

THE IMPACTS OF RECENT SUPREME COURT DECISIONS ON EMPLOYEE BENEFITS PLANS: DEI, ESG, AND OTHER CONSIDERATIONS

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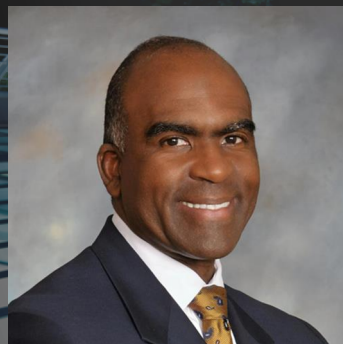
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Impact of the Affirmative Action Decisions on Diversity Initiatives and Performance Goals

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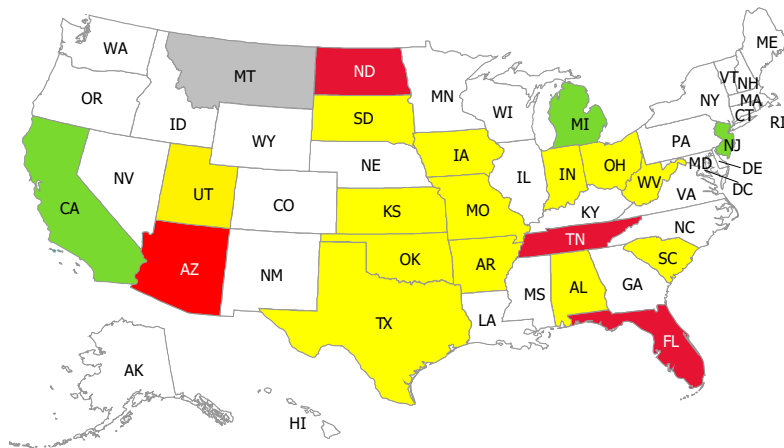
Current Climate


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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



A couple is shown from behind, embracing on a beach at sunset. The man is wearing a dark suit and is making peace signs with both hands raised. The woman is wearing a white t-shirt and a red bikini top. The background features a calm ocean and a sky with soft, golden light from the setting sun.

Potential Implications

Next Steps for Colleges and Universities

- In what ways, if any, does our admissions process consider race or ethnicity, and what changes, if any, should be implemented now?
- How do our mission, goals, and messaging as they relate to diversity align with the Court's ruling?
- What education and training may be necessary for admissions officers and other key stakeholders?



Implications for Employers

- No immediate 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.





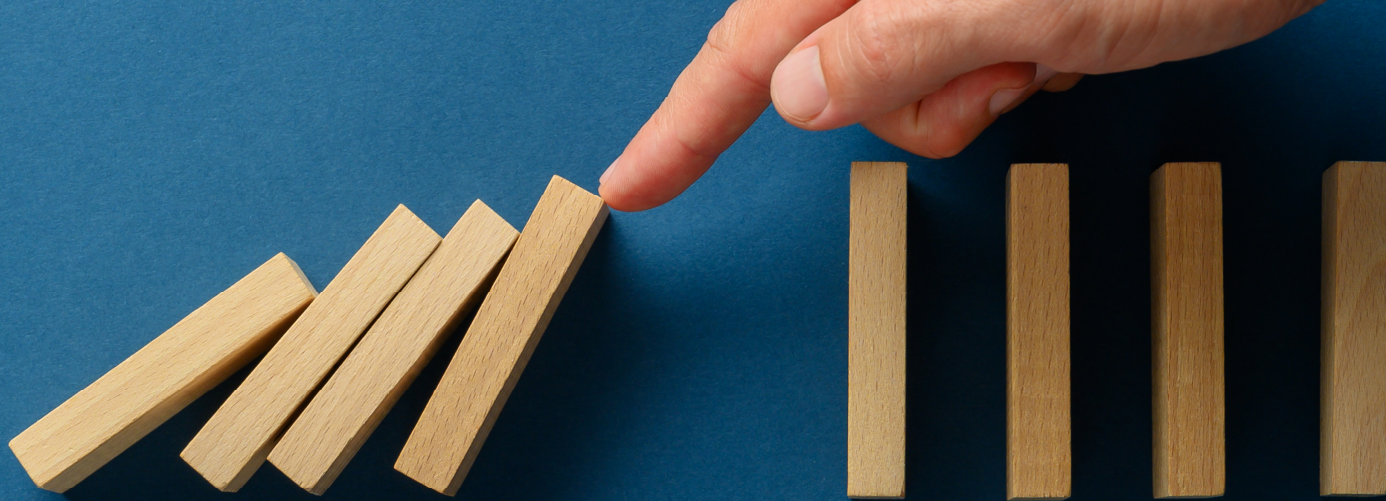
Implications for Grantmaking and Investing

