RACIALLY DISCRIMINATORY CORPORATE POLICIES: WHO'S LIABLE?*

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Laws banning discrimination have been on the books across America for more than a century and a half. Their prohibitions are among the most morally grounded, widely known, and widely supported in our law.[1] Despite these facts, the last decade saw a cavalcade of corporations adopt policies that seemingly commit to violating these laws.[2] While academics have spilled much ink considering *whether* such policies violate these laws, remarkably little attention has focused on *whom* these laws make liable for corporate violations. That omission masks a surprisingly under-appreciated near-consensus that American law makes *individual decisionmakers* liable for programmatic discrimination by the enterprises through which those decisionmakers discriminate. Specifically, both America's longest-standing federal nondiscrimination law and the corporate laws of every state I've investigated assign such liability to the individual actors themselves—either making them directly liable to the victims of their discrimination in the first instance or

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* Note from the Editor: The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. To join the debate, please email us at info@fedsoc.org

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[1] *See, e.g.*, *2021 National Poll on Reimagining Rights and Responsibilities in the U.S.*, HARV. KENNEDY SCH. CARR CTR. FOR HUM. RTS. POL'Y (May 2021), https://www.hks.harvard.edu/centers/carr/programs/reimagining-rights-responsibilities/2021-poll; *Public Opinion on Civil Rights: Reflections on the Civil Rights Act of 1964*, ROPER CTR. FOR PUB. OP. RSCH. (Jul. 2, 2014), https://ropercenter.cornell.edu/public-opinion-civil-rights-reflections-civil-rights-act-1964.

[2] *See, e.g.*, Letter from Kris W. Kobach, et al., Attorneys General of 13 states, to Fortune 100 CEOs (Jul. 13, 2024), *available at* https://www.tn.gov/content/dam/tn/attorneygeneral/documents/pr/2023/pr23-27-letter.pdf (arguing that race-preferential policies in employment and contracting violate the law, particularly after the Supreme Court's decision in *Students for Fair Admissions v. President & Fellows of Harvard College*). While this article does not cover whether and how specific corporate policies violate these enactments, according to prosecutors, a wide array of common corporate policies likely do so.

holding them liable to shareholders for the corporate liabilities those individual actors create—and universal public policy concerns prohibit any institutional coverage of those personal liabilities.

Officers and directors of major enterprises should bear this consensus in mind when considering the adoption, implementation, or retention of discriminatory policies.

I. PERSONAL LIABILITY OF INVOLVED INDIVIDUALS FOR CORPORATE VIOLATIONS OF 42 U.S.C. § 1981

A. Enactment History and Original Public Meaning

42 U.S.C. § 1981 began life as Section 1 of the Civil Rights Act of 1866.[3] Congress subsequently wrote the Fourteenth Amendment to cut off any argument that the Civil Rights Act of 1866 might overreach Congress's preexisting legislative powers.[4] Following ratification of the Fourteenth Amendment, Congress re-passed Section 1981's antecedent in 1870 to head off any contention that it had lacked the authority to pass Section 1981 in 1866.[5] Congress recodified the statute in 1874.[6] Section 1981's basic structure then remained unchanged until 1991.[7]

Despite the old-timey language of Section 1981,[8] for decades leading up to the 1991 revision, the Supreme Court maintained with uniformity that Section 1981 barred discrimination on the basis of *any* race in *any* contracting, whether by actors private or public.[9] Over the same decades, the Court

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[3] 14 Stat. 27.

[4] *See, e.g.*, Gen'l Bldg. Contractors Ass'n v. Pa., 458 U.S. 375, 389 (1982) ("The 1866 Act represented Congress's first attempt to ensure equal rights . . . . As such, it constituted an initial blueprint of the Fourteenth Amendment, which Congress proposed in part as a means of 'incorporat[ing] the guaranties of the Civil Rights Act of 1866 in the organic law of the land.'") (citing Hurd v. Hodge, 334 U.S. 24, 32 (1948)).

[5] Runyon v. McCrary, 427 U.S. 160, 168-69 n.8 (1976) (recounting the early history of 42 U.S.C. § 1981).

[6] *Id.*

[7] *See* Jones v. R.R. Donnelley & Sons Co., 541 U.S. 369, 372-73 (2004) (discussing the relevant history of 42 U.S.C. § 1981 through its last amendment in 1991).

[8] The section reads, "All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts . . . as is enjoyed by white citizens." 42 U.S.C. § 1981(a).

[9] *See, e.g.*, McDonald v. Santa Fe Trail Transp. Co., 427 U.S. 273, 298 (1976) (Section 1981 "was meant, by its broad terms, to proscribe discrimination in the making or enforcement of contracts against, or in favor of, any race."). These cases predate the rise of textualist and originalist

maintained with the same uniformity that Section 1981's prohibitions are "violated if a private offeror refuses to extend to [an American], solely because [of his race], the same opportunity to enter into contracts as he extends to [other] offerees."[10]

Then, Congress acted in 1991 to dispel any remaining confusion about the extent of Section 1981's ambit. In the Civil Rights Act of 1991, Congress added two subsections to Section 1981, only the first of which—subsection (b)—matters for present purposes. That subsection states:

> For purposes of this section, the term "make and enforce contracts" includes the *making*, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship.[11]

Congress added subsection (b) in part in response to the Supreme Court's 1989 ruling in *Patterson v. McLean Credit Union*.[12] In *Patterson*, an employee sought damages for racial harassment and discrimination under 42 U.S.C.

