that in this space, the people selling these products have
6 many masters, not one, or none. They're independent agents;
7 they're selling products of various other financial
8 institutions.
9 So how can one entity reasonably have the
10 information, one financial institution, that would be required
11 when they don't have access to the information of the other
12 entities for whom the independent agent is also working?
13 MR. THORP: Yes, Your Honor.
14 So first we pointed to the Wink market data to
15 indicate --
16 THE COURT: And they respond to that by saying it's
17 after the fact.
18 MR. THORP: It's retrospective.
19 THE COURT: Okay.
20 MR. THORP: But the fact is that it shows that the
21 industry knows what the commissions are -- generally knows
22 what the commissions are. The ACLI representatives testified
23 to Congress we know that they average about six percent or
24 whatever. So they know what the average is. They know on a
25 retrospective basis exactly what they were across -- across

1 the products.
2 And the point here is that it is not that
3 perfection is required. At the end of the day, what we're
4 talking about is whether an informed adviser, without a
5 conflict, would be comfortable making the recommendation and
6 supervision that goes to that question.
7 But the fact is that the independent agents have
8 multiple masters or sort of -- that people are competing for
9 the independent agent's attention -- that the insurance
10 companies are competing for the independent agent's attention
11 is very similar to a mutual fund front-end loads for
12 broker-dealers, just the broker-dealer is incentivized based
13 on the commission they'll get from selling various mutual
14 funds. In the same way, the insurance companies compete for
15 the attention of the independent agents by offering them
16 desirable commissions. And so it's their vested interest,
17 apart from this rule, to know what the rest of the industry is
18 doing.
19 All we're saying is if -- is that you have to set
20 up procedures in place so that you're captive agents or
21 independent agents that are selling your products are not
22 selling the product merely to get your higher commission. It
23 has to be reasonable, in an objective way, to sell the product
24 to this person.
25 And so the procedures that they need to put -- and

1 so that's why the Best Interest Contract Exemption even
2 includes not merely the agent but also the financial
3 institutions, because the agent is, to some extent, at the
4 mercy of the incentives. And with indexed annuities, the
5 market intermediaries, and for all of them, the insurance
6 companies, play a big role in the conflict problem. And
7 that's why they're included in the contract exemption as part
8 of the solution.
9 They want to sort of -- to be shielded from that
10 and to provide conflicted incentives to the adviser and face
11 no consequences.
12 Did that answer your question, Your Honor?
13 THE COURT: Yes, I mean, to the extent you can. I
14 think there's some wish and a prayer here about the
15 information that they can reasonably be expected to have
16 access to.
17 MR. THORP: I would note, Your Honor, that to the
18 extent they claim they can't do it, let's set aside this
19 rulemaking, they have exactly that same problem with regard to
20 their sales to employer-based plans directly under ERISA where
21 the loyalty provision applies as a matter of statute. So they
22 had better have a means of dealing with this, because it's an
23 obligation on them regardless.
24 And similarly, they all have an obligation,
25 regardless of whom they're selling to, to supervise the

1 suitability requirements. They say these suitability
2 requirements are highly detailed and souped up now and
3 therefore -- and yet they have to have mechanisms in place
4 under state law to supervise those sales, even of independent
5 agents.
6 The ways they deal with that is -- is to sort of
7 set up procedures. They also, some of them, outsource that to
8 the market intermediaries to do the oversight. So there are
9 means to do this. And it's not a perfection standard. Their
10 reply brief suggested a scenario that I think is helpful.
11 They said what if the agent that's making the sale says, "I
12 see two products. One is objectively worse, but it pays me a
13 higher commission. Can I recommend that product without
14 violating the rule?"
15 In our footnote in the reply brief that they
16 mentioned earlier, we said, no, if you see an objectively
17 inferior product and you're recommending it merely to get the
18 commission, that violates the duty of care. And that's all,
19 at the end of the day, we're seeking, that -- let me just
20 frame this one step back.
21 When setting exemptions from the prohibited
22 contract -- for prohibited transaction rules, what the
23 Department likes to do, as has been discussed over the years,
24 even in Congressional testimony back in I think 2004, what the
25 Department likes to do is pass the conflicted transaction

