

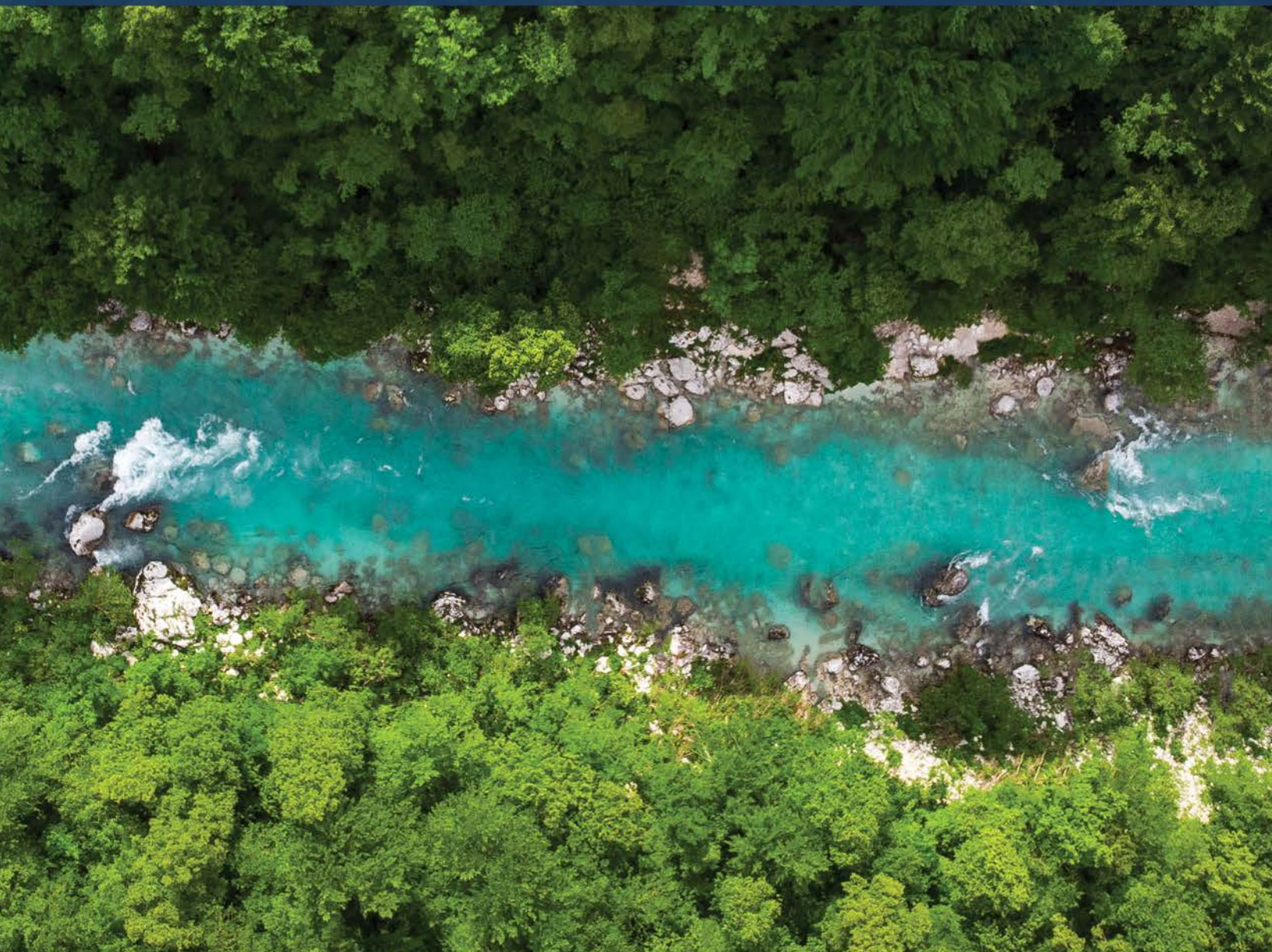


MINTZ

A MINTZ ESG PRIMER

The Current State of Environmental, Social, and Governance Matters in American Corporations

Thomas R. Burton, III; Jacob H. Hupart; Jennifer B. Rubin;
Danielle Dillon; Will G. McKitterick; Evan M. Piercey; and Ellen Shapiro



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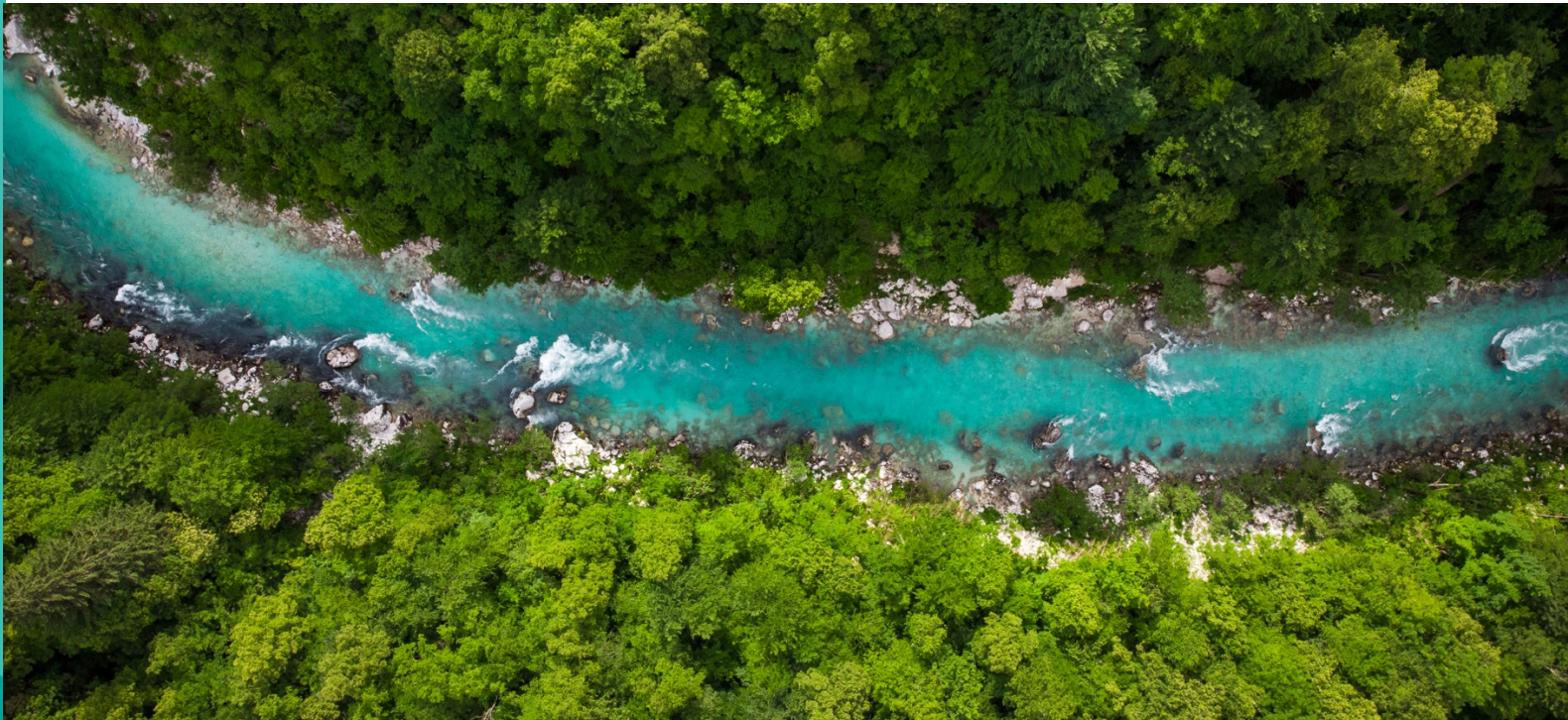
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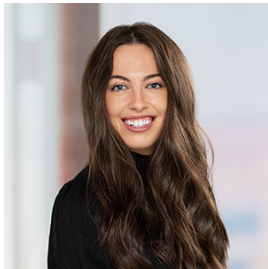
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CHAPTER 1

Introduction

In recent years, environmental, social, and governance (“ESG”) issues have come to increasing prominence among regulators, corporations, the media, and the public. Broadly speaking, ESG issues (in the business context) focus on non-financial factors, such as environmental sustainability, the broader impact on society, responsible investment, corporate governance considerations, and other ethical issues. Notably, there has recently been considerable investor and regulatory pressure to incorporate ESG issues in corporate strategy and decision-making.

However, ESG issues have become significantly more politically fraught. Indeed, the salience of ESG issues has increased dramatically as politicians seize upon ESG issues — whether in favor or against — as a means to demonstrate allegiance to a particular perspective in American politics, and to attract favorable media, donor, and voter attention. Such incentives have created a legal, regulatory, and public relations minefield that companies must now navigate. Further, this ESG landscape is in a state of constant flux due to the press of developments.

This ESG Primer is designed to provide an overview of the current state of affairs in the United States with respect to the ESG issues that businesses typically confront, including the impact of the Supreme Court’s recent affirmative action decision on DEI initiatives. It is divided into a number of individual modules (summarized briefly below) that address particular topics of interest.

The attorneys in the Mintz ESG Practice are prepared to address, and available to discuss, any of these issues in further detail.

Polarized ESG Rulemaking at the State and Local Levels

This section summarizes recent pro- and anti-ESG rulemaking at the state level, focusing on, among other things, sustainability directives and divestment rules enacted to promote ESG, and boycott initiatives and other anti-ESG rules enacted to combat the increasing prevalence of ESG factors. It also outlines certain practical guidance that companies may employ when navigating this maze of competing rules and regulations concerning ESG.

Trends in ESG Regulation and Enforcement

This section focuses on federal regulation and enforcement relating to ESG issues under the Biden Administration, with a particular focus on the proposed Securities and Exchange Commission (“SEC”) climate disclosure rules and other related actions — both rules and enforcement — undertaken by the SEC. This section also addresses other agency actions in the context of ESG (e.g., the Commodity Futures Trading Commission or “CFTC”), as well as legal and political efforts to counteract this regulatory and enforcement focus at the federal level. Finally, this section also provides some advice about how to adapt to these new regulatory regimes.

Trends in Private ESG Litigation

This section examines recent private litigation undertaken in connection with ESG issues. This includes various types of shareholder litigation and identifies potential legal vulnerabilities that corporations may encounter in the ESG context. Some thoughts are also offered on tactics that may diminish potential liability in this area.

Constitutional Climate Change Litigation

This section briefly addresses the recent litigation brought by private civil society plaintiffs to vindicate public and constitutional rights with respect to climate change and the impact such litigation may have on the broader legal landscape.

ESG & DEI Policies

This section examines ESG in the workplace, focusing on DEI initiatives, policies, and efforts that are promulgated by private companies. It also focuses on the recent impetus for mandatory board representation and reporting.

Challenges to DEI Initiatives

This section addresses certain lawsuits and challenges brought against private companies that have implemented DEI policies. Such legal maneuvers typically fall within four categories: (i) challenges to board diversity mandates and disclosures; (ii) challenges where companies allegedly failed to comply with their stated DEI goals; (iii) anti-DEI efforts by shareholders and activists; and (iv) failures to implement or apply anti-discrimination policies. This section provides an overview of the current legal landscape with respect to each of these issues.

How Should Employers and Stakeholders Think About DEI in the Wake of the Supreme Court's Decision in Students for Fair Admissions, Inc. v. President and Fellows of Harvard College?

In this section, there is a detailed legal analysis of the Supreme Court's recent decision that was proclaimed as "ending affirmative action." The focus here is on the aftermath and implications of the decision, including how corporate DEI efforts can adapt and the prospect of litigation concerning such programs.

Practical Takeaways for Employers and Stakeholders

This section briefly provides certain practical guidance for corporate DEI policies and initiatives that companies contemplate or implement.



CHAPTER 2

Polarized ESG Rulemaking at the State and Local Levels

As nationwide attention to ESG continues to grow, companies and investors alike are increasingly examining sustainability-based metrics to assess financial opportunities. This trend is driven in part by a growing consensus that companies can only deliver sustainable long-term growth when they manage their resources prudently, treat their employees well, and act as responsible stewards with an eye to the long-term viability of their surrounding natural environments. In turn, a growing number of ESG-minded investors, persuaded of the financial and ethical necessity of employing such considerations, are beginning to use ESG metrics to help guide their investments. At the same time, as will be discussed further below, several federal regulators in the Biden Administration have also taken concerted steps to encourage investors to consider ESG factors in their investment decisions.

Yet ESG, though popular, has proven to be a polarizing issue nationally. The ideological chasm between pro- and anti-ESG state and local governments appears to be growing wider by the day. All told, over two-thirds of US state legislatures considered anti-ESG legislation in the first half of 2023, while 14 states enacted legislation restricting the use of ESG factors in public investments and procurements.¹ On the other hand, 42 pro-ESG bills were introduced in 11 states, although only one (Colorado SB 23-16) was enacted into law in that time period.² Caught in the middle of this political divide are a broad swath of fiduciaries, including investment managers, private equity funds, and

¹ *ESG Legislation in the First Six Months of 2023*, PLURAL (July 25, 2023), available at: <https://learn.pluralpolicy.com/hubfs/PLURAL%20%7C%20ESG%20Legislation%20in%202023.pdf>.

² *Id.*

companies with national operations or portfolios that straddle polarized state lines. For these entities, conflicting with a state’s anti-ESG rules can cause significant problems. For example, just last year, Texas blacklisted ten (10) major financial firms from securing state banking contracts because they were deemed to be “boycotting” fossil fuel companies.³ Alternatively, conforming to a State’s pro-ESG initiatives, such as newly mandated hiring practices, can be expensive and time-consuming. Companies and institutional investors alike, operating nationally or at least in both red and blue states, must navigate a growing minefield of legislative incongruence affecting the expanding field of ESG-focused investment.

A. Pro-ESG Rulemaking at the State Level

On the political left, several states have passed legislation or rules aimed at mandating or incentivizing fiduciaries to integrate ESG factors into their investment decisions in order to cultivate the monetary and social benefits that accrue from such investments. The pro-ESG initiatives taken by state governments can be divided into two general categories: sustainability directives and divestment rules.

i. Sustainability Directives:

Several Democratic-led state legislatures and liberally inclined municipalities have recently passed bills or instituted rules and regulations that require entities, particularly state pension plans or other state investment bodies, to incorporate ESG criteria and other non-financial information into their investment strategies. On occasion, these entities are required to report ESG criteria to state legislatures or other regulatory bodies. Moreover, some of these initiatives go beyond tackling climate-related risk, and address other economic and social ills plaguing companies.

- **New York City’s Tit. 22 § 1-03(c)(2)(i):** In February 2023, New York City’s Banking Commission instituted a new rule requiring banks that hold city funds to develop detailed plans and steps to combat discrimination in their operations. Thus, in order to hold New York City funds, banks must certify that their board

³ Richard Vanderford, *Texas Blacklists BlackRock, UBS and Other Financial Firms Over Alleged Energy Boycotts*, WALL STREET JOURNAL (Aug. 24, 2022), available at: <https://www.wsj.com/articles/texas-blacklists-blackrock-ubs-and-other-financial-firms-over-alleged-energy-boycotts-11661381425>.

of directors have “established and will adhere to a policy of hiring and promotion . . . without regard to race, color, religion, religious affiliation, sex, sexual orientation, national origin, marital status, disability or age.”

- **Illinois Sustainable Investing Act PA 101-473 §§ 15(a)-(b), 20(a):** Effective as of January 1, 2020, the Illinois Sustainable Investing Act directs state and local government entities that manage public funds to “develop, publish, and implement sustainable investment policies applicable to the management of all public funds.” The entities’ sustainable investment policies are directed to include “material, relevant, and decision-useful sustainability factors” for each public agency to “prudently integrate . . . into its investment decision-making, investment analysis, portfolio construction, due diligence, and investment ownership in order to maximize anticipated financial returns, minimize projected risk, and more effectively execute its fiduciary duty.” Relevant factors include consideration of a company’s corporate governance and leadership, environmental footprint, social capital, human capital, and business model, as well as innovation factors.

ii. Divestment Rules:

In addition to sustainability directives, a collective of pro-ESG states have taken a more restrictive approach, barring state agencies and public funds from holding stakes in, for example, major fossil fuel producers and other companies in industries often viewed as non-sustainable.

- **New York Pension Fund Net Zero Target:** This initiative, set by the New York State Common Retirement Fund in December 2020, requires the Fund to transition its investments to achieve a net zero portfolio by 2040. In aid of this effort, the Fund is directed to conduct a review of its investments in the energy sector every four years and to make appropriate adjustments thereafter to decrease exposure to climate-related investment risk by divesting from companies that fail to meet certain minimum standards for sustainability.
- **California S.B. 1173:** California’s S.B. 1173 prohibits California’s Board of Public Employee Retirement System (CalPERS) and the State’s Teachers’

Retirement System “from making new investments or renewing existing investments of public employee retirement funds in a fossil fuel company.” In addition, it also requires these entities to liquidate investments in fossil fuel companies on or before July 1, 2027.

B. Anti-ESG Rulemaking at the State Level

While ESG-focused investing continues to proliferate, so too has Republican opposition to such considerations in state and local governments across the country. In the first half of 2023, the United States Congress and at least 37 states have introduced some 156 anti-ESG bills targeting ESG investing or contracting.⁴ Many of these bills, in addition to anti-ESG regulations, are aimed at preventing state pension funds or agencies from doing business with investors or companies that consider ESG criteria. These rules invoke the apprehension that ESG-based investing is largely politically and socially motivated and that such concerns come at the expense of shareholder returns.⁵ In turn, conservative-leaning politicians have advocated two general categories of bills to stamp out ESG-focused investing in their states: boycott and divestment bills.

i. Boycott Initiatives:

Several states have passed or are working to enact legislation that would prevent states from using their assets to do business with financial institutions that “boycott” or “discriminate” against companies that operate in particular industries disfavored by the ESG movement, such as fossil fuel producers or firearms manufacturers.

- **Texas S.B. 13:** Enacted on September 1, 2021, S.B. 13 constitutes one of the most far-reaching anti-ESG laws on state books and applies to numerous state retirement funds. The law requires the state’s Comptroller to maintain a list of financial institutions that “boycott” energy companies. It then prohibits state institutions from investing in listed companies and requires the state to fully divest, within 360 days, from all listed companies that fail to cease boycotting energy companies within 90 days of receiving notice from the state. The new

⁴ *ESG Legislation in the First Six Months of 2023*, PLURAL (July 25, 2023), <https://learn.pluralpolicy.com/hubfs/PLURAL%20%7C%20ESG%20Legislation%20in%202023.pdf>.
⁵ Ellen Meyers, *Republicans Ride ESG Backlash to State Financial Offices*, ROLL CALL (Nov. 17, 2022), <https://rollcall.com/2022/11/17/republicans-ride-esg-backlash-to-state-financial-offices/>.

law, interestingly, does not apply to indirect holdings in actively or passively managed investment funds or private equity funds. However, it does require fund managers to remove listed companies from funds or create new funds that do not involve listed companies.

- **Florida H.B. 13:** On May 2, 2023, not long after the passage of New York’s Tit. 22 § 1-03, Florida Governor Ron DeSantis signed anti-ESG legislation known as H.B. 3 into law. The new law seeks to restrict the use of ESG factors in the investment of state and local funds. It also creates a significant attestation requirement that applies to any bank that holds, or intends to hold, Florida public funds. The law requires these entities to confirm that they are not “discriminating” or “denying or canceling . . . services” to *any* person on the basis of a long laundry list of asserted ESG factors, which it designates as an “unsafe and unsound practice.” Fla. Stat. § 280.02(26)(f) (effective July 1, 2023). A failure to comply with H.B. 3 may lead to the suspension or disqualification of the fund as a QDP, civil fines, or lawsuits by the Attorney General of Florida.

ii. Anti-ESG Rules:

Other states have proposed or passed legislation, or have taken binding regulatory action, that aims to bar public entities, including state pension funds, from considering ESG criteria when investing state resources. These rules bar the consideration of factors outside those that seek specifically to maximize investment returns.