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statutory interpretation. Had the Court employed the modern (which is to say the textualist-originalist) approach to statutory interpretation to construe the version of Section 1981 extant between 1870 and 1991, it arguably would have reached a different interpretation of the statute. *See, e.g.*, CHARLES FAIRMAN, HISTORY OF THE SUPREME COURT OF THE UNITED STATES: RECONSTRUCTION AND REUNION 1864-88, PART ONE 1258 (Paul A. Freund ed., 1971) ("In *Jones v. Mayer* the Court appears to have had no feeling for the truth of history, but only to have read it through the glass of the Court's own purpose. It allowed itself to believe impossible things—as though the dawning enlightenment of 1968 could be ascribed to the Congress of a century agone.") (footnote omitted); George Rutherglen, *The Improbable History of Section 1981: Clio Still Bemused and Confused*, 2003 SUP. CT. REV. 303, 321 ("Under the 1866 Act, only the more limited rights, simply to participate in public economic life, were protected: the rights to be a person generally recognized as capable of entering into contracts and holding property. These rights could not be violated by isolated acts of discrimination, but only by concerted refusals to deal with an entire class of individuals."). However, as explained below, the subsequent history of Congress's 1991 amendment to the statute renders this argument moot: whatever the original interpretative community would have understood the text of Section 1981 to mean in 1866 and 1870, the original interpretative community *for the 1991 amendment* clearly understood the statute's new text to adopt and codify the prior case law.

[10] *Runyon*, 427 U.S. at 170-71. The Supreme Court released its opinions in *Runyon* and *McDonald* on the same day (June 25, 1976), with seven of the Justices signing on to both majority opinions. Accordingly, while only the *McDonald* opinion focuses on the universality of Section 1981's protection of Americans *of all races* against racial contracting discrimination, with *Runyon* instead focusing on the applicability of Section 1981 to the categorical refusal *of private parties* to extend contracts to any black customers, one can properly read the cases in conjunction as clarifying that Section 1981 bars *private* actors from deciding not to contract with *any* American because of *any* race.

[11] 42 U.S.C. § 1981(b) (emphasis added).

[12] 491 U.S. 164 (1989).

§ 1981. The Supreme Court held that racial harassment relating to conditions of employment was not actionable under Section 1981 because the statute did not apply to conduct which occurs after the formation of a contract and which does not interfere with the right to enforce established contractual obligations. Congress responded with subsection (b). Its primary goal was to codify the prior judicial interpretations of the statute concerning Section 1981's application to post-contract-formation conduct (including discriminatory termination). But it simultaneously expressly included language that would assure that henceforth Section 1981 would clearly govern *entry* into contracts.

The original public meaning of Section 1981, as amended in 1991, is thus clear. The modern version of Section 1981 "protects the equal right of all persons . . . to *make* and enforce contracts without respect to race."[13] Thus, "Section 1981 prohibits intentional race discrimination in the *making* and enforcement of public and private contracts."[14]

B. Personal Liability for Section 1981 Violations

Focused as it is on contracts, one might imagine that Section 1981 would only assign liability for a corporation's illicitly discriminatory contracting decisions to the contracting enterprise in privity with a plaintiff. That would be reasonable, but also very wrong. *All* of the courts of appeals that have considered the issue have agreed that the personnel responsible for a Section 1981 violation are *personally* liable for the damages worked.

The Fourth Circuit faced the question first. In 1975, in *Tillman v. Wheaton-Haven Recreation Association*,[15] after the Supreme Court held a community swimming pool's policy against black memberships to violate the Civil Rights Act of 1866, the district court—on remand—"absolved the directors from all liability" for the policy,[16] reasoning that although the directors knew that they were intentionally approving racial discrimination, they didn't know that it was illegal when they did so.[17]

The Fourth Circuit reversed. It reasoned that (a) Section 1981 created a statutory tort; (b) "[g]enerally, a tortfeasor who acted intentionally cannot defend on the ground that he mistook the law"; and (c) "Section 1981 . . .

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[13] Domino's Pizza, Inc. v. McDonald, 546 U.S. 470, 474 (2006) (cleaned up) (emphasis added).
[14] Jenkins v. Nell, 26 F.4th 1243, 1249 (11th Cir. 2022) (emphasis added).
[15] 517 F.2d 1141 (4th Cir. 1975).
[16] *Id.* at 1142.
[17] *Id.* at 1143.

create[s] no exception[] to these principles."[18] The court expressly held that "a complainant relying on § 1981 . . . need not prove that the defendant knew the duties these statutes impose. Stated conversely, ignorance of the rights secured by these statutes is not a defense to an action brought to enforce them."[19] As a result, the *Wheaton-Haven* court held that "a director who actually votes for the commission of a tort is personally liable, even though the wrongful act is performed in the name of the corporation . . . . Proof that the director voluntarily and intentionally caused the corporation to act is sufficient to make him personally accountable."[20]

Since *Wheaton-Haven*, at least seven more U.S. courts of appeals have reached the same conclusion. In 1985, the Seventh Circuit expressly followed *Wheaton-Haven* on this issue.[21] 1986 saw the Third Circuit follow suit in *Al-Khazraji v. St. Francis College*.[22] It, too, reasoned that:

> [a]lthough Section 1981 is a federal civil rights remedy it is in the nature of a tort remedy.
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> An individual, including a director, officer, or agent of a corporation, may be liable for injuries suffered by third parties because of his torts, regardless of whether he acted on his own account or on behalf of the corporation. "An officer of a corporation who takes part in the commission of a tort by the corporation is personally liable therefore."[23]

The Third Circuit expressly held that "directors, officers, and employees of a corporation may become personally liable when they intentionally cause an infringement of rights protected by Section 1981, regardless of whether the corporation may also be held liable," so long as they "are personally involved in the discrimination . . . and if they intentionally caused [the] infringe[ment of] Section 1981 rights, or if they authorized, directed, or

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[18] *Id.*

[19] *Id.*

[20] *Id.* at 1144.

