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Assessing D&O Coverage Amid Challenges To DEI Policies

By **Peter Gillon and Patrick Blood** (October 13, 2023, 11:22 AM EDT)

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In recent years, corporate directors and executives have faced challenges from conservative groups opposed to corporate diversity, equity and inclusion initiatives, with some efforts taking the form of shareholder litigation.

The U.S. Supreme Court's recent decision **overturning** the use of affirmative action in university admissions provides new ammunition for these claims and is likely to embolden potential claimants.[1]

This DEI backlash comes on the heels of a period characterized by shareholder litigation and legislative and regulatory measures that sought to compel robust initiatives. Companies now face the tension of liability exposure from both sides of the debate.

To protect against these risks while working to promote inclusivity and fairness in the workplace, companies must continue to monitor legal developments and carefully bolster their DEI policies.

In this way, companies can maximize the benefits of a diverse workforce, ensure compliance with shifting law and confirm that both their directors and officers and employment practices' liability insurance policies provide sufficient coverage for potential claims.

Incendiary Challenges to DEI

It is a striking feature of our current domestic political climate that well-intended efforts to address the threat of global warming, to protect freedom of religion, or to protect minority groups against discrimination in the workplace have been attacked as so-called woke policies and turned into political wedge or culture war issues to divide the public, raise funds for candidates and in some cases incite violence.

Anti-DEI rhetoric and legislative priorities have become a central plank in the platforms of many conservative politicians. For example, Florida Gov. Ron DeSantis' Individual Freedom Act, or H.B. 7 — otherwise known as the Stop WOKE Act — inter alia, bans private employers from requiring diversity training on race-related topics.[2]

Similar efforts are playing out across the country with at least a dozen states proposing legislation to ban diversity initiatives in higher education.[3]

Anti-DEI Litigation

Not surprisingly, the proponents of these efforts have turned to the courts. Beginning in 2022, a handful of conservative public interest law firms and activist groups directed their efforts toward soliciting plaintiffs, providing funding and filing lawsuits to challenge corporate DEI initiatives.

Litigation may come in the form of securities litigation, shareholder derivative actions, and employee or contractor actions under anti-discrimination civil rights laws. The following examples illustrate these claims.

Starbucks

The National Center for Public Policy Research, the conservative think tank behind a series of shareholder anti-DEI initiatives, filed a derivative suit against Starbucks in 2022, alleging that employment policies designed to increase workforce diversity discriminate based on race in violation of federal and state civil rights law.[4]

The complaint further alleged that officers and directors breached fiduciary duties to shareholders and Starbucks by adopting illegal policies.[5]

Kellogg's

On Aug. 7, America First Legal, the conservative organization led by former Trump speechwriter and senior policy adviser Stephen Miller, submitted an investigation request with the U.S. Equal Employment Opportunity Commission seeking an EEOC charge and alleging that Kellogg's DEI initiatives, such as goals to achieve 25% diverse management and a "fellowship for Black chefs to work with [its] Research and Development (R&D) team to help them better understand food's role in Black communities," constituted unlawful, discriminatory hiring, training and promotional practices.[6]

Comcast

In Moses v. Comcast Cable Communications Management LLC, the Wisconsin Institute for Law & Liberty filed suit in 2022 on behalf of small business owners, alleging that a Comcast program offering grants and marketing advice to minority-owned small businesses violates federal and state civil rights laws.[7]

Perkins Coie and Morrison Foerster

On Aug. 22, the American Alliance for Equal Rights, an organization led by the strategist behind the lawsuit resulting in the end of affirmative action, **filed lawsuits** against Perkins Coie LLP and Morrison Foerster LLP alleging the firms' diversity fellowships — open only to racial minority, disabled or LGBTQ candidates — harmed nondiverse Alliance members who wish to apply for the fellowship and violate Section 1981 of the Civil Rights Act.[8] Both lawsuits were recently **dropped** after the firms **revised** the programs' requirements.

Affirmative Action and Letters From Attorneys General

On June 29 the Supreme Court, in SFFA v. Harvard,[9] overturned decades of precedent and held that consideration of race as a factor in college admissions violated the Equal Protection Clause and Title VI of the Civil Rights Act.

