

EFFECT OF RECENT SUPREME COURT CASES ON PUBLIC COMPANY DEI INITIATIVES

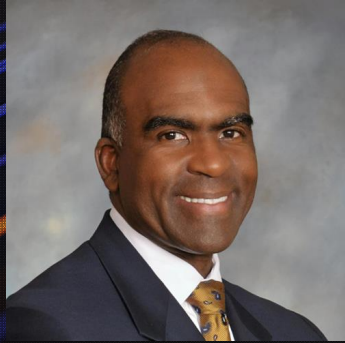
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Program Overview

- Impact of the Affirmative Action Decisions on Diversity Initiatives and Performance Goals
- DEI Strategy Considerations
- DEI Performance Goals
- Board Oversight and DEI Issues
- The “S” in ESG: Human Capital Disclosure
- DEI and Nasdaq Board Diversity Disclosure Requirements



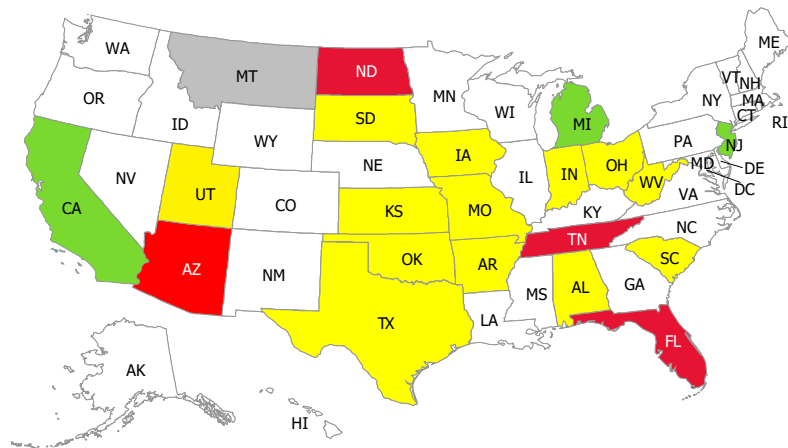
Impact of the Affirmative Action Decisions on Diversity Initiatives and Performance Goals


Current Climate

Current Political and Legislative Climate Regarding DEI Programming

- Letter-writing fencing match among AGs across the country.
- There are currently more than 30 bills pending (some of which have been enacted) across 18 states that challenge an entity's ability to establish DEI programs or offices, or create DEI initiatives, trainings, or curriculum.
- While most of these pending laws seek to limit the activities of public entities, including public universities or schools, depending on the success of these efforts, we expect to see additional efforts to expand these proposals.

- Pro-DEI Measures
- Bill(s) Passed
- Bill(s) Pending
- Bill(s) Rejected





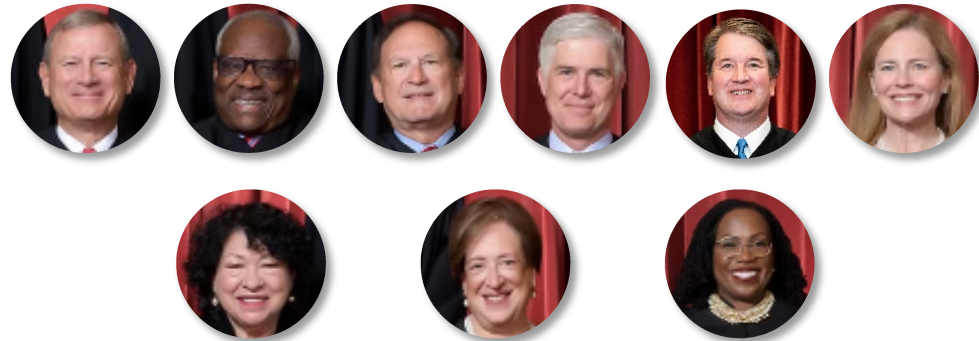
SCOTUS:
Affirmative Action in College
Admissions Is Unconstitutional

Students for Fair Admissions (SFFA)
v.
Harvard & UNC

SFFA v. Harvard & UNC

Race-Based College Admissions Fail Strict Scrutiny

- Split along ideological lines (6–3)
- No precedent **expressly** overruled



The Court's Issues with Harvard and UNC's Programs



1. Immeasurable goals
2. Lack of fit between means and goals
3. Necessarily use race in a “negative manner”
4. Perpetuate stereotypes
5. No meaningful end points

Some Race-Related Considerations Allowed

- **Universities** may consider “an applicant’s discussion of how race affected his or her life, be it through discrimination, inspiration, or otherwise.”
- **Governmental interests that can justify the use of race-conscious decision-making:**
 - Remediating specific identified instances of past illegal discrimination
 - Avoiding imminent and serious risks to human safety in prisons



Potential Implications

Implications for Employers

- No direct impact on private employer DEI efforts (with mounting litigation that may be further clarified soon).
- Analyze each employment discrimination statute separately according to its own text and body of law.
- This decision has emboldened plaintiffs and legal advocacy groups to bring challenges to employer DEI efforts.



