



DISAGREEMENT ON U.S. DEI LEGISLATION AND INITIATIVES CREATES UNCERTAINTY FOR COMPANIES

Companies are faced with increasing challenges from internal and external forces, meaning that policies and initiatives related to diversity, equity, and inclusion ("DEI") must be carefully thought out and more likely than not, a "one size fits all approach" will not work given the lack of consistency and every-changing requirements.

The consideration of environmental, social, and governance ("ESG") factors in the context of corporate America has been a focus of states, federal agencies, and companies in the last few years. Facing pressure from a myriad of sources, including voters, investors, and various other stakeholders, these entities have proposed and adopted various policies and laws meant to increase and encourage DEI within the workplace, such as diversifying board compositions and leadership positions and encouraging companies to disclose DEI related statistics.

Such efforts, however, have not been without challenge. In the past year, a number of states enacted what can be characterized as "anti-ESG" legislation. While much attention has been focused on legislation relating to climate change, a significant number of these measures also target DEI by restricting the use of ESG factors in investments. For example, in January 2023, Mississippi proposed [House Bill 818](#) which clearly prohibits a Mississippi retirement investment board from making "an investment decision with the primary purpose of influencing any social or environmental policy or attempting to influence the governance of any corporation." Predictably, parties from both sides have taken the battle to courts, and courts have struck down or enjoined

laws meant to improve DEI as well as laws aimed at curtailing discussion about DEI within the workplace.

This varying legislation and subsequent decisions by the courts have resulted in an obvious lack of uniformity and clarity on this issue. In turn, the ensuing uncertainty may have significant ramifications for companies as they seek to follow these ever-changing requirements.

GROWING DISAGREEMENT OVER DEI

Despite a growing push to increase DEI policies, it appears that states, companies, and agencies are taking conflicting approaches within the DEI space.

California

In 2018 and 2020, California adopted two laws aimed at improving diversity on corporations' boards:

- Senate Bill 826: Mandated that every publicly held corporation, with headquarters in California, must have one or more female directors on their board, based on its size.
- Assembly Bill 979: Required that the boards of corporations, based in California, meet particular quotas regarding racial, ethnic, sexual preference and transgender status.

Both laws were challenged in California state courts for violating California's Equal Protection Clause, as the plaintiffs asserted that the gender and diversity mandates were unconstitutional. California Superior Courts struck down both laws and most recently, in December 2022, the California Court of Appeals *upheld* the termination of both laws.

Florida

The Florida state legislature affirmatively pushed back on DEI when it adopted the "[Stop Wrongs Against Our Kids and Employees Act](#)" ("Stop W.O.K.E. Act") in April of 2022. The Stop W.O.K.E. Act restricts the content that teachers, public employers, and private employers may address in classrooms and workplace trainings on issues such as race and gender. Under the Act, it is also considered an "unlawful employment practice" to discriminate against an individual based on their race, gender, color, or national origin "to achieve diversity, equity, or inclusion."

Actions were brought by employers, students, and academics, challenging the Act for violating the First Amendment and the Equal Protection Clause of the Fourteenth Amendment. A federal court in the Northern District of Florida granted a preliminary injunction in favor of the employers in August 2022, and in favor of the students and academics in November 2022, finding that the Act enforced viewpoint discrimination targeting speech.

The State of Florida appealed the preliminary injunctions to the U.S. Court of Appeals for the Eleventh Circuit, but until there is a new ruling, the injunction will remain.

Anti-ESG Bills

Including Florida, many states have taken measures to specifically restrict or prohibit the consideration of ESG factors when making investments. As of January 2023, 21 states have either adopted and enacted anti-ESG investing laws and regulations, or they have proposed such laws to their state legislatures. These laws either explicitly or implicitly focus on DEI policies. For example, the proposed Arkansas bill specifically references DEI in its proposed anti-ESG bill, [House Bill 1049](#). It provides that "[a] financial institution shall not utilize standards or guidelines based on nonfinancial, nontraditional, and subjective measures, including without limitation environmental, social, and governance criteria; diversity, equity, and inclusive policies; or political and ideological factors." Similarly, the state of Arizona's [investment policy](#) prohibits the consideration of non-pecuniary factors when evaluating investments, including factors that intend to further "[c]orporate governance structures based on social characteristics."

Challenges to Federal Agencies

State legislatures are not the only entities embroiled in this conflict. At the end of 2022, the Department of Labor ("DOL") finalized a rule ("Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights") allowing ERISA fiduciaries to consider ESG factors and concerns, which could include DEI factors. The DOL, however, maintained that ERISA fiduciaries may not consider such factors at the cost of investment returns or assume greater risk in doing so.

In response, 25 states (in addition to other parties) filed a [complaint](#) against the DOL in Texas federal court on January 26, 2023. They argued that the new rule "undermines key protections for retirement savings of 152 million workers . . . in the name of promoting environmental, social, and governance ("ESG") factors in investing." These states additionally wrote that the rule "oversteps" the DOL's authority under ERISA and is both "arbitrary and capricious." As a remedy, the states asked for a preliminary injunction and for the court to rule in their favor, enjoining the enforcement of this particular rule by the DOL. While a ruling does not seem imminent, the fact that 25 states signed on to this lawsuit is significant and demonstrates a definitive split amongst states as to the prevalence and involvement of ESG factors in investing.

Commissioner Mark Uyeda of the U.S. Securities and Exchange Commission ("SEC") expressed a similar sentiment in a speech on January 27, 2023. Entitled "ESG: Everything Everywhere All at Once," the Commissioner's speech conveyed a concern with the new rule, going as far as to call it unlawful under Supreme Court precedent and stating that the DOL was "speaking with a forked tongue" which "ought to be the hallmark of acting in an arbitrary and capricious manner." Commissioner Uyeda's criticism has not been reserved solely for the DOL – he also has questioned climate-related proposals the SEC has been considering and noted in his speech that there is simply still too much variation in terms of how stakeholders think about ESG to enforce standardized measures or ratings regarding this issue.

KEY TAKEAWAYS

It seems that the only consistency regarding the role of ESG in corporate America is the *inconsistency* in views and lack of consensus surrounding this issue. Legislation aimed at ameliorating these disparities, as well as legislation

attempting to curtail the proliferation of diversity initiatives, have faced equal challenges within the courts.

Given this, and the possibility of further disagreement as states continue the politicization of ESG, companies should ensure they are actively monitoring this area of legislation and litigation on a routine basis so as to stay apprised of any changes. Further, companies that operate on a global scale are even more challenged as rules in jurisdictions outside of the US favor or require DEI goals and reporting, which may create a potential conflict. Therefore, while there is pressure by shareholders, government entities, and various other stakeholders regarding this issue, companies need to be cognizant of the risks they may face when implementing various policies and initiatives and act with such risks in mind. Ultimately, a "one size fits all" approach, given the lack of consistency across jurisdictions, will not provide a solution for companies here.

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