

## Board Diversity Is Here to Stay: Extrajudicial Avenues

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# Board Diversity Is Here to Stay: Extrajudicial Avenues

Maryann Lennon\*

*Board diversity laws have become a focus of corporations, lawmakers, and courts across the country as constitutional challenges to the policies continue to be raised. California is one of the first states to implement statutes relating to board diversity requirements for publicly held corporations within the state. Nasdaq has followed in similar footsteps, implementing new rules that require a certain number of diverse members on boards for companies listed on the exchanges or a statement explaining a lack thereof. Supporters of the board diversity laws may want to lean on arguments made upholding affirmative action policies within the university system. But that inclination has benefits and risks.*

*Affirmative action policy could be used to show the potential effect these board diversity laws could have on corporations. The affirmative action data could be beneficial as there are studies in education that suggest the benefits of diverse schools are translatable to other contexts. Because little-to-no data about the effect diversity on business outcomes exist, decades of affirmative action data fill an important gap. At the same time, affirmative action policy might not be the most stable moor to tie a ship. During the October 2022 term, the originalist-leaning Court signaled it is near to striking down affirmative action policies in higher education. This was confirmed by the Court's decisions on June 29, 2023.*

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*This Note predicts the decision could have a ripple effect on all board diversity related statutes. As affirmative action policies are struck down, policy proponents must distinguish board diversity statutes from affirmative action policies to survive the Court's scrutiny. The path forward will require reliance upon empirical evidence, self-governance of boards and corporations, and for the rule makers at the SEC to step in and take the matter into their own hands.*

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## INTRODUCTION

Diversity on boards of directors is a focus for many corporations given the increasing demands for gender, racial, and ethnic diversity in boardrooms and the recognition of the benefits of diverse groups and thinkers.<sup>1</sup> Resulting from a greater desire for diversity, state legislatures and national stock exchanges have begun taking the initiative and creating their own rules and regulations to promote diversity on boards.<sup>2</sup> Even though many corporations support the new board diversity requirements, some companies nonetheless oppose the rules. The state of California implemented two board diversity laws, which are now on appeal in the state court system; the laws were initially struck down as unconstitutional.<sup>3</sup> Additionally, the Nasdaq exchange implemented its own board diversity rules for companies listing on its exchange. Similar to California, Nasdaq's rules are facing constitutional challenges, involving litigation within the Fifth U.S. Circuit Court of Appeals.<sup>4</sup>

Board diversity statutes possess similarities with prior constitutional arguments involving affirmative action policies in higher education. Affirmative action policies have received constitutional support through

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<sup>1</sup> Carey Oven & Linda Akutagawa, *The Board Diversity Census of Women and Minorities on Fortune 500 Boards*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 25, 2021), <https://corpgov.law.harvard.edu/2021/06/25/the-board-diversity-census-of-women-and-minorities-on-fortune-500-boards/> (discussing how protests over racial injustices and state legislative action on board composition in 2020 made clear that the need for greater representation of women and minorities in the boardrooms of America's largest companies can no longer be stalled).

<sup>2</sup> See CAL. CORP. CODE § 301.3 (West 2021); CAL. CORP. CODE § 301.4 (West 2021); see also *See NASDAQ 5600 Series Rule 5605*, NASDAQ, <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series>.

<sup>3</sup> CAL. CORP. CODE § 301.3 (West 2021); CAL. CORP. CODE § 301.4 (West 2021); see also *Crest v. Padilla*, No. 19-STCV-27561, 2022 WL 1565613, at \*1 (Cal. Super. Ct. May 13, 2022); *Crest v. Padilla*, No. 20-STCV-37513, 2022 WL 1073294, at \*1 (Cal. Super. Ct. Apr. 1, 2022).

<sup>4</sup> See Jody Godoy, *Showdown over Nasdaq board diversity rule heads to 5th Circuit*, REUTERS (Aug. 29, 2022, 10:05 AM), <https://www.reuters.com/legal/government/showdown-over-nasdaq-board-diversity-rule-heads-5th-circuit-2022-08-29/>.

court decisions;<sup>5</sup> therefore, constitutional claims of affirmative action policies could aid the current legal battle California's statutes are undertaking as well as Nasdaq's new rule that has been adopted and accepted by the SEC.