Next Steps for Employers

- Companies have adopted widely varying DEI programs/strategies, and the risk is fact-specific.
- **Key Questions:**
 - ✓ What programs or strategies consider race, gender, or other protected characteristics?
 - ✓ What is the business rationale for those programs?
 - ✓ Have we conducted appropriate statistical analyses under direction of counsel to assess legal risk?
 - ✓ What programs or strategies might employees or litigants misinterpret as providing a benefit on the basis of race or other protected characteristics?



Implications for Race-Conscious Contracting

- Federal law (Section 1981) prohibits granting contracts or more favorable contractual terms on the basis of race.
- Many organizations seek to contract with minority and women-owned business enterprises and/or have supplier diversity programs and initiatives.
- We are seeing more challenges to diversity programs under Section 1981.





Implications for Grantmaking and Investing

- We could see similar challenges to:
 - Nonprofit foundations, educational institutions, and/or government actors who seek to provide grants or benefits to underrepresented groups or minority-led organizations
 - Investment firms and funds who seek to invest with minority-led funds or fund managers or otherwise base investment decisions on factors related to gender, race, or ethnicity

Assessing Contracts, Investments, and Grants

- Questions to ask:
 - Does the program create a contract?
 - Does the program actually grant benefits on the basis of race or other protected characteristics?
 - Is the program protected by the First Amendment?





DEI Strategy Considerations

Program Creation

- Consider replacing race-exclusive eligibility criteria with race-neutral criteria that increase representation among underrepresented groups, including:
 - First generation
 - Residents of historically-disadvantaged geographic areas
 - Individuals who demonstrate that they have faced barriers in the industry due to their backgrounds
- Consider providing “no-strings-attached” support to students to encourage diversity in industry without any agreement to contract.



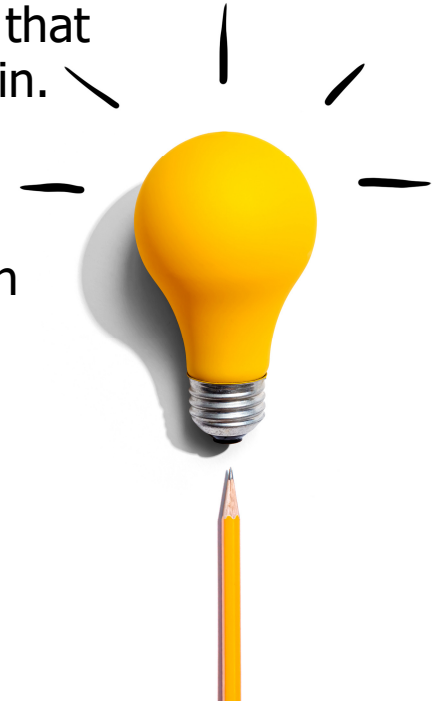
Program Implementation

- Ensure that stakeholders understand the actual eligibility criteria for the DEI programs they support.
- Assess both technical eligibility requirements and the ultimate pool of participants.
- Ensure that internal and external communications about DEI programs are accurate and consistent.



Invest in Strategies to Promote Inclusion

- **Hiring:** Structure interviews so every candidate is asked the same questions and evaluated in the same way.
- **Engagement:** Train managers to structure meetings so that everyone participating is given the opportunity to weigh in.
- **Leadership Development:** Determine which skills are critical for promotion to leadership and ensure that all employees in the pipeline are given opportunities to learn those skills.



Invest in Strategies to Promote Inclusion

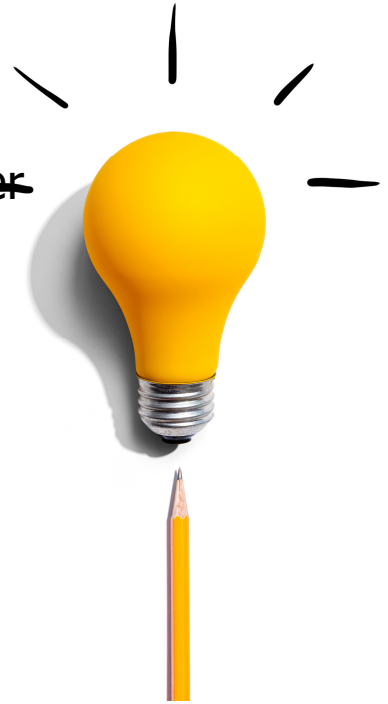
- Evaluate managers on:
 - How they foster inclusion
 - The cohesiveness of their teams
 - Their ability to behave respectfully in the face of stress
 - Their engagement in mentorship and sponsorship
- Rewards based on feedback regarding kindness, civility, and respect.