- **Florida’s Resolution on ESG:** Prior to the passage of Florida’s H.B. 3, on August 23, 2022, the State Board Administration of Florida (“SBA”) approved a resolution proposed by Governor Ron DeSantis that will, in part, prevent SBA fund managers from considering ESG factors when investing state resources. The resolution also requires fund managers to focus solely on maximizing investment returns on behalf of Florida’s retirees.
- **Pennsylvania H.B. 2799:** The Pennsylvania House of Representatives has proposed a bill that would prohibit any business operating in Pennsylvania from using, inter alia, social credit scores or ESG factors as a sole condition of

financing or providing services. The bill also aims to prevent ESG scores from being exclusively or primarily used in decision-making in consumer transactions and would block state Treasury and retirement funds from exclusively using ESG scores when making investment decisions.

C. Practical Takeaways

The proliferation of both pro- and anti-ESG legislation and regulations poses real concerns for investment managers, including public pension funds and large institutional investors that work with state agencies or invest in markets across the country. In today's world, large institutional investors and corporations are not generally confined to the jurisdiction of one or two states but instead conduct business on a national or even international level. These entities must pay close attention to states with new ESG legislation or regulation that have loudly pressed the issue and publicized their intentions, including to stop doing business with companies that either fail to adhere or are overly reliant on ESG-based investment considerations.

The impact of new ESG rules and legislation cannot be understated. For example, on December 1, 2020, Florida's chief financial officer, Jimmy Patronis, announced that the state would remove about \$2 billion in assets from a prominent asset manager.⁶ That decision relieved the entity from managing about \$600 million in short-term investments and, eventually, \$1.43 billion of long-term securities. Those monies will be reallocated to other money managers. Conversely, New York City's Banking Commission has already barred five banks from holding city funds, several of which failed to submit anti-discrimination plans as required by the Commission's new rule.⁷

Managers looking to navigate the proliferation of pro- and anti-ESG rules have a number of options. We recommend that fiduciaries prepare for the coming impact of these state-level ESG laws (both pro- and anti-ESG). Here is what to expect and how to adapt to meet this growing challenge:

⁶ Ellen Kennedy, *The ESG Investing Backlash*, KIPLINGER (Sept. 6, 2022), <https://www.kiplinger.com/investing/esg/605184/the-esg-investing-backlash>.

⁷ Rajashree Chakravarty, *NYC Regulator Halts City Deposits at Capital One, KeyBank*, BANKING DIVE (May 26, 2023), <https://www.bankingdive.com/news/nyc-regulator-halts-city-deposits-capital-one-keybank/651435/>.

- **Expect More Litigation:** Decisions to fund or boycott certain industries will increasingly have real economic consequences for investors and may lead to litigation by state attorneys general, with implications for the market. There also exists the potential for private litigation to proliferate as companies navigate increasingly complex pro- and anti-ESG state laws and regulations, particularly with respect to fiduciary duties (including claims that could be brought against corporations, institutional investors, and fund managers alike).
- **Monitor Pro- and Anti-ESG Legislation:** This is a rapidly evolving regulatory space. The vast majority of states have passed some form of ESG program, either in support or against this new focus. Yet there are important discrepancies between these laws, and numerous exceptions exist that may help companies and funds preserve their current investment strategies without violating anti-ESG legislation.
- **Strengthen ESG Approaches:** Companies and institutional investors should pay close attention to their policies, procedures, and public disclosures to ensure they do not violate new anti-ESG rules and regulations. For example, in Florida, fund managers can avoid breaking state rules or being blacklisted if they demonstrate, with clear guidance and data-driven evidence, that their investments are based primarily, if not exclusively, on pecuniary factors aimed at generating the highest returns, rather than ESG-based indicators.
- **Divide Between “Red” and “Blue”:** Navigating carve-outs in anti-ESG laws may not be a viable option for some of the largest institutional investors that operate nationally. In this case, it may be possible and necessary for companies to “divide” their business into pro- and anti-ESG entities to enable doing business in both types of jurisdictions — e.g., by creating “BlueCo” and “RedCo.”
- **Consult with Attorneys:** If nothing else, it is critical for investors to understand the nuances of new ESG-focused laws and regulations, including both pro- and anti-ESG rules. Consulting with knowledgeable attorneys before deploying

new investment strategies is critical to ensure ESG-focused investment policies do not violate the laws and regulations in particular states.





CHAPTER 3

Trends in ESG Regulation and Enforcement

While ESG remains a controversial topic at the state and municipal level, federal agencies, spurred on by the Biden Administration's commitment to ESG, have launched a variety of their own ESG regulatory initiatives. At the vanguard of this effort is the SEC, which recently promulgated new disclosure rules to expand public companies' reporting requirements to encompass ESG-related issues. The SEC also recently launched an ESG Task Force aimed at prosecuting asset managers for making misleading disclosures in connection with ESG marketing efforts. Other government agencies have asserted their authority over alternative aspects of ESG regulation. The CFTC, for one, has signaled interest in regulating carbon markets through the creation of its own task force to root out fraud. Finally, across the broader US government, several federal (and municipal) agencies have initiated prosecutions against fossil fuel producers for harms caused by their emissions, signaling a change in these agencies' enforcement priorities.

However, not all actors at the federal level are supportive of the Biden Administration's ESG agenda. ESG initiatives have met strenuous pushback from elements in the Republican-controlled House of Representatives who vehemently oppose the federal government's efforts to regulate and promote ESG. In addition, the Supreme Court has stymied efforts by the EPA to promote more aggressive restrictions on fossil fuel producers.

All told, clients can expect ESG-focused enforcement actions to increase in the near future in light of the number of federal agencies engaged in pursuing the Biden Administration's ESG agenda. However, as ESG becomes more politicized, significant institutional forces, including House Republicans and an ideologically conservative Supreme Court, will likely continue to push back on agency and administrative efforts to

address ESG. Ultimately, the 2024 election cycle will be dispositive as to whether federal regulation of ESG issues continues apace.

A. The Biden Administration's Commitment to ESG

President Biden has been an avid supporter and promoter of ESG issues ever since the beginning of his administration. Within days of his inauguration, President Biden made his focus on ESG issues clear by asking the Office of Management and Budget to work with other government agencies to provide concrete suggestions on a variety of topics, including climate change. As one of his first acts in office, President Biden signed an executive order to have the United States rejoin the Paris Climate Accords. Moreover, in April 2021, President Biden hosted a two-day climate summit in which he announced new targets for the United States to reduce greenhouse gas emissions by 2030.

The Administration's efforts to promote ESG issues also extend to the government's own supply chain. On November 10, 2022, the Federal Acquisition Regulatory (FAR) Council published the Federal Supplier Climate Risks and Resilience Rule,⁸ requiring several thousand federal contractors that receive large volumes of annual federal agency contract obligations to disclose three important considerations: (1) how their operations contribute to climate change; (2) the climate risks they face; and (3) and how they plan to reduce their own emissions.⁹ The proposed rule intends to reduce the harmful climate-related financial impact of the \$637 billion in products and services the federal government purchases on an annual basis and to strengthen the United States' supply chain to become more resilient.

Beyond climate change, the Administration has supported efforts by various agencies to promote ESG-based rulemaking and regulation, even in the face of staunch opposition from Republicans. For example, earlier this year, the Administration was quick to veto (Biden's first) a resolution passed in the House and Senate aimed at overturning

⁸ *Federal Supplier Climate Risks and Resilience Proposed Rule*, OFFICE OF THE FEDERAL CHIEF SUSTAINABILITY OFFICER (Nov. 10, 2022), available at: <https://www.sustainability.gov/federalsustainabilityplan/fed-supplier-rule.html#:~:text=Under%20the%20proposed%20Federal%20Supplier,risks%2C%20and%20set%20science%2Dbased.>

⁹ Steven Mufson, *Emissions Disclosure Rules Loom for Government Contractors and They're Not Happy*, WASHINGTON POST (May 2, 2023), available at: <https://www.washingtonpost.com/politics/2023/05/02/emissions-disclosure-rules-loom-government-contractors-they-not-happy/>.

the US Department of Labor’s (“DOL”) so-called “ESG Rule,” which clarifies that Employment Retirement Income Security Act (“ERISA”) plan fiduciaries may consider ESG factors that are reasonably related to an investment’s risk-return analysis.¹⁰ In so doing, the President issued a clear policy statement that his administration approves of utilizing ESG factors in making investments. This position indicates that President Biden perceives ESG investing not only as significant in itself but also as a political fight in which the Democratic party has an advantage over Republicans. It also implies that future activity in this space — such as the SEC’s oft-delayed rule on climate disclosures — will likely receive additional impetus to come to fruition.

B. The SEC at the Vanguard of ESG-Regulation and Enforcement Activity

Within the Administration, the SEC has been a prominent proponent of greater regulation of ESG-based investing. SEC Chairman Gary Gensler has advocated for stronger ESG-based disclosure and regulatory requirements, and has repeatedly emphasized the SEC’s focus on initiatives related to climate and other ESG matters. Two of the SEC’s most ambitious initiatives include the promulgation of new ESG-focused disclosure requirements for reporting companies and the SEC’s launch of its new ESG Task Force to enforce these requirements.

Yet while the SEC has arguably taken the mantle of the agency with the largest impact when it comes to passing new ESG-based rules, it has moved perhaps more slowly and deliberately in its efforts than some would like. Under Chair Gensler’s tenure, the SEC has issued far fewer regulations now than any administration going back to George W. Bush’s presidency, adopting only twenty-two (22) rules as of August 2023 since Gensler became the agency’s leader in April 2021.¹¹ Prominently, the SEC has yet to finalize its signature regulation promulgating new climate disclosure rules and other planned ESG-reporting priorities. According to an agency spokesperson, the Commission has taken its time issuing the new rules in order to “get things right — based

¹⁰ Jacob H. Hupart, *President Biden Issues First Veto to Protect ESG Investing*, MINTZ (Mar. 21, 2023), available at: <https://insights.mintz.com/post/102iaw3/president-biden-issues-first-veto-to-protect-esg-investing>.

¹¹ Andrew Ramonas, *Gensler Lags Predecessors in SEC Rulemaking as ESG Plans Linger*, BLOOMBERG LAW (Aug. 29, 2023), available at: <https://news.bloomberglaw.com/esg/gensler-lags-predecessors-in-sec-rulemaking-as-esg-plans-linger-1>.

on the economics, the Commission’s legal authorities, and promoting the SEC’s mission” at the expense of expediency.¹²

Many expect Chair Gensler’s regime to attempt to finish Biden’s first term with a flurry of ESG regulations and other rules in the coming months. Indeed, the SEC announced on September 20, 2023, that it had finalized its recently promulgated update to the “Names Rule,” which was initially proposed in May 2022.¹³ Nevertheless, the SEC still has several major initiatives that have yet to be finalized, including the much-anticipated rollout of new ESG-focused disclosure rules for public companies. Time is of the essence for Gensler and other ESG proponents at the SEC. As the 2024 election nears, a GOP takeover of Congress and the Presidency could scuttle Gensler’s rollout of the SEC’s new climate disclosure rules, in addition to other agency initiatives.

i. The SEC’s New Disclosure Rules Are Game-Changing:

On March 21, 2022, the Securities and Exchange Commission (“SEC”) unveiled its long-anticipated proposed rules on climate disclosures, entitled “The Enhancement and Standardization of Climate-Related Disclosures for Investors.” The SEC’s rule requires public companies to publish information for investors on their climate-related risks and an accounting of carbon emissions stemming from their operations. The SEC proposal is an attempt to “advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk[,]” an identified political priority for the Biden Administration’s environmental agenda.¹⁴

The rule will apply broadly to all issuers with registered classes of securities in the public US capital markets. Specifically, as stated by the SEC, the “proposed climate-related disclosure rules would apply to a registrant with Exchange Act reporting obligations . . . and companies filing a Securities Act or Exchange Act registration

¹² *Id.*

¹³ Jacob H. Hupart, *SEC Approves “Names” Rule to Combat Greenwashing*, MINTZ (Sept. 27, 2023), available at: <https://insights.mintz.com/post/102ionm/sec-approves-names-rule-to-combat-greenwashing>.

¹⁴ *Executive Order on Climate-Related Financial Risk*, THE WHITE HOUSE (May 20, 2021), <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/>.

statement.”¹⁵ Under the new rule, climate-related disclosures would be incorporated directly into existing SEC filings (including Forms 10-K and 10-Q), increasing both the prominence of the disclosures, and the prospect of potential liability for any misleading or inaccurate statements. So as to give companies time to comply, the disclosures are anticipated to be “phased-in” over the next five years and will include certain safe harbors for more difficult reporting requirements, as discussed below.

As to the substance of the rule, it would require companies to report on the following ESG-related metrics.

- **GHG Emissions:** Registrants will have to disclose certain kinds of GHG emissions, regardless of any materiality determination. The SEC has structured its proposed emissions reporting requirements into “scopes,” which distinguish between direct and indirect emissions. Scope 1 emissions are direct GHG emissions from the company’s operating assets and activities, Scope 2 emissions are the GHG emissions that the company is indirectly responsible for based upon its consumption of electricity, and Scope 3 emissions reflect the indirect GHG emissions relating to the company’s supply chain and products. While Scope 1 and 2 emissions are comparatively straightforward to calculate, deriving a company’s Scope 3 emissions is a complex and challenging process, subject to substantial estimations and various approximations. In turn, the SEC will only require the disclosure of Scope 3 emissions if those emissions are material.
- **Climate-Related Risks:** The SEC’s proposed rules would also require a registrant “to disclose any climate-related risk reasonably likely to have a material impact on the registrant’s business or consolidated financial statements.”¹⁶ The SEC has recognized the uncertainties inherent in this formulation and has expressly provided a safe harbor for any forward-looking

¹⁵ *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Proposed Rule (Apr. 11, 2022), available at: <https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors>.

¹⁶ *Id.*

statements in line with protections afforded by the Private Securities Litigation Reform Act (“PSLRA”).

- **Other Disclosures:** In addition to the aforementioned requirements, the SEC has requested disclosures concerning “transition risk,” which the SEC’s draft rule has defined as “the actual or potential negative impacts . . . attributable to climate-related risk,” to include “reputation impacts (including those stemming from a registrant’s customers or business counterparties).”¹⁷ Thus, the SEC’s proposed disclosure rules could be read to require companies to assess whether the activities of their business counterparties could result in potential negative impacts on their own operations. Additionally, the proposed rules contain multiple statements expressing the need for meaningful disclosure and an aversion to “boilerplate” language. This may signal a particular animus towards generic disclosures in the climate context, which may ultimately be the target of enforcement actions to come.
- **Governance Rules:** The SEC has also proposed significant prescriptive changes to corporate governance with respect to climate change and related disclosures. Specifically, according to the SEC, the proposed rules would require a registrant to disclose: (1) information concerning the board’s oversight of climate-related risk as well as management’s role in assessing and managing those risks; (2) whether any member of its board of directors has expertise in climate-related matters; (3) the processes and frequency by which the board discusses climate-related factors; (4) whether certain management positions are responsible for assessing and managing climate-related factors; and (5) the process by which the responsible managers are informed about and manage climate-related factors. The stated purpose of such disclosures is to “enable investors to better understand how the firm is informed about climate-related factors and how frequently the firm considers such factors as part of its business strategy, risk management, and financial oversight.”¹⁸

¹⁷ *Id.*

¹⁸ *Id.*

These rules, while not finalized, constitute a profound shift in the SEC's disclosure regime. For the first time, climate-related financial disclosures could be mandatory for public companies trading in the US capital markets, and these corporations would have to disclose their greenhouse gas emissions. This presents a new arena for regulatory enforcement and private civil litigation relating to those disclosures that may spread. The increased prevalence of and access to detailed environmental data likely to result from these rule changes will place additional pressure on corporations as they try to adhere to new standards of conduct in this emerging and rapidly evolving area.

Further, this proposal has now been echoed by state-level disclosure initiatives. For example, on September 14, California's legislature passed a similarly sweeping climate bill to compel major companies (both private and public) operating within the state to disclose their greenhouse gas emissions by reporting similar Scope 1, Scope 2, and Scope 3 GHG emissions, as well as their response to climate risk,¹⁹ which was signed into law by Governor Newsom on October 7, 2023.²⁰

The outsized impact of the new rule was evident when the SEC invited public comments on the new rules and received over 15,000 comments from individuals and organizations representing all aspects of modern American society.²¹ Few, if any, of the SEC's rule proposals have ever received such voluminous, significant, and diverse comments. In addition, the comments themselves ranged from brief statements to complex legal arguments, either in support or in opposition, as well as detailed proposals for further changes to the proposed climate disclosures. While the rule was generally well received — 84% of comments were delivered in the form of form letters, and 83% of form letters broadly expressed support for the proposed climate disclosure rule — both proponents and opponents of the rule have identified a handful of key issues as ripe for

¹⁹ Jacob H. Hupart, *California Compels Disclosure of Greenhouse Gas Emissions by Major Companies Operating in California*, MINTZ (Sept. 28, 2023), available at: <https://insights.mintz.com/post/102ionk/california-compels-disclosure-of-greenhouse-gas-emissions-by-major-companies-oper>.

²⁰ Jacob H. Hupart, *Governor Newsom Signs California Climate Disclosure Bills, Although Expressing a Degree of Skepticism Concerning Timing and Cost*, MINTZ (Oct. 11, 2023), available at: <https://insights.mintz.com/post/102ipq5/gov-newsom-signs-california-climate-disclosure-bills-although-expressing-a-degr>.

²¹ Jacob H. Hupart, Megan Gates, William F. Weld, Douglas P. Baumstein, Jennifer B. Rubin, Will G. McKitterick, *What Public Comments on the SEC's Proposed Climate-Related Rules Reveal—and the Impact They May Have on the Proposed Rules*, MINTZ (July 20, 2022), available at: <https://www.mintz.com/insights-center/viewpoints/2301/2022-07-20-what-public-comments-secs-proposed-climate-related-rules>.

potential revision. These include, among others, the length of the phase-in period and the disclosure of Scope 3 GHG emissions. If changes are made to the SEC’s proposed climate disclosure rule, it is likely that such changes will relate to these issues.

ii. Additional Disclosure Initiatives at the SEC:

In addition to the new but yet-to-be-implemented disclosure requirements, another aspect of the SEC’s regulatory agenda on climate change has been the issuance of comment letters to individual reporting entities. These letters focus on the purported flaws with companies’ climate change disclosures. In September 2021, the SEC published a “Sample Letter to Companies Regarding Climate Change Disclosures,” which stated that “information related to climate change–related risks and opportunities may be required in disclosures related to a company’s description of business, legal proceedings, risk factors, and management’s discussion and analysis of financial condition and results of operations.”²² The SEC further stated that its “illustrative letter,” provided by the Division of Corporate Finance, “contains sample comments that the Division may issue to companies regarding their climate-related disclosure or the absence of such disclosure[,]” and outlined nine topics on which the SEC intended to focus. In a recent quantitative analysis of these letters, Mintz calculated the number of sample letter recipients, which industries and sectors of the economy they operate in, which questions companies were most frequently asked, and what the timing and content of these letters signal in terms of the SEC’s focus on climate-disclosures.²³

Finally, the SEC has promulgated new rules to combat “greenwashing,” including the “Investment Company Names Rule” (“Names Rule”)²⁴ and the “Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies” (“ESG Disclosure Rule”).²⁵ Taken together, these rules are intended to address exaggerated or unsubstantiated claims by companies and investors that their products and services are

²² *Sample Letter to Companies Regarding Climate Change Disclosures*, SECURITIES AND EXCHANGE COMMISSION (Sept. 22, 2021), available at: <https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures>.

