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*“promoting ethics in public life”*



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January 14, 2021

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 (Dec. 11, 2020)**

Dear Secretary Countryman:

The National Legal and Policy Center (NLPC) hereby submits these comments opposing the proposed rule that, in the name of diversity, would effectively require a raced-based and sex-based quota system whereby members of Nasdaq must have at least two “diverse” members on their Board of Directors, regardless of the size of the Board.<sup>1</sup> Such a rule not only violates well-established anti-discrimination jurisprudence but also impermissibly interferes with corporate governance principles.

Moreover, the alleged benefits that these diversity rules purport to advance are not only not proven, but also the rule may lead to cosmetic or token changes to Board compositions without showing any of the alleged benefits in the way the company operates.

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<sup>1</sup> Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity,” *Federal Register*, Vol. 85, No. 239, December 11, 2020, pp. 80472-80505 [Release No. 34-90574; File No. SR-NASDAQ-2020-081] (hereinafter “proposed rule”)

<https://www.federalregister.gov/documents/2020/12/11/2020-27091/self-regulatory-organizations-the-nasdaq-stock-market-llc-notice-of-filing-of-proposed-rule-change>

## Interest of NLPC

NLPC is a nonprofit, public interest and policy center founded in 1991, whose overall mission is to promote ethics in public life. NLPC has a Corporate Responsibility Project that promotes integrity in corporate governance, including honesty and fair play in relationships with shareholders, employees, business partners and customers. In doing so, NLPC places special emphasis on the responsibility of the corporation to defend and advance the interests of the people who own the company, the shareholders, not someone else's political agenda.

In that regard, NLPC has over the years attended stockholder meetings as a shareholder to advocate the interests of shareholders and oppose calls by activists to advance one-sided special interests that are often hypocritical.<sup>2</sup>

### **The Proposed Rules Are Unwarranted and Would Require Illegal Quotas in Board Composition**

The proposed rules, if approved by the SEC, would mandate that Nasdaq-listed companies:

*(i) Provide statistical information regarding diversity among the members of the company's board of directors under proposed Rule 5606; and (ii) have, or explain why it does not have, at least two "Diverse" directors on its board under proposed rule 5605(f)(2). "Diverse" means a director who self-identifies as: (i) Female, (ii) an Underrepresented Minority, or (iii) LGBTQ+. Each listed company must have, or explain why it does not have, at least one Female director and at least one director who is either an Underrepresented Minority or LGBTQ+. . . . "Female" means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth. "Underrepresented Minority" means. . . an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races*

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<sup>2</sup> See, e.g., *Flaherty Rips Alphabet/Google at Annual Meeting for Caving to 'Left-Wing Mob'* (June 19, 2019)

<https://nlpc.org/2019/06/19/flaherty-rips-alphabet-google-at-annual-meeting-for-caving-to-left-wing-mob/>; *Facebook Opposes Shareholder Proposal on Ideological Diversity* (May 28, 2019)

<https://nlpc.org/2019/05/28/facebook-opposes-shareholder-proposal-on-ideological-diversity/>; see also Letter to Editor from NLPC Chairman Peter Flaherty, Wall Street Journal (May 27, 2020) (criticizing Blackrock's CEO Larry Fink for disinvesting in fossil fuel companies but not China companies complicit in human-rights abuses, because neither Fink's "idea of moral and socially responsible investing nor that of his so-called "progressive" critics takes into account these human-rights issues." ). <https://nlpc.org/2020/05/27/wall-street-journal-letter-poor-larry-fink/>

or Ethnicities. “LGBTQ+” means an individual who self-identifies as any of the following: Lesbian, gay, bisexual, transgender or a member of the queer community.<sup>3</sup>

NLPC supports the compelling and well-researched comments submitted in opposition to these proposed rules by David R. Burton, Senior Fellow on Economic Policy at the Heritage Foundation (January 4, 2021). Mr. Burton summarizes his 21-page, heavily footnoted comments as follows:

As discussed in detail below, the empirical literature has been misrepresented by Nasdaq. Moreover, if, as Nasdaq claims, diversity requirements (as defined by Nasdaq) are such an obvious and simple way to increase returns, then boards, management and shareholders will require no regulatory mandate to adopt them because it will be in their own financial interest to do so. The fact that Nasdaq feels compelled to mandate diversity as it defines it belies the argument that it is in investor’s interest. The rule represents an attempt to pursue political or social objectives unrelated to the Commission mission and likely to be detrimental to investor interests.<sup>4</sup>