1 through an independent fiduciary. They can often do that in
2 the plan space, because there are multiple entities related to
3 the plan. And so a potential conflicted transaction that's
4 probably beneficial, you pass it through someone else who can
5 sign off on it and say, yes, that's in the best interest, it's
6 okay to do even though there's formal conflict.
7 But here when the insurance industry is dealing
8 directly with the consumer, there's no nobody else who can
9 sort of objectively say yes, this is -- this is good for you.
10 And so all of the conditions are intended to impose on the
11 seller sufficient duties to make sure that they will police
12 themselves. And because that's what's in play in the retail
13 space, that's why these conditions are necessary and the
14 Department concluded they're necessary, because you need
15 sufficient regulations imposed on the adviser and their
16 financial institution to police themselves.
17 They say, "Don't worry about us; we're policing
18 ourselves just fine." But especially with regard to what is
19 in effect this duty of loyalty, we submit that all of the
20 evidence in the record suggests they are not.
21 THE COURT: All right. Let's keep track of the
22 time here. I haven't been keeping it. But twelve o'clock is
23 the witching hour. So you-all reserved time. Twelve o'clock
24 is the end of the time.
25 MR. THORP: Okay. Just one word about adequate

1 notice. Under the logical outgrowth standard, this Circuit's
2 case law says that as long as the agency provides a
3 description of the subjects and issues involved and the --
4 which is the APA statutory language, and it grows out of that,
5 that adequate notice was provided.
6 I think the United Steel Workers of America case
7 from '87 in the Fifth Circuit, in that case, the agency
8 requested comments regarding, quote, "what should the
9 appropriate scope of this provision be" and found that
10 adopting a definition that hadn't been proposed in the
11 rulemaking was a logical outgrowth because it stayed within
12 those terms.
13 Similarly here, the Department asked whether the
14 proposal to -- quote -- this is Page 785 of the administrative
15 record -- "Whether the proposal to revoke relief for security
16 transactions involving IRAs, but leave in place relief for IRA
17 transactions involving insurance annuity contracts that are
18 not securities, strikes the appropriate balance and is
19 protective of the interests of the IRAs."
20 So this makes clear that they were asking for
21 comment on this, and then they went on to ask several
22 questions that really went to the issue of should we also move
23 the rest of the annuities over to the Best Interest Contract
24 Exemption.
25 Plaintiffs say that, well, the Department used the

1 word "determined" earlier when it sort of laid out its initial
2 proposal, so therefore that meant that indexed annuities were
3 shielded from any further regulation. That, I think, is
4 contrary to the nature of -- of a notice of proposed
5 rulemaking, and the language I just quoted makes clear that
6 their proposal was both to revoke and to leave in place, and
7 they invited comment on both sides of that. Therefore, we
8 think that we are well within our authority.
9 And as the Fifth Circuit said in Brazos Electric
10 Power Company that plaintiff might be surprised at the choice
11 that the Department actually made doesn't mean that they
12 weren't given adequate notice.
13 Thank you, Your Honor.
14 THE COURT: All right. Thank you.
15 Mr. Ogden, did you reserve time?
16 MR. OGDEN: I hope so, Your Honor. I have a couple
17 of limited points. I'll go after my colleagues.
18 THE COURT: And the government reserved 10 minutes?
19 Is that what you intended?
20 MS. NEWTON: Yes, Your Honor.
21 THE COURT: Okay. 10 was also what you said,
22 Mr. Scalia?
23 MR. SCALIA: That's correct, Your Honor.
24 THE COURT: Okay. All right.
25 MR. SCALIA: Although I'm down to nine, by my