²³ *Id.*

²⁴ Rule, *Investment Company Names*, SECURITIES AND EXCHANGE COMMISSION (May 25, 2022), available at: <https://www.sec.gov/files/rules/proposed/2022/33-11067.pdf>.

²⁵ *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices*, SECURITIES AND EXCHANGE COMMISSION (May 25, 2022), available at: <https://www.sec.gov/files/rules/proposed/2022/33-11068.pdf>.

environmentally friendly or have unique social benefits. The Names Rule, which was approved by the SEC on September 20, 2023,²⁶ requires registered investment companies whose names suggest a focus on a particular type of investment to invest at least 80% of the value of their assets in those investments. Notably, this requirement applies to any fund whose name suggests the fund focuses its investments on particular characteristics, such as “growth,” “value,” or names indicating the incorporation of ESG factors. The ESG Disclosure Rule aims to provide “specific requirements about what a fund or adviser following an ESG strategy must include in its disclosures” so as to improve the consistency and comparability of ESG-related disclosures among various investment funds and advisors focused on ESG investing.²⁷

iii. The SEC Launches a New Task Force to Enforce ESG Rules and Regulations:

Beyond issuing new disclosure rules, the SEC recently doubled down on efforts to enforce the regulation of ESG investing. The Commission issued a risk alert in 2021, which highlighted several potential ESG-related problem areas related to investors’ current disclosure practices, including instances of “potentially misleading statements regarding ESG investing processes and representations regarding the adherence to global ESG frameworks.”²⁸ In that report, the SEC’s staff noted that many firms, despite claiming to have formal processes in place for ESG investing, lacked proper policies and procedures related to ESG investing that were reasonably designed to prevent violations of the law, or were simply not implemented.²⁹

As part of its effort to address these issues, on March 4, 2022, the SEC announced the creation of a new Climate and ESG Task Force in the Division of Enforcement to investigate alleged corporate environmental, social, and governance misdeeds. The ESG Task Force was initially tasked with identifying any material gaps or misstatements in issuers’ disclosure of climate risk under existing rules. According to the SEC’s website,

²⁶ Jacob H. Hupart, *SEC Approves “Names” Rule to Combat Greenwashing*, MINTZ (Sept. 27, 2023), available at: <https://insights.mintz.com/post/102ionm/sec-approves-names-rule-to-combat-greenwashing>.

²⁷ *Id.*

²⁸ Risk Alert, *The Division of Examinations’ Review of ESG Investing*, SECURITIES AND EXCHANGE COMMISSION (Apr. 9, 2021), available at: <https://www.sec.gov/files/esg-risk-alert.pdf>.

²⁹ *Id.*

it is also committed to “analyz[ing] disclosure and compliance issues relating to investment advisers’ and funds’ ESG strategies.”³⁰ Since its inception, the ESG Task Force has been busy sending subpoenas to asset managers in connection with their marketing efforts and has focused on prosecuting entities for greenwashing, or making exaggerated disclosures concerning ESG-related issues, as well as fund managers that have failed to develop and implement internal guidelines for ESG investing.

- **Greenwashing:** The SEC announced in March 2023 that it had reached a \$55.9 million settlement agreement with Brazilian mining company Vale SA, the largest and most significant settlement obtained by the Task Force to date.³¹ The SEC had charged the company with making exaggerated and misleading statements about the safety of its dam, which collapsed in January 2019, killing 270 people and causing massive environmental and social harm, including the loss of more than \$4 billion in Vale’s market capitalization.³² Interestingly, the scrutinized disclosures at issue in the case were made by the company’s CEO in a magazine article, which signals the ESG Task Force is not only concerned with statements made in public filings, such as 10-Ks and proxy statements, but other voluntary reports published on a company’s website or in third-party publications.
- **ESG Policy Failures:** In November 2022, the ESG Task Force announced another successful settlement for \$4 million with Goldman Sachs, which was charged for policy and procedural failures involving two of its mutual funds and one separately managed account strategy marketed as ESG investments.³³ Specifically, the Commission alleged Goldman Sachs, after failing to implement internal ESG policies, developed said policies and then failed to adhere to

³⁰ Press Release, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues*, SECURITIES AND EXCHANGE COMMISSION (Mar. 4, 2021), available at: <https://www.sec.gov/news/press-release/2021-42>.

³¹ Press Release, *SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse*, SECURITIES AND EXCHANGE COMMISSION (Apr. 28, 2022), available at: <https://www.sec.gov/news/press-release/2022-72>.

³² *Id.*

³³ Press Release, *SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments*, SECURITIES AND EXCHANGE COMMISSION (Nov. 22, 2022), available at: <https://www.sec.gov/news/press-release/2022-209>.

them.³⁴ In announcing the settlement, the ESG Task Force’s Co-Chief emphasized that “[t]oday’s action reinforces that investment advisors must develop and adhere to their policies and procedures over their investment processes, including ESG research, to ensure investors receive the advisory services they would expect to receive from an ESG investment.”³⁵ This prosecution serves as a warning to other fund managers that the SEC expects ESG investors to develop and adhere to clear policies and procedures with respect to ESG investments.

More recently, in September 2023, the SEC (although not the ESG Task Force) announced a \$19 million settlement with an investment advisor subsidiary of Deutsche Bank AG that marketed itself as a leader in ESG, in connection with, inter alia, misstatements regarding “its controls for incorporating ESG factors into research and recommendations for ESG integrated products[.]”³⁶

While these efforts ostensibly signal the SEC’s commitment to police both internal ESG processes and policies as well as ESG-related disclosures, the SEC has only initiated a handful of enforcement actions since the inception of the ESG Task Force. In fact, the SEC has only highlighted the involvement of the ESG Task Force in five successful prosecutions since it announced its creation in 2022.³⁷

C. More Agencies Commit to Policing ESG Issues

In addition to the SEC, a growing number of agencies and governmental entities across the United States government have also begun promoting and enforcing laws related to ESG. The CFTC, for one, has taken steps to expand its regulatory reach to police fraud and other misconduct in the burgeoning market for carbon credits. In addition, regulatory actions have proliferated across the United States Government in the past few years, and enforcement priorities have shifted, placing certain polluters —

³⁴ *Id.*

³⁵ *Id.*

³⁶ Press Release, *Deutsche Bank Subsidiary DWS to Pay \$25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG*, SECURITIES AND EXCHANGE COMMISSION (Sept. 25, 2023), available at: <https://www.sec.gov/news/press-release/2023-194>.

³⁷ See *Enforcement Task Force Focused on Climate and ESG Issues*, SECURITIES AND EXCHANGE COMMISSION (last modified Apr. 11, 2023), available at: <https://www.sec.gov/securities-topics/enforcement-task-force-focused-climate-esg-issues>.

particularly fossil fuel producers — in the crosshairs of federal regulators for the first time. Moreover, mounting pressure from civil society has placed added pressure on government agencies to address climate change more forcefully.

i. The CFTC Expands Its Reach to Regulate Carbon Markets:

The SEC is by no means the only agency committed to pursuing the Biden Administration’s ESG agenda. Agencies across the government are attending to ESG issues within their spheres of regulatory influence. One prominent example concerns the CFTC’s efforts to regulate carbon markets. In June 2023, the CFTC announced its enforcement division would create a new Environmental Fraud Task Force, which is empowered to combat environmental fraud and misconduct in derivative and spot markets that trade in carbon credits.³⁸ The Task Force will also examine the use of these markets to determine how to structure them to address climate change and other environmental risks. In announcing the creation of the Task Force, CFTC Chairman Rostin Behnam noted his concern that fraud and manipulation may be rank in the voluntary carbon markets, which have expanded rapidly as an increasing number of firms make claims as to their various carbon initiatives.³⁹

In the same June 2023 announcement, the CFTC issued a whistleblower office alert to carbon market participants, identifying certain types of misconduct of interest to the CFTC. The CFTC’s solicitation of whistleblowers is in connection with “potential fraud and manipulation” in “voluntary carbon markets,” particularly in circumstances “in which high-quality carbon credits, also known as carbon offsets, are purchased and sold bilaterally or on spot exchanges.”⁴⁰ In particular, the CFTC announced that it was interested in information concerning “manipulative and wash trading, ‘ghost’ credits, double counting, fraudulent statements relating to material terms of the carbon credits, and potential manipulation of tokenized carbon markets,” highlighting that individuals who

³⁸ Press Release, *CFTC Division of Enforcement Creates Two New Task Forces*, COMMODITY FUTURES TRADING COMMISSION (June 29, 2023), available at: <https://www.cftc.gov/PressRoom/PressReleases/8736-23>.

³⁹ *Id.*

⁴⁰ Jacob Hupart, *CFTC Asserts Enforcement Authority Over Carbon Markets*, MINTZ (June 27, 2023), available at: <https://insights.mintz.com/post/102ii3z/cftc-asserts-enforcement-authority-over-carbon-markets>.

supplied information could receive “monetary awards if that information leads to the success of a CFTC enforcement action.”⁴¹

Irrespective of whether the announcement leads to any whistleblowers coming forward or even any subsequent enforcement actions, this statement serves as a bold declaration of policy that “[t]he CFTC has enforcement authority and regulatory oversight over” “the voluntary carbon credit market.”⁴² In effect, the CFTC has announced that it will be exercising jurisdiction over carbon markets, including the purchase and sale of carbon offsets, and that it plans to pursue enforcement actions related to alleged misconduct in connection with carbon markets. Thus, another federal regulator has asserted itself in the context of financial regulations concerning climate change, adding to the complexity of the regulatory environment that individual businesses need to navigate.

ii. Fossil Fuel Litigation at the Federal and Municipal Levels:

Climate change litigations — principally against private fossil fuel companies — have traditionally been pursued by local governments in the United States and through private civil litigation in the courts.⁴³ These suits, typically brought by private lawyers operating on a contingency fee, frequently proceed under theories of nuisance, as well as other common law claims. Actions were also brought by state attorneys general, such as the New York Attorney General’s unsuccessful nuisance suit against ExxonMobil. Since 2017, the attorneys general of California, Connecticut, Delaware, Massachusetts, Minnesota, New Jersey, Rhode Island, Vermont, and the District of Columbia, as well as 35 municipal governments in California, Colorado, Hawaii, Maryland, New Jersey, New York, South Carolina, Washington, and Puerto Rico have filed lawsuits against major oil and gas producers to hold them accountable for allegedly deceiving the public about their products’ roles in climate change.⁴⁴

⁴¹ *Id.*

⁴² *Id.*

⁴³ Jacob Hupart, *Potential Climate Change Litigation by the Federal Government in a Biden Administration*, MINTZ (Nov. 15, 2020), available at: <https://insights.mintz.com/post/102gk8g/potential-climate-change-litigation-by-the-federal-government-in-a-biden-administ>.

⁴⁴ Press Release, *DOJ Backs Communities Suing Big Oil, Reversing Trump-era Position*, CENTER FOR CLIMATE INTEGRITY (Mar. 16, 2023), available at: <https://climateintegrity.org/news/doj-backs-communities-suing-big-oil-reversing-trump-era-position>.

More recently, however, the Biden Administration has made known that it intends to pursue climate-based litigation against fossil fuel emitters.⁴⁵ This is reflective of a sea change in administrative policy since the Trump Administration, where the Department of Justice (“DOJ”) frequently filed amicus curiae briefs on behalf of fossil fuel company defendants, arguing that certain claims brought against them were preempted by federal law. In fact, in March of 2023, Biden’s solicitor general, Elizabeth Prelogar, urged the Supreme Court to deny a petition by ExxonMobil and Suncor Energy to remove their case from state to federal court.⁴⁶ In her brief, Solicitor General Prelogar backed Colorado communities’ position in the suit, arguing that the case arises solely under state law and belongs in state rather than federal court. The Supreme Court, in tacit approval of Prelogar’s position, upheld a Third Circuit decision in May 2023 to remand parallel cases brought by state and local governments in Delaware and New Jersey back to state court.⁴⁷

Beyond merely supporting these suits, the Biden Administration also authorized its DOJ to bring suits directly against large-scale emitters. This represents a significant escalation in potential liability risk for fossil fuel companies. Not only does the federal government possess greater resources to prosecute such actions, but the DOJ may avail itself of other aggressive means (beyond civil tort suits) to prosecute fossil fuel producers, such as through an enforcement action. In fact, just this past April, the Justice Department reached multimillion-dollar settlements in three major lawsuits against US fossil fuel producers.⁴⁸ The suits accused the producers of using faulty equipment to manufacture and refine natural gas, failing to control leaks, and allowing hazardous air pollution to seep into the atmosphere in violation of the Clean Air Act standard set by the EPA.⁴⁹ In turn, defendants were required to spend about \$16 million on repairs,

⁴⁵ Lesley Clark, *Biden Fails to Fulfill Pledge on Climate Lawsuits*, CLIMATEWIRE (Jan. 19, 2022), available at: <https://www.eenews.net/articles/biden-fails-to-fulfill-pledge-on-climate-lawsuits/>.

⁴⁶ Press Release, *DOJ Backs Communities Suing Big Oil, Reversing Trump-era Position*, CENTER FOR CLIMATE INTEGRITY (Mar. 16, 2023), available at: <https://climateintegrity.org/news/doj-backs-communities-suing-big-oil-reversing-trump-era-position>.

⁴⁷ Jacob Hupart, *Supreme Court Rejects Efforts by Fossil Fuel Companies to Litigate Climate Change Issues in Federal Court*, MINTZ (May 16, 2023), available at: <https://insights.mintz.com/post/102ieto/supreme-court-rejects-efforts-by-fossil-fuel-companies-to-litigate-climate-change>.

⁴⁸ Hannah Rabinowitz, *DOJ Reaches Multimillion-dollar Settlements Against Oil and Gas Companies It Says Were Failing to Control Harmful Leaks*, CNN POLITICS (Apr. 20, 2023), available at: <https://www.cnn.com/2023/04/20/politics/doj-gas-company-pollution-settlements-climate/index.html>.

⁴⁹ *Id.*

upgrades, and other fixes to the problems and were forced to commit to implementing plans to address future leaks by installing new equipment and performing independent audits.⁵⁰

In this new regulatory environment, the DOJ may begin to pursue more actions against a broader array of companies outside the fossil fuel industry. For example, the DOJ may consider taking aggressive actions against companies that have apparently prepared insufficiently for climate change, perhaps by siting critical facilities in an area vulnerable to sea level rise. Corporations operating in the United States should consider their potential climate change liability under the Biden Administration, and prepare accordingly.

D. Federal Pushback Against ESG Regulation

The federal government's wide-ranging efforts to promote ESG have not been well-received from all corners of the government. The Biden Administration and its agencies have faced stiff resistance from a range of institutional actors across the government that are politically opposed to such reform efforts.

i. The Supreme Court Shuts Down New EPA Emissions Regulations:

One center of resistance that has emerged as of late has come from the conservative-dominated Supreme Court. The Court's recent ruling in *West Virginia v. EPA*, for example, barred the EPA from putting state-level caps on carbon emissions under the 1970 Clean Air Act.⁵¹ In analyzing the statutory grant under which the EPA claimed authority to promulgate its rule, the Supreme Court concluded that the rule exceeded the EPA's power, as it presented a "major question" of economic and national importance that required a clearer statement from Congress to confer such authority, narrowing the scope of the EPA's authority as an environmental regulator.⁵²

The ruling will almost certainly slow down the United States' transition to clean energy and could have broader effects on other agencies' ability to promulgate new ESG rules. For example, the ruling could have implications for the SEC's proposed

⁵⁰ *Id.*

⁵¹ *West Virginia v. EPA*, 142 S. Ct. 2587 (2022).

⁵² *Id.* at 2609 ("[t]he agency instead must point to 'clear congressional authorization' for the power it claims.").

Enhancement and Standardization Climate-Related Disclosures for Investors Rule (discussed above), which seeks to impose extensive disclosure requirements on US public companies and foreign private issuers relating to climate change and climate-related risks. Following the Supreme Court’s ruling, if the SEC finalizes its new disclosure rule in substantively similar form, it will likely trigger challenges under the major questions doctrine and skepticism from courts as to whether it conflicts with the agency’s statutory authority.

ii. House Republicans Continue to Vigorously Oppose ESG Policies:

Congressional Republicans have also strenuously opposed the Biden Administration’s ESG agenda. As one example, in July 2023, three House Republicans, Congressman Jim Jordan (R-OH), Thomas Massie (R-KY), and Dan Bishop (R-NC), sent a letter on behalf of the House Committee on the Judiciary to three major asset managers and two nonprofit organizations (the Glasgow Financial Alliance for Net Zero and the Net Zero Asset Managers Initiative) demanding these organizations “produce relevant documents and information” in connection with allegedly “collusive agreements to ‘decarboni[ze]’ and reduce emissions to net zero by 2050.”⁵³ In effect, this Republican-controlled House Committee is pursuing a theory that coordinated efforts to reduce carbon emissions constitute violations of the antitrust laws of the United States.

Members of the Republican-controlled House of Representatives have been signaling for months that they perceive antitrust law as a potent means to combat coordination among private sector entities to reduce carbon emissions. These latest developments merely represent an escalation of that proposed tactic. Still, these letters reveal significant details about the particular focus of the House Committee on the Judiciary. In particular, the letters are clear in requesting documents “relating to any agreement or commitment, or any effort to reach such an agreement or commitment, between or among [target], other asset managers, and alliances or initiatives . . . to advance decarbonization and net zero emissions goals,” and specifically requesting “communications reflecting or suggesting agreement or commitment as to specific steps,

⁵³ Jacob Hupart, *House Republicans Issue Letters to Major Asset Managers Concerning Potential Antitrust Violations Allegedly Caused by ESG Policies*, MINTZ (July 7, 2023), available at: <https://insights.mintz.com/post/102iivo/house-republicans-issue-letters-to-major-asset-managers-concerning-potential-anti>.

policies, or best practices.”⁵⁴ The letters also ask about the role of the asset managers in “voting for directors and stockholder proposals” in connection with their “decarbonization and net zero emissions goals.”⁵⁵ Further, the letters indicate an ideological hostility to the “radical ‘steps such as halting sales of new internal combustion engine passenger cars by 2050, and phasing out all unabated coal and oil power plants by 2040,” as “[s]uch restrictions limit output and increase prices, and deprive businesses of investments and consumers of choices . . . [with] potential [far-reaching] consequences for American freedom and economic well-being.”⁵⁶ Indeed, this last point — that these “commitments” to “decarbonization and net zero emissions” will “affect output, price, or the choices available to consumers and investors” — is echoed in their specific document requests, reflecting this particular emphasis.

Moving forward, we recommend clients closely monitor developments on Capitol Hill as Congressional Republicans increasingly initiate efforts to combat the use of ESG principles, particularly concerning climate change, in the private sector.

E. Practical Takeaways

As indicated above, there now exists a concerted effort at the federal level to initiate and enshrine new ESG rules and regulations into law, and to spread the impact of ESG rules to new actors across the US economy. In turn, clients must heed these new rules and determine how to comply with them in order to avoid unnecessary regulatory scrutiny and enhanced litigation exposure. We recommend clients keep the following in mind to avoid conflicting with the new ESG rules and regulations promulgated by the federal government:

- **ESG Will Remain an Enforcement Priority in the Short Term:** Given the SEC’s forthcoming disclosure rules (which are anticipated to be robust) and the growing number of enforcement actions across the government, we expect ESG to remain an enforcement priority through 2024.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

- **Prepare for More Enforcement Actions:** Clients can expect a greater number of ESG-based enforcement actions to target companies outside of the oil and gas industries, which were traditionally the focus of ESG enforcement actions, particularly when the SEC finalizes its new disclosure rules. Clients can expect ESG enforcement to continue at both the federal and local levels.
- **The 2024 Election Could Change Everything:** As ESG becomes more politicized, significant institutional forces, including House Republicans and an ideologically right-leaning Supreme Court, have signaled strong opposition to agency and administrative efforts to address ESG issues. The 2024 election cycle, if Republicans claim majorities in the House and Senate or return to the White House, could seal the fate of many of the Biden Administration's recently implemented ESG regulatory initiatives, as well as those currently in development.