[21] Musikiwamba v. ESSI, Inc., 760 F.2d 740, 753 (7th Cir. 1985) ("We agree with the Fourth Circuit that personal liability cannot be imposed on a corporate official for the corporation's violations of section 1981 when the official is not alleged to have participated in the actual discrimination against the plaintiff . . . . Personal liability is imposed only when the officer is alleged to have taken part in the *illegal act* initially giving rise to the corporation's liability.") (citing *Wheaton-Haven*, 517 F.2d at 1144, among other authorities).

[22] 784 F.2d 505 (3d Cir. 1986).

[23] *Id.* at 518 (citing Goodman v. Lukens Steel, 777 F.2d 113, 118 (3d Cir. 1985); Zubik v. Zubik, 384 F.2d 267, 275-76 (3d Cir. 1967)).

participated in the alleged discriminatory conduct."[24] The Third Circuit has reiterated this holding as recently as 2020.[25] The Sixth Circuit reached the same conclusion in 1986.[26] The Tenth Circuit concurred as early as 1991[27] and expressly reiterated the point in 2002.[28] The Second Circuit did the same in 2020.[29] Slightly less clearly, the Fifth[30] and Eleventh[31] Circuits have agreed. So have district courts outside these circuits.[32]

I have identified *no* counter-authority. *No* court of appeals has rejected this approach and read Section 1981 to hold discriminating corporations liable while holding harmless the individuals through which those corporations act. With one voice, the courts that have considered the topic agree that Section 1981 leaves the individuals responsible for violations personally liable for the resulting damages.

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[24] *Id.*

[25] Pedro v. City Fitness LLC, 803 F. App'x 647, 652 n.9 (3d Cir. 2020).

[26] Jones v. Continental Corp., 789 F.2d 1225, 1231 (6th Cir. 1986) ("[T]he law is clear that individuals may be held liable for violations of § 1981," including when acting as "'agents' of the employer.") (internal citations omitted).

[27] Allen v. Denver Pub. Sch. Bd., 928 F.2d 978, 983 (10th Cir. 1991), *overruled on other grounds* Kendrick v. Penske Transp. Servs., 220 F.3d 1220, 1228 (10th Cir. 2000).

[28] Flores v. Cty. of Denver, 30 F. App'x 816 (10th Cir. 2002) ("[A]n individual defendant can be held liable under § 1981 if the individual defendant was personally involved in the discriminatory conduct.").

[29] Whidbee v. Garzarelli Food Specialties, Inc., 223 F.3d 62, 75 (2d Cir. 2020) ("We now explicitly hold what has been implicit in our previous cases: individuals may be held liable under § 1981 [when] a plaintiff [has] demonstrate[d] 'some affirmative link to causally connect the actor with the discriminatory action[ ]' [and the claim is so] 'predicated on the actor's personal involvement.'") (internal citations omitted).

[30] Foley v. Univ. of Houston Sys., 355 F.3d 333 (5th Cir 2003) ("recogniz[ing] . . . a tension" in prior assertion that "it has not yet been decided [in the Circuit] 'whether a § 1981 claim lies against an individual defendant not a party to a contract giving rise to a claim'" while nonetheless reiterating that the Circuit has "accepted that § 1981 liability will lie against an individual defendant if that individual is 'essentially the same as the [contracting party] for the purposes of complained-of conduct'") (citing Felton v. Polles, 315 F.3d 470, 481 (5th Cir. 2002)).

[31] Powell v. Am. Remediation & Envt'l, Inc., 618 F. App'x 974 (11th Cir. 2015) (faulting district court for having "overlooked the fact that [while] '[i]ndividual capacity suits under Title VII are . . . inappropriate [since] [t]he relief granted under Title VII is against the employer, not individual employees whose actions would constitute a violation of the Act' . . . [A]n employee may be held personally liable under 42 U.S.C. § 1981 for intentionally infringing rights that statute protects.") (citing Busby v. City of Orlando, 931 F.2d 764, 772 (11th Cir. 1991); Faraca v. Clements, 506 F.2d 956, 595 (5th Cir. 1975)).

[32] *See, e.g.*, Plymale v. Dyer, 837 F. Supp. 2d 1077, 1086-89 (E.D. Cal. 2011) (agreeing that where a plaintiff "establish[es] that [a] defendant was involved personally in . . . adverse action and intentionally infringed on Section 1981 rights," such individual defendants would bear personal liability under § 1981, before assessing evidence and finding no such personal involvement).

II. CORPORATE LEADERSHIP'S LIABILITY TO SHAREHOLDERS

Above and beyond Section 1981's direct assignment of personal liability to the corporate actors responsible for a company's discriminatory contracting decisions, the structure of American corporate law strongly suggests that officers and directors face personal liability for corporate discrimination for a broader reason: our law holds them personally responsible for harming their corporations through a decision to illegally discriminate.

