December 29, 2020

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-0609

Re: Request for Comments on Proposed Rule to Adopt Listing Rules Related to Board Diversity; SR-NASDAQ-2020-081, 85 Federal Register 80472

Dear Secretary Countryman:

Judicial Watch, Inc. is a non-partisan, not-for-profit, public interest organization headquartered in Washington, DC. Founded in 1994, Judicial Watch seeks to promote accountability, transparency and integrity in government, and fidelity to the rule of law. In furtherance of these goals, Judicial Watch files public comments and amicus curiae briefs on issues involving civil rights as well as prosecutes lawsuits on matters it believes are of public importance. Judicial Watch respectfully submits this comment in opposition to Nasdaq’s Proposed Rule Change to Adopt Listing Rules Related to Board Diversity. We urge the SEC to decline adopting the Proposed Rule because it violates the Fifth


3 See e.g., Crest v. Padilla, No. 19ST-CV-27561 (Cal. Super. Ct. Aug. 6, 2019) (challenging California Senate Bill 826, which requires boards of directors of California-based, publicly held domestic or foreign corporations to satisfy a gender quota); Crest v. Padilla, No. 20ST-CV-37513 (Cal. Super. Ct. Sept. 30, 2020) (challenging California Assembly Bill 979, which requires boards of directors of California-based, publicly held domestic or foreign corporations satisfy racial, ethnic, sexual preference, and transgender quotas).
Amendment to the U.S. Constitution, requires companies listed on Nasdaq to discriminate, and will likely lead to extensive litigation. In addition, Judicial Watch is concerned about potential conflicts of interest related to the Proposed Rule as Nasdaq also has recently announced a partnership with Equilar to provide services to listed companies that have not met the Proposed Rule’s “diversity objectives.”

I. The Proposed Rule Violates the Fifth Amendment of the U.S. Constitution.

Although the Fifth Amendment, unlike the Fourteenth Amendment, does not have an express equal protection clause, the Supreme Court has held that “[t]he reach of the equal protection guarantee of the Fifth Amendment is coextensive with that of the Fourteenth.” United States v. Paradise, 480 U.S. 149, 166, n. 16 (1987) (plurality opinion); Adarand Constructors v. Pena, 515 U.S. 200, 217 (1995). Therefore, the Fifth Amendment forbids the federal government from: (1) creating racial classifications that are not narrowly tailored to serve a compelling government interest; and (2) creating gender classifications that are not substantially related to the achievement of important government objectives. See Adarand, 515 U.S. at 227; see also United States v. Virginia, 518 U.S. 515, 533 (1996).

The Proposed Rule violates the equal protection component of the Fifth Amendment’s Due Process Clause. “At the heart of the Constitution’s guarantee of equal protection lies the simple command that the Government must treat citizens as individuals, not as simply components of a racial, religious, sexual or national class.” Miller v. Johnson, 515 U.S. 900, 911 (1995) (quoting Metro Broadcasting v. FCC, 497 U.S. 547, 602 (1990) (O’Connor, J., dissenting) (internal quotation marks omitted)). The Proposed Rule, however, does just that. It would require:

Nasdaq-listed companies, subject to certain exceptions, (A) to have at least one director who self-identifies as a female, and (B) to have at least one

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4 In addition, in instances where board members are found to meet the definition of “employee,” exchange members who comply with the Proposed Rule may also violate Title VII. See Title VII of the 1964 Civil Rights Act, 42 U.S.C. § 2000e(a) (“It shall be an unlawful employment practice for an employer (1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual’s race, color, religion, sex, or national origin; or (2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual’s race, color, religion, sex, or national origin.”).

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+, or (C) to explain why the company does not have at least two directors on its board who self-identify in the categories listed above[.]

Contrary to the fundamental guarantee of equal protection under the law, the Proposed Rule’s requirement to have at least one director who self-identifies as a specific race is a racial quota that, if adopted as law, will violate the Fifth Amendment. All racial classifications, both disadvantaging and benefitting minorities, are subject to strict scrutiny. Adarand, 515 U.S. at 227. To survive strict scrutiny, the government must demonstrate that the racial classifications are narrowly tailored to further a compelling government interest. Id. “Diversity” itself is not a compelling interest. See Grutter v. Bollinger, 539 U.S. 306, 330 (2003); see also Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1, 551 U.S. 701, 729-731 (2007). Neither is “outright racial balancing,” which the Supreme Court deems “patently unconstitutional.” Grutter, 539 U.S. at 330.

What Nasdaq proposes is unlike any other racial classification approved by the Supreme Court. Cf. Grutter, 539 U.S., at 316, 335-336 (holding constitutional an affirmative action program that considered race as only one factor in achieving student body diversity and did not seek any particular number or percentage of minority students). Nasdaq justifies the Proposed Rule’s racial quota by relying on studies that purportedly show that racial diversity on boards discourages “groupthink” by increasing “cognitive diversity.” But this justification “embod[ies] stereotypes that treat individuals as the product of their race, evaluating their thoughts and efforts—their very worth as citizens—according to a criterion barred to the Government by history and the Constitution.” Miller v. Johnson, 515 U.S. 900, 912 (1995). This numerical set-aside amounts to just another form of unconstitutional racial balancing. See Parents Involved in Cmty. Sch., 551 U.S. at 732 (“Racial balancing is not transformed from ‘patently unconstitutional’ to a compelling state interest simply by relabeling it ‘racial diversity.’”).