DEI Performance Goals

Impact on Incentive Plan Performance Goals

- ESG performance goals have become widely used for annual incentive plans.
 - ESG metrics are more often used in annual incentive plans than long-term plans, because of the inherently subjective nature of the metrics
- Diversity and inclusion is one of the most prevalent ESG metrics in annual incentive plans, having increased in use over the past several years



Impact on Incentive Plan Performance Goals

- According to a 2023 FW Cook report, the most common DEI goals relate to diverse leadership representation, promotion and hiring of diverse employees across the entire organization, and improvement in diverse representation across the entire organization
- In the past, DEI goals have measured outcomes or actions/steps toward desired outcomes
- Care must be taken to avoid quotas



Impact on Incentive Plan Performance Goals

- Incentive compensation tied to DEI goals is attracting scrutiny and has already led to litigation.
- Example: A federal District Court in Washington recently dismissed claims brought against Starbucks in an oral decision reaffirming the rights of boards of directors to determine DEI strategy and policies, including under the corporate “business judgment rule.”
- SFFA does not prevent companies from continuing to use DEI performance metrics in incentive plans. However, DEI goals should be reviewed.

Impact on Incentive Plan Performance Goals

- Companies should review their DEI performance metrics with company counsel to:
 - Ensure that DEI performance metrics are tied to the overarching business goals of the company
 - Structure DEI performance metrics to measure actions/steps to be taken toward a strategic goal, rather than outcomes



Impact on Incentive Plan Performance Goals

- Companies should review their DEI performance metrics with company counsel to:
 - Avoid metrics that are tied to quotas or that use protected categories as “tiebreakers”
 - Ensure that DEI performance metrics cannot be construed to utilize protected categories to determine employment outcomes
 - Ensure that DEI performance metrics are communicated in a way that underscores the tie to the company’s business, mission, and future success



Impact on Incentive Plan Performance Goals: Examples

- *Examples of how DEI performance goals can tie to a company's business goals:*
 - Ensuring that the company hires the best talent by broadening the pipeline for prospective employees
 - Cultivating a diverse and inclusive workforce to attract and retain employees
 - Having a workforce that reflects the company's customer base
 - Eliminating bias across the workforce and supply chain

Impact on Incentive Plan Performance Goals: Examples

- *Performance Goal that will likely increase risk*
 - During 2024, increase number of People of Color in the law department by 25%
- *Performance Goals that will lower risks while advancing objectives*
 - Our company's customers are of a wide range of backgrounds, races and geographic locations. Our business will be most successful if our workforce reflects our customer base (design of products, marketing, etc.).
 - During 2024, our hiring team will reach out to 25% more Community Colleges and geographic locations for new hires than in 2023, and will have targeted outreach to HBCUs.
 - During 2024, our HR team will send out surveys soliciting input on Belonging to our workforce and have a goal of 75% responses.
 - By the end of 2024, HR will propose to management a targeted strategy for retaining our workforce by creating a better sense of Belonging throughout our workforce.

Impact on Incentive Plan Performance Goals: Examples

- *Performance Goal that will likely increase risk*
 - During 2024, develop internship programs that are open only to Minority applicants. (Note that several law firms have been recently sued for this type of program.)
- *Performance Goal that will lower risks while advancing objectives*
 - During 2024, develop internship programs that are open to First Gen students, students from underserved communities, veterans, and students from Community Colleges.
 - Alternative: Open the program to all students, and include questions on the application that focus on life experiences.

Takeaways and Next Steps

Takeaways

- Court did not change legal analysis under Title VII or Section 1981
- We can expect greater scrutiny/increased litigation risk
- It will take time for the law to evolve



Next Steps

- Conduct inventory of DEI practices, especially those that are race-exclusive or race-conscious
- Review performance goals, messaging, and communications
- Conduct refresher trainings
- Discuss level of risk tolerance with leadership
- Mitigate unnecessary risk



Board Oversight and DEI Issues

Board Oversight of DEI Issues Before Harvard/UNC

- As a result of events in 2020, companies and their boards assumed greater responsibility over DEI initiatives and made increased public comments about DEI issues and the commitment to diversity with respect to their workforce, representation on the board and society in general. In 2020 only 72 of S & P 500 companies included in its annual report DEI statements. By the end of 2022, the number had risen to 402. Proxy statements now routinely address board diversity, as well as increased shareholder proposals on diversity both for and against
- This dramatic change did not result from regulatory requirements but rather from internal board consensus, as well as pressure from various stakeholders inside and outside of the company (stockholders, employees and customers)
- The SEC human capital rule in 2020 and the NASDAQ diversity disclosure rule in 2021 contributed to increased public disclosure of DEI commitments



Public Company Risks Relating to ESG and DEI

- Companies before the Harvard/UNC decisions were facing backlash on numerous fronts including shareholder proposals and demands to retract DEI policies and programs, threats of reverse discrimination lawsuits, government investigations and enforcement actions and potential antitrust risks
- Companies are increasingly including risk factors in their public filings on the costs of compliance and lack of standards on ESG/DEI reporting, the risks of complaints, lawsuits and shareholder proposals from both pro-ESG/DEI and anti-ESG/DEI stakeholders and increased regulatory oversight at the federal and state level. Actual ESG/DEI complaints and lawsuits will trigger additional disclosure requirements and expanded risk factors