- 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

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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.



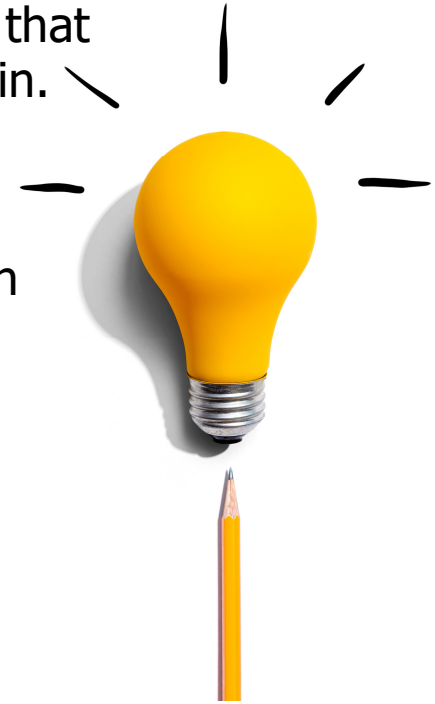
Program Implementation

- 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

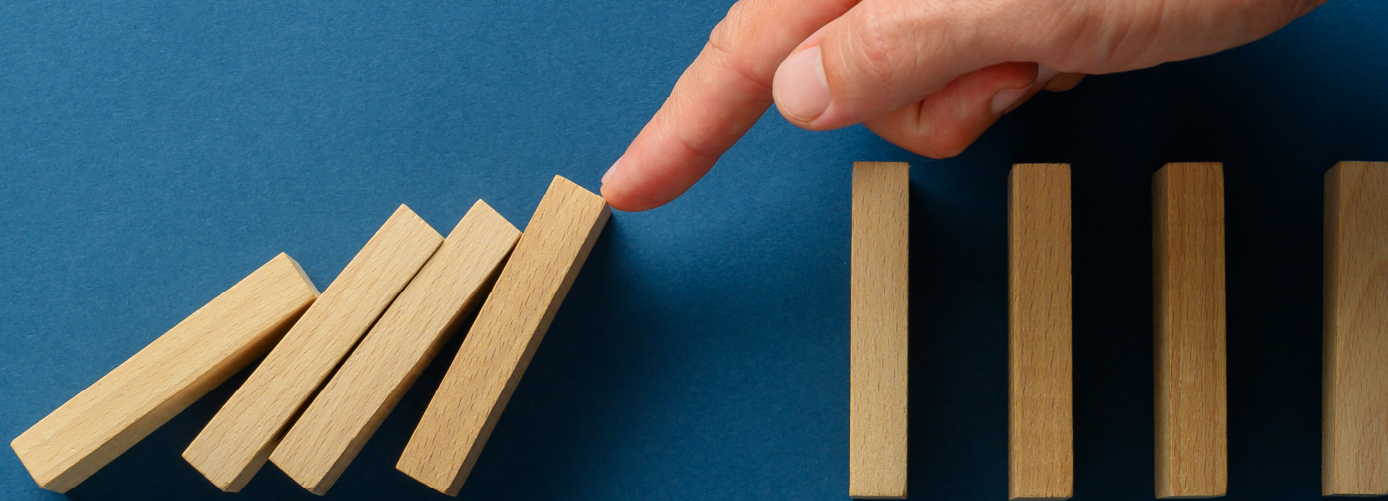
- **Hiring:** Structure interviews so every candidate is asked the same questions and evaluated in the same way.
- **Engagement:** Train managers to structure meetings so that everyone participating is given the opportunity to weigh in.
- **Leadership Development:** Determine which skills are critical 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

