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**COMMENTARY**

*From Boardrooms to Courtrooms: Nasdaq's Diversity Rule Faces  
Legal Challenges*

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In 2022, more than half of the board seats on Fortune 500 companies were held by white men.<sup>1</sup> While women and racial minorities have seen gradual increases in boardroom representation, the pace of this progress still significantly lags behind the nation's demographic realities. Many companies have committed to creating a leadership structure and overall workforce more reflective of our society. But the securities exchange Nasdaq, like several other private entities, has come under fire for its policies aimed at corporate America's diversity problem.

Nasdaq proposed a board diversity rule in 2021 that requires its listed companies to have, or explain why they do not have, two diverse board members, including at least one director who identifies as female and at least one who identifies as an underrepresented minority or LGBTQ member.<sup>2</sup> The Securities and Exchange Commission regulates national securities exchanges like Nasdaq and approved the rule after providing notice of the proposal and an opportunity for comment.<sup>3</sup> Two conservative groups, the Alliance for Fair Board Recruitment and the National Center for Public Policy Research, subsequently sued the SEC. They argued that the agency was endorsing a race-based and sex-based quota in violation of federal securities laws and the Constitution.<sup>4</sup>

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<sup>1</sup> DELOITTE & ALLIANCE FOR BOARD DIVERSITY, MISSING PIECES REPORT 17 (7th ed. 2023), <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/us-missing-pieces-7th-edition-report.pdf>.

<sup>2</sup> Order Approving Nasdaq Proposed Rule Changes Related to Board Diversity, Exchange Act Release No. 34-92590 (Aug. 12, 2021).

<sup>3</sup> *Id.*

<sup>4</sup> Andrew Ramonas & Clara Hudson, *Nasdaq's Board Diversity Win Invigorates SEC Disclosure Plans*, BLOOMBERG L. (Nov. 9, 2023, 3:00 AM),

On October 18, 2023, a three-judge panel of the Fifth Circuit rejected the claims and held that the SEC had the statutory authority to approve the rule.<sup>5</sup> The court said there was substantial evidence that shareholders value information about board diversity in their investment and voting decisions, which brings the issue within the SEC’s oversight.<sup>6</sup> The court also concluded that the rule is not subject to constitutional scrutiny because Nasdaq is a private entity, not a state actor,<sup>7</sup> and its actions are not attributable to the SEC.<sup>8</sup> The rule will start to take effect at the end of this year.

The decision by the Fifth Circuit comes after state and federal judges overturned California laws requiring companies to have diverse board members.<sup>9</sup> But in contrast to those California laws, Nasdaq’s board diversity rule is not an explicit mandate. Nasdaq and the SEC said, and the Fifth Circuit panel agreed, that the rule is a disclosure-based framework that *encourages* companies to increase board diversity, not a quota that requires it.<sup>10</sup> A company can comply with the rule by either meeting the diversity objectives or explaining why it does not. Nasdaq will not evaluate the substance of a company’s explanation – all companies must do is provide one.<sup>11</sup> The exchange has even given examples of permissible explanations. A company can say that it does not meet the diversity objectives “because it does not believe Nasdaq’s listing rule is appropriate,” or “because it does not believe achieving Nasdaq’s diversity objectives are feasible given the company’s current circumstances.”<sup>12</sup> Companies can also use a broader definition of diversity that encompasses factors like veteran or disability status, so long as they disclose that information under the rule.<sup>13</sup>

More than a dozen Republican attorneys general from states like Arizona, Florida, and Texas opposed the rule, which they viewed as an illegal quota.<sup>14</sup> By requiring companies to explain why they do not meet the diversity objectives, Nasdaq punishes them with “the threat of a forced apology and bad PR,” the officials said.<sup>15</sup> On the other hand, a

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[https://www.bloomberglaw.com/bloomberglawnews/esg/BNA%200000018b95bcdce3a3fbddbe17b70001?bna\\_news\\_filter=esg](https://www.bloomberglaw.com/bloomberglawnews/esg/BNA%200000018b95bcdce3a3fbddbe17b70001?bna_news_filter=esg).