1 count, and I'll aim to stay within that.
2 Your Honor, with respect to the types of sales
3 activities covered, the government has admitted to you that
4 what are traditionally regarded as sales activities are
5 treated as fiduciary under this rule. Your questions, I
6 think, brought that out.
7 But just to be clear, for example, in Pages 52 and
8 27 of the Joint Appendix, you see, for example, in the text of
9 the rule itself, that a communication that could reasonably be
10 viewed as suggestion that the advice recipient engage in or
11 refrain from taking a particular course of action, that would
12 be treated as fiduciary.
13 Likewise, I have to disagree with Ms. Newton with
14 respect to the concept of putting before a potential customer
15 a group of particular investment options. The rule does not
16 indicate that you need to actually advocate purchase of any of
17 them, because as she admitted, the rule says you look at
18 context. And what the rule indicates is that providing,
19 quote, "a selective list of securities to a particular advice
20 recipient as appropriate for that investor would be a
21 recommendation to the advisability, even if no recommendation
22 is made with respect to any one security."
23 And a final example, Your Honor, if I were an
24 insurance agent with a proprietary product and just said to my
25 customer, "I'm a salesperson; I want to offer you this really

1 good product; I think it would be good for you," that makes
2 you a fiduciary, although under any other reasonable
3 understanding of the common law, you would not have been.
4 Now, the Labor Department also says that the
5 statute changes the common law. But what it hasn't done is
6 addressed Varity and Pegrams' indication that you still look
7 to the common law in understanding what "fiduciary" means.
8 And when you look to the common law, you see there must be a
9 recognized distinction between a fiduciary on the one hand and
10 somebody on the other hand who's merely functioning as a
11 salesperson.
12 The Labor Department also said, Your Honor, that
13 there was no seller's carve-out. But the thing is, there is a
14 seller's carve-out they put in the rule. Because, again, they
15 claimed during the rulemaking they couldn't distinguish
16 between sales and advice activity, that it was an artificial,
17 unreal distinction. But they drew it in their large plan
18 sellers' exemption. And if you look at their reply brief at
19 Page 10, they simply have no meaningful response to that
20 argument we've made, showing that there can be a distinction
21 drawn, as there was at common law, between being a salesperson
22 and being a fiduciary.
23 Your Honor, with respect second to the private
24 right of action, you asked a question, and it was just a
25 question, but you said, "Now aren't people subject to claims

1 that they weren't" -- "Now aren't people subject to claims
2 that they weren't already subject to?" That's absolutely
3 true; they are. The federal government has designed the
4 standards that must be met. And by the way, there is no
5 fiduciary duty for IRA fiduciaries. There's no duty of
6 loyalty, prudence. Those are things that are being added by
7 the Labor Department. They have defined the standards.
8 THE COURT: Well, there could be a such a duty
9 arising out of state law, depending on the transaction.
10 MR. SCALIA: But the people that they're talking
11 about here are not fiduciaries under state law. They're just
12 brokers, dealers, sales agents and the like.
13 Second, they also are imposing programs that have
14 to be adopted. They're very complex. You're liable if you
15 don't have a good program or policy.
16 Even more important, the Department of Labor has
17 indicated what remedies must be available, and it's even
18 dictated the forum in which litigation can occur.
19 So at some point, Your Honor, you know, the
20 intentionality of what they've done makes it unmistakable that
21 they have set about creating a private right of action in a
22 manner that's inconsistent with Sandoval. They've raised the
23 argument that, well, these are going to be state law claims.
24 But it just doesn't matter; there's a purposeful intent to
25 create enforceable rights.

1 They say that it's by contract. But as you've
2 heard them say, people are being pushed into these contracts
3 because of the overbroad fiduciary definition. And again, it
4 doesn't really matter whether there's a contract or not.
5 By the way, the rule require entry of a contract.
6 That's indicated at Joint Appendix Page 132. One of the
7 things the BIC rule says is that you have to enter a written
8 contract. It's not true that all broker-dealers have written
9 contracts. But at the end of the day, it doesn't matter. At
10 some point, it's just a matter of common sense.
11 Alexander v Sandoval says the federal government
12 can't create private rights of action. Astra relies upon
13 Grochowski, both of which say you can't end-run Sandoval.
14 That's what they did. They --
15 THE COURT: Okay. I just want to put a button on
16 this one, Mr. Scalia, because I attempted to restate the
17 argument as I understood it.
18 You're not arguing literally that these rules
19 create a private right of action; if I'm wrong, you'll correct
20 me. But my understanding is that you're arguing the import of
21 these is that a private right of action exists that would not
22 have because it is forcing your members to engage in a
23 contract that they would not have and thereby are subjecting
24 themselves to potential liability.
25 MR. SCALIA: Your Honor, we're arguing both. But I