Moreover, employing racial classifications for the sake of “cognitive diversity” and inclusion does not further a compelling government interest. “[T]he interest in diversity of viewpoints provides no legitimate, much less important, reason to employ race classifications apart from generalizations impermissibly equating race with thoughts and behavior.” Metro Broadcasting, 497 U.S. at 602 (O’Connor, J., dissenting) (emphasis in original); see also Lutheran Church-Missouri Synod v. FCC, 141 F.3d 344, 355 (D.C. Cir. 1998) (citing approvingly J. O’Connor’s dissent in Metro Broadcasting).

Additionally, “the [Supreme] Court has given every indication of wanting to cut back Metro Broadcasting,” where it found that diversity was only an “important” government interest. Lutheran Church-Missouri Synod, 141 F.3d at 354-355. The Supreme Court overruled Metro Broadcasting to the extent that it was inconsistent with its holding in Adarand that racial classifications at all government levels are subject to strict scrutiny review. 515 U.S. at 227. It is thus doubtful that the Supreme Court would now
elevate “diversity” from an important to a compelling government interest. Moreover, a race-conscious program is not narrowly tailored if it uses a quota system, like the one proposed by Nasdaq. See Grutter, 539 U.S. at 334. Thus, this quota system will surely fail strict scrutiny review. Simply put, the diversity interest advanced by Nasdaq is insufficient under the law to justify the Proposed Rule’s racial quotas.

Further, the Proposed Rule’s requirement to have at least one director who self-identifies as a female is a gender quota that, like the racial quota, if adopted as law, will violate the Fifth Amendment. Gender classifications are constitutional only if the government can demonstrate “exceedingly persuasive justification” for the classification. Virginia, 518 U.S. at 531. To meet this burden, the government must show that the classification is substantially related to achieving an important governmental objective. Id. at 533.

Just like its justification for racial quotas, Nasdaq justifies the gender quotas by relying on studies that purportedly show that gender diversity on boards discourages “groupthink” by increasing “cognitive diversity.” For a gender classification to be constitutional, not only must the justification be “genuine, not hypothesized,” but it also “must not rely on overbroad generalizations about the different talents, capacities, or preferences of males and females.” Id. Yet, Nasdaq’s justification is, at its essence, exactly that—an assumption that women think so differently than men that it can affect the output of a board.

Moreover, the “comply-or-explain” framework does not save the Rule from its constitutionally fatal flaws. Nasdaq portrays its Proposed Rule as a choice rather than a mandate. However, this “choice” is unduly coercive. As explained below, the government cannot encourage or facilitate private discrimination. The Proposed Rule is designed to do just that, with or without the option to explain non-compliance. Although the Proposed Rule permits a listed company to explain in a public statement why it has failed to meet the racial and gender quotas, “the relevant question is not whether a [Rule] requires the use of such measures, but whether it authorizes or encourages them.” Bras v. California Public Utilities Commission, 59 F.3d 869, 875 (9th Cir. 1995). If adopted, the SEC would undoubtedly be authorizing and encouraging Nasdaq-listed companies to use racial and gender quotas.

This sort of government authorization and pressure to employ such quotas violates the Fifth Amendment. That is precisely what the D.C. Circuit Court of Appeals found in MD/DC/DE Broadcasters Ass’n v. FCC, 236 F.3d 13, 18 (D.C. Cir. 2001). There, the court found that although a FCC rule allowed broadcasters to select one of two options for “broad outreach” in recruiting efforts, one of the options was unconstitutional because “the rule [created] pressure to recruit women and minorities, which pressure ultimately [could] not withstand constitutional review.” Id. This “option,” the court explained, was instead a “government mandate for recruitment targeted at minorities [and females]” that constituted a “racial [and gender] classification” that subjects persons of different races to ‘unequal treatment.”’ Id. at 20 (emphasis added). This was true even though the other option did not focus specifically on race or gender. Id. at 18-20. Similarly, the Proposed Rule’s “comply-or-explain” framework does not transform the Rule from being unconstitutional to
II. The Proposed Rule Requires Nasdaq Members Discriminate.

The Proposed Rule, if adopted, will inevitably require listed companies to discriminate on the basis of race and sex when selecting board members, in violation of the Constitution: “A ‘law compelling persons to discriminate against other persons because of race’ is a ‘palpable violation of the [Fifth] Amendment,’ regardless of whether the persons required to discriminate would have acted the same way regardless of the law.” Monterey Mech. Co. v. Wilson, 125 F.3d 702, 707 (9th Cir. 1997) (quoting Peterson v. City of Greenville, 373 U.S. 244, 248 (1963)). This requirement to discriminate puts skin color and gender ahead of merit.