This note examines the different paths board diversity statutes should consider to withstand constitutional scrutiny. The purpose of board diversity statutes has been contested, and not much is known about the potential impact as these laws are so new. Affirmative action policies have been acknowledged policies for a longer period, compared to board diversity statutes.<sup>6</sup> Decades ago, the Supreme Court found having a more diverse student body has a positive influence on education systems, especially for psychological reasons as the blatant inferiority sentiment from segregation is removed.<sup>7</sup> Empirical data notwithstanding, this history creates a strong inference that board diversity does the same for boardroom psychology. When courts heard cases like *Brown v. Board of Education*, there was some scientific support, but not perfect empirical support about the benefits of desegregation.<sup>8</sup> At a glance, affirmative action policies for universities and board diversity seem similar but it is still essential that supporters of board diversity statutes do not rely solely upon the constitutionality of affirmative action policies at universities. Leading Supreme Court commentators believe the Court will likely overturn *Grutter v. Bollinger* and *Regents of the University of California v. Bakke*, two cornerstones of affirmative action jurisprudence.<sup>9</sup>

This note concludes discussing the effects of the decisions in cases like, *Students for Fair Admissions v. President and Fellows of Harvard*

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<sup>5</sup> See *Brown v. Bd. of Educ.*, 347 U.S. 483 (1954); *Regents of Univ. of Cal. v. Bakke*, 438 U.S. 265, 299 (1978).

<sup>6</sup> See Jeffrey H. Cohen, *New California Law Becomes First in Nation to Require Diversity on Boards of Public Companies*, SKADDEN (Oct. 2, 2020), <https://www.skadden.com/insights/publications/2020/10/new-california-law>.

<sup>7</sup> See *Brown*, 347 U.S. at 483.

<sup>8</sup> *Id.* at 494-95 (“Segregation of white and colored children in public schools has a detrimental effect upon the colored children. The impact is greater when it has the sanction of the law; for the policy of separating the races is usually interpreted as denoting the inferiority of the negro group. A sense of inferiority affects the motivation of a child to learn. Segregation with the sanction of law, therefore, has a tendency to [retard] the educational and mental development of Negro children and to deprive them of some of the benefits they would receive in a racial[ly] integrated school system.’ Whatever may have been the extent of psychological knowledge at the time of *Plessy v. Ferguson*, this finding is amply supported by modern authority.”).

<sup>9</sup> See, e.g., Amy Howe, *In Cases Challenging Affirmative Action, Court Will Confront Wide-Ranging Arguments on History, Diversity, and the Role of Race in America*, SCOTUSBLOG (Oct. 26, 2022, 4:06 PM), <https://www.scotusblog.com/2022/10/in-cases-challenging-affirmative-action-court-will-confront-wide-ranging-arguments-on-history-diversity-and-the-role-of-race-in-america/>.

*College*, and the impact that decision could have on board diversity statutes. The Supreme Court striking down affirmative action policies within higher education could create a ripple effect seen through all diversity requirements, including board diversity laws. Therefore, proponents of board diversity laws should create a space that separates the laws for corporations from affirmative action policies and rely on empirical data and evidence that diverse boards have substantial economic benefits for corporations.<sup>10</sup> Institutions of higher education and corporate boards are innately different; the difference relies upon self-governance of corporations and the social and economic pressures that have become exceedingly more influential and pertinent.<sup>11</sup> Additionally, avenues include opportunities for legislative intervention and SEC rulemaking, as ways to protect board diversity.<sup>12</sup> Supreme Court decisions regarding affirmative action should not be the end of the road when there are many other avenues for board diversity supporters to take in efforts to safeguard these policies.

This note explores board diversity statutes, the legal action these statutes are facing, and the potential future that board diversity has inside, and outside, the legal system. Part I discusses where board diversity originated from and the related rules and laws that have been enacted, both in states and for national stock exchanges, related to diversity on corporate boards. Part II discusses the current legal challenges that board diversity related statutes are now seeing at the state and federal level. Part III compares the challenges board diversity is facing with the challenges affirmative action is facing today, looking at the history and similarities between the constitutional arguments. Part IV examines other extrajudicial avenues board diversity could explore to expand the impact if it is continually struck down in by the court. This note concludes by tying these parts together and making the conclusion that even though board diversity and affirmative action may have similarities, the death of one does not mean the end of the road for the other.