1 think the second is sufficient. Even if technically it's not
2 a Sandoval type private right of action, which is all that
3 Judge Moss ever addressed, it is equivalent to that. And
4 Astra and Grochowski tell us you can't do an end-run around
5 Sandoval.
6 And it relates to my third and final point, Your
7 Honor, which is simply their exemptive authority. We're back
8 to the question of whether this immense new regulatory
9 program, which Judge Moss conceded was of great political and
10 economic significance, is something that one would have
11 expected to find in a regulatory authority; it's just an
12 exemptive authority.
13 And we submit that you would not -- you would not
14 expect that an exemptive authority would be one where you
15 could impose new regulatory burdens. You wouldn't expect that
16 an exemptive authority is one whereby an agency that can't
17 regulate IRAs suddenly begins to do so. You wouldn't think
18 that an exemptive authority could become a podium from which
19 the Department of Labor could criticize the securities laws.
20 You know, it says the disclosure duties under the securities
21 laws are insufficient. It criticizes the distinction that
22 securities laws draw between advisers and salespeople. It
23 criticizes actively managed mutual funds and proprietary
24 products.
25 That kind of sweeping global approach towards the

1 financial services industry is just not something as a matter
2 of common sense, and also under the UARG case and others, you
3 would ever expect to find in that exemptive authority.
4 And then finally, again, you wouldn't think that an
5 authority to reduce regulations could become an authority to
6 impose class action liability, which they purposefully set out
7 to doing.
8 So, again, in answer to your question, Your Honor,
9 even if it's not technically a private right of action, it's
10 certainly not something that's in that modest, ancillary
11 provision that was purely an exemptive authority.
12 In conclusion, Your Honor, the Labor Department
13 hasn't disputed how integrated these rules are and that if the
14 BIC fails, or indeed the private right of action itself fails,
15 all of these rules must fail together because they were
16 adopted as an integrated whole.
17 THE COURT: Okay. Thank you.
18 MR. SCALIA: Thank you, Your Honor.
19 THE COURT: Did you reserve time, Counsel?
20 MR. GUERRA: I did. And I'm told I have
21 seven-and-a-half minutes, but I'll try to be very brief. I'd
22 also like to give Mr. Ogden.
23 THE COURT: This math isn't working for me.
24 Everybody is claiming they have additional time, and I'm not
25 showing it. So let's right now agree. They've got --

1 MR. THORP: Eight minutes, we believe.
2 THE COURT: Eight minutes, seven.
3 How many for you?
4 MR. OGDEN: I'd like 2.
5 THE COURT: Two. All right. 17. Last offer. I
6 accept.
7 MR. GUERRA: Thank you, Your Honor. I hope that
8 colloquy didn't count against my time.
9 THE COURT: No, but that did -- that did though.
10 MR. GUERRA: On the annuities -- the study, the
11 Seligman study, Your Honor, we've just done a word -- a text
12 word search to confirm it doesn't mention annuities except one
13 time -- or twice actually, and that's when it says that
14 suitability rules can meaningfully mitigate the risks of
15 conflicts of interest. So that study doesn't substantiate the
16 theory that there's harms.
17 Mr. Thorp also mentioned field experiments and
18 surveys of insurance agents. We've explained this in our
19 papers. Those things predate the 2012 rules. He mentions
20 post 2012 rules, comments by regulators and their
21 observations. Those are observations about the complexity of
22 fixed index annuities; they're not observations about harms.
23 So you're back to really they're -- they're pinning
24 all of this on the mutual fund studies. And he now -- as I
25 indicated, they've run away from all of the other studies.