As Warren Buffet explained in a letter to Berkshire Hathaway shareholders, “At Berkshire, we are in the specialized activity of running a business well, and therefore we seek business judgment.”6 Requiring Nasdaq members to focus more on race and gender takes away from the focus on merit. To put it bluntly, as Warren Buffet did when discussing such requirements, the Proposed Rule “sounds as if the mission is to stock Noah’s ark.”7 Under this Rule, the question won’t be “Who has the best business judgment?” Instead, it will be “What are the racial and gender checkboxes that we need to fill?” The SEC should not be in the business of condoning and mandating such discriminatory decision-making.

III. The Proposed Rule Amounts to Government Action.

For an action to violate the Fifth Amendment, the government must act. Discrimination on the basis of race or sex violates the Constitution “only when it may be attributed to [government] action.” Edmonson v. Leesville Concrete Co., 500 U.S. 614, 619, 111 S. Ct. 2077, 2082 (1991) (citation omitted). Here, the Rule would constitute government action on the part of the SEC for purposes of establishing an equal protection claim. See Blount v. SEC, 61 F.3d 938, 941 (D.C. Cir. 1995).

The Proposed Rule only takes effect if the SEC approves it. Under the Securities Exchange Act, the SEC is a governmental body charged with ensuring that every self-regulatory organization (“SRO”), such as Nasdaq, complies with the provisions of the Act, the SEC’s own rules and regulations, and the SRO’s own rules. See generally 15 U.S.C. § 78s. Nasdaq’s proposed rules cannot “take effect unless approved by the Commission.” Id. at §78s(b)(1). Once the SEC approves a proposed rule, it, in effect, becomes binding federal law. The rule then “may be enforced by such organization to the extent it is not inconsistent with the provisions of [the Exchange Act], the rules and regulations thereunder, and applicable Federal and State law.” Id. at § 78s(b)(3)(C).

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7 Id.
As has been the case in other actions maintained against the SEC, a court is likely to find that the proposed rule, if adopted, constitutes government action. In Blount, the D.C. Circuit Court of Appeals rejected the argument of defendant-intervenor, a self-regulatory organization, that a challenged rule was not the product of government action. Blount, 61 F.3d at 941. And in New York Republican State Comm. v. SEC, government action was not an issue that barred the court from hearing a claim challenging the constitutionality of FINRA’s proposed rule that was adopted by the SEC. 927 F.3d 499, 503 (D.C. Cir. 2019).

Further, the SEC, as a federal governmental agency, is forbidden from encouraging and facilitating discrimination on the basis of race and sex. The U.S. Supreme Court has recognized that “the impetus for the forbidden discrimination need not originate with the State if it is state action that enforces privately originated discrimination.” Moose Lodge No. 107 v. Irvis, 407 U.S. 163, 172 (1972) (citing Shelley v. Kraemer, 334 U.S. 1 (1948). As the Court announced in Reitman v. Mulkey, the government may not authorize or encourage private discrimination. 387 U.S. 369, 375-76 (1967). In that case, the Court found that an amendment to the California Constitution amounted to government authorization of private discrimination in the housing market. This was enough for the Court to find state action, such that the government was encouraging and facilitating private discrimination in violation of the Fourteenth Amendment. Id.

In short, if the SEC adopts the Proposed Rule, it will amount to government action facilitating and encouraging private discrimination on the basis of race and sex, in violation of the Fifth Amendment. There is no doubt that litigation will commence shortly after the Proposed Rule goes into effect.8

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8 Judicial Watch foresees potential challenges to the Proposed Rule to be brought by companies listed in the exchange, their shareholders, and prospective board members. Companies will commence litigation because “[a] person required by the government to discriminate by ethnicity or sex against others has standing to challenge the validity of the requirement, even though the government does not discriminate against him.” Monterey Mech. Co. v. Wilson, 125 F.3d 702, 707 (9th Cir. 1997); see also Peterson v. City of Greenville, 373 U.S. 244, 248, 10 L. Ed. 2d 323, 83 S. Ct. 1119 (1963) (A “law compelling persons to discriminate against other persons because of race” is a "palpable violation of the Fourteenth Amendment," regardless of whether the persons required to discriminate would have acted the same way regardless of the law). A shareholder could bring a derivative action alleging the same. A prospective board member will allege the “discriminatory classification prevent[s] the [prospective board member] from competing on an equal footing.” Id. (citing Northeastern Fla. Chapter, Associated Gen. Contractors of America v. Jacksonville, 508 U.S. 656, 667(1993)).
The Proposed Rule is repugnant to the Constitution’s guarantee of equal protection under the law. Because it runs afoul to the Fifth Amendment, Judicial Watch urges the SEC to reject this flagrantly unconstitutional Rule.

Sincerely,

Thomas J. Fitton
President, Judicial Watch, Inc.