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<sup>10</sup> Cf. Adam Chilton et al., *Assessing Affirmative Action's Diversity Rationale*, 122 COLUM. L. REV. 331 (2022) (showing diversity's positive effect in boosting the impact of student-run law reviews through empirical study).

<sup>11</sup> Ellen Holloman & Hyungjoo Han, *How ESG and Social Movements are Affecting Corporate Governance*, LEXISNEXIS (Oct. 27, 2021), <https://www.lexisnexis.com/community/insights/legal/practical-guidance-journal/b/pa/posts/how-esg-and-social-movements-are-affecting-corporate-governance> (providing guidance on the recent trends in Environmental, Social, and Governance, the #MeToo movement, and Black Lives Matter impacting corporate governance and the workplace).

<sup>12</sup> See *Investor Bulletin: An Introduction to The U.S. Securities and Exchange Commission – Rulemaking and Laws*, SEC, [https://www.sec.gov/oica/investor-alerts-and-bulletins/ib\\_rulemaking](https://www.sec.gov/oica/investor-alerts-and-bulletins/ib_rulemaking) (Aug. 20, 2015).

## I. BOARD DIVERSITY LAWS AND RULES

Diversity among boards is an important matter for many businesses, investors, and national exchanges. Along with the increasing demand for diversity among boards, governments and national exchanges have begun to create requirements for diversity on their own accord.

### A. *Historical Background*

Progress has been made with diversity among members of corporate boards but at a gradual rate, which has required decades to see any substantial change.<sup>13</sup> Studies that look at Fortune 500 companies and their board compositions suggest women and minorities have made more progress in board representation between 2016 and 2020 than between 2010 and 2016.<sup>14</sup> Although this increase is positive, it will require decades more for the achievement of equitable gender and minority board representation. Women and minority board members are more likely than white men to bring experience with corporate sustainability and socially responsible investing, sales and marketing, technology in the workplace, and government to their boards.<sup>15</sup> In today's post-pandemic world, these skills are essential to a business's success and less than 55% of board members in the Fortune 500 report having any one of these skills.<sup>16</sup> Studies from 2016, 2018, and 2020 show that the impact of placing women and minorities in the positions of board chair and nominating or governance chair can pay immediate and future dividends for the promotion of board diversity.<sup>17</sup> The business case for board diversity is not some new idea, and the benefits of a diverse board is known, which makes board diversity quotas an essential component to corporate governance.<sup>18</sup>

Employment diversity attracts attention from states all over the country, as well as major stock exchanges.<sup>19</sup> At least a dozen states have considered, and more than half of them have enacted, legislation dealing with diversity and inclusion in the workplace in the 2021-2022 biennium.<sup>20</sup> Diverse board members can speak their minds, challenge the status quo,

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<sup>13</sup> See Oven & Akutagawa, *supra* note 1.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *See id.*

<sup>19</sup> See Rich Ehsen, *Will More States Set Board Diversity Mandates?*, LEXISNEXIS (Jan. 13, 2022), <https://www.lexisnexis.com/community/insights/legal/capitol-journal/b/state-net/posts/will-more-states-set-board-diversity-mandates>.

<sup>20</sup> *Id.*

and do what is in the best interest of all stakeholders.<sup>21</sup> An essential component to the economic success of businesses is for diverse board members to bring their unique perspective and life experience into the strategic decision-making process.<sup>22</sup> Then, as boards become more diverse, companies will become more inclusive, creating a virtuous cycle.<sup>23</sup>

### B. *Laws and Rules*

The State of California and Nasdaq have begun to implement laws and rules relating to

board diversity requirements for publicly held companies and companies listed on its stock exchange.

#### 1. California Senate Bill 826

In 2018, California implemented Senate Bill No. 826 (“SB 826”), which added Sections 301.3 and 2115.5 to the California Corporations Code.<sup>24</sup> Section 301.3 states that by the end of 2019, publicly held corporations, both domestic or foreign, whose principal executive offices are located in California, must have a minimum of one female director placed upon its board of directors.<sup>25</sup> Additionally, SB 826 states that no later than the close of the 2021 calendar year, publicly held corporations must have a minimum of three female directors, if their number of directors are two or more, two female directors if the number is five, and one female director if they have fewer than four board members.<sup>26</sup> If the publicly held corporations failed to comply, California would fine the corporations \$100,000 for a first offense and \$300,000 for every subsequent offense.<sup>27</sup>