Harvard/UNC Aftermath

- In the wake of the US Supreme Court's recent decision striking down affirmative action in higher education, corporations are being swept into a nationwide conflict over DEI initiatives
- Given the Supreme Court's rejection of race-conscious decision-making in Harvard/UNC, those legal challenges have increased over the past few months. Following those lawsuits, there will inevitably be stockholder derivative litigation directed at corporate boards in connection with their role in overseeing the business
- Corporate boards should consider taking action now that will both satisfy their fiduciary obligations and help protect against claims of fiduciary breach to come
- Corporate boards need to carefully review DEI statements with respect to potential reverse discrimination litigation
- Companies that dial back or eliminate DEI efforts could face SEC investigations and shareholder derivative suits. Employers could face pay equity and disparate impact enforcement and class actions, discrimination litigation and other negative repercussions, including to personnel, morale and their bottom line
- Many companies are taking the opportunity to reaffirm their commitments to DEI and explaining publicly why it continues to be tied to long term strategy value



Board Liability

- Directors of Delaware corporations (and those incorporated in many other jurisdictions) have a fiduciary duty to monitor risk of harm to the corporation. When directors become apprised of a material risk, they can be held personally liable if they consciously disregard their duty to respond and address the risk
- Having been arguably apprised of a risk that the corporation is in violation of the law, directors discharging their fiduciary duties should consider addressing the risk to the corporation that it will be found in violation of the law, or they may expose themselves to litigation risk if the corporate risk later comes to fruition
 - Ex. if the corporation suffers a judgment finding the corporation is in violation of the law in an anti-discrimination class action directed at DEI policies

Mitigating Risk

- A board (or a committee thereof reporting to the full board) need only direct that the risk be investigated and evaluated with the conclusions later reported back to the board to determine whether further action need be taken
- The review of the corporation's DEI programs should be conducted by competent DEI counsel providing a report to the board, which may include advice regarding actions to be taken
- Critically, the board's delegation of the review of DEI programs, the report back to the board on the results of that review, and the board's deliberations as to next steps, if any, must be documented in board minutes

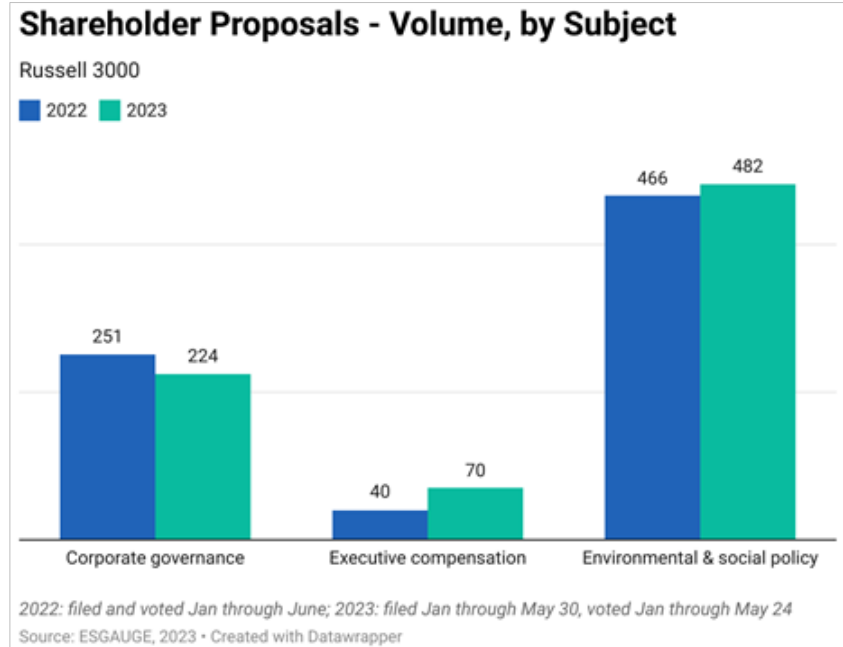
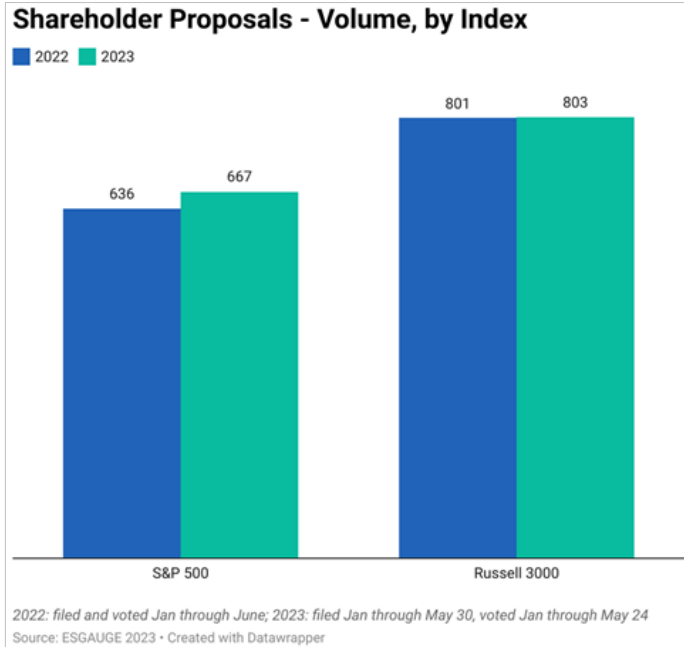
Mitigating Risk (cont'd)