CHAPTER 4

Trends in Private ESG Litigation

The rise in ESG-related disclosures and regulatory actions, combined with growing consumer demand for ethically sourced and produced products and services, has generated a steep rise in private ESG litigation. There has been a marked increase in the use of new legal avenues by investors and other stakeholders to pursue their interests in this area. Shareholder class actions alleging breaches of fiduciary duties against companies that have used ESG metrics to guide investment decisions have proliferated, as have shareholder challenges to the accuracy of companies' climate-related public disclosures, also known as "greenwashing" claims. In addition, the Delaware Chancery Court recently signaled its willingness to entertain *Caremark* claims (i.e., the duty of corporate directors and officers to monitor and provide oversight over a corporation's operations), which are likely to grow in prominence following the implementation of the SEC's new disclosure rules. Moreover, the intersection of ERISA fiduciary duties and ESG investment has exposed investment plan fiduciaries to heightened risk from the plaintiffs' bar. Corporations, fund managers, and other economic players must prepare for ESG litigation risks to remain persistently high for the next few years, as the drivers underlying these actions are unlikely to abate.

A. Anti-ESG Private Shareholder Litigation

In the past year, conservative activists filed several lawsuits against companies challenging fiduciaries' decisions to adopt or adhere to ESG-based policies, procedures, and marketing efforts. This has placed corporate defendants in a difficult position. Under growing pressure from consumers to adopt more socially conscious policies, many

corporations feel it is necessary to promote their commitment to ESG-based reforms. By promoting these efforts, however, fiduciaries have exposed themselves to increased litigation from anti-ESG activists, who believe ESG-focused policymaking is a direct violation of fundamental duties owed to shareholders — a recurring theme in these actions being that ESG reforms actually run counter to a fiduciary's duty to maximize shareholder profit.

Shareholders, pensioners, and consumers alike are also increasingly using lawsuits to challenge fiduciaries' reliance on ESG factors. As discussed below, ESG-based shareholder suits were traditionally levied against companies for their failure to demonstrate or live up to their ESG goals or commitments. Companies were also sued for overstating their ESG accomplishments, a phenomenon called "greenwashing" that will be discussed further below. A spate of more recent plaintiffs' suits, however, have focused on holding companies accountable for their *success* in meeting ESG goals.

- ***Craig v. Target Corp. et al., No. 23-00599 (M.D. Fla.)***: In August 2023, American First Legal, a conservative legal activist group, sued Target on behalf of the company's investors, alleging the retailer misrepresented the adequacy of its risk-monitoring policies following customer backlash over its launch of certain LGBTQ-themed merchandise.⁵⁷ The lawsuit, filed in the Middle District of Florida against the company and its executives, accuses defendants of violating Sections 10(b) and 14(a) of the Securities Exchange Act of 1934.⁵⁸ Specifically, the lawsuit alleges Target's board "for years spent Target's valuable financial and reputational capital on the pursuit of ESG and DEI mandates behind the façade of Target's classic middle-class brand, all the while falsely and misleadingly portraying the risks of its strategy to Target's shareholders in order to secure re-election and insulate itself from accountability."⁵⁹ Plaintiff is seeking damages for the decline in

⁵⁷ *Target sued by investor over backlash to LGBTQ Merchandise*, CNBC (Aug. 9, 2023), available at: <https://www.cnbc.com/2023/08/09/target-sued-by-investor-over-backlash-to-lgbtq-merchandise.html>.

⁵⁸ *Id.*

⁵⁹ Kevin LaCrois, *Target Hit with ESG-Backlash Securities Suit*, THE D&O DIARY (Aug. 14, 2023), available at: <https://www.dandodiary.com/2023/08/articles/esg/target-hit-with-esg-backlash-securities-suit/>.

Target's share price caused by consumer backlash to the company's decision.

These suits are emblematic of broader efforts by conservative factions to use politically motivated litigation to overturn allegedly "woke policies" championed by corporate America.⁶⁰ They are also representative of the growing number of class actions filed by non-ideologically aligned shareholders against corporate directors and officers to challenge their adoption of ESG-based policies, procedures, and marketing efforts. Regardless of who files these actions, anti-ESG shareholder suits are unlikely to abate in the near term, particularly as public companies are compelled to offer more detailed disclosures pursuant to the SEC's new, yet still pending, ESG disclosures rule.

B. New Avenues for ESG-Based Litigation Proliferate

ESG-based private litigation is developing rapidly in a variety of areas. In a dramatic turn of events, the Delaware Court of Chancery, the country's preeminent interpreter of corporate law and arbiter of business disputes, has signaled a renewed willingness to entertain *Caremark* claims brought in the ESG context and other areas. At the same time, the plaintiffs' bar has filed a growing number of class actions aimed at imposing liability on companies for greenwashing their products and services. Finally, ERISA has emerged as a vital battleground for litigating fiduciary duty claims against pension fund managers caught in the crosshairs of litigious pro- and anti-ESG investors.

i. The Revitalization of *Caremark* Claims:

Recent developments in Delaware's Court of Chancery concerning *Caremark* claims are likely to intersect increasingly with the SEC's proposed new disclosure obligations to create a new category of corporate risk.⁶¹ The Court of Chancery first

⁶⁰ See, e.g., Daniel Wiessner, *Starbucks Diversity Programs Targeted by Former Trump Aide's Legal Group*, REUTERS (Oct. 18, 2022), available at: <https://www.reuters.com/legal/government/starbucks-diversity-programs-targeted-by-former-trump-aides-legal-group-2022-10-18/>; Allison Frankel, *How a Disney Books-and-Records Case Blew Up Into Culture War*, REUTERS (Mar. 14, 2023), available at: <https://www.reuters.com/legal/government/column-how-disney-books-and-records-case-blew-up-into-culture-war-2023-03-14/>; Nate Raymond, *Pfizer Defeats Race-bias Lawsuit Over Minority Fellowship Program*, REUTERS (Dec. 16, 2022), available at: <https://www.reuters.com/legal/pfizer-defeats-race-bias-lawsuit-over-minority-fellowship-program-2022-12-17/>.

⁶¹ Jacob H. Hupart, Douglas P. Baumstein, Jonathan L. Kravetz, Ellen Shapiro, Will G. McKitterick, *Caremark Liability Following the SEC's New ESG Reporting Requirements*, MINTZ (Dec. 16, 2022), available at: <https://www.mintz.com/insights-center/viewpoints/2301/2022-12-21-caremark-liability-following-secs-new-esg-reporting>.

announced that corporate directors have an affirmative duty of oversight to monitor so-called "mission-critical" aspects of their business in *In re Caremark Int'l Inc. Deriv. Litig.*⁶² In this landmark decision, the court announced fiduciaries' duty of oversight, a subsidiary of the duty of loyalty, noting that a board must "exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations[.]"⁶³ Thus, since *Caremark*, "duty to monitor" claims have typically involved allegations of some form of illegal activity on the part of employees concerning a "mission-critical" aspect of a company's business, and a claim by a plaintiff that the alleged unlawful conduct would not have occurred had directors properly exercised oversight.

Caremark actions, however, were once notoriously difficult to plead; in explaining the doctrine, the Chancery Court famously called it "the most difficult theory in corporate law upon which a plaintiff might hope to win a judgment."⁶⁴ This was largely due to *Caremark's* stringent pleading standards with regard to demand futility, which required a plaintiff "plead with particularity that the board cannot be entrusted with the claim because a majority of the directors may be liable for oversight failures[.]" which is "extremely difficult to do."⁶⁵ As a result, *Caremark* claims frequently resulted in early dismissal.

In recent years, however, the Delaware courts have breathed new life into the *Caremark* doctrine by allowing these types of claims to proceed to discovery.⁶⁶ This sea change in jurisprudence came following the Delaware Supreme Court's decision in *Marchand v. Barnhill*, a case arising from a listeria outbreak at a Blue Bell ice cream manufacturing plant that killed three consumers and sickened many others.⁶⁷ Blue Bell's directors were eventually sued in a derivative *Caremark* action by a plaintiff-stockholder for their failure to oversee and monitor the company's food safety operations. In overturning the lower court's dismissal of the action, the Delaware Supreme Court held that "[u]nder *Caremark*, a director may be held liable if she acts in bad faith in the sense

⁶² 698 A.2d 959 (Del. Ch. 1996).

⁶³ *Id.* at 970.

⁶⁴ *Id.* at 967.

⁶⁵ *In re Boeing Co. Deriv. Litig.*, No. 2019-0907-MTZ, 2021 Del. Ch. LEXIS 197, at *2 (Del. Ch. Sept. 7, 2021).

⁶⁶ *Id.* at *1-3.

⁶⁷ *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

that she made no good faith effort to ensure that the company had in place any 'system of controls.'"⁶⁸ While the company had safety practices in place, commissioned audits from time to time, and allowed government inspectors to review Blue Bell's facilities, the court held that these efforts did "not imply that the *board* implemented a system to monitor food safety *at the board level*."⁶⁹ Instead, the court found the board failed to demonstrate it had made "a good faith effort" to monitor the company's "central compliance risks" or its "essential and mission-critical" operations — i.e., the health and safety of Blue Bell's ice cream manufacturing operations."⁷⁰

Marchand is notable not because it changed the *Caremark* standard, but because it demonstrated the Delaware court's willingness to permit *Caremark* claims to surmount a motion to dismiss challenge if they could be plausibly pled. The case ultimately laid the groundwork for a slew of subsequent decisions demonstrating the renewed vitality of *Caremark* claims. For example, in *In re Clovis Oncology Deriv. Litig.* in the Court of Chancery,⁷¹ the court cited the Delaware Supreme Court's decision in *Marchand* to hold that the plaintiff adequately pled that the board of a pharmaceutical company failed to follow health and safety regulations imposed by the Food and Drug Administration. In analyzing the plaintiff's complaint, the Court of Chancery found that the plaintiffs adequately pled facts suggesting the company's board of directors, which operated in a highly regulated industry and whose main operations concern centered on issues of drug safety and efficacy, disregarded "multiple warning signs that management was inaccurately reporting [the drug's] efficacy."⁷² In addition, in *Inter-Marketing Group USA, Inc. v. Armstrong*,⁷³ the Court of Chancery permitted the plaintiff's pleadings to proceed based on *Caremark* claims against an oil pipeline operator resulting from an oil spill. The court held that, while the board received reports regarding general pipeline activity, those reports were devoid of substance, and the board "never reviewed pipeline integrity policy [or] procedure[.]"⁷⁴

⁶⁸ *Id.* at 822 (citations omitted).

⁶⁹ *Id.* (emphasis in original) (citation omitted).

⁷⁰ *Id.* at 823-24.

⁷¹ *In re Clovis Oncology, Inc. Deriv. Litig.*, No. 2017-0222-JRS, 2019 Del. Ch. LEXIS 1293 (Del. Ch. Oct. 1, 2019).

⁷² *Id.* at *3.

⁷³ *United States v. Armstrong*, No. 2017-0030-TMR, 2020 Del. Ch. LEXIS 391 (Del. Ch. Jan. 31, 2020).

⁷⁴ *Id.* at *34.

Not all *Caremark* suits will survive a motion to dismiss, as the pleading standard for a breach of duty to monitor claim is still difficult to satisfy. Nevertheless, corporations are likely to face more litigation of this type from the plaintiffs' bar, particularly following the implementation of the SEC's new climate-risk reporting requirements. In addition to spurring companies to reevaluate their internal compliance and reporting regimes, the SEC's new climate-related disclosure rule will likely fuel ESG-related *Caremark* claims, creating new direct and indirect risks for corporate officers. For example, plaintiffs may leverage new climate-related disclosures to plead that directors have failed to implement an appropriate system of controls to monitor "mission-critical" components of their business with exposure to climate risk. Even if unsuccessful, these suits pose considerable indirect risks to companies as well. They can result in the disclosure of embarrassing or harmful information about the company, its board, or managers and lead to the replacement of key company executives or directors by aggrieved shareholders. Moreover, they can give rise to board issues, such as proxy battles, that are expensive and resource-intensive to address.

To avoid such suits, clients should focus on identifying the obligations and risks they face with regard to ESG issues, including what ESG-related risks could detrimentally affect a "mission-critical" aspect of a company's business. Once cognizant of that risk, clients should implement and maintain appropriate governance structures so they are aware of, and can take appropriate steps to address, ESG risk. Finally, with these new systems in place, companies should take steps to prepare for the SEC's new climate-related disclosure requirements. While taking such steps, it is advisable that corporate executives and boards seek input from subject matter experts and experienced legal counsel to help design and implement robust compliance and monitoring regimes that can discourage or forestall future litigation in the form of *Caremark* or other claims related to ESG.

ii. Greenwashing Class Actions Take Off:

Recent regulatory actions and consumer trends have also motivated companies to make public claims about their products' sustainability.⁷⁵ Corporations are making detailed environmental and sustainability disclosures, either in response to regulations requiring disclosures or through their own efforts to market their products and services. In response, the plaintiffs' bar has begun to target these representations as "greenwashing," bringing a growing number of false advertising class action lawsuits against companies that they allege cannot substantiate their claims.

"Greenwashing" occurs when companies make false or inflated claims about the environmentally beneficial nature of their products, services, or their business generally. For example, greenwashing is evident when companies charge a premium for goods or services they misrepresent as "sustainable."⁷⁶ Accordingly, greenwashing claims will often consist of plaintiffs highlighting companies' public statements about their products' environmental impacts and alleging that those statements are unsupported by company actions. There is, however, no broadly accepted definition of greenwashing, and claims will vary by product and service, as well as across different markets, regulators, and jurisdictions.

So far, plaintiffs in greenwashing class actions have mostly targeted retailers and consumer-facing companies in industries like footwear, apparel, food, and beverages. Many of these suits are filed in states with strong consumer protection laws, like New York and California. Most notably, a significant number of these class-action cases have recently survived initial motions to dismiss. This trend signals that courts are starting to consider these claims seriously. Nevertheless, class claims that proceed past a motion to dismiss stage, particularly those that are certified, may have uncertain outcomes, be expensive to litigate, and can result in costly settlements for companies as well as significant reputational harm.

⁷⁵ Jacob H. Hupart, Douglas P. Baumstein, Joshua Briones, Will G. McKitterick, Jared Solomon, Alex Mejia, *Greenwashing Class Action Litigation: An Emerging Risk for Companies' Claims of Sustainability*, MINTZ (Aug. 2, 2023), available at: <https://www.mintz.com/insights-center/viewpoints/2151/2023-08-02-greenwashing-class-action-litigation-emerging-risk>.

⁷⁶ Adam Hayes, *What Is Greenwashing? How it Works, Examples, and Statistics*, INVESTOPEDIA (Mar. 31, 2023), available at: <https://www.investopedia.com/terms/g/greenwashing.asp/>.

Most of this litigation is still in the early stages, meaning that it is unclear what success these shareholder plaintiffs will ultimately achieve. However, several of these cases have progressed past the initial pleadings stage, which suggests these actions are likely to continue in the near term.

- ***Fagen v. Enviva Inc., No. 8:22-cv-02844 (D. Md.)***: The plaintiff, a former Enviva investor, filed a putative class action asserting claims under Sections 10(b) and 20(a) of the Securities Act, alleging Enviva Inc. and certain of its officers and directors made false and misleading statements regarding the sustainability of its wood pellet production and procurement processes. Enviva Inc. is the world's largest producer of wood pellets, a renewable alternative to coal. The plaintiff's class challenged certain statements by the company that alleged sustainability was the foundation of Enviva's business. The lawsuit was filed after the publication of an October 2022 short-seller report regarding Enviva's business, which alleged the company was "flagrantly greenwashing its wood procurement" and characterizing its claims of being a "pure play ESG Company" as "nonsense on all accounts."⁷⁷ The company's stock price plummeted after the release of the report. The court is currently considering Enviva's motion to dismiss the case.
- ***Smith v. Keurig Green Mountain, Inc., No. 18-cv-06690-HSG, 2023 WL 2250264 (N.D. Cal. Feb. 27, 2023)***: The plaintiff filed common law breach of express warranty, unjust enrichment, and misrepresentation claims against Keurig for promoting its Keurig K-cups as "recyclable." Keurig marketed and sold its K-cups as recyclable, with labeling on K-cup packaging stating that consumers could "[h]ave [their] cup and recycle it, too," along with instructions on the packaging for how consumers could recycle the products.⁷⁸ However, plaintiffs alleged that the K-cups were, in practice, unrecyclable even if consumers followed the illustrated steps on

⁷⁷ Complaint at 3 ¶ 4, *Fagen v. Enviva Inc., et al.*, No. 8:22-cv-02844 (D. Md. Nov. 3, 2022) (ECF No. 1).

⁷⁸ Second Amended Class Action Complaint at 6 ¶ 21, *Smith v. Keurig Green Mountain, Inc.*, No. 18-cv-06690-HSG (N.D. Cal. July 13, 2022) (ECF No. 141).

the product packaging, as most recycling facilities were unable to capture materials as small as K-cups - and even if some could, there was no market where they could be recycled.⁷⁹ In 2019, the Northern District of California denied Keurig's motion to dismiss,⁸⁰ and in 2020, granted the plaintiff's motion for class certification. In February 2023, the court granted final approval of a \$10 million settlement between the plaintiff and the defendant.⁸¹

- ***Lee v. Canada Goose, No. 20 Civ. 9809 (VM), 2021 WL 6881256 (S.D.N.Y. June 29, 2021)***: The plaintiff filed a class action against apparel company Canada Goose, which sells jackets and coats with coyote fur components. The plaintiff's allegations centered on the product tags Canada Goose attached to its coats, describing its coyote fur as sourced through "ethical" and "sustainable" practices. The complaint alleged violations of common law doctrines, namely breach of express warranty and unjust enrichment, as well as violations of the DC Consumer Protection Procedures Act (CPPA) and other state consumer protection statutes. More specifically, the plaintiff alleged that because coyote trappers in North America regularly use inhumane practices like leg-hold traps and snares, the company's representations are misleading to consumers (among other allegations).⁸² While Canada Goose argued in its motion to dismiss that its representations are substantiated by third-party standards, the plaintiff claimed that even compliance with the standards would be misleading, as "the[standards themselves authorize inhumane trapping practices."⁸³ In June 2021, the Southern District of New York granted the defendant's motion to dismiss in part, but allowed the plaintiff's CPPA claims over Canada Goose's representations about ethical and sustainable fur sources to proceed to trial.⁸⁴

⁷⁹ *Id.* ¶ 2.

⁸⁰ *Smith v. Keurig Green Mountain, Inc.*, 393 F. Supp. 3d 837, 850 (N.D. Cal. 2019).

⁸¹ *Smith v. Keurig Green Mountain, Inc.*, No. 18-cv-06690-HSG, 2023 WL 2250264, at *6 (N.D. Cal. Feb. 27, 2023).

⁸² *Id.* at *2-3.

⁸³ Complaint at 7 ¶ 23, *Lee v. Canada Goose US, Inc.*, No. 20 Civ. 9809 (VM) (S.D.N.Y. Nov. 20, 2010) (ECF No. 1).

⁸⁴ *Lee v. Canada Goose*, No. 20-Civ-9809, 2021 U.S. Dist. LEXIS 121084, at *27 (S.D.N.Y.).

A recent Mintz survey reviewed the field of pending greenwashing class actions filed in federal courts in order to glean how courts view these cases.⁸⁵ Our study yielded the following observations:

First, courts have generally denied motions to dismiss in cases where the defendant company made broad sustainability claims on product labels. In the past two years, we identified at least five cases where challenges to such sustainability representations survived a motion to dismiss.⁸⁶ These cases suggest that companies must use caution when using certain broad terms — "humane," "sustainable," and "recyclable" — and consider how a "reasonable consumer" would interpret these phrases.

