

## BOARD DIVERSITY REMAINS IN THE SPOTLIGHT

On August 6, 2021, the Securities and Exchange Commission ("SEC") [approved](#) the Nasdaq Stock Market's ("Nasdaq") Board Diversity Rule, which addressed board diversity disclosures and encouraged the creation of more diverse boards through a market-led solution. The same month, the Alliance for Fair Board Recruitment ("Alliance"), along with the National Center for Public Policy Research ("NCPPR"), petitioned the U.S. Court of Appeals for the Fifth Circuit to invalidate the rule.

Following a lengthy appeals process, the Fifth Circuit on October 18, 2023 ruled in favor of Nasdaq. Alliance swiftly responded, requesting that the entire Fifth Circuit hear argument *en banc*. While the Fifth Circuit has yet to provide an answer as to Alliance's latest petition, the decision to request a hearing *en banc* shows that the issue remains very much in flux. Regardless, the rule itself remains in effect, which is of consequence to companies who are currently required to comply or will need to comply going forward.

[Nasdaq's Board Diversity Rule](#) requires all operating companies listed on Nasdaq's U.S. Exchange to (1) publicly disclose board-level diversity statistics using a [Board Diversity Matrix template](#); and (2) either comply with the Board Diversity Rule's diversity requirements or provide an explanation in the event of noncompliance.

First, companies must disclose (i) the total number of directors and (ii) how those directors self-identify regarding gender, predefined race and ethnicity categories, and LGBTQ+ status. These statistics must be published prior to the company's annual shareholder meeting, either (a) in a proxy or information statement, or (b) on the company's website. The Rule provided a transition period for companies to comply with the Board Diversity Rule, which varied according to companies' listing dates and market tiers. Second, a company must either have diverse members on its board of directors, or provide an explanation for its lack of diversity on its board. The specific diversity requirements for the board of directors vary based on company size and company type; for example, while U.S. and foreign issuers must have at least two diverse board members, a company with five or fewer board members may satisfy the diversity requirement with at least one diverse board member. Companies should avail themselves of [detailed instructions and a template](#) provided by Nasdaq.

In its [petition for review](#), Alliance contended that Nasdaq's rule constitutes impermissible state action in violation of the Fifth and Fourteenth Amendments, and that the SEC's approval violates the agency's statutory obligations under the Securities Exchange Act ("Exchange Act") and the Administrative Procedure Act ("APA"). The Fifth Circuit panel rejected these arguments, finding first that Nasdaq is not bound by constitutional restrictions because it is a private entity rather than a state actor, and further that the SEC acted within its authority in approving the rule.

In finding that Nasdaq is a private entity rather than a state actor, the court noted that Nasdaq is a self-regulatory organization (SRO) that is registered with and regulated by the government (specifically, the SEC), rather than an entity that is created or controlled by the government. The court looked to factors including Nasdaq's method of selecting its board of directors and the fact that companies listed on the Exchange contract directly with Nasdaq to support its conclusion. Additionally, the court found, Nasdaq's adoption and the SEC's approval of the diversity rule is not "fairly attributable" to the government because (1) the exchange listing standards are not a traditional, exclusive public function; (2) there is no evidence the SEC "compelled or even significantly encouraged" Nasdaq to promulgate the rule, and (3) the rule was generated by Nasdaq itself, whereas the SEC merely engaged in the review and approval process as mandated by statute. The SEC's mere approval of a private entity's initiatives, the court concluded, does not rise to the level of state action.

The panel further rejected petitioners' arguments that the SEC's approval of the rule was outside of its administrative authority. Under the Administrative Procedure Act ("APA"), the SEC's Approval Order may only be set aside if it is "in excess of statutory...authority." First, the court held that the SEC did not act improperly by considering the perspective of investors, finding that under the Exchange Act, the SEC may consider any evidence that is "relevant to the issue at hand." Second, the court found that a disclosure rule need not be relevant in a securities fraud context to be deemed "relevant" under the Exchange Act, as the primary purpose of the Exchange Act is to promote full disclosure. Third, the court ruled that the SEC's approval of the rules did not constitute arbitrary and capricious action in violation of the APA, as the SEC had conducted an independent review of substantial evidence showing that Nasdaq's disclosure rules provide information that 1) is considered valuable by many investors, and 2) is not currently widely available in the market. Additionally, the panel held that the SEC had reviewed sufficient evidence that supported its conclusion that Nasdaq's disclosure rule would contribute to the "maintenance of fair and orderly markets," furthering the objectives of the Exchange Act. With the Fifth Circuit yet to grant an *en banc* appeal, it remains to be seen how this will play out.

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