- Should the corporation later be determined to have violated the law, taking preventive measures before the risk materialized will serve three important purposes:
 - The board will have documented that it satisfied its fiduciary duties of oversight with respect to the risk
 - The board will have created a succinct record that may later be used to respond to books and records demands, with the potential impact of causing plaintiffs' counsel to abandon further efforts at investigation or litigation
 - Even if the conclusions and recommendations from the review later turn out to be wrong, the board can later invoke the review as a defense to liability

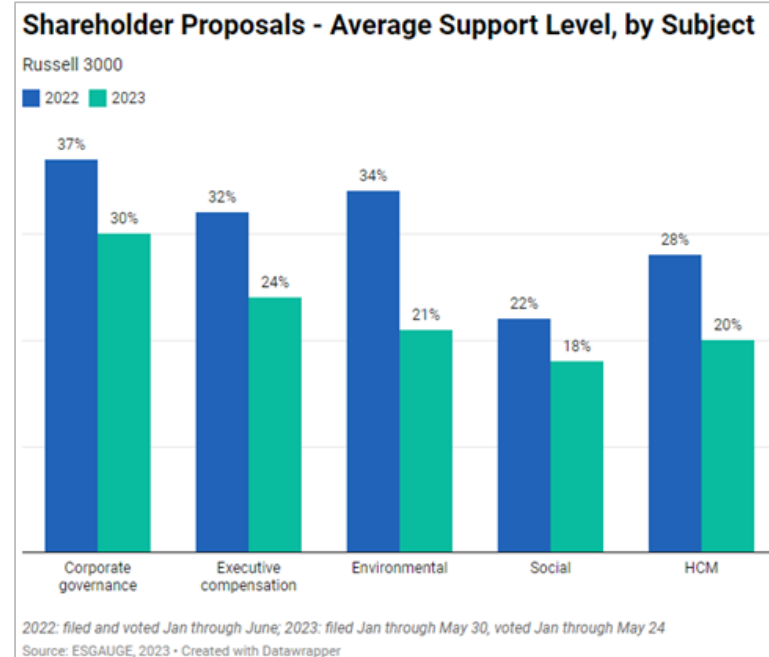
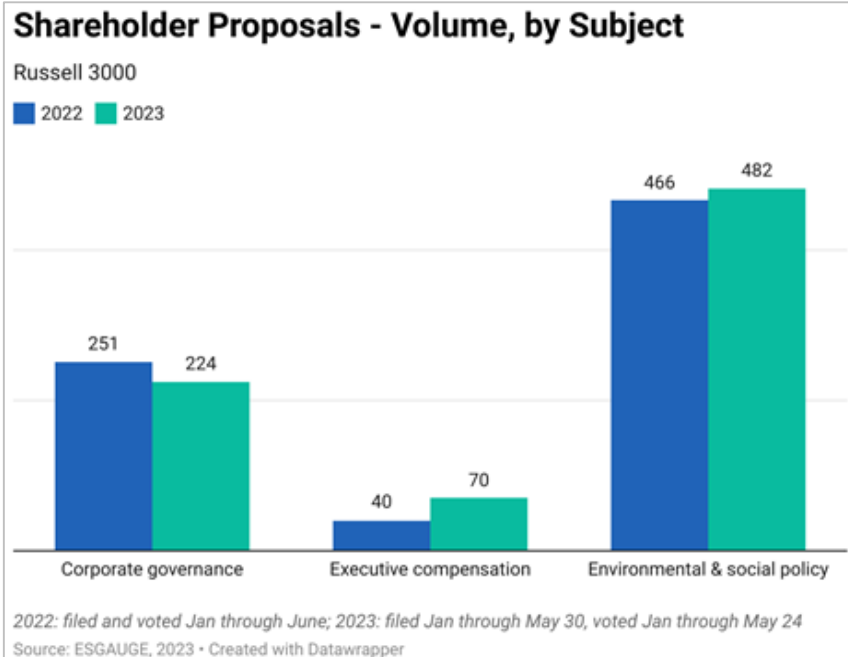
Shareholder Proposals

- DEI issues have been the subject of shareholder proposals in the past and this is likely to increase next proxy season in the wake of the Harvard/UNC decisions
- Although the inclusion of these shareholder proposals in proxies has increased, in the past few years, the passage rate is very low because management has persuaded a majority of stockholders that they are already addressing the subject matter of the proposals in the best interests of company

