Shareholder cases challenging DEI programs could get boost from Trump's executive order

By **Jenna Greene**

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Commentary On the Case by Jenna Greene

An empty conference room is seen as the first phase of FMC Corporation employees return to work in the office in Philadelphia, Pennsylvania, U.S., June 14, 2021. REUTERS/Hannah Beier Purchase Licensing Rights

Jan 23 (Reuters) - For U.S. publicly traded companies weighing the future of their diversity, equity and inclusion programs in the wake of President Donald Trump's executive order gutting affirmative action measures, the risks go beyond getting hit with a federal probe.

Also a threat are shareholder actions, which lawyers tell me are likely to be bolstered by the order. The White House decree issued on Tuesday includes a provision instructing federal agencies to identify up to nine private-sector targets for civil compliance investigations.

"Clearly, the (litigation) risk has increased with the explicit directive," said David Glasgow, executive director of the Meltzer Center for Diversity, Inclusion, and Belonging at New York University School of Law.

And that's not because the initiatives are necessarily illegal. The U.S. Supreme Court in Students for Fair Admissions v. Harvard in 2023 nixed race-conscious college admissions policies, but it's less clear how the decision applies in the employment context.

While Glasgow said programs such as an internship limited to members of a specific demographic group are likely to be problematic, other corporate DEI initiatives focused on fairness, inclusion and culture should be on solid ground.

Still, given the new executive order, some shareholders may argue that keeping any DEI programs exposes a company to needless litigation, reputational and financial risks – and therefore financial risks to investors.

Is it safer just to scrap everything?

Companies that support DEI, viewing it as good for their business and their bottom line, are "between a rock and a hard place," Orrick, Herrington & Sutcliffe employment law partner Mike Delikat told me.

"They're asking 'What do we do?'" Delikat said. "They believe in and want to continue (their programs), but on the other hand, they don't want to get sued by conservative shareholders and now the government."

Already, Target Corp is battling a shareholder lawsuit for allegedly misleading investors about the market risks of its DEI initiatives. Filed by the conservative advocacy group America First Legal and law firms Boyden Gray and Lawson Huck Gonzalez, the lawsuit survived a motion to dismiss in December.

Shareholder Brian Craig claims the retailer's board overlooked potential negative responses to its LGBTQ "Pride" sales and marketing campaign in May 2023, resulting in a customer backlash that allegedly triggered a stock drop.

U.S. District Judge John Badalamenti in Fort Myers, Florida, ruled that the plaintiffs had presented enough information for now to pursue claims that Target violated various securities laws by making materially false and misleading disclosures about efforts to guard against social and political risks.

Target and its outside counsel from Kirkland & Ellis did not respond to requests for comment.

Boyden Gray managing partner Jonathan Berry sees the lawsuit as the tip of the iceberg.

Trump's executive order "raises the risk that companies will face enforcement actions or sanctions for their unlawful DEI programs, and thus raises the risk they will face more shareholder actions too," he said via email.

Other companies are currently facing shareholder proposals targeting their DEI programs.

Costco shareholders at the company's annual meeting on Thursday overwhelmingly sided with the company's pro-DEI board, voting to reject a proposal by the National Center for Public Policy Research. The proposal called for the retail giant to evaluate the risks of its current DEI program and publish a report.

The conservative think tank said Costco's "People and Communities" program "still openly expresses a 'commitment to equity' (which means equality of outcome, not opportunity)," has a supplier diversity program that picks suppliers based on their race and sex and appears to factor race and sex in promotions.

The programs potentially expose Costco to discrimination claims by white, Asian, male or straight employees, the proposal said.

Costco board members in opposing the proposal argued in a proxy statement that the company's "commitment to an enterprise rooted in respect and inclusion is appropriate and necessary."

The company also said it regularly reviews its DEI policies and all "are legally appropriate." The National Center's "broader agenda is not reducing risk for the Company but abolition of diversity initiatives," Costco said.

Costco did not respond to a request for comment.

The National Center for Public Policy Research said a spokesperson was not immediately available for comment.

An earlier DEI lawsuit by the center also fell flat when a federal judge in Spokane, Washington, in 2023 tossed its complaint against Starbucks.

The National Center sued over the coffee chain's alleged DEI initiatives including hiring goals for Black and other people of color, awarding contracts to "diverse" suppliers and advertisers and tying executive pay to diversity.

In dismissing the case with prejudice, Chief U.S. District Judge Stanley Bastian, who was appointed to the bench by President Barack Obama, wrote that the complaint "resembles nothing more than a political platform."

Whether other courts are apt to share his view in the wake of Trump's executive order remains to be seen.

Technically, the order "only seeks to 'encourage' the private sector to end DEI programs," noted Lucian Bebchuk, director of Harvard Law School's Program on Corporate Governance, via email.

It does not order them to do so.

Still, he said, the order will affect the "atmospherics and the environment" DEI programs find themselves in and will contribute to the "backlash" against them.

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