Wolters Kluwer

Vital Briefing

Managing the risk of anti-DEI investor litigation

By *Lene Powell, J.D.*

Corporate policies to promote diversity, equity, and inclusion (DEI) are widespread in the U.S. However, with DEI a lightning rod in a politically polarized nation, diversity initiatives have come under attack.

Key takeaways:

- Conservative groups have brought investor lawsuits challenging DEI initiatives at Disney, Starbucks and Target.
- The lawsuits take place against a broad background of DEI-related conservative actions, including a warning by 13 attorneys general, a shareholder proposal at Apple, and Florida's "Stop WOKE" Act.
- The lawsuits include both shareholder derivative and securities fraud actions.
- While the Disney and Starbucks lawsuits were dismissed, there may be more anti-DEI litigation to come.
- Examining these lawsuits can guide companies in responding to DEI-related litigation risks.

Disney: shareholder derivative

A Disney stockholder was solicited by counsel to serve a demand for inspection of books and records on Disney in the Delaware Court of Chancery.

- Disney publicly opposed Florida House Bill 1557, the "Parental Rights in Education Act" (known to critics as "Don't Say Gay") restricting instruction on sexual orientation or gender identity in Florida classrooms.
- The board held a special meeting to discuss Disney's approach to the legislation and the employees' negative response, then issued a public rebuke.
- The demand alleged that Disney officers and directors breached fiduciary duties by putting their own beliefs ahead of obligations to stockholders and flouting the risk of losing rights associated with a special tax district.

The court ruled for Disney, finding that the company's public rebuke of HB 1557 was a business decision the board was empowered to make. The court ruled:

- The shareholder's disagreement with Disney's position on HB 1557 was not evidence of wrongdoing.
- There was no evidence that the directors suffered from disabling conflicts, were grossly negligent, or acted in bad faith.
- The plaintiff had not demonstrated a proper purpose to inspect books and records.
- Such an inspection would not be reasonably related to the plaintiff's interests as a Disney stockholder and would intrude upon the "rights of directors to manage the business of the corporation without undue interference."

The inspection request was denied.

Starbucks: shareholder derivative

Following an open demand letter in March 2022, the American Civil Rights Project (ACRP) filed a complaint on behalf of the National Center for Public Policy Research (NCPPR), a conservative advocacy group and shareholder of Starbucks Corp.

- The complaint alleged that Starbucks officers and directors breached their fiduciary duties to shareholders by adopting DEI policies that were illegally discriminatory.
- The policies related to increasing employee DEI, including goals of achieving representation of Black, Indigenous, and people of color (BIPOC) of at least 30 percent at all corporate levels and at least 40 percent at all retail and manufacturing roles by 2025.
- The complaint argued that the DEI initiatives violated state and federal

©2023 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from CCH Incorporated.

The court considered the following factors in determining plaintiff interest:

(1) any indications that plaintiff is not the true party in interest;

(2) plaintiff's unfamiliarity with the litigation and unwillingness to learn about the suit;

(3) degree of control exercised by the attorneys over the litigation;

(4) degree of support received by plaintiff from other shareholders;

(5) lack of any personal commitment to the action on the part of the representative plaintiff;

(6) remedy sought by plaintiff in the derivative action;

(7) relative magnitude of plaintiff's personal interests compared to [their] interest in the derivative action itself; and

(8) plaintiff's vindictiveness towards defendants.

non-discrimination laws, creating risks that were "tangible and materially threaten the value of Starbucks and its shareholders' interests in Starbucks."
- The complaint sought declaratory and injunctive relief.

The court dismissed the complaint in September 2023.

Shareholder interests. Applying a multi-factor test, the court found that NCPPR did not fairly represent the interests of Starbucks or its shareholders.