#### 2. California Assembly Bill No. 979

In 2020, California implemented Assembly Bill No. 979 (“AB 979”), which amended Section 301.3 and added Sections 301.4 and 2115.6 to the California Corporations Code.<sup>28</sup> The addition of Section 301.4 to the

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<sup>21</sup> Michael Buck and Victor Crawford, *It’s Time to Make Board Diversity an Expectation, Not Just a Priority*, FORTUNE, (Jun. 23, 2021) <https://fortune.com/2021/06/23/board-diversity-women-poc-inclusion-talent-business-leadership/>.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> S.B. 826, 2018 Reg. Sess. (Cal. 2018).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> Assemb. B. 979, 2019 Reg. Sess. (Cal. 2020).



California Corporations Code stated that by the end of 2021, publicly held corporations, both domestic or foreign, whose principal executive offices are located in California, must have a minimum of one member from an underrepresented community as a director placed upon its board.<sup>29</sup> AB 979 also stated that no later than the close of the 2022 calendar year, the publicly held corporations must have a minimum of three directors from underrepresented communities if the number of directors is nine or more on the board, two directors from underrepresented communities if the number is more than four but under nine, and one director from an underrepresented communities if the board has fewer than four board members.<sup>30</sup> If the publicly held corporations failed to comply, California would fine the corporations \$100,000 for a first offense and \$300,000 for every subsequent offense.<sup>31</sup>

### 3. Nasdaq Rule 5605

Nasdaq adopted Rule 5605, which included a section on “Diverse Board Representation.”<sup>32</sup> Rule 5605 is located under Nasdaq’s corporate governance requirements for companies listing on the exchange. This rule applies to companies listed, with some exceptions for foreign issuers, smaller reporting companies, and companies with smaller boards, to have, or explain why they do not have, at least two members of its board of directors who are diverse.<sup>33</sup> If a company satisfies the requirements of Rule 5605, which lays out the objective of the rule, but fails to meet the requirements of the diverse board members, the company must do the following: (i) specify the requirements of Rule 5605(f)(2) that are applicable; and (ii) explain the reasons why it does not have two diverse directors, or one diverse director, if they fall in one of the exempt categories.<sup>34</sup> Additionally, each company must annually disclose information regarding each director’s voluntary self-identified characteristics and post the board diversity makeup to the company’s website.<sup>35</sup> Following the first year of disclosure, all companies must

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *See NASDAQ 5600 Series Rule 5605*, NASDAQ, <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series>

<sup>33</sup> *See id.* (including (i) at least one Diverse director who self-identifies as Female; and (ii) at least one Diverse director who self-identifies as an Underrepresented Minority or LGBTQ+).

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at Rule 5606.

disclose the current year and the immediately preceding year's diversity statistics using the "Board Diversity Matrix."<sup>36</sup>

## II. LEGAL CHALLENGES TO BOARD DIVERSITY LAWS AND RULES

Since the State California and Nasdaq implemented laws and rules relating to board diversity requirements for publicly held companies and companies listed on its stock exchange, the laws and rules have been faced with legal opposition.

### A. Challenges to California Laws

Constitutional challenges to the two statutes from California were heard in the Superior

Court of the State of California for the County of Los Angeles.<sup>37</sup> Opponents of the statutes filed multiple suits, and three California plaintiffs, represented by Judicial Watch, both in state and federal court, asserted that the statutes employed unconstitutional classifications of board candidates based on gender and race.<sup>38</sup> The plaintiffs' complaints asserted that expenditure of taxpayer funds or taxpayer-financed resources on the statutes were illegal because it forced companies to appoint a specific number of directors based upon race, ethnicity, sexual preference, transgender, or gender status and could not demonstrate a compelling governmental interest required for the use of such classifications under the California Constitution.<sup>39</sup> These legal challenges were heard in two separate cases, based on the respective statutes, *Crest v. Padilla I* and *Crest v. Padilla II*.<sup>40</sup> Both cases analyzed the similar claim that the individual statutes were violating the California Constitution on similar grounds.