To this observation, NLPC would add that the diversity rule is a solution in search of a problem. As Nasdaq itself has even admitted, “Nasdaq believes a supermajority of listed companies have made notable strides to improve gender diversity in the boardroom and have at least one woman on the board. Nasdaq also believes that listed companies are diligently working to add directors with other diverse attributes....” So why the mandate? Nasdaq readily admits that its proposal is driven by last year’s visible “*social justice movement [that] has brought heightened attention to the commitment of public companies to diversity and inclusion.*”<sup>5</sup> As Mr. Burton aptly put it:

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<sup>3</sup> 85 FR 80473.

<sup>4</sup> Burton Comments at 5.

<sup>5</sup> *Id.* Perhaps to demonstrate how woke the Nasdaq is, its diversity rule uses the term “Latinx” in place of “Latino” to describe a minority category, even though a 2020 Pew Research Center survey found that only 23% of U.S. adults who self-identified as Hispanic or Latino were aware of the term “Latinx” and that of those, 65% said it should not be used to describe their ethnic group. Pew Research Center, *About One-in-Four U.S. Hispanics Have Heard of Latinx, but Just 3% Use It* (Aug. 11, 2020). <https://www.pewresearch.org/hispanic/2020/08/11/about-one-in-four-u-s-hispanics-have-heard-of-latinx-but-just-3-use-it/> Moreover, the quota can be met by someone who “self-identifies” as a Latinx or Black, even though they are not. See CNN, *A White professor says she has been pretending to be Black for her entire professional career* (Sept. 4, 2020). <https://www.cnn.com/2020/09/03/us/jessica-krug-gwu-black-trnd/index.html>

In contemporary political parlance, [“social justice”] is associated with ideologies that, at the least, [are] deeply suspicious of market outcomes and countenance a high degree of government intervention in the economy. Often, it is a proxy term for Social Democratic or socialist views on economics and critical race theory on social issues. Its economic dimension rests on the premise that a pre-determined distribution of goods should be enforced by the state. This is a substantially different conception of justice than most, which rely on evaluating individual actions, merit and desert. . . . [The Nasdaq Rule] opines about how important “social justice” is, and “stakeholders” are, as the motivation for the proposed rule. Yet it fails to actually discuss what social justice is or to define “stakeholder” (let alone offering suggestions on how boards or management would weigh the claims of competing ‘stakeholders’ or the implications of these concepts for shareholders and society at large). To Nasdaq, social justice and stakeholders are buzzwords or fuzzwords that count as virtue signaling for Nasdaq management.

Burton Comment at 4, n.15.

Moreover, if transparency is another goal of the proposed rule so that investors have information about the diversity of the Board composition of a Nasdaq-listed company before deciding to invest in that company, that information is available on the company’s website with the biographical information of its Board members as well its officers. Investors are unlikely to access such information from the SEC. It is in the company’s interest to promote and advertise the diversity of its board if it believes that such diversity will attract investors, regardless of, or in addition to, the economic performance of the company.

### **The Proposed Rule Requiring Racial and Gender Quotas Constitutes Unlawful Discrimination**

Nasdaq claims that the diversity requirements are not mandates because the rule only mandates the reporting of the composition of Board members. 85 FR 80492. Not so. If the company does not meet the arbitrary quota of minority membership on its Board without an explanation satisfactory to Nasdaq, the company will face delisting from Nasdaq. No doubt, a proffered explanation for not achieving the quota that the company believes such quotas are unlawful and not in the public interest would not be acceptable. In any event, “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). The Rule thus constitutes government action for purposes of establishing an equal protection claim. *See Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995).

Accordingly, the proposed rules are intended to impose arbitrary racial and gender quotas without showing a compelling governmental interest, and thus violate the Constitution’s equal protection clause of the Fifth Amendment and as well as statutory provisions prohibiting discrimination. As one civil rights and constitutional lawyer explained in analyzing the proposed rule:

[R]acial quotas are forbidden as a means of pursuing diversity, even in the unusual contexts where an applicant’s race can be considered to promote diversity. That’s what the Supreme Court ruled when it [struck down](#) a racial quota in college admissions. [Such quotas] violated both the Constitution and 42 U.S.C. 1981, which bans racial discrimination in public and private contracts. (See *Gratz v. Bollinger*, 539 U.S. 244, 276 n.23 (2003)).