Corporations are creatures of state law, leaving the duties of corporate officers defined by each state's discrete corporate code. In theory, this could mean that the obligations of American corporate officers and directors could vary across each of the fifty states, not to mention the District of Columbia and the other sovereign or quasi-sovereign entities enjoying the power to charter corporations.[33] But in practice, the corporate codes show remarkable convergence on this point. Most relevantly, all those I have examined (a) impose fiduciary obligations on officers and directors; (b) include among them—however styled—a duty to conduct business lawfully; and (c) exempt from the usually applicable business-judgment rule an intentional decision to violate substantive law.[34]

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[33] All sovereign native American tribes have this power, as do incorporated overseas territories (such as Puerto Rico) and unincorporated overseas territories (such as American Samoa).

[34] A number of examples are discussed in depth below. To matter-of-factly state that *all* American jurisdictions share these rules would require a comprehensive survey of all such jurisdictions. While I have not verified the law of *every* American jurisdiction, the pattern appears clear from the concurrence on at least one of these points (without known exception) of:

1. California (CAL. CORP. CODE § 204 (specifying that corporations "may not eliminate or limit the liability of directors (i) for acts or omissions that involve . . . a knowing and culpable violation of law")),
2. Delaware (described in body text, below),
3. Illinois (*e.g.*, Davis v. Dyson, 900 N.E.2d 698, 713-14 (Ill. App. 2008) ("[A] violation of a statute . . . that has caused detriment to the organization . . . also constitutes a breach of fiduciary duty.")),
4. Louisiana (*e.g.*, Fair Farms, Inc. v. Holt, 124 So.3d 25, 34 n.8 (La. App. 2013) (citing La.R.S.12:96) (provision subsequently amended in 2015 to La.R.S. 12:1-831-32) (continuing to bar indemnification of officers or directors who violate their duty of loyalty, intentionally inflict harm on the corporation, or intentionally violate criminal law)),
5. Massachusetts (Harhen v. Brown, 730 N.E.2d 859, 866 n.7 (Mass. 2000) (recognizing that where challenged action or inaction "is an illegal act or results in the continuation of an illegal act, the business judgment rule does not apply")),
6. Nevada (Kahn v. Dodds (*In re* AMERCO Derivative Litig.), 252 P.3d 681, 700 (Nev. 2011) ("[T]o show that a director breached his or her fiduciary duty, a shareholder must

As a result, it appears that American corporate law's consensus holds personally liable the officers and directors who adopt, implement, or fail to eliminate discriminatory policies.

A. Fiduciary Duty to Conduct Lawful Business

Among the fiduciary duties state laws impose on corporate officers and directors are duties of loyalty and of care. While different states' courts describe it differently, they consistently hold that there is a duty to comply with substantive law that falls under one or the other of these duties.

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prove that the director's 'act or failure to act constituted a breach of his or her fiduciary duties' and that the 'breach of those duties involved intentional misconduct, fraud or a knowing violation of the law.'"); *In re* Allegiant Travel Co. Stockholder Derivative Litig., 2020 U.S. Dist. LEXIS 239566, *14-*16 (D. Nev. 2020)),

7. New Jersey (N.J. STAT. ANN. § 14A2-7(3) (barring corporations from "reliev[ing] a director or officer from liability for any breach of duty based upon an act or omission . . . involving a knowing violation of law")),
8. New York (Roth v. Robertson, 118 N.Y.S. 351, 353 (N.Y.S. 1909) (holding "directors and officers of a corporation [who] engage[d] in *ultra vires* transactions" through illegal bribes "jointly and severally liable"); *In re* Leasing Consultants, Inc., 592 F.2d 103, 110 (2d Cir. 1979) ("New York courts have recognized that commission by a corporation of illegal acts, even if intended to be advantageous to the corporation, may entail hazards to the corporation [and] its stockholders . . . who may, therefore seek relief in court.")),
9. North Carolina (Seraph Garrison, LLC v. Garrison, 787 S.E.2d 398, 406-7 (N.C. Ct. App. 2016)) ("[A] director or officer's failure to ensure the corporation is operated according to law amounts to a breach of fiduciary duty. . . . [T]he business judgment rule cannot protect defendant's failure to remedy problems he both created and ignored.")),
10. Washington (discussed in body text, below), and
11. Wyoming (*see* WYO. STAT. §§ 17-11-110 (holding officers and directors liable for losses from "willful misconduct"), 17-16-202 (barring articles of incorporation from eliminating personal liability for an "intentional violation of criminal law"), and 17-19-842 (specifying that exemption of officers from liability of corporations "does not affect individual liability for intentional torts or illegal acts")).

Federal courts have—without contradiction by any relevant state forums—similarly interpreted the laws of at least:

1. Florida (*e.g.*, Amerifirst Bank v. Bomar, 757 F.Supp. 1365, 1376-77 (S.D. Fla. 1991) ("The Amended Complaint alleges throughout that Defendants acted . . . illegally . . . . If true, these allegations would take the Defendants' management decisions beyond the protection of the business judgment rule.") and
2. Texas (*In re* Life Partners Holdings, Inc. S'holder Derivative Litig., 2015 U.S. Dist. LEXIS 168198, *62-*63 (W.D. Tex. 2015) ("If a disinterested director approves a corporate act that violates positive law with 'actual knowledge' of its illegality, he is liable for breach of fiduciary duty, which, as a 'knowing violation of law,' cannot be exculpated.")).

