ROPES & GRAY

ALERT

July 6, 2023

Supreme Court Rules against University Affirmative Action Policies: Implications for ESG Investing and Engagement

Attorneys
Megan Bisk
Douglas Brayley
Douglas Hallward-Driemeier
Michael R. Littenberg
Amy D. Roy
Robert A. Skinner

On June 29, the U.S. Supreme Court ruled in *Students for Fair Admissions, Inc. v. President and Fellows of Harvard College* that Harvard University's and the University of North Carolina's admissions programs violate the Equal Protection Clause of the Fourteenth Amendment. The 6-3 majority opinion held the race-conscious admissions programs at Harvard and UNC to be unconstitutional. Although the decision applies directly only to educational institutions, it may have significant collateral impact on ESG investing and engagement in both the public and private markets. In this Alert, we provide a summary of the decision as well as a discussion of potential implications for ESG investing practices.

Background

In *SFFA v. Harvard*, Students for Fair Admissions, a nonprofit advocacy organization, sued Harvard University, alleging that Harvard illegally discriminated against Asian American applicants on the basis of race. A similar action was filed against UNC. Both trial courts ruled in favor of the universities. The Supreme Court's June 29 opinion, authored by Chief Justice Roberts and joined by Justices Thomas, Alito, Gorsuch, Kavanaugh, and Barrett, reversed and concluded in favor of the challengers. Applying constitutional strict scrutiny, the Court examined (1) whether the universities' use of race as a factor in admissions furthered compelling governmental interests, and (2) whether the use of race was narrowly tailored to achieve those interests.

The Opinion and Dissents of the Court

The Court's stated guiding principle was that "[e]liminating racial discrimination means eliminating all of it" (a contention the dissent scrutinized). Ultimately, it found that, while Harvard and UNC had articulated "commendable goals" such as promoting a robust marketplace of ideas, those goals were "not sufficiently coherent for purposes of strict scrutiny." Furthermore, the Court held that the means applied to achieve the stated interests were not narrowly tailored to achieve the interests; assigning students to racial categories and making admissions decisions based on them was held to be both imprecise and overbroad. Writing for the majority, Justice Roberts stated that:

> [W]e have permitted race-based admissions only within the confines of narrow restrictions. University programs must comply with strict scrutiny, they may never use race as a stereotype or negative, and – at some point – they must end. Respondents' admissions systems – however well intentioned and implemented in good faith – fail each of these criteria. They must therefore be invalidated under the Equal Protection Clause of the Fourteenth Amendment.

The majority opinion did not engage in any interpretation of Title VI of the Civil Rights Act of 1964 (which governs educational institutions receiving federal funding), the law under which Harvard was sued. This is because, the Court said, past cases held that any conduct that violates the Equal Protection Clause of the Fourteenth Amendment also violates Title VI, and "no party asks us to reconsider" that precedent.

In a concurring opinion, Justice Gorsuch, joined only by Justice Thomas, analyzed Title VI as distinct from the Equal Protection Clause, concluding as a matter of statutory interpretation that the universities' admissions policies violated Title VI. He went on to compare Title VI to Title VII of the Civil Rights Act, which prohibits discrimination by private employers, writing: "If this exposition of Title VI sounds familiar, it should. Just next door, in Title VII, Congress made

it 'unlawful…for an employer…to discriminate against any individual…because of such individual's race, color, religion, sex, or national origin.'" Notably, however, the majority opinion made no reference to Title VII.

Justice Sotomayor filed the chief dissenting opinion, which was joined by Justices Kagan and Jackson. The dissent wrote that American society is not in fact colorblind and that the principle of considering race in university admissions decisions had for decades empowered schools to promote diversity and in turn create more equal opportunities for students of diverse races.

Going Forward

While momentous for colleges and universities, the Court's holding does not, on its face, apply beyond that context. The Court's holding is limited to colleges and universities, and in fact the Court signaled that different considerations may apply – and a different result could be obtained – in other contexts, such as military academies. The holding does not directly implicate corporate hiring programs or private employers' diversity efforts, which are subject to Title VII of the Civil Rights Act of 1964, not the Equal Protection Clause of the Fourteenth Amendment. Indeed, the majority opinion did not take this opportunity to denounce "diversity" as a compelling interest generally, as some had predicted it might. The holding also does not address the role of diversity in ESG integration by investment managers.

Furthermore, the Court's opinion expressly allows the universities to continue to consider race in admissions decisions, albeit in a narrower and more tailored way. First, the Court agreed that, while the educational interests articulated by Harvard and UNC were not narrowly tailored enough (at least as stated), they were still "commendable." Second, the Court made clear that universities may consider how race might have affected an individual applicant's qualifications for admission, so long as this consideration is specific to the applicant and not based on broad racial categories or stereotypes – for example, a university may consider an applicant's demonstrated courage in overcoming racial discrimination.