2023 Proxy Season - Shareholder Proposals Volume



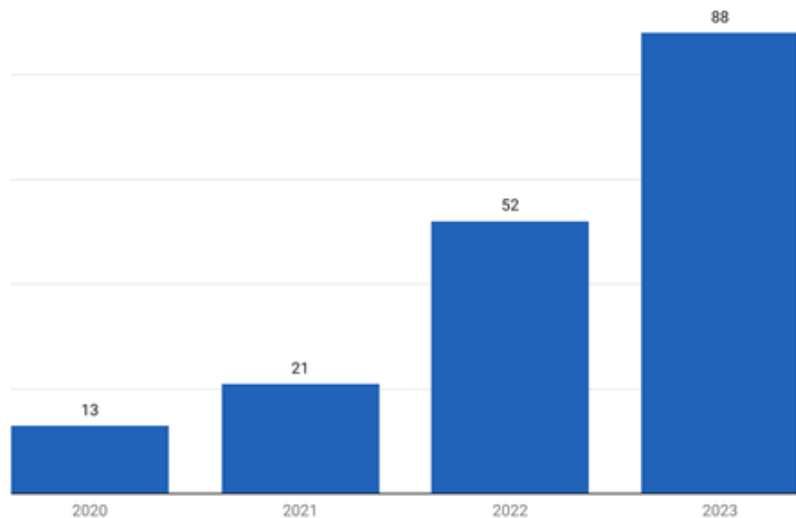
2023 Proxy Season - Shareholder Proposals by Subject



Anti-ESG Proposals

Number of shareholder proposals by anti-ESG proponents

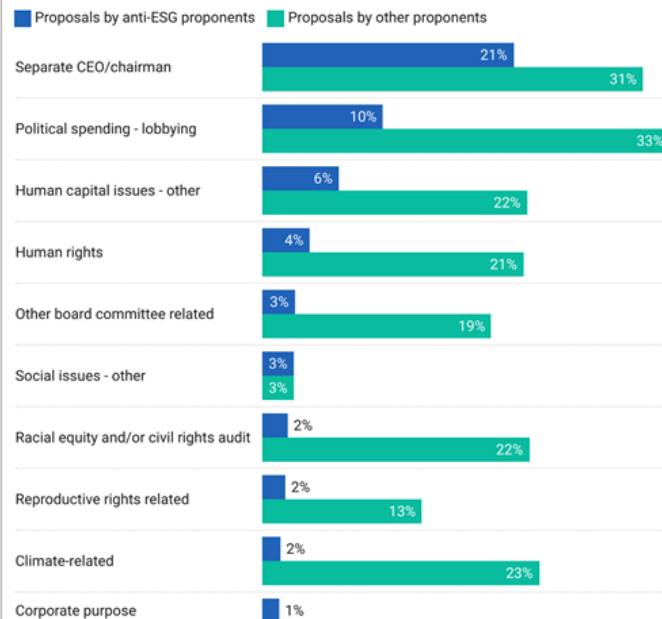
S&P 500



Proposals tracked from National Center for Legal and Policy Center, National Center for Public Policy Research, Steven Milloy, Bahnsen Group, David Bahnsen, Inspire Investing, and William Hild.

Source: ESGAUCE, 2023 • Created with Datawrapper

Average support level: Anti-ESG proponents vs other shareholder proponents (S&P 500)



Proposals tracked from National Center for Legal and Policy Center, National Center for Public Policy Research, Steven Milloy, Bahnsen Group, David Bahnsen, Inspire Investing, William Hild

Source: ESGAUCE, 2023 • Created with Datawrapper

The "S" in ESG: Human Capital Disclosure

SEC's Modernization Efforts

- As part of the SEC's ongoing efforts to modernize the disclosure requirements for public companies, it amended Item 101 of Regulation S-K to require that companies describe their human-capital resources
 - This includes any human-capital measures or objectives that management focuses on in conducting business, to the extent such disclosure would be material
- The adopting release stressed the SEC's belief that human capital is a material resource for companies and an important disclosure for investors, and it emphasized a principles-based approach to the disclosure



SEC's Modernization Efforts

- Disclosure about human capital can run the gamut from Covid-19 protocols, hiring practices, workplace culture and employee well-being efforts, overall policy and strategy toward maintaining its workforce, and DEI policies and procedures
- As the 2020 rules reflected the agency's traditional, principles-based approach to disclosure—rather than the prescriptive approach reflected in the SEC's more recent rulemakings—what companies choose to disclose in public filings can vary significantly

SEC's Focus on Human Capital Disclosures

- While the “E” remains a priority at the nationwide SEC, the current administration has signaled a renewed focus on the “S” in ESG matters
- The SEC Chair Gary Gensler is acutely focused on “comparable” and “consistent” ESG disclosure and expressed dissatisfaction with disclosure provided in response to the 2020 revisions regarding human capital
- Human capital disclosure rulemaking is on the SEC’s rulemaking agenda this year but the proposed rules have been delayed with priority given to the SEC’s climate change proposal that has also been delayed