#### 1. *Crest v. Padilla I*

The Superior Court of the State of California for the County of Los Angeles held in *Crest v. Padilla I*, that SB 826 violated the Equal

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<sup>36</sup> *Id.*

<sup>37</sup> See David A. Bell, et al., *California Court Finds California Board Diversity Law Unconstitutional*, HARV. L. SCH. F. ON COR. GOVERNANCE, (Apr. 23, 2022), <https://corpgov.law.harvard.edu/2022/04/23/california-court-finds-california-board-diversity-law-unconstitutional/>.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Crest v. Padilla*, No. 19-STCV-27561, 2022 WL 1565613, at \*1 (Cal. Super. Ct. May 13, 2022); see also *Crest v. Padilla*, No. 20-STCV-37513, 2022 WL 1073294, at \*1 (Cal. Super. Ct. Apr. 1, 2022).

Protection Clause of the California Constitution.<sup>41</sup> Judge Duffy-Lewis found that the law created a quota that “affects two or more ‘similarly situated’ groups in an unequal manner.”<sup>42</sup> The court applied strict scrutiny and held that the State had failed to show that the legislation was narrowly tailored to meet a compelling state interest.<sup>43</sup> The court found a lack of proof that SB 826’s use of a gender-based classification was actually remedial and “designed as nearly as possible to restore the victims of specific purposeful or intentional, unlawful discrimination to the positions the victims would have occupied in the absence of discrimination.”<sup>44</sup> The court’s language and reasoning signaled that, if asked to rule on a different statute more consistent with the nature of other existing legislation intended to prevent and remedy discrimination, the result might have been different.<sup>45</sup> Shortly after the decision enjoining SB 826, the California Secretary of State announced that she directed the filing of an appeal of the decision.<sup>46</sup>

## 2. *Crest v. Padilla II*

The Los Angeles Superior Court in *Crest v. Padilla II* struck down California Corporations Code Section 301.4, also citing a violation of the Equal Protection Clause of the California Constitution.<sup>47</sup> Judge Terry A. Green held that the law violated the Equal Protection Clause of the California Constitution on its face because it “treat[ed] similarly situated individuals—qualified potential corporate board members—differently based on their membership (or lack thereof) in certain listed racial, sexual orientation, and gender identity groups” and required “that a certain specific number of board seats be reserved for members of the group on the list,” thereby excluding members of other groups from those seats.<sup>48</sup> Judge Green found that the Secretary of State of California failed to identify a compelling interest in the case to justify this classification and that the statute was not narrowly tailored to serve the interests offered.<sup>49</sup> In its language, the court did not criticize the goal of the California

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<sup>41</sup> *Crest*, 2022 WL 1073294, at \*20; see also McCandless et al., *California Court Strikes Down Second Board Diversity Law*, DENTONS, (June 7, 2022) <https://www.dentons.com/en/insights/articles/2022/june/7/california-court-strikes-down-second-board-diversity-law>.

<sup>42</sup> *Crest*, 2022 WL 1565613, at \*3.

<sup>43</sup> *Id.* at \*12.

<sup>44</sup> *Id.*

<sup>45</sup> McCandless et al., *supra* note 42.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Crest v. Padilla*, No. 20-STCV-37513, 2022 WL 1073294, at \*19 (Cal. Super. Ct. Apr. 1, 2022).

<sup>49</sup> See *id.*

legislature in enacting the statute but, instead, criticized the specific means the statute took to serve its commitment to equal treatment and opportunity.<sup>50</sup>

### 3. *Alliance for Fair Board Recruitment v. Weber*

As of recent, the U.S. District Court for the Eastern District of California found that California Assembly Bill 979 (“AB 979”) violates federal law.<sup>51</sup> A conservative group, the Alliance for Fair Board Recruitment, filed a lawsuit in the U.S. District Court for the Eastern District of California challenging the legislation under the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution.<sup>52</sup> The group also contended in the suit that the statute violated the prohibition in 42 U.S.C. § 1981 against discrimination on the basis of race in the making and enforcing of contracts by hurting those who do not identify as members of a certain class from board positions.<sup>53</sup> The court reasoned that the legislation created a racial quota because it mandated that a board’s composition consist of a fixed number of “Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native” individuals.<sup>54</sup> The court also granted summary judgment for the Alliance for Fair Board Recruitment with respect to its claim that the statute violated the prohibition in 42 U.S.C. § 1981.<sup>55</sup>

Additionally, the court went on to address whether AB 979 could require corporations to have a board member from an LGBTQ background. In this case, the court could not find a way to separate the references to LGBTQ groups because AB 979’s language was “almost exclusively cast in racial and ethnic terms.”<sup>56</sup>

### C. *Challenges to Nasdaq Rule 5605*

Once Nasdaq adopted Rule 5605, the legal challenges began to confront the exchange and the SEC. These challenges focused on

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<sup>50</sup> McCandless et al., *supra* note 42.