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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
 - 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.
- 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
 - 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 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

A top-down photograph of five hands of diverse skin tones (dark brown, medium brown, light brown, and two shades of white) resting flat on a dark, textured wooden surface. The hands are arranged in a horizontal line, with the fingers pointing towards the center. The lighting is soft, highlighting the textures of the skin and the wood. A black smartwatch is visible on the leftmost hand.

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



Impact of the Affirmative Action Decisions: Other Potential Impacts on Benefit Plans

Other Potential Benefit Plan Impacts

- There is a risk that the *Harvard-UNC* cases may provide an opening for challenges to other activities by employee benefit plans
- Other potential risk areas could include:
 - Benefit programs that are targeted to support minority engagement or participation
 - Investment activities made to favor ESG goals / ESG mandates
 - For example, a plan investment mandate to consider minority-owned asset managers and/or plan paid service providers

Broader Political Climate: Attack on ESG

- There is a common political context between *Harvard-UNC* cases and anti-ESG movement.
- ESG investing is already under attack
 - For example, in June, American Airlines sued for alleged inclusion of ESG funds and ESG considerations in plan investments
 - DOL's ESG Rule under attack in litigation (challenges to DOL ESG Rule) and Congress (several proposed bills to prohibit ESG considerations)
 - Very active "anti-ESG" movement at the state level

Potential Risk Examples: Minority Mandates

- A recent example of potential risk:
 - In early August 2023, the American Alliance for Equal Rights filed a race discrimination lawsuit against several entities affiliated with *Fearless Fund Management, LLC*, an Atlanta-based asset manager, alleging violations of 1981 related to the asset manager's grant program, which sought to support Black female business owners.
- Could we see similar ERISA challenges, such as against a plan investment mandate to consider minority-owned asset managers and/or plan paid service providers?

Potential Risk Areas

- In light of these potential risks, employers may want to consider if their benefit programs or investment mandates could be viewed as using race-conscious considerations.
- Will race-conscious benefit plan activities be unlawful? It will depend....
 - If extended beyond education, the *Harvard-UNC* decisions could be read as prohibiting such mandates if they are based on race alone.
 - But probably still safe if activity (for example the selection of the manager and/or service provide) is based on a totality of factors and not just the consideration of race.
- Analogous to the legal analysis around permissible ESG investment considerations
- At any rate, this is an emerging and evolving area of the law and ERISA fiduciaries may want to continue to monitor.

Supreme Court Skepticism of Federal Agency Actions: What Could It Mean for ERISA Regulation?

Trend Away from Deference to Regulatory Agencies

- *Chevron v. Natural Resources Defense Council* (1984)
 - Established the principle of deference (“Chevron deference”) to an agency’s reasonable interpretations of ambiguous laws that the agency must implement.
 - For most of the following nearly 40 years, the Chevron deference figured prominently in administrative law jurisprudence.
 - Agencies did not always win, but the Chevron test was consistently applied.
- But the Supreme Court is showing not so much deference to Chevron deference anymore.
- Federal agencies facing a more exacting Supreme Court that is less willing to give them the benefit of the doubt when regulations are challenged.