Second, courts have not considered third-party verification as definitive proof of sustainability claims. Rather, they have analyzed company sustainability statements even if companies provided external verification.

Third, courts have denied a motion to dismiss in cases where the defendant company made demonstrably inaccurate statements that misrepresented a product's recyclability, environmental impact, or sustainability.

In turn, we advise clients to consider the following before making statements concerning the environmental impact of their products. *First*, avoid making demonstrably inaccurate statements concerning the "recyclability" or "sustainability" of products without verifying the accuracy of such statements. *Second*, avoid labeling products with broad terms or phrases such as "sustainable," "humane," or "recyclable." Companies should use caution when using these terms and consider how a "reasonable consumer" would interpret these phrases. *Third*, whenever possible, "show your work" by validating your claims on company promotional materials, websites, or product labels, or disclosing methodologies behind certain claims. Finally, exercise heightened care when making sustainability claims about specific products through product tags or labels. Courts

⁸⁵ Jacob H. Hupart, Douglas P. Baumstein, Joshua Briones, Will G. McKitterick, Jared Solmon, Alexi Mejia, *Greenwashing Class Action Litigation: An Emerging Risk for Companies' Claims of Sustainability*, MINTZ (Aug. 2, 2023), available at: https://www.mintz.com/insights-center/viewpoints/2151/2023-08-02-greenwashing-class-action-litigation-emerging-risk#_ftnref37.

⁸⁶ *Id.*

appear to scrutinize such statements severely, and a non-trivial number of these cases have recently survived motions to dismiss.⁸⁷

iii. Challenges to ESG in ERISA:

The intersection of ERISA fiduciary duties and ESG investment has exposed investment plan fiduciaries to heightened risk. Both ERISA's statutory language and US Supreme Court case law⁸⁸ require that fiduciary investment decisions be made for the sole purpose of maximizing the financial returns of shareholders on a risk-adjusted basis. ERISA plan fiduciaries are tasked with selecting and managing investments "solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of providing benefits to participants and their beneficiaries."⁸⁹

That mandate, however, was extended by the Department of Labor's new rule in 2022 on prudence and loyalty in selecting plan investments, which took effect in January 2023. The new rule explicitly permits plan fiduciaries to consider ESG factors when selecting investments for ERISA-regulated plans. Specifically, it allows fiduciaries to "take into account the potential financial benefits of investing in companies committed to positive environmental, social, and governance actions."⁹⁰ Importantly, however, the rule does not require plan fiduciaries to consider ESG factors, and it prohibits fiduciaries from selecting ESG investments for non-pecuniary reasons. Any ESG factors relied upon must be relevant to the financial success of a plan's assets.

Opponents of the new rule, however, have argued that it flouts the very ERISA provisions and Supreme Court precedent that require fiduciaries to manage plan assets for the exclusive purpose of maximizing financial returns. Alternatively, critics complain the rule's inherent flexibility will encourage fiduciaries to give ESG factors greater weight

⁸⁷ See, e.g., *White v. Kroger Co.*, No. 21-cv-08004-RS (N.D. Cal. Mar. 25, 2022); *Lee v. Canada Goose*, No. 20 Civ. 9809 (VM), 2021 WL 2665955 (S.D.N.Y. June 29, 2021); *Ulster v. Vital Farms, Inc.*, No. A-21-CV-447-RP, 2022 WL 1491091 (W.D. Tex. Jan. 31, 2022), *report and recommendation adopted*, 2022 WL 1514068 (W.D. Tex. Mar. 2, 2022); *Rawson v. ALDI, Inc.*, No. 21-cv-2811, 2022 WL 1556395 (N.D. Ill. May 17, 2022); *Hanscom v. Reynolds Consumer Prods. LLC*, No. 21-cv-03434-JSW, 2022 WL 3549677 (N.D. Cal. Aug. 18, 2022).

⁸⁸ *Fifth Third Bancorp. v. Dudenhoeffer*, 573 US 409 (2014).

⁸⁹ 29 USC §1104 (a)(1)(A)(i).

⁹⁰ Press Release, *US Department of Labor Announces Final Rule to Remove Barriers to Considering Environmental, Social, Governance Factors in Plan Investments*, US DEPARTMENT OF LABOR (Nov. 22, 2022), available at: [US Department of Labor announces final rule to remove barriers to considering environmental, social, governance factors in plan investments | U.S. Department of Labor \(dol.gov\)](https://www.dol.gov/eis/whistleblowers/press-releases/2022/11/22/2022-11-22-01).

in a way that runs counter to their obligation to maximize shareholder profit. In turn, plaintiffs, including private litigant shareholders and a number of State Attorneys General, have filed suit in federal court to challenge the DOL's rule.

- ***Utah, et al. v. Su, No. 2:23-cv-00016-Z (N.D. Tex.)***: In January 2023, twenty-five State Attorneys General and certain oilfield exploration interests filed a lawsuit challenging the Department of Labor's new rule allowing ERISA fiduciaries to consider ESG factors in their investment strategies. According to the plaintiffs, the rule subverts the fiduciary duties required under ERISA and exceeds the authority granted to the DOL by Congress. The complaint specifically alleged that the 2022 Rule impermissibly authorizes fiduciaries to consider and promote "nonpecuniary benefits," even though ERISA fiduciaries may only act with the motive to further the financial benefits of the plan assets. On September 22, 2023, Judge Kacsmayk dismissed the suit,⁹¹ ruling that the DOL enacted the rule in accordance with the Administrative Procedures Act and that it did not violate ERISA (noting that the DOL rule did not have an "overarching regulatory bias in favor of ESG strategies").⁹²
- ***Spence v. American Airlines, Inc. et al., No. 4:23-cv-00552 (N.D. Tex.)***: The plaintiff filed a putative class action of current and former American Airlines pilots in the Northern District of Texas on June 2, 2023, against American Airlines, its Employee Benefits Committee, its retirement plan administrator, and its financial advisors for alleged breaches of fiduciary duties under ERISA relating to the consideration of ESG principles in management of the class plaintiffs' 401(k) plan. In the complaint, the plaintiffs allege that the selection and inclusion of investment options that pursue ESG policy goals via investment strategies, proxy voting, and shareholder activism is inconsistent with the defendants' fiduciary duties under ERISA. The complaint also alleges that the inclusion of ESG funds

⁹¹ A separate (but largely similar) lawsuit remains pending in the Eastern District of Wisconsin. See Complaint, *Braun & Luehrs v. Walsh*, No. 23-cv-234, (E.D. Wis. Feb. 21, 2023) (ECF No. 1).

⁹² Memorandum Opinion & Order, *Utah et al. v. Walsh et al.*, No. 2:23-cv-00016-Z, (N.D. Tex. Sept. 21, 2023) (ECF No. 109).

in the American Airlines 401(k) plan also breaches fiduciary duties because ESG funds are allegedly more expensive and perform less well than peer investments. The plaintiffs request an injunction to stop the defendants from continuing such breaches and monetary relief to restore the 401(k) plan to its prior position had it not offered ESG funds.

- ***Wong et al. v. New York City Employee's Retirement System et al., No. 652297/2023 (N.Y. Sup. Ct.)***: In May 2023, the plaintiffs filed a complaint in New York Supreme Court alleging their pension administrators breached their fiduciary duties because of the New York City's Qualified Pension Plans' decision to divest approximately \$4 billion from fossil fuel investments in an effort to combat climate change. The plaintiffs have alleged the familiar refrain that the Plan fiduciaries' divestment decision constitutes an unlawful abdication of their responsibility to maximize returns for pension participants. Specifically, the plaintiffs claim that divestment led the Plan to miss a boom in the energy sector's growth since mid-2021, which allegedly contributed to the growing fiscal gap in New York City's pension system that will require additional investment from NYC's general fund. Plaintiffs seek a declaration that the Plans' divestment decision constitutes a breach of fiduciary duties owed to the plaintiffs, and an order requiring the Plans to rescind their divestment policy and make future decisions solely on relevant risk-return factors.

All signs indicate that these types of suits are unlikely to dissipate over the coming years, as ESG-based investing will likely remain a highly polarizing and politicized area of the law. Pension administrators caught in the middle of this legal maelstrom will likely face more costly litigation, investigations, or enforcement proceedings for any ESG-focused investment decisions they elect to make in the future. Moreover, if plan fiduciaries concede to ESG critics, they may find themselves at odds with other pro-ESG investors or other regulators criticizing lackluster efforts to promote more socially responsible investment. In order to forestall litigation, fiduciaries should seek to proactively engage with stakeholders on both ends of the ESG debate and consider

working with experienced counsel to develop appropriate legal strategies and responses to inquiries into their ESG practices.

C. Practical Takeaways

We fully expect the volume of securities class actions and shareholder derivative litigation to increase following the SEC's finalization of its new climate-related disclosure rules. The new rule will require companies to report in detail on how climate risks are influencing their operations and how they are adapting accordingly through the adoption of risk-management processes and other internal policies. The rule will also require companies to specifically quantify the greenhouse gas emissions produced by their value chains and announce goals to reduce these emissions. Yet disclosures that are more detailed will only heighten the litigation risk faced by reporting companies that, for example, fail to align their conduct with their reported statements.

New disclosure requirements will likely lead to an increase in the number of *Caremark* suits, challenging boards for failing to secure "mission-critical" aspects of their businesses from the climate-related risks they report in their annual and quarterly filings. The SEC's new rule will also result in more greenwashing class actions challenging the veracity of companies' statements concerning their commitment to ESG issues. In addition, in the ERISA context, we expect activists to continue to fight to bar plan administrators from even considering ESG factors when directing plan investments. All told, corporate officers, directors, ERISA plan managers, and fiduciaries generally, will face heightened risk from litigation in the years to come. Be prepared to address the below trends, and to take the following steps to mitigate exposure to ESG litigation risk:

- **Private ESG Suits Will Continue to Proliferate:** We expect to see an increase in securities actions (both class actions and derivative suits) alleging claims based on fiduciaries' stated commitments to ESG issues, particularly once the SEC's new enhanced disclosure rule is finally implemented.
- **Be Proactive:** ESG issues are, and will continue to be, the subject of fierce debate and increasing scrutiny by concentrated pools of investment capital. Directors, officers, managers, and fiduciaries generally, therefore, cannot

afford to be reactive or boilerplate in their approach to addressing these threats.

- **Refine ESG Policies:** Directors and fund managers must work with senior management to adopt and refine ESG policies that respond to the current litigation landscape and anticipate future litigation developments. Any such policies must carefully account for the various ESG compliance, tracking, and disclosure requirements applicable to fiduciaries under federal and state law.
- **Make the Connection Between ESG and Shareholder Returns:** ESG policies should reflect how such considerations are relevant to specific business and investment strategies, profitability, and an entity's ability to attract investment and employee capital. Ensuring a clear connection between an entity's ESG policies and its financial returns is necessary to mount a strong affirmative defense against the growing tide of breach of fiduciary duty cases against corporate directors, officers, plan administrators, and fiduciaries generally.





CHAPTER 5

Constitutional Climate Change Litigation

Activists have also entered the fray of litigants suing to help promote adherence to ESG principles at the state level. Several civil society organizations are placing added pressure on state and local governments to do more to address climate change directly. Recent successes in two lawsuits levied by student activists, raising novel constitutional challenges to state and federal project permitting laws, have opened up a whole new front of climate-based litigation against fossil fuel producers.

- ***Held v. State*, No. CDV-2020-307 (Mont. Dist. Ct. 2020):** In *Held v. Montana*, youth activists within the state achieved a ruling that the state's energy project permitting laws violate Montanan's constitutional right to a healthy environment.⁹³ The order, handed down by a Montana trial court, states that a provision of the Montana Environmental Policy Act (MEPA), which prohibited consideration of greenhouse gas emissions and corresponding climate change impact in environmental reviews, violated the plaintiff's right to a clean and healthful environment under the Montana Constitution.⁹⁴ The August 2023 ruling highlights how affirmative constitutional climate rights — also called "green amendments" — can be used to stem emissions and pave the way for climate issues beyond those related to water and air quality to be considered in state court litigations in other states that carry similar "green amendments" in their constitutions. Moreover, while only two other states (Pennsylvania and New York) have

⁹³ Sam Bookman, *Held v. Montana: A Win for Young Climate Advocates and What it Means for Future Litigation*, HARVARD ENVIRONMENTAL & ENERGY LAW PROGRAM (Aug. 30, 2023), available at: <https://eelp.law.harvard.edu/2023/08/held-v-montana/>.

⁹⁴ *Id.*

amended their state bill of rights to include similar green amendments, fifteen other states, including New Mexico, New Jersey, and Florida, have active campaigns to codify similar provisions in their own state constitutions.

- ***Juliana v. United States*, No. 6:15-cv-01517-TC (D. Or. 2016)**: In *Juliana v. United States*, the plaintiffs assert that the government knowingly violated their due process rights of life, liberty, and property, as well as the government's sovereign duty to protect public grounds, by encouraging and permitting the combustion of fossil fuels. The plaintiffs sought both declaratory judgment, declaring "the federal government's fiduciary role in preserving the atmosphere and an injunction of [the government's] actions which contravene that role." The case is another example of a burgeoning area of environmental litigation referred to as "atmospheric trust litigation," a concept based on the public trust doctrine and international responsibility related to natural resources. In January 2020, a Ninth Circuit panel dismissed⁹⁵ the case on the grounds that plaintiffs lacked standing to sue for an injunction, but in June 2023, a district court granted the plaintiffs' motion for leave to amend their complaint.⁹⁶

These two suits represent only the beginning of this movement. Youth-led constitutional climate lawsuits, as in *Held and Juliana*, are currently pending in four other states, with one suit (brought in Hawaii) set to go to trial in June 2024.⁹⁷ And while some of these suits were dismissed in the early stages of litigation, other similar challenges are likely to be launched in the near future, particularly in light of the ruling in *Held*.

⁹⁵ *Juliana v. United States*, 947 F.3d 1159 (9th Cir. 2020).

⁹⁶ *Juliana v. United States*, No. 6:15-cv-01517-AA, 2023 US Dist. LEXIS 95411 (D. Or. June 1, 2023).

⁹⁷ Dharna Noor, *Montana's Landmark Climate Ruling: Three Key Takeaways*, THE GUARDIAN (Aug. 20, 2023), available at: <https://www.theguardian.com/us-news/2023/aug/20/what-happened-montana-climate-trial-decision>.



CHAPTER 6

ESG & DEI Policies

The legal and regulatory landscape is in constant flux. Compliance is challenging, as many employers must navigate an ever-changing, multi-jurisdictional maze. Following the death of George Floyd, and more recently in response to the Supreme Court's decisions in *Students for Fair Admissions, Inc. v. President and Fellows of Harvard College* and its companion case, many employers are paying increased attention to their DEI goals. In this section, we discuss a number of the trends that are impacting how companies are approaching DEI efforts.

A. Mandatory Board Representation and Reporting

Of increasing importance to stakeholders and employees alike are not just the ESG values companies endorse, but how companies actually act on those values. For some state legislatures and regulatory agencies, proof starts with the composition of corporate boards. This is exemplified in the Nasdaq “Show or Tell” rule, which requires Nasdaq-listed companies to publicly disclose their board diversity (via a Nasdaq-provided matrix, or a matrix that is substantially similar), specifically noting the total number of board members and how they each self-identify with respect to race, gender, and LGBTQ+ status.⁹⁸ As part of this disclosure, companies are also required to explain whether they have at least two diverse directors, and if not, why not — hence, show or tell.⁹⁹ Companies that fail to meet these requirements must publicly disclose an

⁹⁸ We discuss the challenge to this rule in section V.B *infra*.

⁹⁹ The Nasdaq Stock Market LLC, *Form 19b-4*, File No. 2020-081, at 3 (February 26, 2021), available at: <https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081.pdf>

explanation via its annual proxy statement or its website, or else be subject to delisting.¹⁰⁰ Show, tell, or pay the price.

Accompanying this trend, several states have passed similar laws requiring the disclosure of board diversity, including Washington, Illinois, and New York.¹⁰¹ However, some state laws, such as the Washington law, require a specific percentage of female board members but do not assess a penalty for compliance failure. While the enforcement mechanisms of these mandates have not yet been tested, we have seen, as discussed later, some of the judicial challenges to these laws and mandates. Take, for example, California's passage of twin laws, which required board seats for females and individuals from other underrepresented backgrounds.¹⁰² We discuss in Section V the legal scrutiny facing these laws, both of which are currently temporarily enjoined, but which nevertheless represent significant efforts by a state to prioritize DEI through legislation.

B. DEI Initiatives, Policies, and Efforts Promulgated by Private Companies

In the wake of the death of George Floyd, many companies issued public statements promising to make their workplaces more inclusive and diverse. A number of these public proclamations transformed into concrete initiatives with quantifiable objectives and aspirations. These took many forms, some more general than others, ranging from public statements by a company's CEO to goals set forth in a company's annual DEI or ESG reports to statements made in SEC filings. The most common statements tend to highlight or focus on a company's commitment to diversity. Public statements aside, approximately one in six Fortune 500 companies publish annual DEI reports, which are yet another form of signaling a company's commitment to diversity initiatives and often include specific and definable goals — i.e., striving for a certain

¹⁰⁰ *Id.* at 6.

¹⁰¹ See, e.g., The Women on Corporate Boards Study Act (Section 408 of the Business Corporation Law, S4278) (New York); RCW 23B.08.120 (Washington); and H.B. 3394 (Illinois).

¹⁰² See Senate Bill 826, which would require public corporations in California to have a certain number of female directors on their board, and Assembly Bill 979, which would require a certain number of board seats to be allocated to members of specifically enumerated underrepresented communities.

percentage of employees to come from underrepresented communities by some future date.¹⁰³

To meet quantifiable and attainable DEI goals, many companies have attempted to increase diversity through recruitment, hiring programs, or both, which specifically target underrepresented individuals. For example, Wells Fargo’s “Diverse Search Requirement Program,” which we discuss below, requires that diverse candidates be interviewed for all open jobs with an annual salary of more than \$100,000. Another permissible way for companies to ensure candidate pools are robust enough to produce a more diverse workforce is through an inclusive panel requirement. A similar rule intended to promote diversity to broaden the scope of candidates to include underrepresented individuals is the National Football League’s (“NFL”) “Rooney Rule,” which requires NFL teams to interview at least two minority candidates for head coaching jobs and one minority candidate for other roles, such as general manager or assistant head coach. These organizations focus on creating broad enough candidate pools to ensure the ultimate goal of a more representative workforce.

On the other hand, many companies have also realized that they may achieve DEI goals by examining their external relationships and their impacts on the corporate mission to achieve DEI in the workplace. An example is supply chain diversity. By prioritizing supply chain diversity, companies focus on suppliers (i.e., other businesses) that are owned and operated by members of underrepresented communities. Citi’s Global Head, Supply Chain Development, Inclusion and Sustainability described supplier diversity as “a strategic business imperative” and “a must-have” that affords companies “the opportunity of continued advancement, innovation, and creativity.”¹⁰⁴ Target provides another example, not only setting a goal of spending \$1.78 billion with “diverse suppliers” by the end of 2021, but also investing 5% of the annual media budget with Black-owned

¹⁰³ See “Diversity Annual Report Examples From Fortune 500 Companies,” PURPOSE BRAND (Aug. 25, 2022), <https://purposebrand.com/blog/diversity-report-examples-fortune-500/>.

¹⁰⁴ See Helen Adams, *Procurement and Supply Chain Live: Javette Hines, Citi*, SUPPLY CHAIN DIGITAL (Oct. 17, 2021), available at: <https://supplychaindigital.com/procurement/procurement-and-supply-chain-live-javette-hines-citi>.

media by the end of 2022.¹⁰⁵ Whether via commitment by word or by cash, efforts to prioritize fostering and supporting diversity are growing increasingly more common.

