

Alert

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Court of Appeals Hears Oral Arguments in Case Challenging Nasdaq's Board Diversity Rules

On August 29, 2022, the Fifth Circuit Court of Appeals heard oral arguments in a case against the Securities and Exchange Commission (SEC) seeking to invalidate Nasdaq's board diversity rules that were initially proposed by Nasdaq on December 1, 2020, and approved by the SEC on August 6, 2021 (see our [prior alert](#)). The National Center for Public Policy Research and the Alliance for Fair Board Recruitment are challenging Nasdaq's board diversity rules and sued the SEC as the regulator that approved the rules. They argued that the rules impermissibly compel speech in violation of the First Amendment and violate the Fifth Amendment by encouraging discrimination on the basis of protected classifications.

What do Nasdaq's board diversity rules require?

Nasdaq's board diversity rules are a disclosure standard designed to encourage a minimum board diversity objective for listed companies and provide consistent, comparable disclosures concerning a listed company's board composition.

The rules require companies listed on Nasdaq to

1. publicly disclose board diversity statistics using a standardized template and
2. have or explain why they do not have at least two diverse directors.

The diversity objectives provide that companies must have at least one female director and one director who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or as LGBTQ+. Under the rules, listed companies are also required to annually disclose their board diversity statistics using a prescriptive matrix, referred to as the "board diversity matrix." A company's repeated failure to comply with the rules would subject the company to delisting.

What role did the SEC play in the board diversity rules?

Stock exchanges like Nasdaq are for-profit enterprises subject to SEC oversight, which is tasked with reviewing and approving each exchange's rules, including its listing standards. Such review is limited to determining whether the rule is consistent with the requirements of the Securities Exchange Act of 1934. If so, the SEC must approve the rule regardless of the SEC's own policy views.

With respect to the Nasdaq board diversity rules, the SEC concluded that the rules met the statutory requirements because the rules would facilitate more consistent and comparable disclosure of information important to investors' investment and voting decisions.

What happens next?

The recent oral arguments were heard before a three-judge panel. If the National Center for Public Policy Research and the Alliance for Fair Board Recruitment lose before the three-judge panel, they could seek a rehearing before the full Fifth Circuit Court of Appeals or appeal to the Supreme Court. If the SEC loses and the rules are struck down by the panel, the SEC could also seek



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rehearing or an appeal or let the ruling stand. In the meantime, the Nasdaq board diversity rules continue to be in effect.
