Published on *The National Law Review* https://natlawreview.com

DEI Under Scrutiny, Part II: Spotlight on Environmental, Social, and Governance Considerations

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Diversity, equity, and inclusion (DEI) typically falls under the "Social" prong of environmental, social, and governance (ESG), which focuses on human capital. DEI and ESG efforts were dealt a blow by the Supreme Court of the United States' June 2023 decision in *Students for Fair Admissions, Inc. v. Harvard College*, 143 S. Ct. 2141 (2023), in which the Court struck down affirmative action admissions policies in higher education—a decision that also has ramifications for private employers' DEI initiatives, voluntary affirmative action plans, and ESG efforts.

Quick Hits

- DEI falls under the "Social" prong of ESG, which focuses on the people in the workplace.
- ESG practices, especially related DEI efforts, face scrutiny from all sides, particularly after the Supreme Court's decision banning race-conscious admissions in higher education.
- Private employers may want to determine their risk tolerance, evaluate their ESG and DEI programs, and develop a cohesive approach to mitigating risk.

Even before the Supreme Court's decision, ESG—especially efforts related to the "S"—came under scrutiny of certain groups, with Florida Governor Ron DeSantis creating an alliance of states to fight what he calls "ESG financial fraud" and supporting a bill that, among other things, prohibits ESG consideration by state or local governments in issuing bonds.

Conversely, in October of this year, California Governor Gavin Newsom signed a bill requiring venture capital firms operating in the state to report annually the number of diverse founders in which they invest, and to disclose data about their race, sexual orientation, gender identity, disability, and veteran status.

Since the *SFFA* decision, and due to contra-ESG efforts, private employers are facing expanded risk of reputational harm, litigation, and inquiries from internal and external stakeholders. As a result, employers may want to perform a risk assessment of current DEI and ESG initiatives.

The Shifting Legal Landscape

In the wake of the *SFFA* decision, corporate DEI-related ESG commitments may expose private employers to increased attacks from public interest groups, civil rights lawsuits, shareholder-derivative litigation, and inquiries from internal and external stakeholders, as these commitments are scrutinized by numerous groups. America First Legal (AFL) filed civil rights complaints with the U.S. Equal Employment Opportunity Commission (EEOC) and wrote letters to CEOs and boards of directors alleging that corporate DEI commitments violate civil rights laws, run afoul of their fiduciary duties, and waste corporate assets. In July 2023, attorneys general from thirteen states wrote letters to Fortune 100 companies threatening "serious legal consequences" over diversity policies, criticizing company pledges to foster diversity and support minority-owned businesses during racial justice protests in 2020. Of note, attorneys general from twenty-one states responded with letters saying they "vigorously oppose any attempts to intimidate or harass businesses who … advance [DEI]."

Then, there are the lawsuits—civil rights claims and shareholder derivative lawsuits from groups like AFL and the National Center for Public Policy Research, which supported a shareholder derivative suit against a company's officers and directors alleging that corporate DEI commitments constitute a breach of their fiduciary duty and amount to waste of corporate assets. The lawsuit was eventually dismissed. AFL also sued a company over its LGBTQ Pride marketing, alleging that the company committed securities fraud by misleading investors regarding its oversight of risks related to its ESG and DEI policies. AFL has challenged diversity programs under Section 1981 of the Civil Rights Act of 1866, alleging that such programs violate Section 1981's ban on race discrimination in contracting by promoting race-based preferences. These suits led to several organizations changing the requirements of their DEI programs to focus less on race. AFL has also backed a suit by an employee alleging that the employer's DEI programs amount to reverse discrimination under Title VII of the Civil Rights Act of 1964.

Key Takeaways

In light of these challenges, employers that seek to continue or even expand their DEI and ESG commitments may want to consider the following actions.

- **Understanding and continuing to monitor the laws applicable to DEI and ESG initiatives.** Employers may want to determine which nondiscrimination or other laws may affect their DEI and ESG programs, and remain abreast of the quickly evolving application of these laws to these initiatives, including actions by state and federal regulators, and activist shareholders and other organizations.
- **Assessing the organization's risk tolerance.** While DEI and ESG initiatives create risk, backing away from those commitments may create different reputational, employee relations, and productivity risks. Understanding the organization's degree of risk tolerance may help employers determine next steps.
- **Conducting a privileged risk assessment or gap analysis of DEI and ESG initiatives and public commitments.** Consider

conducting an inventory of DEI and ESG programming to understand the legal risk level of these programs and to assess proactively the potential implications of descriptions of current and planned initiatives in ESG reports and other outward facing communications.

- **Developing a cohesive, overall strategy for mitigating risk related to DEI and ESG.** Employers may want to ensure all stakeholders are on the same page and that DEI and ESG goals are aligned with their organization's risk tolerance and business goals.
- **Focusing on inclusion and belonging.** Often, the risk from DEI efforts stems from a hyper-focus on diversity in recruiting and promotion, and on metrics. Employers may want to consider directing efforts toward inclusion and belonging, which may help retain existing diverse workers and create a culture that supports opportunities for all employees.

Read Part I.

National Law Review, Volumess XIII, Number 335

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