1 They don't talk about Evans and Fahlenbrach. They don't talk
2 about the studies that talk about extensive trading. They
3 want you to say that the Kristofferson study is good enough
4 because the front-end loads there look a lot like commissions.
5 But that still doesn't account for the dynamics of the mutual
6 fund setting versus the dynamics in the fixed index annuity.
7 The Department itself said that it thought that the
8 CEM study was reflective of the fact that you're not paying
9 enough for investment managers. We don't have that going on
10 here for the reasons I mentioned earlier.
11 And so -- and the Department again -- the
12 Department itself didn't put forward this theory that this
13 looks like a commission and insurance sale. It said, as I
14 quoted before, that the reason we think they're going to be
15 the same forms of underperformance in the insurance context is
16 because of what we see in the Evans and Fahlenbrach study.
17 And it doesn't say anything about fixed index annuities.
18 I think Mr. Thorp said that the price spread or
19 margins, in terms of the compensation, are reason for thinking
20 that the NAIC suitability rules won't work to prevent
21 conflicts of interest -- the harms of conflict of interest. I
22 don't believe that's in the actual rationale that the
23 Department put forward, and I don't understand what it's got
24 to do with preventing people from being sold unsuitable
25 products. The regulation is designed to prevent precisely

1 that.
2 And we're not disputing that there are potential
3 conflicts of interest created by the compensation scheme. The
4 point is, what evidence is there that they actually hurt
5 people. The mutual fund studies don't get you across -- get
6 you to the first yard line, because they haven't -- they don't
7 account for -- they're about different dynamics than we have
8 with respect to the fixed index annuities.
9 On the complexity point, Your Honor, the range
10 doesn't help. And what we've heard really this morning is a
11 number of new Chenery violations by government counsel. He
12 says, well, you have economic incentives to ruin independent
13 agents and so therefore you have every reason to know. That's
14 not in the Department of Labor's rationale.
15 And he says you better be doing compliance with the
16 BIC exemption, because otherwise you've been violating your
17 obligations to ERISA plans all of these years. But my
18 understanding, from quick consultation with my clients, is
19 that the way we've been able to do that in the past is in
20 compliance with the 8424 exemption. And of course now they're
21 taking that away. So I think that's just a bootstrapping
22 argument on their part.
23 And finally, Your Honor, I would end -- one other
24 observation about the complaint data. Whatever the
25 deficiencies in the NAIC compilation of complaint data might

1 be, those deficiencies would have existed before 2010 and
2 after 2010. And if you look at the data that Mr. Thorp
3 pointed to in their defendant's appendix, it shows that in
4 2007, you had 230 complaints about FIAs; in 2014, 77. That's
5 a two-thirds reduction.
6 In terms of complaints per million dollars of
7 premium, it went from a hundred -- one complaint every 630 --
8 one complaint ever $109 million of premium to one complaint
9 every 633 million.
10 On a relative basis, whatever shortcomings there
11 might be in under-inclusiveness, that shows dramatic
12 improvement since these rules went into place.
13 And finally, Your Honor, on the idea about hiding
14 the ball with respect to data, this is a situation in which
15 the Department of Labor is coming in and saying we're going to
16 upend the world that you've been living in for four decades.
17 We're going to change these regulations.
18 The burden is on them under --
19 THE COURT: I don't think they put it quite that
20 way.
21 MR. GUERRA: No, that's effectively what they're
22 doing, especially with respect to our distribution system
23 that's what they're doing. We've been out there two decades
24 selling through independent agents, and they're saying, you
25 know, we're going to -- we're going to change this world