Take—as almost all state courts do—Delaware law as exemplary of the pattern. Delaware Chancery Courts describe the duty to comply with known law as a species of "the duty of loyalty," which can be breached by "acting in bad faith."[35] They reason that while "Delaware law allows corporations to pursue diverse means to make a profit, [it imposes] a critical statutory floor, which is the requirement that Delaware corporations only pursue 'lawful business' by 'lawful acts.'"[36] As the same Delaware court concluded:

> In short, by consciously causing the corporation to violate the law, a director would be disloyal to the corporation and could be forced to answer for the harm he has caused. Although directors have wide authority to take lawful action . . . they have no authority knowingly to cause the corporation to become a rogue, exposing the corporation to penalties from criminal and civil regulators.[37]

Every other state I have examined finds its way to a parallel interpretation of its corporate code. By way of geographically representative examples, despite their dissimilarities, both North Carolina and Washington State so read their statutes.[38]

Accordingly, American fiduciary law appears to uniformly require officers and directors to abide by substantive law in how they run a corporation. As with other fiduciary principles, this one is usually policed by shareholders bringing derivative suits in the name of the corporation they partly own.

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[35] City of Hialeah Emples. Ret. Sys. v. Begley, 2018 Del. Ch. LEXIS 1442, *10 (Del. Ch. 2018).

[36] *Id.* (citing *In re* Massey Energy Co., 2011 Del. Ch. LEXIS 83, *20 (Del. Ch. 2011)).

[37] *Id.* (quoting Desimone v. Barrows, 924 A.2d 908, 934-35 (Del. Ch. 2007)). This reasoning highlights the availability of a theory largely paralleling the right of shareholders to derivatively assert claims for fiduciary breach against officers and directors adopting, implementing, and retaining policies they know to violate substantive law: that such actions are definitionally ultra vires. Because, as another Delaware Chancery Court memorably put it, "this state does not 'charter lawbreakers,'" *no* illegal action by such officers or directors can be authorized actions on behalf of a corporation. Kanell v. Niv, 2017 Del. Ch. LEXIS 640, *50 (Del. Ch. 2017). The point has been further developed in other jurisdictions, including Washington State. Harstene Pointe Ass'n v. Diehl, 979 P.2d 854 (Wash. App. 1999) ("[T]o hold that [a member's] challenge is barred by ultra vires would be to hold the regularly adopted corporate procedures a nullity. If, as [the chartered enterprise] suggests, [the Washington statute under which it was organized] prevents [the member's] challenge, the corporation would be free to disregard its own bylaws . . . . In short, the corporate articles and bylaws would be largely meaningless.").

[38] *See* Durand v. HIMC Corp., 214 P.3d 189, 199 (Wash. Ct. App. 2009) (approving of an action against officers and directors who authorized intentional illegal actions, where "the legislature has specifically expressed the public policy that" such acts are illegal); *Seraph Garrison*, 787 S.E.2d at 406 (finding ". . . a director or officer's failure to ensure the corporation is operated according to law amounts to a breach of fiduciary duty").

B. Exception to Business Judgment Rule for Intentional Violations of Law

Normally, a challenge to a corporate act as a fiduciary breach would need to overcome the high hurdle imposed by the business judgment rule. That rule generally protects corporate officers and directors from personal liability for decisions they make in the exercise of their reasonable business judgment that such acts would benefit a corporation. However, just as every state I've examined carves out knowing decisions to violate substantive law from the universe of allowed options for corporate fiduciaries, every state I've examined that has addressed the issue also carves out such decisions from the application of the business judgment rule.

Again, Delaware cases provide a clear explanation. "Under Delaware law, a fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity."[39] More pointedly, "a fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profits by violating the law."[40] And, again, other states agree. Washington courts, for example, have similarly rejected assertions of the business judgment rule to shield intentional violations of law for more than a decade.[41]

This makes sense. After all, there is a deeper question at issue when an agent decides to expand corporate operations to sell crack than whether he reasonably anticipates crack sales to prove profitable. The same principle applies to all other corporate decisions to knowingly violate substantive law. The business judgment rule, which otherwise would shield such decisions from Monday morning quarterbacking, simply does not apply when legislatures have declared the judgment at issue verboten.

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[39] *City of Hialeah Emples. Ret. Sys.*, 2018 Del. Ch. LEXIS at *10 (citing Metro Commc'n Corp. BVI v. Advanced Mobilecomm Techs. Inc., 854 A.2d 121, 131 (Del. Ch. 2004)).

[40] *Id.*

[41] *Durand*, 214 P.3d at 199 (denying application of the business judgment rule as a defense "because the legislature has specifically expressed the public policy" by outlawing the challenged corporate behavior); Thompson v. Datamarine Int'l, 2009 Wash. Super. LEXIS 836, *30 (Wash. Super. 2009) (holding that the defendant "breached his fiduciary duties . . . when he became aware of and permitted" illegal acts, because, "[w]hile the above actions may have been taken for the benefit of the companies, they were *ultra vires* and illegal acts").

III. ADVICE OF COUNSEL DEFENSES

Individual officers and directors will face personal liability for *knowingly* adopting, implementing, and retaining illegal, discriminatory policies. So what counts as "knowingly"?

That question could arise in litigation where individual defendants assert their reliance on the advice of counsel as a defense. How such an assertion plays out will obviously depend on the facts of each case,[42] but it will also turn on what kinds of claims the individual defendants assert their defense against. The defense may very well protect at least some individual defendants from personal liability for breaching their fiduciary duties. However, it *should not* ever protect *any* individual defendant who was personally involved in the decision to discriminate from personal liability under Section 1981.

A. Applicability and Limits of Advice of Counsel Defense in Fiduciary Breach Litigation

Since the species of fiduciary breach claim at issue relies on a showing that a fiduciary *knowingly* violated the law, a well-grounded advice of counsel defense could serve as a get-out-of-jail-free card for some officers and directors. Some, but not all.