The court concluded:

- NCPPR received little support from other shareholders. NCPPR owned just 56 shares of Starbucks stock, worth approximately $6,000 of a company with a market capitalization of more than $121 billion. NCPPR shareholder proposals had previously been rejected with only one to three percent of votes in favor.
- NCPPR sought to advance its own self-described political interests, not the interests of the Starbucks board, management and the vast majority of other shareholders. According to the court, NCPPR has "a clear goal of dismantling what it sees as destructive DEI and ESG initiatives in corporate America."
- For example, an NCPPR nationwide campaign inveighed against the "evils of woke politicized capital and companies" and "woke" CEOs who were "shameless monsters who are willing to sacrifice our future for their comforts." An NCPPR investor voting guide stated that "[s]aving capitalism also means ending the hard-left politicization of American corporations by the eruption of so called 'ESG' initiatives."
- NCPPR showed vindictiveness towards the defendants, urging shareholders to vote against every Starbucks board member up for reelection.

Business judgment protection. The court also found that NCPPR failed to overcome the business judgment presumption that the Starbucks board acted on an informed basis, in good faith, and in the honest belief that rejecting the demand was in the best interest of Starbucks.

- The complaint failed to allege that the Starbucks board's refusal of the demand was wrongful; that the investigation was unreasonable, not undertaken in good faith, or not sufficiently informed, or that the board's process was in any way inadequate.
- The board engaged outside counsel, management, and relevant subject matter experts to assist it in evaluating the demand's contentions.

The complaint was dismissed with prejudice.

Target: securities fraud

Retail giant Target faced customer backlash and boycotts in May 2023 relating to LBGTQ Pride-themed merchandise. Target announced it pulled some merchandise due to "volatile circumstances" including "threats impacting our team members' sense of safety and well-being."

America First Legal, a group founded to "oppose the radical left," filed a securities fraud complaint on behalf of Target investor Brian Craig, alleging the company had misled investors. The complaint contends that Target issued proxy statements stating, among other things, that the board was monitoring for social and political risks relating to Target's ESG and DEI mandates.

©2023 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from CCH Incorporated.

The complaint:

- Alleges the board monitored only the backlash risk of doing *too little* on ESG and DEI, not *too much*—even though Target knew its ESG and DEI mandates were a “double-edged sword” that risked backlash from the opposite side as well;
- Lists other DEI-related actions by Target unrelated to the Pride campaign, including an “expressly race-based hiring plan” pledging to increase representation of Black team members across the company by 20 percent over three years;
- Alleges investors were damaged when Target suffered billions of dollars in losses due to boycotts relating to the LBGTQ Pride marketing campaign;
- Asserts claims under Sections 10(b) and 14(a) of the Exchange Act and related rules;
- Seeks damages, declaratory relief, and a declaration that Target’s 2023 director election was void.

The litigation is ongoing.

Conclusion — managing anti-DEI investor litigation

Investor litigation targeting corporate DEI activities is unlikely to subside, given the varied sources of risk that may give rise to investor claims.

A wide variety of triggers can form the basis of anti-DEI investor claims, including discrimination claims by employees and contractors, customer boycotts, and government enforcement actions.

Yet as the litigation discussed here shows, protections may be available.

- The business judgment rule can raise a presumption that officers and directors acted in the best interest of the company.
- However, the business judgment presumption may face jeopardy if officers and directors fail to follow adequate processes or investigate potential issues, or engage in self-dealing or fraud.
- Another possible defense is that the plaintiff shareholder does not fairly represent other shareholders or the best interest of the company.
- Lack of fair representation may potentially be shown by small proportion of ownership, unpopular shareholder proposals, incendiary political rhetoric, and vindictive demands.
- Statements that are general and aspirational in nature are frequently found to lack falsity.

In reviewing DEI policies and disclosures, companies may want to especially consider the following:

- Letter from 13 attorneys general from predominantly GOP-led states to Fortune 100 CEOs;
- Letter from 21 attorneys general from primarily Democrat-led states responding to the above.

In this emerging area of risk, companies should proceed with caution and consider consulting outside counsel.

©2023 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from CCH Incorporated.