1 radically and C & O Motors says you had better show a need to
2 do that when you have heavy reliance interests.
3 And they're saying it's our fault that we haven't
4 given them the data to demonstrate that need. But everything
5 they've pointed to, to try to show that the conflicts always
6 end badly with respect to the purchase of FIAs don't fly, the
7 complaint data, the surveys, the mutual fund studies, and so
8 they can't now sort of say draw a negative inference because
9 the industry wasn't able to provide information that can
10 justify our rule.
11 Thank you, Your Honor.
12 THE COURT: All right. Thank you.
13 Better start talking from there while you're
14 walking.
15 MR. OGDEN: With respect to the First Amendment,
16 Your Honor, on the waiver point, this claim arises directly
17 under the First Amendment and relief authorized by the
18 Declaratory Judgment Act. No case the government cites says
19 those claims have to be exhausted. It's not an APA claim, so
20 it's not subject to exhaustion requirements. It's a
21 preenforcement challenge directly arising under the First
22 Amendment to the Constitution. Be a terrible rule if those
23 had to -- couldn't be brought where there were violations of
24 the law.
25 Second, we still have no answer to Sorrell and

1 Edenfield when they say that speech in a private setting to a
2 paying client is unprotected. Those cases involve precisely
3 such speech. It is protected, absent regulation incidental to
4 a licensing scheme.
5 Third, this is not a regulation of misleading
6 speech. They expressly say in the -- in the rulemaking at 84
7 that misleading -- it is not limited to misleading speech.
8 Ms. Newton admitted that they are not claiming that the speech
9 is inherently misleading. In response to your question, Your
10 Honor, she said there's merely a potential to mislead.
11 Zaterer and many other cases make clear that's not an adequate
12 basis. They've got to separate the misleading speech; they've
13 got to regulate only misleading speech. This is not that.
14 This is not a neutral purpose. She claimed it was
15 a neutral purpose. But the purpose she espoused is protecting
16 investors from conflicted advice. That is not neutral from
17 the point of view of the First Amendment. That is precisely
18 what is prohibited in the Thompson versus Western States
19 Medical Center case.
20 And finally, we are challenging the contract
21 requirements under the First Amendment. We're challenging all
22 of the burdens that this regulation imposes based on content
23 and on a content discriminatory basis.
24 I think I've probably used my two minutes.
25 Thank you, Your Honor.

1 THE COURT: All right. Thank you, Mr. Ogden.
2 MR. THORP: Your Honor, briefly.
3 First, plaintiffs' fundamental problem is with the
4 statute. The statute says you're a fiduciary subject to
5 prohibited transactions if you render investment advice for
6 compensation. The fact that we now have expanded the
7 regulation to the scope of the statute doesn't change that --
8 that issue.
9 So, for example, they say, well, you say now a
10 suggestion would make us fall under these terms. That's
11 because the suggestion language about sort of what makes it a
12 recommendation is directly modeled on the FINRA rule in the
13 securities context and is entirely reasonable in -- in
14 determining what counts as a -- as a recommendation, which it
15 goes to rendering investment advice for a fee.
16 With regard to Varity, they say that you should
17 look at the common law to trump the statute. That's not
18 what -- what happens. In Mertens it says that Congress
19 expressly departed from the common law in determining who
20 would fall under these fiduciary terms. The common law
21 continues to have import, but it's because once you've defined
22 who, then the common law helps with understanding how
23 fiduciaries have to behave.
24 Plaintiffs want to sort of make it a circle. They
25 want to say Congress said "fiduciary" means you render

1 investment advice, and we determine what "render investment
2 advice" means by determining our abstract principles about
3 what a fiduciary is. That's exactly backwards.
4 And Verity doesn't help them. Because in Verity,
5 the Court looked at the common law, not just for its broad
6 understanding of what counts as a fiduciary, but for the
7 questions of what counted as administration of a plan.
8 Plaintiffs have done nothing parallel here. They
9 don't look to any common law meaning of "render investment
10 advice." They simply don't. They want to rest on a pure
11 abstract theory of what counts as a fiduciary and use it to
12 overturn Congress's express choice to mean that you come under
13 these fiduciary requirements -- the prohibited transactions
14 anytime you render investment advice for a fee or other
15 compensation.
16 They then say that the Department is being
17 inconsistent by sort of treating sellers differently in one
18 context, this large plan seller's exemption.
19 What the Department did -- they have it exactly
20 backwards. What the Department did there was say under
21 certain circumstances, where fiduciaries are dealing with
22 fiduciaries and sophisticated parties, we don't think this
23 rule needs to apply. But we're not going to leave you with
24 that carve-out if you expressly hold yourself out as a
25 fiduciary and say "we are behaving as fiduciaries."