An advice of counsel defense applies to fiduciary breaches almost everywhere.[43] It generally "requires the defendant show that he made a full

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[42] As an example of how specific facts can bear on such a defense, consider how the matter was raised—though the district court did not address it—in *NCPPR v. Schultz*, Case No. 2:22-CV-00267-SAB (E.D. Wa. 2023). That case saw a shareholder bring fiduciary breach and ultra vires claims against the officers and directors of Starbucks. The defendants sought (and obtained on other grounds) a dismissal of the action. *Id.*, Dkt. 35. But in the company's motion to dismiss, it raised the "assessments" it had "commissioned . . . former U.S. Attorney General Eric Holder Jr." to perform on "Starbucks['] progress on civil rights," including "recommendations for how Starbucks can better advance DEI." *Id.*, Dkt. 19, at pp. 4-5. As the plaintiff countered, the company never actually asserted that this supposed authority had told any individual defendant that any program at issue was legal, and the "assessments" themselves failed to include any opinion as to the legality of any policy the case discussed. *Id.*, Dkt. 26, at pp. 18-19. To the extent that any officers or directors of any corporation intend to rely on a document produced by outside counsel to support an advice of counsel defense, they should verify that the document *actually provides advice concerning the legality of the policy at issue*. Forward-looking corporations should only commission and pay for the prophylactic work of outside counsel that provides advice on the (il)legality of such policies.

[43] *E.g.*, Aimone v. Aimone, 529 P.3d 35, *P33 (Wyo. 2023) ("[R]eliance on advice of counsel can be a defense to an alleged breach of a fiduciary duty" when a fiduciary "rel[ies] in good faith upon opinions, reports, statements or other information provided by another person that [he] reasonably believes is a competent and reliable source for the information.") (internal citations

disclosure of all material facts to his attorney and that he then relied 'in good faith on the specific course of conduct recommended by the attorney.'"[44] Generally, even where a defendant disclosed all relevant facts and followed a lawyer's advice, the defense will apply only if that lawyer was competent and if a reasonable person would have relied on his advice.[45]

In making such a determination, a court would likely consider whether the reliance was undertaken "in good faith." The common law of trusts (from which the states' corporate laws' fiduciary requirements arose) has long provided that fiduciaries "may rely on the advice of counsel when reasonably justified under the circumstances."[46] This makes the "fundamental question" "whether a prudent [fiduciary] in those particular circumstances would have acted in reliance on counsel's advice. Of course, reliance would be improper if there were significant reasons to doubt the course counsel suggested."[47]

As Delaware courts have explained, not all defendant reliance on the advice of counsel will trigger the defense because "[o]btaining advice of counsel . . . is not dispositive" in determining whether "a fiduciary is not acting disloyally."[48] Yes, "[t]aking the advice of legal counsel . . . evidences prudence," but "[r]eliance . . . is not a complete defense . . . [since] that would reward a [fiduciary] who shopped for legal advice that would support the [fiduciary]'s desired course of conduct or who otherwise acted unreasonably in procuring or following legal advice."[49]

While the exact parameters of unreasonably relying on legal advice have not been fully mapped, it is sufficiently clear that "*subjective* good faith

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omitted); Hyde Park Venture v. FairXchange, LLC, 292 A.3d 178, 207 (Del. Ch. 2023) ("[D]irectors benefit from legal advice about what course of action to take, and they gain a potential affirmative defense in the form of reliance on advice of counsel, which renders them 'fully protected' under Delaware law.") (internal citations omitted).

[44] U.S. v. Bush, 626 F.3d 527, 539 (9th Cir. 2010) (citing U.S. v. Ibarra-Alcarez, 830 F.2d 968, 973 (9th Cir. 1987)).

[45] *See, e.g.*, New Phoenix Sunrise Corp. & Subs. v. Comm'r, 408 F. App'x 908, 917-18 (6th Cir. 2010); Litt v. Wycoff, 2003 Del. Ch. LEXIS 23, *28 (Del. Ch. 2003) ("There can be no personal liability of a director for losses arising from 'illegal' transactions if a director were financially disinterested, acted in good faith, and relied on advice of counsel reasonably selected in authorizing a transaction.") (citing Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996)).

[46] Clark v. Feder Semo & Bard, P.C., 739 F.3d 28, 31-32 (D.C. Cir. 2014) (citing Restatement (Third) of Trusts § 77 cmts. b and b(2) (2005); George G. BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES § 541 (2013)).

[47] *Id.* at 32 (citing Restatement (Third) of Trusts § 77 cmt. b(2); BOGERT, *supra* note 46, § 541 & n.57).

[48] Paradee v. Paradee, 2010 Del. Ch. LEXIS 212, *28 (Del. Ch. 2010).

[49] *Id.* at *29 (citing Restatement (Third) of Trusts § 77 cmt. b(2) (2007)).

standing alone is not a defense" when such reliance "fell short of *reasonable* standards."[50] This means that even if a fiduciary acted in reliance on legal advice he actually believed to be valid, he cannot enjoy the defense if his belief was unreasonable. It is worth noting that the opposite should not be inferred: subjective *bad* faith (reliance on advice a fiduciary does *not* actually believe to be valid) should negate a reliance on the advice of counsel defense *even where* a hypothetical reasonable fiduciary would have followed that advice.[51]

This distinction means that an advice of counsel defense to a fiduciary breach claim against officers and directors who adopt, implement, or retain discriminatory policies could pan out differently for different defendants. What a non-lawyer defendant could reasonably rely on may well differ from what a lawyer defendant could accept as reasonable legal advice. Put differently, in litigation of such claims, all non-lawyer individual defendants' first line of defense would almost surely be to blame their lawyer co-defendants (especially those in a general counsel's office) for their decisions in terms that would most likely leave those co-defendants fully exposed to liability.[52]

B. Inapplicability of Advice of Counsel Defense in Section 1981 Litigation

However applicable an advice of counsel defense may be in shareholder derivative litigation over the harms worked by officers' and directors' fiduciary breaches, that defense will have *no bearing* on the litigation of Section 1981 claims against those directly involved in contractual discrimination.