¹⁰⁵ See “We Are Never Done: Inside Target’s 2019-2021 Diversity, Equity & Inclusion Journey - and Where We’re Going Next,” A Bullseye View, TARGET CORPORATE (Mar. 7, 2022), available at: <https://corporate.target.com/article/2022/03/diversity-and-inclusion-goals>; see also “One Year In, See Our Progress on Investing \$2 Billion in Black-owned Businesses, Plus a *New* Fund to Uplift Diverse Voices,” A Bullseye View, TARGET CORPORATE (May 10, 2022), available at: <https://corporate.target.com/article/2022/05/reach-guest-update>.





CHAPTER 7

Challenges to DEI Initiatives

From mandatory board diversity disclosures to specific initiatives and goals implemented by companies, DEI policies take many different shapes. Many, however, have faced significant legal scrutiny. Challenges to board requirements or disclosure laws often take the form of lawsuits, whereas challenges to corporate policies are often brought by disgruntled shareholders and interest groups claiming that the company has failed to live up to its stated DEI goals. Conversely, other challenges are rooted in the notion that DEI efforts themselves constitute discrimination or are otherwise a waste of company resources. In this section, we address challenges both in and outside of the courtroom, brought by a number of different parties, ranging from shareholders to individual plaintiffs, and explore a few other avenues in which DEI initiatives are challenged outside of court, whether through shareholder proposals or claims filed with the Equal Employment Opportunity Commission (“EEOC”) — the federal agency tasked with enforcing federal anti-discrimination laws.

A. Challenges to Board Diversity Mandates and Disclosures

Board diversity mandates and disclosure laws have faced significant scrutiny. Notable examples include the Nasdaq’s board diversity initiative and California’s twin board diversity laws, all of which have been the subject of legal challenges. The Alliance for Fair Board Recruitment, a nonprofit focused on “promot[ing] the recruitment of corporate board members without regard to race, ethnicity, sex, and sexual identity,” challenged the SEC’s authority to implement Nasdaq’s rule, which is aimed at increasing board diversity for Nasdaq-listed companies, alleging that the rule fails to advance a legitimate interest (i.e., preventing fraud) and otherwise adversely impacts the interests

of the shareholders.¹⁰⁶ Joined by the National Center for Public Policy Research, the petitioners together claimed that this rule violates the Equal Protection Clause of the Fourteenth Amendment because it allegedly mandates discriminatory treatment of individuals based on their sex, race, or sexual orientation, and otherwise violates a company’s First Amendment right against compelled speech.¹⁰⁷ The US Court of Appeals for the Fifth Circuit issued a decision on October 18, 2023, roundly rejecting these challenges.¹⁰⁸

The Fifth Circuit quickly disposed of the notion that the Constitution applied to Nasdaq, explaining that Nasdaq is a private entity, not a state actor, and while Nasdaq must register with and is heavily regulated by the SEC, “the Supreme Court has made clear that a private entity does not become a state actor merely by virtue of being regulated.”¹⁰⁹ The Fifth Circuit also rejected the petitioners’ alternative argument that the SEC’s “involvement with and approval of Nasdaq’s Rules render the Rules subject to Constitutional scrutiny,” declining to expand the state-action doctrine, given Nasdaq’s role as a private self-regulated organization.¹¹⁰ The Fifth Circuit otherwise rejected the petitioners’ contention that the SEC exceeded its authority under the Securities and Exchange Act, addressing petitioners’ four arguments in turn. First, the Fifth Circuit explained that the SEC did not improperly consider the “subjective belief and desire of a subset of investors,” noting that the “Exchange Act does not limit the SEC to considering ‘objective evidence’ in deciding whether to approve a proposed rule,” as the petitioners attempted to argue.¹¹¹ Second, the Fifth Circuit rejected the petitioners’ “materiality” argument—which essentially contended that because the disclosure requirement did not pertain to “material” information, the SEC acted outside its authority in approving the rule.¹¹² The Fifth Circuit rejected this “unworkable” materiality standard, explaining that the Exchange Act confers upon the SEC broad discretion to regulate rules, beyond those

¹⁰⁶ Brief at 1, *Alliance for Fair Board Recruitment, Nat’l Ctr. for Pub. Policy Research v. SEC*, No. 21-60626 (5th Cir., Nov. 22, 2021) (ECF No. 103).

¹⁰⁷ *Id.* at 3.

¹⁰⁸ *See Alliance for Fair Board Recruitment, et al. v. SEC*, No. 21-60626, 2023 US App. LEXIS 27705 (5th Cir. Oct. 18, 2023).

¹⁰⁹ *See id.* at *10-11.

¹¹⁰ *Id.* at *20.

¹¹¹ *Id.* at *30.

¹¹² *Id.* at *33-35.

involving exclusively “material” information, and that the SEC’s Approval Order was otherwise supported by substantial evidence that the disclosure requirement would contribute to “investors’ investment and voting decisions.”¹¹³ Third, the Fifth Circuit rejected the petitioners’ claim that approval of Nasdaq’s rule was an overstep into corporate governance, explaining that the SEC “conclusively determined, based on substantial evidence” that the Nasdaq rule was a “disclosure rule, not a mandatory quota,” and the petitioners failed to explain how it regulated the “internal affairs” of a corporation, or otherwise upset the state-federal balance.¹¹⁴ Fourth, the Fifth Circuit declined to apply the “major questions doctrine,” finding that the SEC’s authority was “an ordinary exercise of its power to approve exchange listing rules; a disclosure rule for board diversity information is not significant enough to trigger major questions concerns; and the Exchange Act authorizes SEC approval of exchange disclosure rules.”¹¹⁵ Finally, the petitioners’ argument that this was an “arbitrary and capricious” exercise of authority by the SEC under the Administrative Procedure Act faced a similar fate.¹¹⁶ The Fifth Circuit’s decision has, in effect, upheld the Nasdaq rule, at least for now.

In contrast to the Nasdaq rule and the Fifth Circuit’s decision rejecting challenges to its continued viability, California’s twin board diversity rules (AB 979, which mandated board seats for members of underrepresented communities, and SB 826, which mandated female board representation) have both been struck down by two separate California trial courts.¹¹⁷ In *Crest v. Padilla*, challenging AB 979, the court found that the law violated the Equal Protection Clause of the California Constitution. Though the court recognized that, intuitively, diverse boards would be a solution to the problem of demographically homogenous boards, the state failed to narrowly tailor the law, jumping to “mandating heterogeneous boards” instead of “first try[ing] to create neutral conditions under which qualified individuals from any group may succeed.”¹¹⁸ Challenges to these diversity rules have left states back at the drawing board, with the onus on private

¹¹³ *Id.* at *36-38.

¹¹⁴ *Id.* at *40-42.

¹¹⁵ *Id.* at *45-46.

¹¹⁶ *Id.* at *50-52.

¹¹⁷ Court Order at 2, *Crest, et al. v. Padilla*, No. 20 STCV 37513 (Cal. Super. Apr. 1, 2022) at 2.

¹¹⁸ *See id.* (emphasis in original).

employers to make DEI-related decisions in the absence of state action that would otherwise impose such an obligation.

B. Challenges Where Companies Fail to Live Up to Their Stated DEI Goals

Many corporations have publicly proclaimed a commitment to DEI, making statements that often broadly support workplace diversity and equity. And many of these same companies have sought to transform these purported commitments into policies and initiatives. A number of these policies have, however, met challenges. A wave of litigation has resulted from companies publicly proclaiming a commitment to DEI, purporting to implement DEI initiatives, but allegedly failing to live up to these stated goals and metrics.

One notable example is a shareholder derivative lawsuit brought by the Asbestos Workers Philadelphia Pension Fund against Wells Fargo, alleging that Wells Fargo's claim to focus on recruiting diverse candidates amounted instead to a "well-calculated public relations effort" that was no more than "mere box checking."¹¹⁹ In the wake of George Floyd's death, Wells Fargo emphasized its commitment to DEI in announcing a "Diverse Search Requirement," which would require "diverse candidate slates and interview teams for all roles at Wells Fargo with total direction compensation of more than \$100,000."¹²⁰ In the lawsuit, the plaintiffs state that "[c]racks in Wells Fargo's DEI façade" were then exposed two years later via a whistleblower's account in a *New York Times* article, which detailed a perceived practice of company-conducted fake interviews in order to fulfill their stated commitment to the Diverse Search Requirement.¹²¹ By "conducting sham interviews to nominally fulfill a diversity-enhancing policy," plaintiffs alleged that Wells Fargo not only misled regulators into believing its compliance with anti-discrimination and affirmative action regulations, but also violated federal securities law

¹¹⁹ See Complaint at 28–31, *Asbestos Workers Philadelphia Pension Fund et al. v. Scharf et al.*, No. 3:23-cv-01168 (N.D. Cal. Mar. 15, 2023) (ECF No. 1).

¹²⁰ See *id.* at 2.

¹²¹ See Emily Flitter, *At Wells Fargo, a Quest to Increase Diversity Leads to Fake Job Interviews*, *New York Times* (May 19, 2022), available at: <https://www.nytimes.com/2022/05/19/business/wells-fargo-fake-interviews.html>.

by “misrepresenting to investors Wells Fargo’s commitment to diversity, as well as the Company’s own internal policies.”¹²²

As evidence of Wells Fargo’s alleged impropriety, the plaintiffs pointed to representations by the company purporting to demonstrate its “expanded commitments” to diversity via the Diverse Search Requirement, whether made in response to shareholder proposals, articulated through public testimony by its officers, or disclosed via proxy statements or the company’s Annual Form 10-K.¹²³ The plaintiffs then pointed to the whistleblower’s account alleging that, in practice, the diverse search was illusory — diverse candidates were interviewed even after the role had already been filled.¹²⁴ Plaintiffs further alleged that the board “passively stood by while being presented with DEI problems,” relying on produced books and records that allegedly demonstrated the board and management “were more interest[ed] in the reputation and perception of the Company’s engagement with DEI issues than actually addressing them substantively.”¹²⁵ This case remains pending.

DEI Lawsuits, like the one Wells Fargo is facing, feature common themes: allegations by shareholders that the company is more concerned with its image and public perception than implementing robust, effective policies addressing diversity, equity, and inclusion. Below, we address similar lawsuits against Gap, Oracle, and Qualcomm, each of which highlights this common thread and displays how courts have addressed these claims to date.

- **The Gap.** In a shareholder derivative suit, the plaintiff alleged that Gap “failed to create meaningful diversity within company leadership rules, and . . . made false statements to shareholders in its proxy statements about the level of diversity it had achieved.”¹²⁶ The plaintiff pointed to Gap’s Board of Directors, which included no Black individuals, as well as the composition of Gap’s US employees, as only 4% of employees at the company’s

¹²² See Complaint at 46, *Asbestos Workers Philadelphia Pension Fund et al. v. Scharf et al.*, No. 3:23-cv-01168 (N.D. Cal. Mar. 15, 2023) (ECF No. 1).

¹²³ *Id.* at 10.

¹²⁴ *Id.* at 10.

¹²⁵ *Id.* at 37.

¹²⁶ *Lee v. Fischer et al.*, 34 F.4th 777, 779 (9th Cir. 2022), *aff’g*, *Lee v. Fischer, et al.*, No. 20-cv-06163-SK, 2021 WL 1659842 (N.D. Cal. Apr. 27, 2021), *reh’d*, 54 F.4th 608 (9th Cir. 2022), *aff’d*, 70 F.4th 1129 (9th Cir. 2023).

headquarters and 9% of store leadership identified as Black, as compared to 23% at company distribution centers.¹²⁷ The plaintiff highlighted Gap's alleged propensity to hire minorities for low-level and low-paying jobs in its distribution centers despite its stated commitment to increasing diversity throughout company ranks.¹²⁸ The court ultimately dismissed the case, enforcing a forum selection clause in the company bylaws, which designated the Delaware Court of Chancery as the exclusive forum for all derivative claims.

- **Oracle.** A shareholder brought a suit against Oracle, alleging that the Board of Directors “deceived stockholders and the market by repeatedly making false assertions about the Company’s commitment to diversity[,]” and thus breached their duty of candor in violation of federal proxy laws, and irreparably harmed the company and its image in failing to attain diversity on the company’s board and within the workplace.¹²⁹ As in the Gap lawsuit, the plaintiff here also pointed to the board and company executive officers, which allegedly “remain[ed] devoid of Black people and other minorities[,]” and further noting that Oracle stood “alone in the basement of just a handful of publicly traded companies that have earned the dubious distinction of not having a single Black person on its board.”¹³⁰ Also similar to the Gap lawsuit, the court enforced a forum selection clause contained in Oracle’s bylaws, which designated the Delaware Court of Chancery as the exclusive forum for all derivative claims.
- **Qualcomm.** Shareholders alleged that Qualcomm and its board made materially false and misleading statements touting diversity efforts in its proxy statements. The first statement challenged was in its 2019 Proxy Statement that “the Governance Committee’s goal is to assemble a board of directors that brings to us a diversity of perspectives and skills.”¹³¹ The court considered this “inactionable puffery” as it was not a material

¹²⁷ Complaint at 8, *Lee v. Fischer, et al.*, No. 3:20-cv-06163 (N.D. Cal. Sept. 1, 2020) (ECF No. 1).

¹²⁸ *See id.*

¹²⁹ Complaint at 8-9, *Klein v. Ellison, et al.*, No. 3:20-cv-04439 (N.D. Cal. July 2, 2020) (ECF No. 1).

¹³⁰ *Id.* at 5, 6.

¹³¹ *Kiger v. Mollenkopf*, No. 21-409-RGA, 2021 WL 5299581, at *2 (D. Del. Nov. 15, 2021).

statement.¹³² The other challenged statement was contained in its 2020 Proxy Statement, that “the Governance Committee will include, and instruct any search firm it engages to include, women and racially/ethnically diverse candidates in the pool from which the governance committee selects director nominees.”¹³³ The plaintiffs pointed to the lack of minority presence on the board as evidence; the court, however, made clear that a lack of minority members of the board does not mean that minority candidates were not included in the pool to be seated on the actual board, only that they did not advance from the larger candidate pool.¹³⁴ While this case was ultimately dismissed for various pleading failures (including a lack of particularized allegations in support of many of its claims),¹³⁵ it is another example of how a company’s general statements regarding its commitment to diversity could lead to legal scrutiny.

Beyond shareholder derivative lawsuits, employees and candidates have also levied legal challenges where a company’s diversity initiatives fail to match its stated practices. A very public example of this type of challenge was the lawsuit brought by NFL Coach Brian Flores, which alleged systematic discrimination in hiring practices against the NFL for head coaching jobs, and further alleged that the NFL failed to adequately implement the “Rooney Rule.” The “Rooney Rule” requires NFL Teams to interview at least one Black candidate in connection with any head coach vacancy, and has since been expanded to require two minority coach candidates to be interviewed and at least one minority candidate to be interviewed for other roles, such as general manager, assistant head coach, and coordinator positions.¹³⁶ The plaintiff has alleged the rule is not working as the “numbers of Black Head Coaches, Coordinators, and Quarterback Coaches are not even close to being reflective of the number of Black athletes on the field.”¹³⁷ Moreover, he further alleges that interviews of Black candidates are not done in

¹³² *Id.* at *3.

¹³³ *Id.*

¹³⁴ *Id.* at *3–4

¹³⁵ *Id.*

¹³⁶ See Complaint at 5, *Flores v. National Football League, et al.*, No. 1:22-cv-00871 (S.D.N.Y., Feb. 1, 2022) (ECF No. 1).

¹³⁷ *Id.*

good faith and are “only to comply with the Rooney Rule.”¹³⁸ This case, still pending, exemplifies the importance of companies taking action to back up their stated goals or commitments, or else face a similar fate of litigation.

C. Anti-DEI Efforts by Shareholders and Activists

Challenges to company DEI policies from anti-DEI activists have become increasingly commonplace. Activist groups, shareholders, and, in some cases, employees have utilized several tactics to attack DEI initiatives. Chief among these challenges are shareholder proposals and retraction demands, requests for investigations, and, in some cases, lawsuits.

i. Shareholder Proposals and Demand Letters

Shareholder proposals frequently include requests for company-conducted audits analyzing the impact DEI initiatives and policies have had on the workforce or to put the company’s DEI policies to a vote. There has been a significant uptick in total shareholder proposals seeking such audits overall — up 14 percent from 2020 to 2023 among Russell 3000 companies.¹³⁹ Proposals centering on social issues, including DEI and human rights, have increased in prevalence over that same period, growing to 35 percent of the total by 2023.¹⁴⁰ Unsurprisingly, anti-ESG proposals have also grown substantially — increasing sharply from 14 in 2019 to 74 in 2023.¹⁴¹ While anti-ESG proposals are not limited solely to proposals combatting DEI initiatives, they do comprise a significant portion — as high as two-thirds, according to some research.¹⁴²

One group is responsible for submitting an outsized number of shareholder proposals in recent years: the National Center for Public Policy Research (“NCPPr”). The NCPPr is a conservative think tank and, according to its own annual “Proxy

¹³⁸ *Id.* at 8.

¹³⁹ See Jun Frank, Sandra Herrerea Lopez, *US Shareholder Proposals Jump to a New Record in 2023*, ISS CORPORATE SOLUTIONS (May 24, 2023), available at: (<https://www.isscorporatesolutions.com/library/us-shareholder-proposals-jump-to-a-new-record-in-2023/>). The Russell 3000 Index includes all large-cap, midcap, and small-cap US equities, among others, and which represent 98 % of the value of all US equities.

¹⁴⁰ See *id.* This number does not represent exclusively *anti-DEI* shareholder proposals, but rather reflects all DEI-related proposals, as that term is understood by ISS Corporate Solutions.

¹⁴¹ See *id.*

¹⁴² See Heidi Welsh, *Anti-ESG Shareholder Proposals in 2023*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (June 1, 2023), available at: (<https://corpgov.law.harvard.edu/2023/06/01/anti-esg-shareholder-proposals-in-2023/>).

Navigator” guide, was responsible for filing 57 proposals in 2022 alone.¹⁴³ Most of NCPPR’s shareholder proposals follow a similar pattern: (1) NCPPR requests that the company commission an audit analyzing the company’s impacts on civil rights and non-discrimination and on the company’s business; and (2) justifies the request with a “supporting statement” that warns the company about “anti-racist” policies that “are themselves deeply racist and otherwise discriminatory,” and outlines the contours of a proposed audit.¹⁴⁴

NCCPR is not alone in these efforts. The National Legal and Policy Center (“NLPC”), through its Corporate Integrity Project, has in recent years submitted shareholder proposals aimed at defending the interests of the shareholders, “not someone else’s [mission] or someone else’s political agenda.”¹⁴⁵ For example, NLPC introduced a proposal addressing board diversity at JPMorgan Chase, recommending that JPMorgan adopt a selection process that, in part, would require JPMorgan to present a director nominee’s “skills, experience, and intellectual strengths . . . in a chart or matrix form . . . to the shareholders[.]”¹⁴⁶ NLPC also recently submitted a proposal to Alphabet, Inc. (the parent company of Google and YouTube) requesting that Alphabet conduct a risk audit to determine whether the company has engaged in “unconstitutional censorship,” citing examples of instances NLPC claims that demonstrated Alphabet’s willingness to discriminate against certain types of speech.¹⁴⁷

The Bahnsen Group, an asset management company founded by David Bahnsen, has also utilized the shareholder proposal method to voice its concerns, filing at least seven proposals in 2023 alone.¹⁴⁸ Combining qualities seen in proposals submitted by both NCCPR and NLPC, Bahnsen’s proposal to JPMorgan requested that the company “conduct an evaluation and issue a report” addressing how it “oversees risks related to discrimination . . . and whether such discrimination . . . may impact individuals’ exercise of

¹⁴³ See *Proxy Navigator: Annual Voter Guide 2023*, FREE ENTERPRISE PROJECT, A DIVISION OF THE NATIONAL CENTER FOR PUBLIC POLICY RESEARCH, at 3-4, 27 (2023), available at: <https://nationalcenter.org/wp-content/uploads/2023/05/ProxyNavigator2023-1.pdf>.