Moreover, corporate boards are not an area where diversity justifies the use of race at all. Most courts say that in employment, as opposed to college admissions, diversity is not a reason to consider an applicant’s race. An appeals court [struck down](#) a federal diversity regulation imposed on broadcasters for that reason, finding it unconstitutional. (See *Lutheran Church–Missouri Synod v. FCC* (1998)).

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Quotas also aren’t a valid response to any discrimination in the business world — and the [proposed rule](#) cites no examples of such discrimination, focusing instead on what it describes as the “underrepresentation” of minorities on corporate boards.

The courts have struck down even gender quotas for government boards and commissions in cases such as *Back v. Carter*. Racial quotas are even more contrary to the federal law than gender quotas, because racial classifications are subject to [strict scrutiny](#) under the federal constitution and [42 U.S.C. 1981](#), while gender classifications are subject only to [intermediate scrutiny](#) under the federal constitution.

Most judges say that under strict scrutiny (which applies under both the Constitution and [Section 1981](#)), race-based programs and affirmative action are permitted only as a way of remedying intentional discrimination, not racial disparities amounting only to “disparate impact.” (See, e.g., *Builders Association v. County of Cook* (2001); *People Who Care v. Rockford Board of Education* (1997); *Michigan Road Builders v. Milliken*, 834 F.2d 583, 593 (6th Cir. 1987), *aff’d*, 489 U.S. 1061 (1989)).

In addition to 42 U.S.C. 1981, other federal laws also may be infringed by NASDAQ’s racial and gender quota. Title VII of the Civil Rights Act generally forbids racial and gender quotas and prohibits an employer like NASDAQ from forcing such quotas [on other employers](#). Title VII lets companies use affirmative action in limited circumstances — namely, to fix what the Supreme Court [calls](#) a “manifest racial imbalance” in “traditionally segregated job categories.”<sup>6</sup>

The proposed “one-size-fits-all” rule of requiring two minority board members on a Board regardless of its size and the nature of the business of the particular company, clearly

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<sup>6</sup> Hans Bader, *NASDAQ Proposes Illegal Racial Quotas for Corporate Boards; ACLU Applauds*, CNSNews (Dec. 1, 2020). <https://www.cnsnews.com/commentary/hans-bader/nasdaq-proposes-illegal-racial-quotas-corporate-boards-aclu-applauds>

demonstrates that the rule is simply a cosmetic quota and not tailored to address any alleged “manifest racial imbalance” in the Board composition. As Mr. Bader further explains:

But companies don’t necessarily have such a racial or sexual “imbalance” just because they have no women or minorities on their board. If there aren’t many blacks in the high-tech field, it’s not a high-tech company’s fault that it doesn’t have many black employees, either. That isn’t considered a “manifest imbalance.” And if few women work in a sector like metallurgy, a metallurgical company won’t be deemed to have a manifest sexual imbalance just because it has no female managers or board members. (See *Janowiak v. South Bend* (1984)).

And there just aren’t many black people in high-tech. “Blacks made up 7 percent of U.S. high-tech workforce” and just “3.1 percent” of people in technical jobs at major U.S. tech companies, [according to Fortune](#)<sup>7</sup>

While it is laudable to encourage companies to explore the talent pool for qualified directors, regardless of their skin color, sex, or ethnic backgrounds, at the end of the day, requiring an arbitrary quota for Board membership is inimical to our Constitution and civil rights laws. As Heritage’s Mr. Burton aptly put it in his comments:

Morally, it represents a marked step backwards. It is rejection of the principle that people should be judged on the content of their character and their individual achievement rather than their sex, race, national origin, ethnicity or sexual orientation. It is rejection of the principle that people should be judged as individuals rather than as members of a racial or sexual group. It is a rejection of the principle of equal protection under the law (or, in this case, regulations promulgated under law). It is a rejection of the principle that we are all created equal. Legal discrimination or quotas on the basis of race or sex should be a relic of the past.<sup>8</sup>

### **The Diversity Reporting Rule Violates the Paperwork Reduction Act**

Proposed Rule 5606 contains “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA). 44 U.S.C. 3501 *et seq.* The purpose of the proposed rule is to collect information about the composition of Nasdaq-listed Board members in order to satisfy the diversity quota. Accordingly, the SEC is required to submit the proposed rule to the Office of Management and Budget (OMB), for review in accordance with the PRA to determine its necessity and the burden imposed on the reporting entity “no later than the date of publication of a notice of proposed rulemaking in the Federal Register.”<sup>9</sup>

When the notice of proposed rulemaking goes out for comment, an agency must state the following in the rule preamble: 1) that the proposed rule contains an information

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<sup>7</sup> Id.

