

CLIENT ALERT

Fifth Circuit Overturns Nasdaq Board Diversity Rules

December 16, 2024

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On December 11, 2024, the United States Court of Appeals for the Fifth Circuit (the “Fifth Circuit”), sitting en banc, vacated (in a 9-8 vote) the approval by the Securities and Exchange Commission (the “SEC”) of Nasdaq’s board diversity rules (Nasdaq Listing Rule 5605(f) and Nasdaq Listing Rule 5606(a)).¹

Background

In 2020, Nasdaq submitted to the SEC for approval proposed rules that were designed to promote board diversity among the directors of listed companies (the “Board Diversity Proposal” or the “Proposal”). The Proposal would require companies to (i) have at least one director who identifies as female and at least one director who 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+, or (ii) explain why the company does not have at least two directors on its board who identify in these categories. The Proposal would also require listed companies to provide statistical information about the composition and diversity of the company’s board of directors based on these categories.² The SEC approved the Board Diversity Proposal in August 2021 and the proposed rules went into effect in phases starting December 31, 2023.³

¹ *All. for Fair Bd. Recruitment v. SEC*, No. 21-60626 slip op. at 5 (5th Cir. 2024) (en banc).

² See Exchange Act Release No. 90574 (Dec. 4, 2020), 85 FR 80472 (SRNASDAQ-2020-081).

³ Exchange Act Release No. 34-92590.

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The Alliance for Fair Board Recruitment and the National Center for Public Policy Research challenged the SEC's approval, arguing that the SEC lacked statutory authority to approve the Board Diversity Rule and that the Board Diversity Rule violated the Fifth Amendment's equal protection principles and the First Amendment's free speech clause. In October 2023, a three-judge panel of the Fifth Circuit found that the SEC acted appropriately when it approved the Board Diversity Rule.⁴ The advocacy groups then petitioned the Fifth Circuit for a rehearing en banc.

Under the Securities Exchange Act of 1934, (the "Exchange Act"), an SEC-registered stock exchange, such as Nasdaq, may establish rules only with SEC approval. The SEC may approve an exchange's proposal if (and only if) it is consistent with the requirements of the Exchange Act. As the Fifth Circuit notes, "a proposed rule is not consistent with the requirements of the Exchange Act if it regulates matters not related to the purposes of the Exchange Act."⁵

The Fifth Circuit's Review

The Fifth Circuit held that the primary purpose of the Exchange Act, at its core, is to "protect investors and the macroeconomy from speculative, manipulative, and fraudulent practices, and to promote competition in the market for securities transactions."⁶ The Fifth Circuit concluded that the SEC did not adequately support its conclusion that the Board Diversity Proposal was consistent with this purpose, and had therefore acted arbitrarily and capriciously when it approved the proposal. In doing so, the Fifth Circuit expressly rejected the SEC's contention that *any* disclosure-based rule created by an exchange is related to the purposes of the Exchange Act. The Fifth Circuit noted that disclosure rules must further the primary purpose of the Exchange Act, and concluded that disclosure of diversity statistics did not.

The Fifth Circuit's majority opinion found that its ruling on the Board Diversity Proposal was supported by the Supreme Court's "major questions doctrine," which requires an agency to identify "clear congressional authorization" when it takes an action that has sufficient "economic and political significance."⁷ The Fifth Circuit highlighted the economic ramifications (Nasdaq being the second largest U.S. stock exchange) and political significance (diversity being one of the most politically divisive current political issues) of the Board Diversity Proposal, concluding that it fell within the "major questions doctrine." The Fifth Circuit further observed that the Exchange Act does not even "hint" at the ability of the SEC to influence the composition of boards based on diversity factors, and held that the SEC overstepped its authority in approving the Board Diversity Proposal.

Next Steps

Nasdaq issued a public statement on December 12, 2024 indicating that it does not intend to appeal the Fifth Circuit's decision. As such, Nasdaq (like the New York Stock Exchange) will no longer have board diversity requirements. However,

⁴ *All. for Fair Bd. Recruitment v. SEC*, 85 F.4th 226 (5th Cir. 2024).

⁵ *All. for Fair Bd. Recruitment v. SEC*, No. 21-60626 slip op. at 3 (5th Cir. 2024) (en banc).

⁶ *Id.* at 10.

⁷ *West Virginia v. EPA*, 597 U.S. 697, 723–24 (2022).

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board diversity continues to be an area of focus for large institutional investors and influential proxy advisory firms, and we expect that many boards will continue to advance boardroom diversity initiatives and will continue to make related voluntary disclosures.

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