<sup>5</sup> *All. for Fair Bd. Recruitment v. Sec. and Exch. Comm’n*, 85 F.4th 226, 248 (5th Cir. 2023).

<sup>6</sup> *Id.* at 252.

<sup>7</sup> *Id.* at 239-40.

<sup>8</sup> *Id.* at 245.

<sup>9</sup> Andrew Ramonas, *Nasdaq Board Diversity Regulations Win Fifth Circuit Support (I)*, BLOOMBERG L. (Oct. 18, 2023, 1:25 PM), [https://www.bloomberglaw.com/bloomberglawnews/esg/BNA%2000000183ae04d254a5bfce1515220001?bna\\_news\\_filter=esg](https://www.bloomberglaw.com/bloomberglawnews/esg/BNA%2000000183ae04d254a5bfce1515220001?bna_news_filter=esg).

<sup>10</sup> *All. for Fair Bd. Recruitment*, 85 F.4th at 255.

<sup>11</sup> *Id.* at 238.

<sup>12</sup> *Id.* at 254.

<sup>13</sup> Order Approving Nasdaq Proposed Rule Changes Related to Board Diversity, at 38.

<sup>14</sup> Amicus Brief of Arizona et al. in Support of Petitioner Nat’l for Pub. Pol’y Rsch. at 2-3, *All. for Fair Bd. Recruitment v. Sec. and Exch. Comm’n*, 85 F.4th 226 (5th Cir. 2023) (No. 21-60626).

<sup>15</sup> *Id.* at 16.

group of Nasdaq-listed companies including Microsoft and Comcast filed a brief in support of the rule, arguing that it benefits both companies and investors.<sup>16</sup>

Although Nasdaq's board diversity rule has survived legal hurdles thus far, it is likely to face stiffer opposition down the line. On October 25, the Alliance for Fair Board Recruitment appealed the decision of the three-judge panel and is seeking a rehearing by the full Fifth Circuit.<sup>17</sup> The panel that upheld the rule consisted of three judges appointed by Democratic Presidents, but 12 of the 16 active judges on the Fifth Circuit were appointed by Republican Presidents.<sup>18</sup> Despite the threat of continuing litigation, the SEC looks like it intends to pursue diversity further. The agency's recent rulemaking agenda says that it is considering proposing "rule amendments to enhance registrant disclosures about the diversity of board members and nominees."<sup>19</sup>

In the broader legal landscape, the ruling serves as an early test of the scope of the Supreme Court's decision overruling affirmative action in July. Since the Court struck down race-conscious policies in college admission programs, conservative activists and public officials have set their sights on companies.<sup>20</sup> The Alliance for Fair Board Recruitment insisted in a letter to the Fifth Circuit that Nasdaq's rule and the SEC's approval conflict with the Supreme Court's decision.<sup>21</sup> The organization suing the SEC is led by Edward Blum, the legal activist behind the group that challenged affirmative action.

While Nasdaq's board diversity rule may survive another day in court, the rest of corporate America may not be so lucky. Diversity initiatives have become a political faultline in the United States. Legal attacks on "woke" corporations are just getting started, and there is serious concern that one of them will inevitably fall into the hands of the Supreme Court's conservative majority. Although the highest court in the land has embraced a colorblind constitution, it is difficult to accept that principle when the result continues to be law firms, political offices, universities, and boardrooms dominated by only shades of white men.

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<sup>16</sup> Ramonas, *supra* note 9.

<sup>17</sup> Ramonas & Hudson, *supra* note 4.

<sup>18</sup> Judy Godoy, *US Court Upholds Nasdaq Board Diversity Rule*, REUTERS (Oct. 18, 2023 3:22 PM), <https://www.reuters.com/sustainability/boards-policy-regulation/us-court-upholds-nasdaq-board-diversity-rule-2023-10-18/>.

<sup>19</sup> Ramonas & Hudson, *supra* note 4.

<sup>20</sup> Theo Francis & Lauren Weber, *The Legal Assault on Corporate Diversity Efforts Has Begun*, WALL ST. J. (Aug. 8, 2023 5:30 AM), <https://www.wsj.com/articles/diversity-equity-dei-companies-blum-2040b173>.

<sup>21</sup> Ramonas, *supra* note 9.