Wheaton-Haven, the foundational court of appeals case referenced above, explains why. Section 1981 created a statutory tort. "Generally, a tortfeasor

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[50] *Id.* (emphases added).

[51] *Cf.* U.S. ex rel. Schutte v. SuperValu Inc., 143 S. Ct. 1391, 1401 n.5 (2023) (ruling subjective belief in falseness of a submission was sufficient to trigger False Claims Act liability regardless of the correctness of that belief, while highlighting that the Court was not addressing the converse situation where a defendant subjectively believed its submission to be correct despite "an unjustifiably high risk of illegality that was so obvious it should have been known, even if the defendant was not actually conscious of that risk").

[52] Another way to state this point would be to imagine the cause of action a non-lawyer co-defendant or corporation would assert against a general counsel who unreasonably advised of the legality of an illegal policy (or unreasonably allowed either the corporation or its officers and directors to unreasonably rely on the advice of outside counsel). At a minimum, the corporation and non-lawyer co-defendants would have a malpractice claim against the general counsel for providing unreasonable legal advice (or for allowing reliance on the unreasonable legal advice of outside counsel). Such a claim would squarely differentiate the reasonableness of the lawyer defendant's reliance on advice of counsel from that of any non-lawyer defendants, in ways that the lawyer defendant could not defend by citation to the mere existence of outside counsel's advice devoid of an assessment of its content.

who acted intentionally cannot defend on the ground that he mistook the law."[53] Mistaking it in reliance on a lawyer changes nothing.[54] "Due diligence is a defense for corporate directors who are charged with failing to exercise reasonable care. Its genesis is the law of negligence."[55] Those root cases about the duties of fiduciaries do "not support the contention that a director may violate the law with impunity if he relies on counsel."[56]

IV. PUBLIC POLICY AGAINST COVERAGE OR INDEMNIFICATION OF INDIVIDUAL DAMAGES LIABILITY

Should one expect the economic incidence of liability to actually fall on individual defendants? After all, many (if not most) corporations maintain D&O insurance to protect their officers and directors from job-related liabilities, and even more provide for the indemnification of such officers and directors by the corporation for the same. But as a matter of public policy, generally speaking, no corporation or corporate insurer *can* cover or indemnify an award of damages that results from an officer or director knowingly violating the law.

For more than a century, courts have rejected as contrary to public policy contracts to indemnify or insure parties for their own intentional violations of law.[57] For this reason, courts routinely note that enforcing contracts that would exculpate wrongdoers for intentional illegal acts is incompatible with laws prohibiting those acts.[58] This makes sense, as a policy covering damages

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[53] *Wheaton-Haven*, 517 F.2d at 1143.

[54] *Id.* at 1146 ("Their ignorance of the law, though engendered by lawyers' advice and corroborated by lower federal courts, is no defense.").

[55] *Id.* at 1144.

[56] *Id.*

[57] *E.g.*, Goldman v. Mitchell-Fletcher Co., 141 A. 231, 235 (Pa. 1928) (despite reining back public policy against indemnity for *negligent* torts, reiterating that the "rule that no contribution lies between trespassers applies only to cases where the persons have engaged together in doing wantonly or knowingly a wrong") (citing Acheson v. Miller, 2 Ohio St. 203 (Ohio 1853)); Sutton v. Morris, 44 S.W. 127, 127 (Ky. 1898) ("Where there has been an intentional violation of law, or where the wrongdoer is presumed to have known that the act is unlawful, no right of contribution existed."); Spalding v. Admin. of Oakes, 42 Vt. 343, 349 (Vt. 1869) ("The rule that there can be no contribution among wrong-doers . . . applies properly only to cases where there has been an intentional violation of law.") (internal citation omitted).

[58] Banc of Am. Sec. LLC v. Solow Bldg. Co. II, LLC, 847 N.Y.S.2d 49, 53 (1st Dep't 2007) ("The common business practice of limiting liability by restricting or barring recovery by means of an exculpatory provision . . . is accorded judicial recognition where it does not offend public policy; however, that policy does not extend to acts that are either 'willful or grossly negligent.'") (internal citations omitted).

resulting from intentional violations of law is better described as a criminal conspiracy than as an insurance arrangement.

Given this general rule, officers and directors should consider the likelihood that, should claims against them arise and be fully litigated,[59] the resulting liabilities' incidence would almost surely fall *entirely* on their shoulders.[60] Here, personal liability really should mean *personal* liability.

V. POTENTIAL RAMIFICATIONS: A NOT-SO-HYPOTHETICAL SCENARIO

Consider the following hypothetical:

Imagine a corporation's leadership publicly committed itself to remedying systemic, society-wide inequalities in America and to "doing better" in terms of its own internal, racially-measured, demographic diversity. Imagine that its leadership specified that it would require the pursuit of so-called "equitable hiring practices" to avoid hiring candidates that were white or male at a rate greater than those groups' share of the whole, undifferentiated population (without consideration of the demographics of the relevant pool of qualified, interested applicants) and promised to integrate diversity metrics into its structure to assure "accountability from individual employees all the way to our CEO." Imagine it hired a Chief Diversity and Inclusion Officer (a "CDO") and entrusted him with both management of the company's recruitment policies and oversight of its pursuit of greater workforce diversity (measured through racial demographics).