DEI and Nasdaq Board Diversity Disclosure Requirements

Nasdaq Board Diversity Disclosure Rule

- In August 2021, the SEC approved Nasdaq’s board diversity rule, which is a disclosure standard designed to:
 - Encourage diversity threshold objectives for Nasdaq-listed issuers
 - Provide “apples-to-apples” disclosure regarding board composition among companies
- Nasdaq will require listed companies to **“comply or explain”** with board diversity requirements, which will require most Nasdaq-listed companies to have at least:
 - One director who self-identifies as female (regardless of the director’s designated sex at birth)
 - One director who self-identifies as an underrepresented minority or LGBTQ+
- Companies also must provide a **board diversity matrix** disclosing self-identified board diversity
- The rule provides some flexibility:
 - A company may choose to disclose why it does not meet the diversity objective (i.e., in proxy or on website)
 - Smaller reporting companies and foreign issuers can comply with the diversity objective by including two female directors
 - All companies with five or fewer directors can comply with the diversity objective by including one diverse director
- Nasdaq also is providing companies with access to board recruiting services

Nasdaq Diversity Disclosure – Dates for Compliance

- Listed companies must comply with the new Nasdaq diversity rule by the later of the below dates or the date of the company's annual proxy statement in the same year:
 - Aug. 6, 2023* (one director) and Aug. 6, 2025 (two directors) – Nasdaq Global Select and Nasdaq Global Market
 - Aug. 6, 2023* (one director) and Aug. 6, 2026 (two directors) – Nasdaq Capital Market
- If a company fails to meet these goals, it must provide an explanation regarding its non-compliance by the later of 180 days from the deficiency date or the company's next annual shareholders meeting.

**Later of this date or the date that company files its proxy materials*

Diversity on Boards and More on the Nasdaq Rule

- For purposes of Rule 5605(f), “Diverse” means an individual who self identifies in one or more of the following categories: female, Underrepresented Minority or LGBTQ+
- Underrepresented Minority means any person who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities
- Unlikely that NYSE will follow suit
- Current disclosure is largely based on self-identification; note the potential for liability under the securities laws for opportunistic or unproved identifications

Steps to Consider Taking on Board Diversity

- Add diversity questions to D&O questionnaire (ensure that these are crafted as “self-identifying” and that the respondents explicitly give permission for the information to be shared in SEC filings)
- In addition to gender and race/ethnicity questions, many companies are including questions relating to whether directors and officers self-identify as LGBTQ+, as well as other questions such as ethnic diversity and veteran status

Diversity and Inclusion – ISS and NYC Comptroller Updates

- ISS has asked companies for disclosure of the race/ethnicity of each director and named executive officer, both on an aggregate and self-identified basis
 - Indicated that this outreach is an effort to ensure the accuracy of data in research and proxy reports
- NYC Comptroller Scott Stringer has asked companies to adopt a “Rooney Rule” diversity search policy requiring that qualified female and racially/ethnically diverse candidates be included in the pool of nominees from which directors and CEOs are selected
- NYC Comptroller also has called for companies to publicly disclose their annual EEO-1 report data in order to match their statements regarding commitments to diversity and inclusion

Anti-ESG Movement--Green/ESG Hushing

- References by companies to green and social initiatives declined heavily during earnings calls over recent quarters
- Executives have quieted down in publicly discussing environmental and DEI efforts
- Many companies are engaged in “green hushing” as part of a larger strategy to not weigh in publicly on divisive issues
- Pressure from investors and advocacy groups is persuading companies to shift messaging with investors

How Companies Can Address Anti-ESG Backlash

- The Conference Board in its September 2023 publication [Escalating ESG Backlash Presents Companies with Opportunity \(conference-board.org\)](https://www.conference-board.org/publications/escalating-esg-backlash-presents-companies-with-opportunity) noted the following key points:
 - Expect the level of ESG backlash to increase over the next two years
 - Companies should view backlash as an opportunity to clarify their ESG strategy and communications
 - The most effective response to backlash is to ensure the company’s ESG and sustainability goals align with core business strategy
 - In the US, federal and state policymakers have been, and will likely continue to be, the leading sources of vocal ESG backlash
 - Businesses should be cautious of retreating from the broader public conversations about ESG
 - It is important for companies to avoid dramatic shifts in how they talk about ESG issues and clearly explain any changes to avoid perceptions of insincerity or succumbing to pressure
 - Companies can consider joining forces to make the business case for ESG to amplify their messages and reach with due regard for antitrust concerns
 - Companies should keep backlash in perspective and remember the reasons they focused on ESG in the first place, which are likely to remain valid

Biography



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Sharon, a leader of Morgan Lewis's Workplace Culture Consulting and Training practice, helps companies and organizations create safe, respectful, diverse, and inclusive workplaces. Sharon also leads the firm's DEI and Affirmative Action Task Force, and developed and led the firm's Reproductive Rights Task Force and COVID-19 Task Force. Having previously served as chief of staff and senior counsel to a commissioner at the Equal Employment Opportunity Commission (EEOC), Sharon provides insight on the enforcement of all employment civil rights laws and advises employers on employment discrimination issues.