<sup>51</sup> See *Board Diversity in the Balance: Federal Court Holds that California’s Board of Directors Diversity Requirement Violates Equal Protection*, MAYNARD NEXSEN (June 21, 2023), <https://www.maynardnexsen.com/publication-board-diversity-in-the-balance-federal-court-holds-that-californias-board-of-directors-diversity-requirement-violates-equal-protection>.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

violations of the Equal Protection Clause of the Fourteenth Amendment and on violations of First Amendment protections.

1. *Alliance for Fair Board Recruitment v. SEC*

The Fifth Circuit heard arguments in *Alliance for Fair Board Recruitment v. SEC*, which challenged Nasdaq's board diversity rule.<sup>57</sup> The hearing originated from two conservative groups, National Center for Public Policy Research and the Alliance for Fair Board Recruitment, about a year after the SEC approved Nasdaq's rule and after many companies already started disclosing diversity on their boards.<sup>58</sup> The opponents of the rule argued that the rule violates the Equal Protection Clause of the Fourteenth Amendment by encouraging discrimination on the basis of sex and race.<sup>59</sup> Additionally, plaintiffs in *Alliance* claimed that "it flouts the First Amendment's protection of free speech by requiring companies who do not have diverse boards to engage in 'self-condemnation.'"<sup>60</sup> In a brief, Nasdaq stated that deeming its rule a government action would "turn broad swaths of the nation's economy into arms of the state."<sup>61</sup> A push and pull exists between the conservative opponents and the SEC, where the two conservative groups claim that the SEC did not authorize the rule that Nasdaq implemented.<sup>62</sup> But, the SEC stated that it "fulfills the law's aim by providing investors with useful information," seemingly supporting Nasdaq's diversity rule.<sup>63</sup> In August 2021, the Democratic-led SEC, who tends to align with decisions from textualist-leaning court decisions, approved the rule without any Republican support, who tend to align with originalist-leaning court decisions.<sup>64</sup>

On October 18, 2023, a three-judge panel for the U.S. Court of Appeals for the Fifth Circuit denied petitions to review the SEC's approval of Nasdaq's board diversity disclosure rule, therefore upholding Nasdaq's board diversity rule.<sup>65</sup> The Fifth Circuit rejected lawsuits seeking to block the rule stating that the SEC acted within its authority in approving the rule, and was allowed to consider the opinions of investors who said board diversity information was important to their investment decisions.<sup>66</sup>

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<sup>57</sup> *All. for Fair Bd. Recruitment v. SEC*, 85 F.4th 226, 239 (5th Cir. 2023); see Godoy, *supra* note 4; see *NASDAQ 5600 Series Rule 5605*, NASDAQ, <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series>.

<sup>58</sup> Godoy, *supra* note 4.

<sup>59</sup> *All. for Fair Bd. Recruitment*, 85 F.4th at 237-239.

<sup>60</sup> Godoy, *supra* note 4.

<sup>61</sup> *Id.*

<sup>62</sup> *See id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *All. for Fair Bd. Recruitment v. SEC*, 85 F.4th 226, 236 (5th Cir. 2023)

<sup>66</sup> *Id.* at 248-49.

Additionally, the court stated that while the government regulates Nasdaq, it did not create the exchange or appoint its leadership, which allows for the exchange to create these rules.<sup>67</sup> Although the petitioners could seek review of the decision or further review at the Supreme Court, the Fifth Circuit's decision may give boards and companies the green light in developing and disclosing corporate diversity policies in a manner that will withstand current judicial scrutiny.<sup>68</sup>

### III. BOARD DIVERSITY STATUTE CHALLENGES COMPARE TO CONSTITUTIONAL CHALLENGES TO DIVERSITY IN HIGHER EDUCATION

The challenges that board diversity related statutes are currently facing in courts could be compared to the decades of legislation that affirmative action cases in higher education have faced. Both board diversity statutes and affirmative action policies face equal protection scrutiny, looking at whether there is a compelling governmental interest that is constitutional.