<sup>8</sup> Burton Comment at 16.

<sup>9</sup> 44 U.S.C. 3507(d)(1)(A) and 5 CFR 1320.11. The threshold for triggering the PRA is the collection of information from more than 10 respondents, which is clearly met here.

collection; 2) describe and identify the collection; and 3) indicate that it has been submitted to OMB for review. This step and the solicitation for comments on the collection in the proposed rule replace the 60-day and 30-day Federal Register notices required in the more typical information collection process. The agency must also concurrently submit the proposed collection to OMB for review.<sup>10</sup>

The proposed rule was published in the Federal Register on December 11, 2020. And while the proposed rule states that Nasdaq “believes that the adoption of Rule 5606 will not impose any undue burden on competition among listed companies,”<sup>11</sup> nowhere in the proposed rule, let alone in the requisite preamble, does it state that this proposed collection of information has been submitted to OMB for its review and comment, or why it is exempt from the PRA.

Furthermore, if OMB does not approve the collection of information through its Office of Information and Regulatory Affairs (OIRA) and does not assign an OMB Control Number valid for three years (subject to renewal) to be printed on the proposed Board Diversity Matrix form, no adverse action can be taken against the reporting entity for not complying with the information collection request.<sup>12</sup>

### **The Board Diversity Rule Is Another Example of the Creeping Federalization of Corporate Governance**

While there is a legitimate need for the federal government to regulate the financial markets to ensure their integrity, corporate governance is a matter of state law where the company is chartered. Unfortunately, the federal government has impermissibly intruded on the province of the States in areas of corporate governance, as this proposed rule clearly does.

As Professor Stephen A. Bainbridge noted in his critique of the controversial Sarbanes-Oxley Act:

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<sup>10</sup> A Guide to the Paperwork Reduction Act, *PRA approval process associated with rules* <https://pra.digital.gov/clearance-process/rules/#publish-proposed-rule-in-federal-register-and-submit-request-to-omb>

<sup>11</sup> 85 FR 80504.

<sup>12</sup> To be sure, Independent regulatory agencies such as the Securities and Exchange Commission can, by majority vote, void any OIRA disapproval of a proposed collection of information. See 44 U.S.C. § 3507(f). Nevertheless, the SEC is not exempt from submitting the proposed collection of information rule to the OMB in the first place for its review and possible further public comment.

The corporation is a creature of the state “whose very existence and attributes are a product of state law.” States have an interest in overseeing the firms they create. States also have an interest in protecting the shareholders of their corporations. Finally, as the Court noted in *CTS v. Dynamics*, a state has a legitimate “interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.” In other words, state regulation not only protects shareholders, but also protects investor and entrepreneurial confidence in the fairness and effectiveness of the state corporation law.<sup>13</sup>

The proposed rule acknowledges that this rule is patterned after a similar California law, under litigation, that also requires Board diversity. “California requires companies headquartered in the state to have at least one director who self-identifies as a Female and one director from an Underrepresented Community. *See* Cal. S.B. 826 (Sept. 30, 2018); Cal. A.B. 979 (Sept.30, 2020).”<sup>14</sup> A few other States have or are considering similar legislation.

While those quota laws suffer from the same legal infirmities as this one, as previously discussed, at least they are a creature of state law and not federal law. More important, they are the product of the deliberative legislative process to be approved or defeated by the democratically elected representatives of its citizens rather than by an unelected, unaccountable “independent” bureaucracy through a rushed administrative process without any public hearing.

### Conclusion

For all the foregoing reasons, NLPC urges the SEC to disapprove the proposed Nasdaq Board Diversity Rules.

Respectfully submitted,



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<sup>13</sup>Bainbridge, *The Creeping Federalization of Corporate Law*, Regulation 30-31(Spring 2003). Harvard Law School on Corporate Governance, *The Federalization of Corporate Governance* (June 21, 2018). <https://www.google.com/search?client=firefox-b-1-d&q=corporate+governance+should+be+state+law+not+federal+law>. See also Steinberg, Harvard Law School Forum, *The Federalization of Corporate Governance* (June 21, 2018) <https://corpgov.law.harvard.edu/2018/06/21/the-federalization-of-corporate-governance/>

<sup>14</sup> 85 FR 80482.