Implications for ESG Investing and Engagement

Although the ink on the decision is barely dry, it already has generated keen interest from both asset managers and operating companies. Although still evolving, likely implications for ESG investing and engagement include the following:

- While this case does not directly impact private employer hiring policies, we anticipate that opponents of corporate diversity initiatives will try to extend the case's reasoning to the Title VII context and will continue to challenge perceived "reverse" discrimination. We do not interpret the Supreme Court's decision to require any lessening of employers' open commitment to the value of diversity in their workforces, although the reach of the holding may be developed further in future litigation – which will bear close attention.

- Similarly, we anticipate that critics of ESG investing practices will seize upon the ruling as support for their arguments that consideration of corporate diversity in securities selection and proxy voting is illegal under certain state laws and in breach of an asset manager's fiduciary duties. Ongoing inquiries by red state attorneys general and financial officers, as well as congressional Republicans, base these theories on the premise that promoting diversity at portfolio companies only serves to further the asset manager's social agenda – at the expense of client portfolio returns. For a discussion of the arguments being made by Republican state attorneys general, see our recent podcast and transcript Treacherous Shoals—Navigating Growing Anti-ESG Sentiment: Recent Developments Impacting Asset Managers.

  We do not believe the Supreme Court's decision provides meaningful support for these theories. As noted, the majority opinion does not address the legality of diversity initiatives at private sector companies – whether in the workforce or the boardroom. And while the Court concluded that the universities' "commendable goals" in

pursuing increased campus diversity were not sufficiently coherent to withstand strict constitutional scrutiny, that conclusion does not undermine the common premise underlying ESG investing – that greater diversity at portfolio companies improves their financial performance.

- Republican state attorneys general have been using the specter of antitrust violations to blunt climate initiatives by asset managers that are Climate Action 100+ signatories and insurers that were part of the Net-Zero Insurance Alliance. The campaign against NZIA was particularly successful, recently resulting in a mass exodus from that initiative. Borrowing from the antitrust playbook, we would not be surprised in the near future to see additional open letters to asset managers and a new wave of state AG civil investigative demands focused on diversity. Some managers already have started to prepare for these.

- At the federal level, look for diversity to become a bigger focus of House hearings on ESG, possibly as soon as this month. Although not a principal focus, there was sparring over race and diversity at the last House hearing on ESG. For a discussion of the first two hearings, see our Alerts House Oversight Committee Holds Its First ESG Hearing – An Overview for Asset Managers and Observations from the Second House Oversight Committee Hearing on ESG.

  Hearings will renew in the House as soon as July 12, in what is being referred to by some as "ESG Month." There is speculation that House Republicans will seek to introduce additional anti-ESG legislation in July following the hearings. That legislation would, however, be a performative marker, since it has little chance of becoming law during this legislative session.

- Also expect more scrutiny of voluntary corporate programs focused on enhancing workplace diversity, equity and inclusion. To the extent the Supreme Court's analysis is extended to Title VII, programs will be scrutinized for whether race is being used as a specific consideration in employment decisions and, if so, whether such consideration is sufficiently tied to Title VII's purpose of remedying and eliminating employment discrimination. Programs that are expressed as specific numerical targets, which might be characterized as quotas, will be more susceptible to challenge than those that are designed to combat implicit bias in hiring and promotion or to ensure a diverse applicant pool. The anticipated scrutiny is likely to include both publicly traded and private equity-backed companies. For the former, this is likely to play out in the media and in anti-ESG shareholder proposals during next year's annual meeting cycle. In the private equity arena, managers should expect more scrutiny from pension funds and state officials in states that have anti-ESG statutes, in particular statutes that expressly seek to limit the consideration of diversity. For a state-by-state description of anti-ESG legislation, see our award-winning interactive website, Navigating State Regulation of ESG Investments, that tracks the latest ESG-related legislation, executive actions and initiatives, and coalition activities, as well as changes to state retirement plan investment policies across the United States.

- On the other side of the aisle, expect some pro-ESG investors – in particular investors with an express socially responsible investment mandate and faith-based investors – to be closely watching to make sure that public companies are not backing away from diversity commitments. This will likely in many cases result in a greater focus on diversity in one-on-one engagements and in shareholder proposals. These constituencies also will be focused on "greenhushing" by operating companies.

- In light of the increasing weaponization of diversity as part of the attack on ESG investing, it will be important for managers to ensure there is intentionality in their approach to diversity in their investment decisions and engagement. The focus on intentionality should be holistic, extending to policies, procedures, commitments, targets, public and private statements and disclosures and engagement with and expectations of investee companies. In particular, asset managers should continue to focus on clearly stating and memorializing the economic principles on which their diversity-related investing and engagement practices are based.

Please contact the authors or any member of Ropes & Gray's team for further guidance or advice.

About Our Practice

Ropes & Gray has a leading ESG, CSR and business and human rights compliance practice. We offer clients a comprehensive approach in these subject areas through a global team with members in the United States, Europe and Asia. In addition, senior members of the practice have advised on these matters for more than 30 years, enabling us to provide a long-term perspective that few firms can match.

For further information on the practice, click here.