Following the decision, attorneys general from 13 states sent Fortune 100 CEOs a letter warning of "serious legal consequences" for companies that use "racial quotas and preferences in hiring, recruiting, retention, promotion, and advancement," or "contracting practices, such as racial preferences and quotas in selecting suppliers, providing overt preferential treatment for customers on the basis of race and pressuring contractors to adopt" the policies.[10]

Although the Supreme Court's ruling does not directly implicate DEI policies in private employment, the attorneys general claim that the "principles apply equally to Title VII" — which bars discrimination in private employment — and other federal and state laws.[11]

That same week, 21 other attorneys general sent a rebuttal letter to Fortune 100 CEOs urging businesses to "double-down on diversity-focused programs" and that "corporate efforts to recruit diverse workforces and create inclusive work environments [remain] legal and reduce corporate risk for claims of discrimination."[12]

At the same time, the letter clarifies that only "[p]roperly formulated and administered programs are not unconstitutional" and that "[n]o organization should hire an employee solely based on the individual's race."[13] To that end, the letter suggests "race-neutral" DEI policies that benefit

minority workers are not "improper 'racial quotas.'"[14] Needless to say, the dueling letters divided along partisan lines.

Many institutions that already have adopted DEI policies that may be described as race-based, and thus potentially contrary to SFFA v. Harvard, are facing a dilemma as to whether and how they can modify those policies without instigating complaints from employees and shareholders.

Minimizing Risk and D&O Coverage for DEI Claims

DEI policy has become a hot-button issue, with actors on both sides of the debate pushing conflicting commercial and legal demands on businesses. Officers and directors seeking to craft effective and legal DEI policies must perform a balancing act to minimize risk.

They must reconcile the objectives of:

- Recruiting and retaining talent among millennial employees who strongly favor workplaces with DEI initiatives;
- Satisfying new DEI disclosure requirements imposed by regulatory agencies and stock exchanges;
- Balancing the economic costs of conscious consumerism from investors and customers arising on both sides of the debate;
- Minimizing the risk of discrimination claims from both minority and non-minority groups; and
- Ensuring compliance with conflicting state laws.

The fluctuating law, increased scrutiny and burgeoning litigation on both sides of the debate raise interesting issues as to what risk transfer mechanisms may mitigate this exposure.

What Coverage Applies

For actions like the recent anti-DEI suits against Amazon and Starbucks, which broadly assert that corporate DEI policies discriminate against certain employee classes and that the respective executives and boards violated their fiduciary duties in enacting such programs, the claims may trigger EPLI and D&O policies simultaneously.

While more coverage may seem like a good thing, in practice, this typically leads to disputes over which policies should respond to the claim as primary insurance. We recommend reviewing EPLI to ensure they incorporate broad definitions of "employment practices wrongful acts" that include allegations of systemic employment discrimination in hiring and/or performance evaluation. And attention should be given to the investigative coverage to ensure that it includes administrative proceedings before the EEOC, where some of these claims are being lodged.

At the same time, the breach of fiduciary duty claims, filed nominally on behalf of the company against the company's directors, alleging harm to shareholders as a result of DEI policies, may be covered by D&O policies as well. Derivative claims are generally covered under D&O policies, although policies should be reviewed to ensure that the Insured v. Insured Exclusion incorporates the now-standard carveback for derivative actions.

A review of self-insured retention provisions and "other insurance" clauses is also appropriate in this context.

Adequacy of Available Defense Coverage

Businesses facing these anti-DEI claims will likely incur substantial defense expenses, regardless of the claims' merits. The expenses may commence at the threat of litigation or when a complaint is lodged with the Equal Employment Opportunity Commission or the company's board, underscoring

the importance of securing preclaim investigative coverage without sublimits.

Companies facing these claims may also be subjected to coordinated congressional investigation, state and federal legislative efforts, and public boycotts and the like. An effective defense will either include or at least be coordinated with the target company's political strategy and other countermeasures. We recommend shoring up defense coverage to, at a minimum, provide the opportunity to include such related defense efforts.