Recent Example

- ***West Virginia v. EPA* (decided June 30, 2022)**
 - Two states (West Virginia and North Dakota) and two coal companies challenged an Obama-era EPA regulation under the Clean Air Act regarding carbon emission standards.
 - Court held that the EPA exceeded its authority in adopting a regulation that would have required shifting some electricity production away from coal to natural gas plants and to alternatives such as wind and solar.
 - Fun little procedural curveball—this regulation is not and has never been in effect due to changes in presidential administrations happening at key points in the process.
 - “Major questions” doctrine: “agencies asserting highly consequential power beyond what Congress could have reasonably be understood to have granted.”



Recent Example

- ***Axon Enterprises, Inc. v. Federal Trade Commission* (decided April 14, 2023)**
 - Really two cases rolled into one: Does adjudicative power in a regulatory agency (the FTC and SEC, in this case) preclude federal district court review?
 - Axon faced an FTC proceeding for purchasing its closest competitor.
 - Michelle Cochran faced an SEC proceeding for failing to comply with auditing standards.
 - Both Axon and Cochran challenged the adjudicative power given to the agencies on Constitutional bases.
 - Unanimous decision that the agency adjudicative power did not preclude judicial review.
 - But Thomas and Gorsuch wrote concurrences basically saying—Congress can't give agencies this kind of authority.

Upcoming Example

- ***Loper Bright Enterprises, Inc. v. Raimondo*** (DC Circuit decision August 12, 2022; cert granted for upcoming term).
- Challenge by commercial herring fishermen to regulations by the National Marine Fisheries Service requiring the industry to pay for “at-sea monitors” of fishing practices.
- National Marine Fisheries Service prevailed at DC Circuit.
- Death of Chevron deference? Or a red herring?

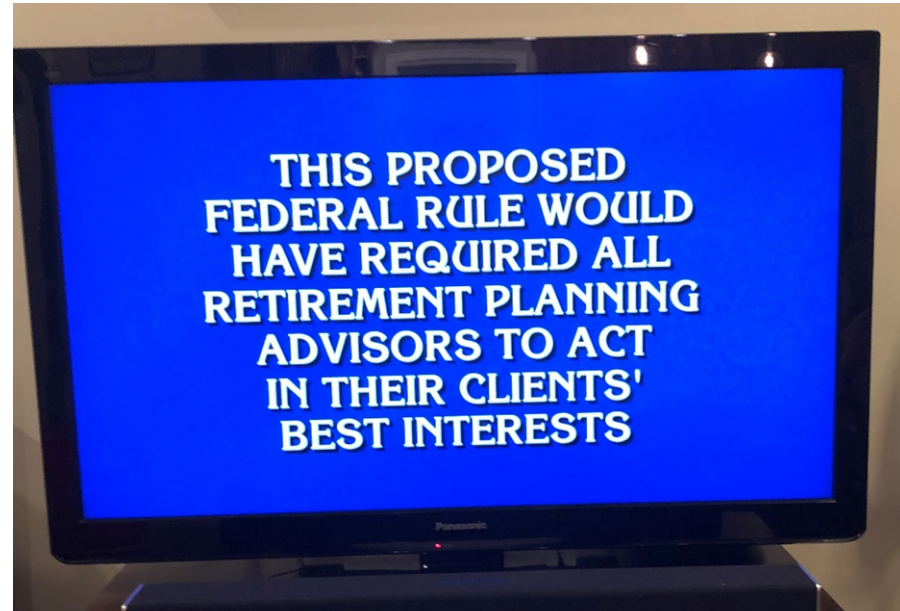


Implications for Employee Benefit Plans?

- Two ERISA-related Department of Labor (DOL) regulations are currently or have recently been the subject of litigation challenging DOL authority.
 - What will this anti-deference trend mean for the outcomes of these cases?
- **Department of Labor “ESG” Regulation**
 - Currently two federal district court cases challenging DOL authority to promulgate the ESG Regulation.
 - One case brought by attorneys general of 25 states
 - One case brought by two plan participants

Implications for Employee Benefit Plans?

- **Return of the DOL Fiduciary Rule**
 - Too much backstory to go into here (over 13 years' worth, in fact)
 - The key issue: What standards should apply to providers of nondiscretionary investment advice—especially in connection with rollovers?



