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Labor Department's Fiduciary Rule Tests First Amendment Limits

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Suppose you walk into your favorite fast-food outlet and order some fries. "Would you like to super-size that?," the counterperson asks. You look up at the calorie listing on the posted menu. It is not in your best interest to consume the extra calories. If the staff is compensated in part based on success in upselling customers, as similar employees often are, do you expect the salesperson to put your interests first? And can the government outlaw this one-on-one solicitation of a commercial transaction—or permit it only if the fast-food joint agrees to enter into a fiduciary relationship with its customers under which it agrees to put their interests ahead of its own?

The Department of Labor's new "fiduciary rule" and associated exemptions (81 Fed. Reg. 20,948; 81 Fed. Reg. 21,002; 81 Fed. Reg. 21,089) raise similar questions. Under the fiduciary rule, most brokers or insurance salespeople may no longer recommend investments to persons investing retirement funds without first agreeing to become the investor's fiduciary under government-dictated contract terms. There are some exceptions: the rule applies only to persons paid by commission or other transaction-based compensation; investors in charge of $50 million or more in retirement funds may fend for themselves; and recommendations about fixed-rate annuities are exempt.

But the practical effect is that most sales personnel in the investment and insurance industries cannot recommend investments to people for their Individual Retirement Accounts (IRAs) without agreeing to a prescribed "best interest contract." That forced agreement not only imposes fiduciary duties, but is also designed to smooth the path for private class-action lawyers to enforce any breach, a provision that is designed to make up for limitations on DOL's enforcement authority.

Several business groups have challenged the fiduciary rule in the Northern District of Texas on First Amendment grounds, contending that the rule goes too far in prohibiting (or severely burdening) truthful and nonmisleading commercial speech. *Chamber of Commerce v. U.S. Dep't of Labor* , N.D. Tex., No. 3:16-cv-01476-M (Aug. 31, 2016). The government insists that the rule regulates professional conduct rather than speech, and thus is not subject to First Amendment review at all.

Yet that argument rests in large part on the government's circular characterization of the investment-sales function as "fiduciary." That regulatory label departs from the traditional understanding of a fiduciary relationship as a continuing relation of trust and confidence, but instead requires certain speakers to assume fiduciary duties in order to make certain communications. The government asserts a nearly boundless power to redefine a term with a settled meaning—"fiduciary"—as a means of excepting a regulation from the full force of the First Amendment, recalling similar efforts to equate inaccuracy with libel, or offensive language with "fighting words."

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The challengers, on the other hand, contend that the fiduciary rule is a content-based regulation subject to strict scrutiny. They point to regulatory distinctions between speakers (commission-compensated or not); hearers (investor of retirement funds or IRA investor); and investments (fixed-rate annuities vs. others). And they note that the rule exempts automated robo-advisers. It seems unlikely, though, that the district court will apply *strict* scrutiny for the fiduciary rule—perhaps because almost all commercial-speech restrictions draw some content-based distinctions.

Instead, the courts are likely to apply a "heightened scrutiny" that is not quite strict, but is higher than the intermediate scrutiny applied in cases such as *Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557 (1980). In *Sorrell v. IMS Health Inc.*, 564 U.S. 552, 566 (2011), the Supreme Court explained that "the First Amendment requires heightened scrutiny whenever the government" imposes content-based limits on speech, and that "[c]ommercial speech is no exception." The Ninth Circuit has since acknowledged that "*Sorrell* modified the *Central Hudson* test for laws burdening commercial speech," *Retail Digital Network, LLC v. Appelsmith*, 810 F.3d 638 (9th Cir. 2016), and other courts are likely to agree.

In any event, whether under heightened scrutiny or under *Central Hudson*'s intermediate scrutiny, the fiduciary rule is likely to fail. In the context of truthful, nonmisleading one-on-one solicitation, the Supreme Court has considered "whether the State's interests in proscribing it are substantial, whether the challenged regulation advances these interests in a direct and material way, and whether the extent of the restriction on protected speech is in reasonable proportion to the interests served." *Edenfield v. Fane*, 507 U.S. 761, 767 (1993).

Edenfield itself involved direct solicitation by accountants; the Court made clear that its approval of more stringent regulation of in-person solicitation of accident victims by lawyers was limited to that context and that profession, so DOL's attempt to draw an analogy between investment salespeople and lawyers is unlikely to succeed.

The government's interest in preventing deception of retirement savers seems substantial, so the First Amendment analysis of the rule under intermediate scrutiny likely will turn on whether the fiduciary rule and its exemptions directly and materially advance that interest, and whether the speech restrictions are disproportionate to the identified harm.

DOL's principal justification is that commission-based compensation renders a broker or insurance salesperson "inherently conflicted." Yet DOL disdains the disclosure system typical of investment regulation. As the challengers point out, to the extent that they are necessary to avoid consumer confusion, disclosure requirements are consistent with the First Amendment. *E.g.*, *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 651-52 (1985). But outright restrictions on "commercial speech that is not itself deceptive," unlike disclosures, are presumptively unconstitutional. To be upheld, they must be "narrowly crafted to serve the State's purposes," *Zauderer*, 471 U.S. at 645. With its sweeping definition of what communications constitute "fiduciary advice," the fiduciary rule is the antithesis of narrowly tailored speech regulation.

DOL would thus have to convince the courts that the relationship between an investment salesperson working on commission and an investor is so fraught with a risk of deception that any such associated investment recommendations must be considered deceptive. That would seem difficult to do.

Reasonable people recognize that someone who is trying to sell something is motivated by the sale rather than by the buyer's interests. More detailed disclosures of the supposed "conflict" would likely advance the rule's goals more directly and more proportionately. DOL's effort to base differential First Amendment protection on the regulatory creation of a "fiduciary" relationship that departs from the traditional legal boundaries of such relationships goes too far.

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