Conduct Exclusions

D&O policies often exclude coverage for fraudulent or criminal acts or omissions. Recent anti-DEI claims allege that DEI policies constitute illegal race-based discrimination in violation of federal employment law.

Again, while the merits of these claims may be questionable, there may be courts that give credence to them, and thus, attention to conduct exclusions is appropriate. Although beyond the scope of this piece, it is critical to ensure that D&O policies include final-adjudication language in the conduct exclusions to ensure coverage at least until a final adjudication of criminal or fraudulent conduct by the accused insured.

Underwriter Scrutiny

An unfortunate result of the uptick in anti-DEI litigation is the potential that insurance underwriters may question policyholders about their DEI policies and assess companies with robust DEI programs as a greater risk. We have not seen evidence of such a pendulum swing, but that is a possibility that risk managers should be watching for.

Ultimately, these are issues appropriate for the business judgment of boards of directors and should not be considered a legitimate basis for underwriting distinctions.

Additional Coverage

The litigious atmosphere around DEI may warrant additional coverage, such as Side D coverage for internal investigations that may arise in connection with EEOC actions or lawsuits over hiring practices. Internal investigations are costly and may easily consume limits.

With corporations and other institutions seeking to implement DEI policies caught in the crossfire of U.S. culture wars, legal and human resource departments and risk managers must be proactive in addressing the challenges and exposures they face.

Best practices for mitigating the risks of these countervailing demands are still being worked out. But risk-transfer mechanisms do exist in the form of D&O and EPLI insurance.

We strongly advise reviewing these insurance policies to ensure that maximum coverage is available for defense costs and other potential exposures.

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[1] Laura C. Hurtado, Jeffrey P. Metzler, Jacob R. Sorensen & Nan McGarry, Supreme Court Strikes Down Race-Conscious Admissions at Harvard and UNC, Pillsbury Law (June 30, 2023), https://www.pillsburylaw.com/en/ news-and-insights/scotus-race-conscious-admission-harvard-unc.html. See also Jeffrey P. Metzler, Julia E. Judish, Jean F. Kuei & Laura G. Killalea, Biden

Administration Issues Guidance to Universities on Implementing Supreme Court Affirmative Action Ruling, Pillsbury Law (Aug. 8, 2023), https://www.pillsburylaw.com/en/news-and-insights/sffa-scotus-guidance.html.

[2] Honeyfund.com v. DeSantis , 4:22cv227-MW/MAF, (N.D. Fla. Aug. 18, 2022).

[3] See generally David A. Lieb, GOP states targeting diversity, equity efforts in higher ed, AP (Apr. 17, 2023), https://apnews.com/article/diversity-equity-inclusion-legislation-7bd8d4d52aaaa9902dde59a257874686.

[4] Nat'l Ctr. for Pub. Policy Research v. Schultz, 22-2-02945-32, (Spokane Cnty. Sup. Ct. Wash. Aug. 30, 2022). Dismissed Aug. 11, 2023.

[5] Id.

[6] America First Kellogg Investigation Request to the U.S. Equal Employment Opportunity Commission, America First Legal (Aug. 9, 2023).

[7] Moses v. Comcast Cable Commc'ns Mgmt. , 1:22-cv-00665-JPH-MJD, (S.D. Ind. Jun. 7, 2022).

[8] American Alliance for Equal Rights v. Perkins Coie LLP, No. 3:23-cv-01877-L (N.D. Tex. Aug. 22, 2023); American Alliance for Equal Rights v. Morrison & Foerster LLP, No. 1:23-cv-23189 (S.D. Fla. Aug. 22, 2023).

[9] Students for Fair Admissions v. President & Fellows of Harvard College , No. 20-1199, 600 U.S. -- (2023).

[10] SFFA Letter to Fortune 100 CEOs, Off. Attorney Gen. & Reporter of Tennessee(July 13, 2023).

[11] Id. at 5.

[12] July 19, 2023 Attorney Generals' Letter to Fortune 100 CEOs, Off. Illinois Attorney Gen. (July 19, 2023).

[13] Id. at 4 (emphasis added).

[14] Id. at 5.