Implications for Employee Benefit Plans?

- In 2020, the DOL issued Prohibited Transaction Exemption (PTE) 2020-02 to interpret DOL investment advice regulations issued in 1975.
- PTE 2020-02 was followed by a set of “Frequently Asked Questions” (FAQs) in April 2021, including an FAQ suggesting that a one-time rollover recommendation could trigger fiduciary status.
- The FAQs were followed by a lawsuit.
 - District court struck down the FAQs (February 13, 2023).
 - The DOL (and the Department of Justice (DOJ)) appealed (April 14, 2023).
 - Then the DOL (and the DOJ) dropped the appeal (May 15, 2023).
- New regulations expected soon. And then back to court?

Additional Resources

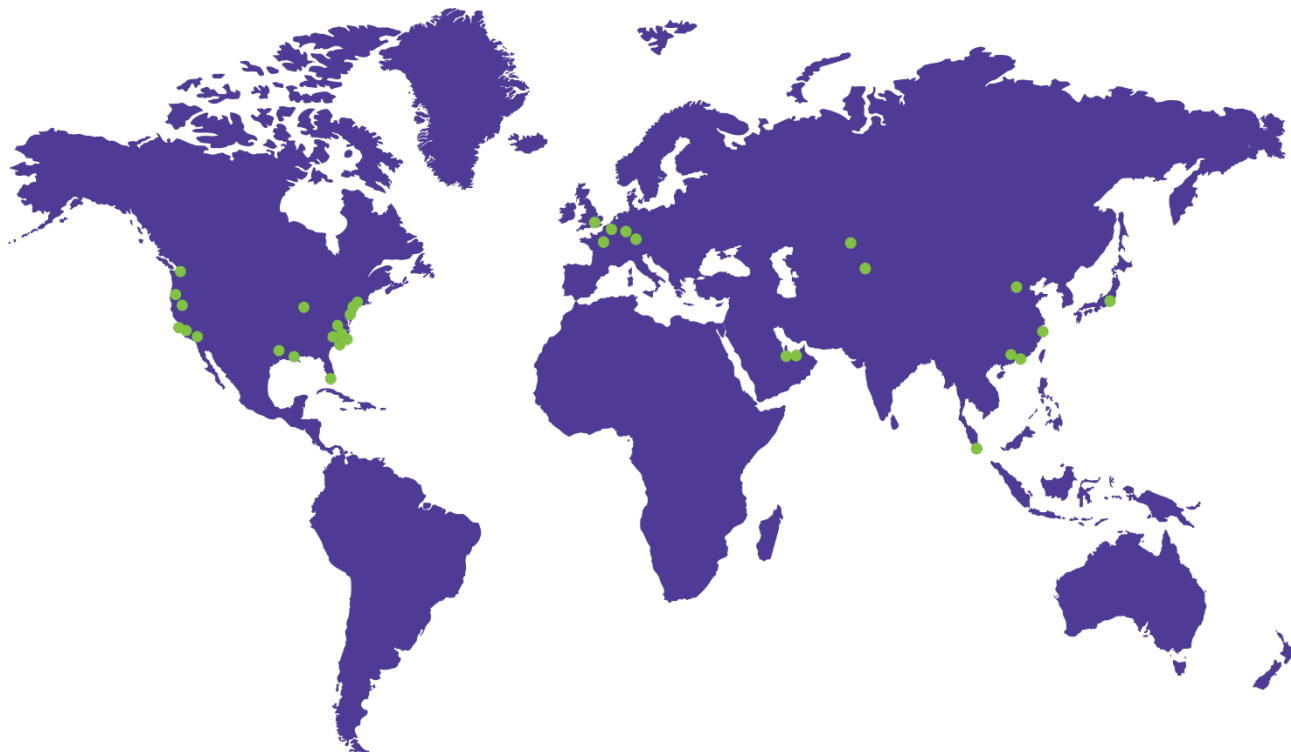
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