¹⁴⁴ See, e.g., Walmart’s proxy statement at 94, available [here](#); Bank of America’s proxy statement at 87, available [here](#); Meta’s proxy statement at 84, available [here](#).

¹⁴⁵ See Corporate Integrity Project, NATIONAL LEGAL AND POLICY CENTER, available at: <https://nlpc.org/corporate-integrity-project/>.

¹⁴⁶ See JPMorgan Chase’s proxy statement at 98, available [here](#).

¹⁴⁷ See Alphabet Inc.’s proxy statement at 98, available [here](#).

¹⁴⁸ See Welsh, *supra* note 126.

their constitutionally protected civil rights,”¹⁴⁹ citing concerns about discrimination based on protected categories as well as certain religious and political speech.¹⁵⁰

Anti-DEI activists have also voiced their concerns through retraction demand letters. NCPPR is also active on this front, submitting several such demands through its law firm, The American Civil Rights Project (“ACRP”). These demand letters often follow a similar pattern: (1) identify the DEI initiatives or policy at issue; (2) cite applicable federal and, where appropriate, state or local anti-discrimination laws; and (3) demand that the company respond to the letter, retract the cited policies, or both, with the threat of a lawsuit for failing to comply.¹⁵¹

Take, for example, ACRP’s letter to Pfizer, Inc. (“Pfizer”). The letter identifies several Pfizer employment policies that ACRP claims constitute “systematic racial, ethnic, and sex discrimination,” including: (1) Pfizer’s commitment to work with diverse suppliers; (2) Pfizer’s commitment to increase its representation of women and racial and ethnic minorities at the VP level and above by 2025; (3) Pfizer’s goal that 50 percent of its summer internship slots be allocated to “underrepresented groups;” (4) Pfizer’s linking employee performance and compensation, in part, to successfully achieving DEI goals; and (5) and Pfizer’s “Breakthrough Fellowship Program,” which is awarded to college students from minority groups identified by the company in its FAQs.¹⁵²

ACRP not only contended that these policies violated applicable federal and state anti-discrimination laws, but also highlighted the potential risks of litigation Pfizer could face from individuals affected by these laws (e.g., “[e]very individual discriminated against under or in the Breakthrough Fellowship Program . . . has standing to bring direct actions against Pfizer.”).¹⁵³ In demanding that Pfizer retract these policies, ACRP also indicated

¹⁴⁹ *Id.*

¹⁵⁰ Letter from Rule 14a-8 Review Team, US Securities & Exchange Commission, to Brian V. Breheny, Skadden Arps Slate Meagher & Flom LLP (Mar. 21, 2023), available [here](#).

¹⁵¹ See e.g., “Open Letter to Officers and Directors of American Airlines Group, Inc.,” AMERICAN CIVIL RIGHTS PROJECT, (Feb. 28, 2023), available [here](#); “Open Letter for Shareholders to Officers and Directors of Pfizer, Inc.,” AMERICAN CIVIL RIGHTS PROJECT, (Sept. 19, 2022), available [here](#) (hereinafter “Pfizer Demand Letter”).

¹⁵² See Pfizer Demand Letter, *supra* note 141 at 2-4.

¹⁵³ See *id.* at 8-9.

that Pfizer Directors and Officers (“D&O”) violated their fiduciary duties by adopting such policies, and, to the extent they were unaware, the letter provides ample notice.¹⁵⁴

ACRP has had limited, albeit some, success. ACRP sent a similar demand letter to Coca-Cola in 2021, which addressed policies announced by Coca-Cola’s then-general counsel that required, in part, that outside counsel for Coca-Cola report on a quarterly basis the race, ethnicity, sex, gender, and disability status of all members of “teams working on [Coca-Cola] matter,”¹⁵⁵ and also that law firms performing work for Coca-Cola ensure that “‘diverse’ attorneys perform at least 30% of all hours billed, with ‘Black attorneys’ performing at least half [15%] of that amount.”¹⁵⁶ Following receipt of ACRP’s letter, Coca-Cola responded that such policies “are not now and never have been company policy,” which, according to ACRP, “satisfied the ACR Project’s concerned investors.”¹⁵⁷

While ACRP has experienced some success with its demand to Coca-Cola, it has not experienced the same level of traction with other demands. This has not, however, led them to relent — they continue to file retraction demands into 2023. One of these retraction demands even ripened into a lawsuit — albeit an unsuccessful one — which we discuss in the next section.

ii. *National Center for Public Policy Research v. Howard Schultz, et al.*
– Where a Retraction Demand Letter Ripens into a Lawsuit

By letter dated March 25, 2022, ACRP — on behalf of NCPPR — sent a letter request to Starbucks, along with all of Starbucks’ individual directors and officers (“Starbucks D&O”), demanding the retraction of the following DEI policies: (1) Starbucks’ goal of achieving BIPOC representation of at least 30 percent at all corporate levels and at least 40 percent at all retail and manufacturing roles by 2025; (2) commitment to completing the rollout of an analytics tool that provides leaders with visibility to current

¹⁵⁴ *Id.* at 9-10.

¹⁵⁵ See “*Open Letter on Behalf of Shareholders to Officers and Directors of Coca-Cola Company*,” AMERICAN CIVIL RIGHTS PROJECT, (June 11, 2021), available [here](#).

¹⁵⁶ See *id.*; see also “*UPDATE: Coca-Cola’s Widely Disseminated Outside Counsel ‘Guidelines’ ‘Have Not Been and Are Not Policy of the Company’*,” AMERICAN CIVIL RIGHTS PROJECT BLOG (Mar. 25, 2022), available at: <https://www.americancivilrightsproject.org/blog/update-coca-colas-widely-disseminated-outside-counsel-guidelines-have-not-been-and-are-not-policy-of-the-company/>. (hereinafter “ACRP Coca-Cola blog post”).

¹⁵⁷ See ACRP Coca-Cola blog post, *supra* note 146.

diverse representation; (3) the incorporation of measurements into its executive compensation programs focused on building inclusive and diverse teams, (4) entry into “the Board Diversity Action Alliance to act alongside peer companies as we are committed to representation of racially and ethnically diverse directors on corporate boards of directors,” (5) increasing its spending with diverse suppliers from \$800 million to \$1.5 billion by 2030, (6) allocating 15 percent of Starbucks’ advertising budget with minority-owned and targeted media companies, and (7) launching the “Leadership Accelerator Program,” which will be made initially available only to Starbucks BIPOC employees at certain levels.¹⁵⁸ As with all other retraction demands, ACRP threatened to sue Starbucks and Starbucks D&O if they failed to comply.¹⁵⁹

Starbucks responded on July 22, 2022, rejecting ACRP’s demand and declining to retract any of its DEI policies. NCPPR then filed a lawsuit against Starbucks and Starbucks D&O in Washington State Court, claiming that the same seven policies NCPPR cited in its demand letter violated anti-discrimination laws and, in relevant part, “require[d] Starbucks to discriminate based on race . . . in its employment decisions . . . in its compensation of its officer . . . [and] in its contracting with suppliers and media companies.”¹⁶⁰ Starbucks and Starbucks D&O then removed NCPPR’s lawsuit to the United States District Court for the Eastern District of Washington and moved to dismiss the complaint. Both motions argued to a certain extent that the DEI initiatives were protected by the business judgment rule, urging the court to dismiss on that ground.¹⁶¹ Starbucks Corporation also emphasized that NCPPR did not fairly or adequately represent the shareholders, citing both NCPPR’s pursuit of its personal interests as well as its “vindictiveness” towards Starbucks.¹⁶²

The court ultimately agreed with Starbucks and Starbucks D&O, granting both motions to dismiss by order dated August 11, 2023. The court subsequently issued a

¹⁵⁸ See “Demand for Retraction of Discriminatory Policies of Starbucks Corporation (“Starbucks”),” AMERICAN CIVIL RIGHTS PROJECT (Mar. 25, 2022), available [here](#).

¹⁵⁹ See *id.* at 5.

¹⁶⁰ Complaint at 2-3, 7-8, *National Center for Public Policy Research v. Howard Schultz, et al.*, No. 2:22-cv-00267-SAB, (E.D. Wash. Aug. 30, 2022) (ECF No. 1-2).

¹⁶¹ See Individual Defendants’ Motion to Dismiss Complaint, *Nat’l Ctr. for Pub. Pol. Rsch. v. Schultz, et al.*, No. 2:22-CV-00267-SAB (E.D. Wash. May 19, 2023) (ECF No. 20) (hereinafter “Starbucks D&O Motion to Dismiss”); Defendant Starbucks Corporation’s Motion to Dismiss Complaint, *Nat’l Ctr. for Pub. Pol. Rsch. v. Schultz, et al.*, No. 2:22-CV-00267-SAB (E.D. Wash. May 19, 2023) (ECF No. 19) (hereinafter “Starbucks Corp. Motion to Dismiss”).

¹⁶² See Starbucks Corp. Motion to Dismiss at 17-20.

written decision on September 11, 2023, wherein it first affirmed Starbucks' assertion that its actions and promotion of DEI initiatives were protected by the business judgment rule. NCPPR failed to show Starbucks did not act on "an informed basis [or] in good faith," and the complaint failed to allege that "Starbucks Board's refusal of the Demand was wrongful, that its investigation was unreasonable or not undertaken in good faith, that it was not sufficiently informed, or that its process was in any way inadequate."¹⁶³ The court further noted that NCPPR's attempt to leverage their 56 out of approximately 1.15 billion outstanding shares of Starbucks stock (amounting to around \$6,000 of a total market capitalization of over \$121 billion) was an effort to "override the authority of the Starbucks Board and obtain disproportionate control of Starbucks' decision-making to advance its own agenda in a manner contrary to the desires of Starbucks Board, management, and the vast majority of other shareholders."¹⁶⁴ Ultimately, the court found that NCPPR's efforts exemplified "obvious vindictiveness toward Starbucks . . . and that it lack[ed] the support of the vast majority of Starbucks shareholders."¹⁶⁵ In further rejecting NCPPR's efforts, the court explicitly called out the group's attempt to use the courts as a political soapbox, writing:

Plaintiff is apparently unhappy with its investment decisions in so-called "woke" corporations. This Court is uncertain what that term means but Plaintiff uses it repeatedly as somehow negative. This Complaint has no business being before this Court and resembles nothing more than a political platform. Whether DEI and ESG initiatives are good for addressing long simmering inequalities in American society is up for the political branches to decide. If Plaintiff remains so concerned with Starbucks' DEI and ESG initiatives and programs, the American version of capitalism allows them to freely reallocate their capital elsewhere.¹⁶⁶

In other words, the court urged NCPPR to take its grievances to the American public, not the courts. To the extent NCPPR pursues similar lawsuits against other

¹⁶³ See *Nat'l Ctr. for Pub. Pol. Research v. Howard Schultz, et al.*, No. 2:22-CV-00267-SAB, 2023 WL 5945958, at *4 (E.D. Wash. Sept. 11, 2023).

¹⁶⁴ See *id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at *5.

companies to which it sent demand letters, this latter line of reasoning could become common among courts reviewing such challenges.

Although the court has not yet issued a written decision, its decision announced at oral argument does help guide future companies that face these lawsuits (perhaps, even from NCPPR). But lawsuits are not the only avenue that activist groups have chosen to take their claims. Others, as discussed in the next section, have enlisted administrative agencies to initiate investigations.

iii. Activist Groups Look to the Equal Employment Opportunity Commission for Assistance

Some activist groups have turned to anti-discrimination agencies to investigate DEI policies. Specifically, America First Legal (“AFL”), a conservative legal organization, has made numerous filings with the EEOC, asking the agency to investigate DEI policies of several major companies. Indeed, AFL has sent at least 17 investigation requests to the EEOC based on those advertised on their public website.¹⁶⁷ Two recent filings underscore these efforts.

On June 23, 2023, AFL filed an investigative request with the EEOC against Nordstrom, claiming that Nordstrom “has affirmatively represented to its shareholders, investors, and the Securities and Exchange Commission that it is and will continue favoring certain individuals because of their race, color, national origin, or sex in its employment practices.”

AFL mined Nordstrom’s Form 10-K and other public information to support this conclusion, claiming that: (1) Nordstrom’s Form 10-K “suggests that it is using numerical quotas for hiring, training, and promotion and . . . has taken extraordinary steps to ensure that these quotas are embedded deeply in its business operations,” (2) self-reported data that AFL claims that “hiring and promotion policies are having . . . a disparate impact on white and/or male individuals,” and (3) evidence that Nordstrom “affirmatively favors ‘Black individuals’ in hiring, promotion, and training.” AFL also claims that Nordstrom’s policies are having a disparate impact on “white and/or male individuals,” explaining that

¹⁶⁷ See “Woke Corporations,” AMERICA FIRST LEGAL, available at: <https://aflegal.org/woke-corporations/> (last visited Sept. 3, 2023).

“women are substantially overrepresented in [Nordstrom’s] leadership” and Nordstrom “avers that ‘People of color,’ another term without a fixed or discernable legal meaning, are favored for ‘leadership’ positions.”

On August 9, 2023, AFL filed a similar letter requesting that the EEOC open an investigation into employment practices by the Kellogg’s Company (“Kellogg”) that, according to AFL, unlawfully attempted to “balance its workforce based on race, color, national origin, and sex.” AFL supported this claim with citations to information contained in Kellogg’s publicly filed reports, including: (1) Kellogg’s promise to “achieve 25% underrepresented talent [sic] at the management level in the United States; (2) Kellogg’s goal to increase racially underrepresented talent across all levels by 2% between 2020 and 2022; (3) Kellogg’s aspiration to achieve gender parity of “50/50 at the management level” by 2025; and (4) reference to Kellogg’s “Chief in Residence” program — a fellowship for Black chefs to work with Kellogg’s Research & Development team. These hiring, training programs, and promotional practices are, in AFL’s estimation, “illegal and deeply harmful” and provide “ample evidence that Kellogg’s has knowingly and intentionally violated federal law.”

AFL asserted in both letters that the DEI policies implemented by Nordstrom and Kellogg “foment contention and resentment” and thus warrant the issuance of a “Commissioner charge” — a mechanism that the EEOC can use to investigate claims of discrimination. See 29 C.F.R. §1601.6(a) (explaining the Commissioner charge process). Given how recently these investigation requests were filed, it is too early to determine whether the EEOC has pursued either — let alone made any affirmative findings or conclusions. Regardless of the outcomes, these requests by AFL highlight another avenue of attack that those opposed to DEI policies may pursue. And, unlike a lawsuit or administrative complaint, it is significantly more cost-effective for groups such as AFL to present these issues for the EEOC simply by citing publicly filed information. If the EEOC believes the claims have merit, it can then investigate using the resources of the federal government.

iv. Reverse Discrimination Lawsuits Dovetail with Activist Challenges:

DEI initiatives are also drawing challenges from individual employees who have claimed that they suffered adverse employment actions due, at least in part, to a company's DEI policies. Two recent federal cases illustrate this trend. The first is *DiBenedetto v. AT&T Services, Inc.*, a case filed in the Northern District of Georgia, and the second is *Duvall v. Novant Health Inc.*, a case out of the Western District of North Carolina.

Joseph DiBenedetto, a former 58-year-old white Assistant Vice President at AT&T Services, Inc., filed a lawsuit against AT&T alleging that he was terminated after over two decades with AT&T because he “lack[ed] the . . . skin color, and gender AT&T preferred,” and bringing claims under 42 USC §1981, Title VII, and the Age Discrimination in Employment Act (“ADEA”).¹⁶⁸ Specifically, DiBenedetto explained that in his final years at AT&T, the company “undertook an increasingly aggressive Diversity and Inclusion initiative,” which DiBenedetto alleged resulted in AT&T promoting employees “who were more heavily non-white and more heavily female, than would be expected in the absence of discrimination.”¹⁶⁹ DiBenedetto further claimed that he expressed interest in a promotion and alleged that he was told he was “an old, white male with not enough ‘runway’ left in his career.”¹⁷⁰ These comments were accompanied by, among other things, reference to an internal memorandum sent to DiBenedetto's department indicating that his department needed to “focus more on attracting and retaining diverse employees throughout our organizations, especially at our senior levels.”¹⁷¹ Shortly thereafter, DiBenedetto's role was eliminated as part of a reduction, which he claims disparately impacted other white male employees.¹⁷²

AT&T moved to dismiss the complaint, arguing that it failed to state any plausible claims. The court rejected AT&T's motion in its entirety.¹⁷³ In finding that DiBenedetto

¹⁶⁸ See Complaint at 1-2, *DiBenedetto v. AT&T Servs., Inc.*, No. 21-CV-04527-MHC-RDC (N.D. Ga. Nov. 2, 2021) (ECF No. 1).

¹⁶⁹ See *id.* at 8-9.

¹⁷⁰ *Id.* at 11.

¹⁷¹ *Id.* at 11-12.

¹⁷² *Id.* at 13-17.

¹⁷³ See *DiBenedetto v. AT&T Servs., Inc.*, No. 21-CV-04527-MHC-RDC, 2022 WL 1682420, at *6-7 (N.D. Ga. May 19, 2022) (emphasis added), *report and recommendation adopted*, 2022 WL 18777367 (N.D. Ga. June 6, 2022).

plausibly stated claims of discrimination, the court explicitly referenced AT&T’s DEI policies, noting the following: (1) DiBenedetto “didn’t just point to the [DEI policies] alone to stake his claims — he also presented details about *how it worked in practice*, up to and including its alleged application in his case”; (2) DiBenedetto’s allegations concerning the “operational urgency” of AT&T’s DEI policies, which led to DiBenedetto’s termination; and (3) allegations linking the disproportionate number of White males terminated as part of AT&T’s purported reduction in force to the efforts made to further DEI policies.¹⁷⁴ The court was, however, quick to note that its decision should not be read as condemning AT&T’s DEI efforts, which the court explicitly stated were “permitted under Title VII and promote the statute’s underlying purpose.”¹⁷⁵

DiBenedetto’s case represents one example of how a court, at the pleading stage, might view certain challenges to the effects of a company’s DEI policies. Another case that provides some insight into what a similar challenge could look like at a later stage in the case is *Duvall v. Novant Health, Inc.* Indeed, *Duvall* provides insight into the magnitude of damages companies could face where DEI initiatives or policies end up creating a disparate impact.

Plaintiff David Duvall, a white male, was a former Senior Vice President and Chief Consumer Officer at Novant Health, Inc. (“Novant”).¹⁷⁶ Despite allegedly strong job performance, Duvall claims that he was unexpectedly terminated in 2018 as part of “an intentional campaign [by Novant] to promote diversity in its management ranks” and was subsequently replaced by a white and Black female “for the express purpose of increasing gender and racial diversity among Novant executives.”¹⁷⁷ Duvall also claims that other white, male Novant employees were terminated by Novant in an effort to fulfill its publicly proclaimed diversity goals.¹⁷⁸ Duvall alleged that while “the goal of achieving diversity in leadership has recognized value, terminating high performing employees with no

¹⁷⁴ *Id.* at *6–7.

¹⁷⁵ *Id.* at *8 (“To be clear, the [Court’s] current recommendation does not — and this case, whatever the ultimate result, will not — constitute an appraisal of the virtue of AT&T’s effort, or others like it, to promote diversity and inclusion in the workforce. Such efforts are permitted under Title VII and promote the statute’s underlying purpose.”) (citation omitted).

¹⁷⁶ See Complaint at 2, *Duvall v. Novant Health, Inc.*, No. 3:19-CV-624-DSC (W.D.N.C. Nov. 18, 2019) (ECF No. 1).

¹⁷⁷ See *id.* at 2-5.