Imagine this company saw an executive-level vacancy arise and conducted a nationwide talent search to fill that vacancy. Imagine a white male applicant applied, underwent rounds of interviews, and emerged as what the company's emails referred to as the "frontrunner" with "resounding," positive feedback

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[59] This qualification is material. Before a judgment, an insurer's duty to defend would require coverage of an alleged claim asserting an intentional violation of law (at least pending a reservation of rights by the insurer). However, if an individual defendant neither settled nor defeated that claim, not only would the prohibition of indemnification kick in to deny coverage to the resulting damages, but it would also kick in to require the liable defendant to reimburse the costs of his defense.

[60] This likelihood remains a likelihoood rather than a certainty, in part due to the tension between (1) Section 1981 cases attributing individual liability to individual directors directly involved in acts constituting violations of law, even those lacking knowledge of the acts' illegality, and (2) insurance law cases requiring an intentionally wrongful act to bar indemnification. One could imagine a court differentiating for these purposes the willfulness of an *act* from the willfulness of the *violation* resulting from that act. Of course, in spotting-the-issue for officers and directors, it is equally true to say that a court would stand on solid ground in *refusing* to carve out the intentional acts sufficient to generate personal liability under Section 1981 from the willful or grossly negligent acts (usually a larger set, clearing a lower bar) that are sufficient to bar indemnification.

from the "leadership team" for his selection. Imagine that the company offered this applicant a position, with a stated salary (including a signing bonus and a grant of stock), and—on his raising follow-up questions—emailed a proposed benefits package the same day, along with a promise of a final, comprehensive offer to come the next day.

Imagine that this final offer never came because the CDO intervened to block the hire and to insist on the selection of a "more diverse" candidate. Imagine that, eventually, the company decided to go in a "safer direction" by hiring a black woman for the role.

One might expect from the foregoing discussion that the applicant might sue, challenging the open racial discrimination pursued against him in employment contracting. One might anticipate that, when he did, he would sue not only the company (under Title VII of the Civil Rights Act of 1964 and Section 1981) but also the CDO in his personal capacity (under Section 1981). One might predict that—at least should he prevail—shareholders might pursue the matter further by suing the directors who adopted and retained the policies the CDO implemented that gave rise to the corporate liability for his intentional violation of very well-settled law (along with the other officers involved in the implementation of those policies).

As it turns out, with the exception of that last-stated future possibility, this isn't a hypothetical. These are essentially the alleged facts of *Kascsak v. Velasco*, a case pending in the Western District of Texas.[61] Admittedly, in March 2024, the district court dismissed the Section 1981 claim against the CDO,[62] but it did so *solely* for lack of personal jurisdiction in Texas over the CDO (seemingly a New York resident, working in the employer's New York office, never alleged to have entered or done business in Texas), while rejecting the argument that the Section 1981 claim asserted against him was otherwise inadequate to survive Rule 12 dismissal practice.

Kascsak thus underscores both the current state and clear current direction of the law. Presumably, Mr. Kascsak's counsel will refile his personal claims against the CDO in the Southern District of New York. Given the facts alleged, the Western District of Texas's ruling, and the precedents referenced above—including especially the Second Circuit's *Whidbee v. Garzarelli Food Specialties, Inc.*—one would expect that when that suit follows, it will survive a dismissal motion. Should it not settle, and should the plaintiff prove his

[61] Case No. 1:23-cv-1373.

[62] *Id.*, Dkt. 19.

allegations, one should expect it to culminate in a ruling against the CDO. Meanwhile, if the Western District of Texas case does not settle and instead goes forward to judgment against the company, one should expect shareholders to file a successor case against the broader set of officers and directors who adopted, implemented, and retained the underlying policies of intentional racial discrimination. One should expect that, following judgment(s), the liabilities at issue will be personal liabilities that neither the company nor its insurer will cover, and that one, the other, or both will then pursue from those same liable parties the reimbursement of the incurred costs of defending the suit(s).

VI. CONCLUSION

The legal world has already begun paying heed to the illegality of the policies of faddish discrimination that have sprouted across corporate America over the past decade. The corporate world should pay more heed to the liabilities these illegal policies create—especially for the individual officers and directors who could eventually bear the costs of those policies in their personal capacities.

Other Views:

- Michael J. Yelnosky, *Racial Preferences in Employment After* Students for Fair Admissions v. Harvard, 112 GEO. L.J. ONLINE 74, *available at* https://web.uri.edu/schmidt/wp-content/uploads/sites/2186/Michael-Yelnosky-GLJOFinal.pdf.

- Michael J. Fellows, *Civil Rights—Shades of Race: An Historically Informed Reading of Title VII*, 26 W. NEW ENG. L. REV. 387 (2004), *available at* https://digitalcommons.law.wne.edu/lawreview/vol26/iss2/5/.

- *DAGA Co-chairs Condemn Republican AG Letter That Threatens Businesses over Diversity*, DEMOCRATIC ATT'YS GEN. ASS'N (July 14, 2023), https://dems.ag/daga-co-chairs-condemn-republican-ag-letter-that-threatens-businesses-over-diversity/.