1 The Department was not saying this is a fundamental
2 distinction, but we're saying if -- even though we're giving
3 you this carve-out because it doesn't seem necessary, if you
4 hold yourself out and say "we are fiduciaries," we're then
5 going to subject you to the requirement that you behave as
6 fiduciary. That is not fundamentally inconsistent with the
7 choice the Department made back in 1977 in concluding that
8 there is no inherent seller's exemption from ERISA.
9 With regard to Sandoval, this is not an end-run
10 around Sandoval, as I think the Court sees. And instead they
11 sort of recast it as this broader Step 2 Chevron theory that
12 it's arbitrary because of the nature of the whole regime. But
13 they can't use the Sandoval line of cases to sort of build
14 that point. Even Astra itself, in a footnote -- I believe
15 it's Footnote 4 -- said that agency action would be different
16 and it wasn't deciding the question of when an agency
17 exercises discretion available to it.
18 And here under I think a case called Donovan out of
19 the D.C. Circuit, the Court has noted that when an agency has
20 exemptive authority to set conditions for exemptions, there's
21 great deference to the exercise of that authority.
22 Plaintiffs also challenge sort of the exemptive
23 authority, saying that the -- that the Department doesn't have
24 interpretive authority. Well, the Department has the
25 authority to interpret the statutes -- interpret the statute,

1 including the prohibited transactions.
2 Complaint provisions. What plaintiff really butts
3 up against, again and again, in the theory that things are
4 coercive, is that the broad sweep of the statute means that
5 some of their transactions are prohibited. This makes it
6 fundamentally different from the security laws, where these
7 very transactions are not prohibited; where they're just
8 subject to certain regulation.
9 And so the Department's authority in protecting
10 retirement investors, which are a somewhat distinct population
11 from all investors, subject to the securities laws,
12 appropriately can set conditions that exceed the securities
13 laws and always has, in -- in determining how to protect those
14 with conditions.
15 Plaintiffs say that annuities are fundamentally
16 different, and they can see that there may be conflicts of
17 interest, but just say the Department can't prove that they
18 harm people. That's just hiding behind the lack of data, and
19 the Court should not permit them to do that.
20 These annuities compete in the market with the
21 other products. The commissions and the opaqueness of the
22 compensation mean there's every indication from the
23 theoretical studies to the practical ones that we would expect
24 the conflict of interest to be just as damaging or more
25 damaging in this context, and suitability requirements, which

1 already apply in the securities law context, aren't enough.
2 And the last point I would make it is that one of
3 the -- one of the plaintiffs' counsel just said that the way
4 they get around the requirement is 8424 allows the insurance
5 agents to sell to plans. That's true. It gets around the
6 prohibited transaction. But the text of every exemption into
7 which the Department enters makes clear, because it's a
8 statutory requirement, that no exemption can waive the duties
9 of prudence and loyalty to the extent they apply.
10 So if you're dealing with an employer plan, no
11 exemption can exempt you from the responsibility to act with
12 loyalty, thus not making a recommendation, even between
13 suitable products, based on your own interest. It has to be
14 utterly apart from your own interest. And so plaintiffs are
15 not correct that they can get out of this obligation that they
16 say themselves they can't meet.
17 Thank you, Your Honor.
18 THE COURT: All right. Thank you.
19 Very fine argument.
20 Before weigh adjourn, let me spend just a minute on
21 the issue of timing. You argued your case in Kansas in
22 September; is that correct?
23 MR. THORP: Yes, Your Honor.
24 THE COURT: And you have not heard from the Judge
25 yet?