¹⁷⁸ *Id.* at 3 (noting that other White men were “separated from Novant and replaced by either a racial minority and/or female in a period of 12 to 18 months.”).

justification or purpose other than to achieve diversity constitutes an adverse employment action based on race and/or gender.”¹⁷⁹

After an unsuccessful attempt at partially dismissing the case,¹⁸⁰ the case proceeded to a jury trial, which lasted seven days.¹⁸¹ The jury returned a verdict for Duvall, finding that he had “proven his race (Caucasian) and/or sex (male) were a motivating factor in [Novant’s] decision to terminate him and that [Novant] would not have made the same decision without regard to his race . . . award[ing] [Duvall] **\$10 million in punitive damages.**”¹⁸²

The court’s decision addressing Novant’s post-trial motions illuminates some of the grounds upon which the jury verdict was based — in particular, how Novant’s DEI policies led to the seismic verdict. Specifically, in denying Novant’s renewed motion for judgment as a matter of law, the court made the following explicit findings: (1) to achieve Novant’s goal of promoting diversity, it “was willing to terminate a white male in order to advance diverse candidates and promote [Novant’s] clearly stated goal to promote diversity and inclusion;” (2) there was no evidence to support Duvall’s termination; (3) Novant did not make a good faith attempt to comply with Title VII, and by terminating Duvall “acted in the face of a perceived risk that [its] action[s] violated federal law; and (4) statistical evidence further supported the “demographic effects of [Novant’s DEI] initiative” and further evidence showed that Duvall’s termination resulted from Novant’s “expressed timeline to remake the workforce to reflect the community and ‘embed’ a culture of ‘D&I’ at [Novant].”¹⁸³

Novant has appealed the jury verdict, as well as the court’s decision denying its renewed motion for judgment as a matter of law, among other orders. At this stage, the Fourth Circuit Court of Appeals has not yet issued a decision, which is certain to shed light on how federal courts going forward will view the effects of DEI initiatives.

¹⁷⁹ *Id.* at 3.

¹⁸⁰ See *Duvall v. Novant Health Inc.*, No. 3:19-CV-00624-DSC, 2020 WL 6567140, at *1 (W.D.N.C. Nov. 9, 2020) (denying Novant’s motion for partial summary judgment).

¹⁸¹ See *Duvall v. Novant Health Inc.*, No. 3:19-CV-00624-DSC, 2022 WL 3331263, at *2 (W.D.N.C. Aug. 11, 2022), amended on reconsideration in part, 2022 WL 11271199 (W.D.N.C. Oct. 19, 2022).

¹⁸² See *id.* (emphasis added).

¹⁸³ See *id.* at *4-8.

Both cases illustrate what can go wrong for companies when DEI initiatives or policies are implemented — and provide insight into how courts may view arguments by companies to try and justify the effects of a given DEI policy that may have resulted in an adverse employment action. One significant common thread linking *Duvall* and *DiBenedetto* is that the two companies do not appear to have even attempted to justify the terminations with legitimate, non-discriminatory reasons, leaving them extraordinarily vulnerable to claims of discrimination.

These decisions reflect outcomes not dissimilar to a routine discrimination claim — where an employee successfully proves that the decision was motivated not by business reasons, but rather by their membership in a protected class. Indeed, the court in *DiBenedetto* emphasized as much when it explicitly noted that DEI policies are not, *per se*, unlawful, but they may be if they result in a disparate impact — i.e., they are implemented in an overtly discriminatory manner.¹⁸⁴ Companies should not view these cases as a death knell to DEI initiatives, but rather as illustrative examples of DEI policies that were not structured with the appropriate safeguards in place, which we discuss below. What happens when safeguards fail? And, in the context of implementing DEI initiatives, how can this impact a company? We discuss these very questions next.

D. Challenges and Lawsuits That Ensur When Companies Fail to Adequately Implement or Adhere to Anti-Discrimination Policies

Companies may increasingly face legal scrutiny by failing to implement required anti-discrimination policies, allowing a hostile work environment to persist, or both. These claims differ slightly from shareholder derivative lawsuits challenging the implementation of DEI initiatives, and instead amount to a claim that the company's officers or directors breached their fiduciary duties by failing to properly police or eradicate discrimination. Thus, while different in scope and substance, these challenges similarly cut to the core of a company's efforts to maintain an inclusive environment.

Specifically, *In re McDonald's Corp. Stockholder Derivative Litigation* ("*McDonald's*") serves as a harbinger of future successful challenges not only to poorly implemented DEI policies, but where a company fails to implement (and, in many states

¹⁸⁴ See *DiBenedetto*, 2022 WL 1682420, at *8.

required) anti-harassment and anti-discrimination policies, allows a harassing environment to persist, or both. This case draws attention, in particular, due to its extension of the fiduciary duty of oversight to corporate officers. The duty of oversight was first established *In re Caremark Int'l Inc. Derivative Litig.* (“*Caremark*”), where the Delaware Chancery Court found that corporate directors could be liable for failing to discharge their duty of oversight.¹⁸⁵ *Caremark* liability can occur generally under two circumstances: (i) directors fail to implement a reporting system or controls — referred to by the McDonald’s court as an information systems and controls claim; and (ii) directors, in bad faith, consciously fail to monitor or oversee operations — otherwise known as a red flag claim.¹⁸⁶ In order to prove a breach of the duty of oversight, the court required a showing of bad faith on the part of the director.

The limits of this duty were challenged (and ultimately extended) when McDonald’s stockholders filed a lawsuit against the company and its directors and officers, including David Fairhurst, the company’s former VP and global chief people officer, alleging that Fairhurst allowed a “toxic culture to develop” and “turned a blind eye to sexual harassment and misconduct.”¹⁸⁷ The lawsuit also alleged that Fairhurst engaged in sexual harassment, which served as further evidence of his turning a blind eye to similar behavior. Beyond his own impropriety, stockholders cited a lengthy list of “red flags” that Fairhurst allegedly ignored, including EEOC complaints, strikes by employees citing a culture of sexual harassment, and even congressional inquiries. Fairhurst moved to dismiss, relying on his argument that the duty of oversight did not extend to officers.

The court ultimately disagreed with Fairhurst, holding that officers do owe a duty of oversight, thereby expanding precedent set by *Caremark*.¹⁸⁸ That said, this duty is narrow in both scope and application, applying only to the officer’s duty of responsibility within which officers are required to establish “information systems” (i.e., reporting systems) in their areas of responsibilities, and that officers are only responsible for addressing or reporting “red flags” only in those areas, except for where a red flag is egregious or sufficiently prominent enough that officers could be liable were they made

¹⁸⁵ See *In re Caremark Int'l Inc. Derivative Litig.* (“*Caremark*”), 698 A.2d 959 (Del. Ch. 1996).

¹⁸⁶ See *In re McDonald’s Corp. S’holder Derivative Litig.*, 289 A.3d 343, 359–60 (Del. Ch. 2023).

¹⁸⁷ See *id.* at 357-59.

¹⁸⁸ *Id.* at 349-50.

aware even if it is outside their area of responsibility.¹⁸⁹ The court cited Fairhurst’s own alleged sexual harassment and conscious disregard in ignoring complaints and issues of sexual harassment by others, as evidence of bad faith.¹⁹⁰ The court further found that Fairhurst breached his duty of loyalty by engaging in sexual harassment himself — thus harming the company by violating company policy and positive law, which could otherwise subject the company to liability.¹⁹¹

While *McDonald’s* represents a significant extension of the duty of oversight, plaintiffs must still make specific allegations of bad faith and make a pre-suit demand or plead futility because at least half the board lacks independence or faces a substantial likelihood of liability. These claims must also pertain to a specific officer and their areas of responsibility. However, in response to this successful suit, employers must understand that directors and officers in supervisory roles must be clearly informed and trained on reporting systems (and any oversight obligations that may result). Indeed, the limits of *McDonald’s* and the potential exposure companies could face were highlighted by a subsequent decision where the Delaware Chancery Court dismissed the same claims against the company’s directors.¹⁹² Specifically, while the court previously allowed the claims against Fairhurst to proceed, the plaintiffs failed to make a demand on the *McDonald’s* board of directors and did not adequately allege demand futility — both of which doomed their claims against the board of directors.¹⁹³

Thus, while *McDonald’s* should cause all offices of a company to be cognizant of their potential exposure should the company violate its own policies or the law, the decision did not remove standard prerequisites in shareholder derivative actions.

¹⁸⁹ *Id.* at 363-65, 380-83.

¹⁹⁰ *Id.* at 377-79.

¹⁹¹ *Id.* at 380-82.

¹⁹² See *In re McDonald’s Corp. S’holder Derivative Litig.*, 291 A.3d 652 (Del. Ch. 2023).

¹⁹³ See *id.* at 699-01.



CHAPTER 8

How Should Employers and Stakeholders Think About DEI in the Wake of *Students for Fair Admissions, Inc. v. President and Fellows of Harvard College*?

The Supreme Court's recent decisions concerning higher education affirmative action programming in the *Students for Fair Admissions, Inc. v. Harvard* and its companion case against the University of North Carolina¹⁹⁴ have prompted a reexamination of DEI programming in the corporate workplace. While the Supreme Court decided these cases based upon Title VI of the Civil Rights Act, the Court's decisions, as well as past decisions, instruct the application of the principles from these cases in the private workplaces that Title VII governs.¹⁹⁵ The key takeaways from the Court's decisions provide a roadmap to revisiting, designing, or redesigning appropriate corporate DEI efforts.

A. The Upshot of the Court's Decisions

The Court's decisions squarely rejected the use of racial quotas in the educational context and left little doubt such quotas should be similarly rejected in the workplace. In so holding, however, Justice Roberts left open the notion, at least in the educational context, that higher education institutions could continue to consider in the admissions process how race affected an applicant's life, or how someone's upbringing might have

¹⁹⁴ See *Students for Fair Admissions, Inc. v. President and Fellows of Harvard Coll.*, 600 US ___, 181, 143 S.Ct. 2141, 216 L.E.2d 857 (2023).

¹⁹⁵ See 42 USCA § 2000e (b) ("The term 'employer' means a person engaged in an industry affecting commerce who has fifteen or more employees").

impacted their development and educational path.¹⁹⁶ The learning from these decisions is that corporate DEI programming should be reviewed to ensure that quotas, if any, are eliminated from employment-related actions such as hiring, promotion, or access to resources. But the decisions do not mean that employers lack legitimate methods to widen and support a robust access to the community's talent pipeline, nor programs for development of that talent within the corporation itself or that foster inclusive behavior.

B. The Framework of Future Corporate DEI Efforts

While the Supreme Court's decisions confirm that hiring quotas, numbers, or specific racial percentages may be legally suspect (except in certain, very limited circumstances),¹⁹⁷ the decisions do not counsel DEI abandonment. Employers should consider conducting a review, under the guidance of counsel, of existing DEI programs to ensure that programs and policies create neither intentional nor unintentional quotas. But a quota does not encompass a legitimate corporate mission or aim to achieve an aspirational percentage of diverse individuals if that mission is articulated as an aim to achieve a workforce that better resembles the makeup of the employer's community. Further, hiring and fellowship programs, affinity and employee resource groups, sponsor programs, and the use of diverse candidate slates continue to be lawfully deployed DEI tools. And the use of data — critically important for those companies subject to Office of Federal Contract Compliance Programs (OFCCP) contracting rules, as well as compliance with state pay equity legislation — is a key method to set benchmarks against which employers can assess progress. Data can also disclose gaps in hiring and other practices, and corporate employers can design initiatives to bridge those gaps. Utilizing experts to produce, analyze, and report on that data is helpful (and in some cases critical). There is yet another reason for critical self-examination: undertaking a methodical assessment of identifying and addressing gaps can provide important defenses to claims

¹⁹⁶ See *Students for Fair Admissions, Inc.*, 600 US at 230 (“At the same time, as all parties agree, nothing in this opinion should be construed as prohibiting universities from considering an applicant’s discussion of how race affected his or her life, be it through discrimination, inspiration, or otherwise.”).

¹⁹⁷ See, e.g., *Wygant v. Jackson Bd. of Educ.*, 476 US 267, 280–81, 106 S. Ct. 1842, 1850, 90 L. Ed. 2d 260 (1986) (“We have recognized, however, that in order to remedy the effects of prior discrimination, it may be necessary to take race into account. As part of this Nation’s dedication to eradicating racial discrimination”); *Students for Fair Admissions, Inc.*, 143 S.Ct. at 2192 (“[O]ur precedents explicitly require that any attempt to compensate victims of past governmental discrimination must be concrete and traceable to the *de jure* segregated system, which must have some discrete and continuing discriminatory effect that warrants a present remedy.”) (citation omitted).

that an organization failed to take appropriate steps to stamp out potential discrimination within its existing workforce. It is better to be data-informed than data-ignorant. Any fear of exposure that could inhibit audits can be addressed by conducting the analysis as part of a counsel-led effort to mitigate risk.

C. Targeted Litigation Against the Use of DEI Programs Following the Supreme Court's Decisions and the Importance of Communication

On the heels of the recent Supreme Court affirmative action decisions, other cases have been filed by the same organization that commenced the case against Harvard but against large private law firms attacking the use of DEI fellowship programs.¹⁹⁸ Furthermore, some state attorneys general have sent letters to private employers criticizing the use of DEI programming as being legally suspect.¹⁹⁹ Finally, Students for Fair Admissions has not slowed at all since the Supreme Court issued its decision; they recently filed a lawsuit against the United States Military Academy at West Point, among others, arguing that the Court's decision should be extended to military academies, which were explicitly excluded from the decision.²⁰⁰ These regulators and litigants frequently cast DEI as a zero-sum game — that supporting the hiring or retention of individuals of color automatically undermines the retention of those predominant in the community or, worse, excludes them. Employers should keep in mind that the intended effect (and consequence) of DEI programming is not to limit employment opportunities by race or other characteristics but to ensure that everyone has equal access to success, including those who historically have been disenfranchised from traditional models of promotion and leadership.

The amplification of opportunities is an important point for corporate DEI programming, and businesses should consider expressly inviting all employees to participate in and support employee resource and affinity groups. In addition, employers should consider offering hiring managers different options in sourcing talent, such as

¹⁹⁸ See Complaint, *American Alliance for Equal Rights v. Perkins Coie LLP*, No. 3:23-CV-01877 (N.D. Tex., Aug. 22, 2023); (ECF No. 1); Complaint, *American Alliance for Equal Rights v. Morrison & Forester LLP*, No. 1:23-CV- 23189, (S.D. Fla., Aug. 22, 2023) (ECF No. 1).

¹⁹⁹ On July 13, 2023, attorneys general of 13 states wrote a letter to all of the Fortune 100 CEOs, reminding them, in the wake of the Supreme Court's decision in *Students for Fair Admissions, Inc.*, of their obligation to refrain from discrimination on the basis of race in employment. The letter is available [here](#).

²⁰⁰ See Complaint, *Students for Fair Admissions v. The US Military Academy at West Point, et al.*, No. 7:23-cv- 08262, (S.D.N.Y. Sept. Sept. 19, 2023) (ECF No. 1).

recruiting from new universities and through community affinity groups and other interest-focused organizations, which may naturally result in different workforce dynamics. Questions relating to how an applicant's background impacted the applicant's life remain valid in the hiring process (if otherwise relevant to the person's ability to do the job) as the Supreme Court's decisions expressly affirmed the use of such questions in the educational admissions process. Further, employers should redouble training efforts, particularly with respect to ensuring that managers understand and recognize their own implicit biases. Communication to the greater business can also help: all employees should understand that the corporate aim to produce an inclusive and representative environment also means an employer will never select a candidate to interview or hire without regard to that person's ability to do the job, and certainly not on the sole basis of the individual's gender, race, or any other non-work-related characteristic.





CHAPTER 9

Practical Takeaways for Employers and Stakeholders

As we enter the final quarter of 2023 with 2024 on the horizon, how should employers think about structuring and implementing DEI policies that are effective and aligned with their corporate goals and mission but also do not run afoul of the law? While DEI initiatives and goals are typically highly specific to a given company, there are still several lessons that employers and other stakeholders can draw from the different challenges and hurdles discussed above. Toward that end, we outline six broad lessons, and set forth some specific action items and steps to consider.

A. Ensure That Affirmative Action and DEI Policies Are Clearly Defined and Have Ascertainable and Measurable Goals.

Companies are well within their right to implement robust DEI policies that align with ESG goals. However, as with any corporate policy, it should not be done haphazardly or without defined intent.

Policies that, for example, seek to increase diversity at certain levels (i.e., entry-level positions) should have clear, ascertainable goals and a process in place that enables the company to gauge success or failure. And in the latter circumstance, companies should provide an avenue to explain why the initiative is not succeeding as intended and, critically, why this might not be grounds to conclude it was arbitrary or frivolous (and thus open the company up to successful challenges in court).

While clear goals are encouraged, employers should be cautious when implementing any kind of “quota” or stated numerical allocation in meeting their DEI goals. On the one hand, taking action to align recruiting strategies with a goal of increasing

representation of previously underrepresented community members is certainly permissible and welcome — whether by way of expanded recruitment efforts or broader applicant pools. On the other hand, however, one can stray too far, with the utilization of racial quotas giving rise to employment decisions made based on race (i.e., a protected characteristic) — which has long been prohibited under Title VII and state equivalents (and which was a focus of the recent Supreme Court decisions). Policies that utilize quotas are heavily scrutinized, as noted above, with opponents to such policies encouraging the use of race-neutral employment practices instead.

B. Be Prepared to Support DEI Initiatives with Objective Evidence.

Success is never guaranteed in litigation, but companies will put themselves in significantly stronger positions to support DEI policies and defend against challenges if the initiatives are supported by robust evidence and deliberation among all relevant stakeholders, including the board, officers, and even employees.

Relatedly, a chief reason to support initiatives with objective evidence is that these initiatives are not merely performative — as Gap, Oracle, Qualcomm, and Wells Fargo were accused of doing when they fell short of their stated DEI goals.

C. Ensure that DEI Initiatives Do Not Pit One Group against Another and Are Crafted to Enrich the Workforce, not Cull Parts of It.

This is not an easy goal. Companies should be cautious about implementing policies that appear to take away certain opportunities from one group in favor of another. Sloppy or imprecise implementation could result in lawsuits, such as the one discussed earlier against Novant Health, where a white male was awarded millions because he was terminated in the wake of the company’s purported “D&I” initiative to diversity its workforce.

D. Ensure That Internal Initiatives Are Aligned with a Company’s Overall DEI Initiatives.

Internal efforts — employee affinity groups, or employee resource groups — are commonplace and can be important to a company’s broader DEI efforts. It is critical that companies ensure that they are not merely performative and members feel that they are heard within the company and have an actual role to play in the company’s overall DEI

strategy. Additionally, this can be as easy as ensuring that the company's anti-discrimination policies (as well as anti-bullying or related policies) are clear (as discussed in the next takeaway).

E. Ensure That General Anti-Discrimination, Anti-Harassment, and Anti-Retaliation Policies Are Comprehensive and Effective.

This is especially important in the wake of the *McDonald's* case, where officers now could find themselves liable for breaches of fiduciary duty. But more companies should consider using training as opportunities not only to provide employees with (at times) required anti-discrimination, anti-harassment, and anti-retaliation training but to afford employees space to grapple with general workplace issues that they may be facing.

F. Follow Through on DEI Commitment and Avoid Performative Rhetoric.

This is a simple takeaway, but not an easy one. As discussed, companies are vulnerable to lawsuits on several fronts, both from anti-DEI activists as well as groups that believe policies have not gone far enough — or that the company's rhetoric does not match the actual goals, the framework implemented, or both. In making a commitment to DEI, it is exceedingly important that these are not just empty promises or lofty statements — goals without affirmative steps may make such initiatives merely performative. This is not only important from a risk management standpoint (as Gap, Oracle, Wells Fargo, and Qualcomm have learned), but also for employee morale, recruiting, and retention.