#### A. *Fourteenth Amendment Challenges to Affirmative Action Policies*

Challenges to affirmative action policies under the Fourteenth Amendment face strict scrutiny analysis and, to pass constitutional muster, the policies must be constitutional under the strict scrutiny test. Meaning, to withstand strict scrutiny, affirmative action policies must be a valid compelling state interest.<sup>69</sup> General affirmative action policies consider an applicant's race as a factor in an admission's policy for colleges and universities. The courts then determine whether the policies violate the Equal Protection Clause of the Fourteenth Amendment, which the courts have historically said they have not.<sup>70</sup>

##### 1. Historical cases

Since the 1970s, the Supreme Court has heard cases involving affirmative action policies within higher education and these historical decisions have laid the foundation for Fourteenth Amendment application in these scenarios.

<sup>62</sup> *Id.* at 240 (quoting *Desiderio v. NASD, Inc.*, 191 F.3d 198, 206 (2d Cir. 1999)).

<sup>68</sup> Martin Bell et al., *Fifth Circuit Declines to Review SEC's Approval of Nasdaq's Board Diversity Rule*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 15, 2023), <https://corpgov.law.harvard.edu/2023/11/15/fifth-circuit-declines-to-review-secs-approval-of-nasdaqs-board-diversity-rule/#1b>.

<sup>69</sup> *See Regents of Univ. of Cal. v. Bakke*, 438 U.S. 265, 299 (1978);

<sup>70</sup> *See, e.g., id.* at 272 (1978); *see also Grutter v. Bollinger*, 539 U.S. 306, 343 (2003).

a. *Regents of the University of California v. Bakke*

*Regents of the University of California v. Bakke*, a 1978 Supreme Court case, examined whether a medical school would be able to consider race in their evaluation of an applicant to the institution.<sup>71</sup> The Court stressed that a public university may not discriminate based on race in its admissions policies under the Fourteenth Amendment, but the consideration of race to an extent was not taboo.<sup>72</sup> In *Bakke*, even though there was no single majority opinion, the Court decided that the medical school did not violate the Fourteenth Amendment when it considered race as a “plus” to an applicant’s overall evaluation.<sup>73</sup> The Court held that increasing diversity within the institution was a permissible purpose that could be classified as a compelling state interest.<sup>74</sup> But the medical school could not make decisions solely based upon the race of the applicant.<sup>75</sup> *Bakke* was a pivotal case, as it allowed schools to consider race when admitting students, with the important qualification that race could not be the sole reason for admittance.

b. *Grutter v. Bollinger*

*Grutter v. Bollinger*, a case decided by the Supreme Court in 2003, examined whether the consideration of race as a factor in the admissions process for a state law school was a violation of the Fourteenth Amendment.<sup>76</sup> Following *Bakke*, the Court was asked to determine whether the consideration of race, to support student body diversity, was a compelling state interest that would pass strict scrutiny.<sup>77</sup> In this case, the law school discussed the importance of being able to consider race in their admissions process and the benefits that went along with the consideration, including promoting cross-racial understanding, the breaking down of racial stereotypes, and the enabling of students to better understand their peers of difference races.<sup>78</sup> The law school stressed that this system did not employ the use of a quota system to achieve the sought diversity, but a holistic review of each individual applicant.<sup>79</sup> The Court held that consideration of race as a factor in admissions by a state law school does not violate the Fourteenth Amendment, as supporting student body diversity is a compelling state interest because there are benefits to

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<sup>71</sup> *Bakke*, 438 U.S. at 269-70.

<sup>72</sup> *Id.* at 320.

<sup>73</sup> *Id.* at 318.

<sup>74</sup> *Id.* at 311-312.

<sup>75</sup> *See id.* at 318.

<sup>76</sup> *See Grutter v. Bollinger*, 539 U.S. 306, 311 (2003).

<sup>77</sup> *Id.* at 321.

<sup>78</sup> *Id.* at 330.

<sup>79</sup> *Id.* at 337.

the individuals and institutions.<sup>80</sup> But the Court made an important distinction, stating that the state law school must actively work towards ceasing the consideration of race in the admissions process after they have successfully remedied past discrimination and sufficient diversity has been met.<sup>81</sup> The Court expressed that the school must demonstrate it previously made a serious, good faith consideration of workable, race-neutral alternatives to achieve the sought-after racial diversity.<sup>82</sup> The Court did not want to give the school unlimited, ever-lasting ability to consider race within the admissions process and set an expectation of race considerations within a twenty-five-year timeframe.<sup>83</sup>

c. *Parents Involved in Community Schools v. