

Fifth Circuit Strikes Down NASDAQ Board Diversity Rules

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On December 11, 2024, in *Alliance for Fair Board Recruitment v. SEC*, the Fifth Circuit Court of Appeals (the Court) held that the Securities and Exchange Commission (the SEC) did not have the authority to approve The Nasdaq Stock Exchange's (Nasdaq) board diversity rule (the Rule). The Court ultimately concluded that the Rule was "far removed" from the purposes of the Securities Exchange Act of 1934 (the Exchange Act).^[1] The case was decided by a 9-8 vote, and the Court's action overrules a Fifth Circuit panel's prior decision upholding the Rule.

The Rule required public companies listed on Nasdaq to annually disclose diversity information about their board members using a standardized matrix, which included self-reporting by directors of their ethnicity, gender identity, and sexual orientation. The Rule also required listed companies to have at least two diverse directors, including one female and one self-identified as an underrepresented minority, or explain why they did not.

The Court, applying the "major questions" doctrine,^[2] ruled that the SEC lacked statutory authority to approve the Rule without a clear mandate from the United States Congress. The SEC and Nasdaq had argued, among other things, that the Exchange Act's focus on "full disclosure" gave the SEC broad authority to implement a board diversity disclosure requirement. However, the Court disagreed, interpreting the scope of the Exchange Act more narrowly.

In its majority opinion, the Court explained that the SEC and Nasdaq were incorrect in arguing that U.S. Supreme Court precedent identifies full disclosure as the "core" purpose of the Exchange Act. The Supreme Court has stated that the Exchange Act aims to "substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus achieve a high standard of business ethics in the securities industry."^[3]

The Court emphasized in its opinion that disclosure is a means to achieve broader objectives, such as promoting ethical conduct or preventing fraud, rather than an end in itself. It concluded that a disclosure rule aligns with the Act's purposes only if it addresses issues like fraud, speculation, or other related harms. The Court noted that "it is obviously unethical to violate the law or to disregard a contractual promise. It is not unethical for a company to decline to disclose information about the racial, gender, and LGBTQ+ characteristics of its directors."^[4]

The SEC and Nasdaq contended that the Rule is "merely a disclosure requirement and that it does not actually remake the boardrooms of America's corporations,"^[5] which the Court noted as inconsistent with the administrative record. The Court further noted that "Nasdaq described the [Rule] to impose 'aspirational diversity objectives.' And

corporations that do not meet those objectives must explain why they failed. That is not a disclosure requirement. That is a public-shaming penalty for a corporation’s failure to abide by the Government’s diversity requirements.” [6]

KEY TAKEAWAYS

A Nasdaq representative indicated that Nasdaq does not plan to appeal the ruling, while the SEC is “reviewing the decision and will determine next steps as appropriate.” [7] Companies should review their annual disclosures in light of the ruling to determine whether, and to what extent, to include board-level diversity information going forward.

Winston’s Capital Markets and Securities Law Watch will continue to monitor the status of the Rule and will post additional updates as they become available.

[1] *Alliance for Fair Board Recruitment v. SEC*, No. 21-60626, at 2 (5th Cir. 2024).

[2] The major questions doctrine states that administrative agencies “are creatures of statute. They accordingly possess only the authority that Congress has provided.” *NFIB v. OSHA*, 595 U.S. 109, 117 (2022) (per curiam).

[3] *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (emphasis added).

[4] *Alliance for Fair Board Recruitment v. SEC*, No. 21-60626, at 2 (5th Cir. 2024).

[5] *Alliance for Fair Board Recruitment v. SEC*, No. 21-60626, at 38 (5th Cir. 2024).

[6] *Id.*

[7] <https://news.bloomberglaw.com/esg/nasdaq-board-diversity-regulations-struck-down-by-fifth-circuit>

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