Biography



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Larry serves as a leader of Morgan Lewis's Workplace Culture Consulting and Training Practice and is a former leader of the Firm's Diversity Committee. He counsels employers on corporate diversity initiatives, including best practices and litigation avoidance. He advises employers on building, maintaining, and evaluating diversity and inclusion efforts in a variety of industries, including but not limited to pharmaceutical, medical device, financial, and retail.

Biography



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Carl focuses his practice on domestic and international corporate and securities matters, mergers and acquisitions, project development, and transactional finance. He works extensively in a variety of industries, including the life sciences, telecom/electronics, renewable energy, and maritime industries, and has worked broadly in Latin America, the Caribbean, Europe, Africa, Asia, and the Middle East.

He previously served as co-chair of the International Section of the Boston Bar Association and co-chairs the firm's ESG and sustainability advisory practice and Cuba initiative. Carl is the former leader of the Boston office corporate and business transactions practice. For more than 20 years, Carl has provided legal assistance to microfinance institutions and assisted public charities, foundations, social enterprises and entrepreneurs, impact investment venture capital funds, and other impact investors, including racial equity impact funds."

Biography



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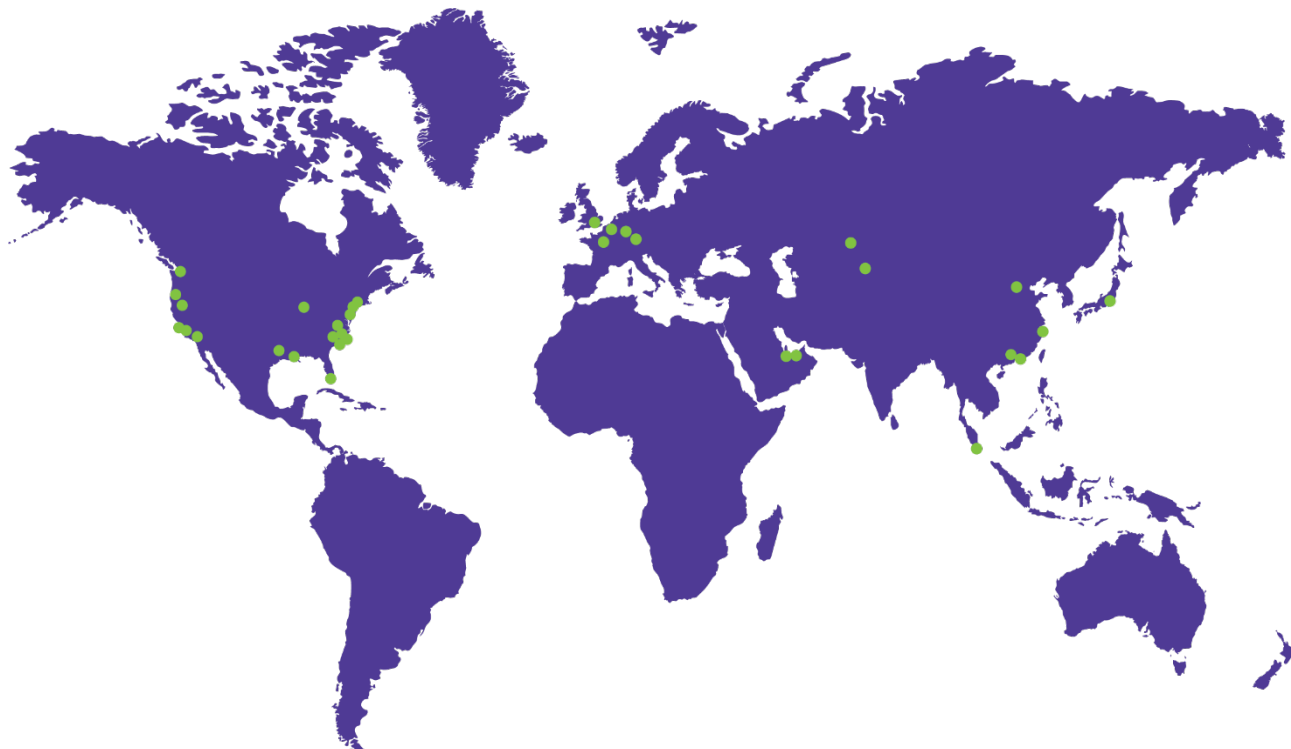
Mims advises on complex executive compensation and employee benefit plan matters, including the design, negotiation, and implementation of executive compensation, equity compensation, and tax-qualified retirement plans and shareholder approval of equity plans. She counsels large publicly and privately owned businesses, including Fortune 500 enterprises, as well as technology companies, colleges and universities, and other non-profit entities, on a range of legal issues related to executive compensation governance, and employee benefit plans.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

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Astana
Beijing
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong
Houston
London
Los Angeles
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