1 MR. THORP: Yes, Your Honor.
2 THE COURT: Do you have any other cases, other than
3 the D.C. case and this case?
4 MR. THORP: There's a new case filed in the
5 District of Minnesota, Your Honor, that narrowly makes the FAA
6 argument, federal arbitration argument made here, but no other
7 arguments.
8 THE COURT: So I just want to talk this through for
9 a moment. Obviously this is a complicated matter. I have
10 read Judge Moss' opinion, and my goal is to write something
11 shorter.
12 But it's complicated. And I want to make sure I do
13 what I can to give y'all adequate time for the next step,
14 which I'm sure, however I come out, there will be that.
15 So I'm assuming there's an appeal that's being
16 lodged in Judge Moss' case to the D.C. Circuit.
17 MR. THORP: Yes, Your Honor.
18 THE COURT: And no one is committed to anything by
19 answering this series of questions. But would you-all be
20 seeking expedited review in connection with that, given that
21 the effective date of the rules is April?
22 MR. SCALIA: My understanding is there has been an
23 indication in the NAFA case that expedition is being sought by
24 NAFA.
25 THE COURT: Okay. Yes, that's not you obviously,

1 but I figured you-all were talking to each other.
2 Either the Judge in Kansas or I or the next ones up
3 are all in different circuits. Conceivably there's a circuit
4 conflict. Is it possible that this thing reaches the Supreme
5 Court -- let's assume that I decide the case in a month. I'm
6 not predicting that. Let's just use that for the sake of
7 discussion.
8 Is it possible that these cases actually get to the
9 Supreme Court and are decided before the effective date of the
10 statute?
11 My guess is no and that someone will be seeking a
12 stay from appellate courts that the rules not take effect. Is
13 that a reasonable assumption about how it will go?
14 MR. SCALIA: Your Honor, the important date is
15 April 10th, but then you need to back out from that because of
16 all of the preparations necessary on the part of our client.
17 So I think a month or two is the timeframe we're
18 hoping is possible. But then undoubtedly there will be
19 activity afterward, potentially other courts, due to the great
20 burden of trying to meet that April 10th deadline.
21 THE COURT: Well, but if no judge, including me --
22 again, this is not a prediction or anything but a question.
23 If no judge has ruled that the rules are -- that
24 the rules should not be enforced, then to prevent the rules
25 from being enforced, those challenging it would seek from

1 either the trial court or from the appellate court a stay
2 pending appeal. Is that --
3 MR. THORP: Your Honor, the NAFA plaintiffs have
4 filed a stay in the appeal in the district court.
5 THE COURT: Have filed a request for that before
6 Judge Moss?
7 MR. THORP: Yes. And it appears that he intends to
8 rule very quickly on that. Our response is due Monday.
9 THE COURT: Okay. But let's just assume that no
10 trial court grants that. Then you have the availability,
11 potentially, of a request for a stay to -- to an appellate
12 court, to the Fifth Circuit, to the D.C. Circuit, et cetera.
13 MR. SCALIA: Yes, Your Honor.
14 THE COURT: Okay. All right. Very good. Thank
15 you all very much.
16 It is possible that I will have some additional
17 questions as I go. And if I do, I will figure out a way to
18 have you-all online or to have you answer those in writing
19 without having additional oral argument. I don't intend to
20 call you back. But time being what it is, I may have some
21 additional questions that I did not have an opportunity to
22 ask. And if I do, I'll put them to you with an opportunity
23 for all of you to hear them and respond, okay?
24 All right. Thank you all very much.
25 (Proceedings concluded.)

1 CERTIFICATE OF OFFICIAL REPORTER

2

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5 Court for the Northern District of Texas, do hereby certify
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D. KEITH JOHNSON, RDR, CRR
15 TEXAS CSR NO. 3781
FEDERAL OFFICIAL COURT REPORTER
16 1100 COMMERCE STREET, ROOM 1572
DALLAS, TEXAS 75242
17 214.753.2325

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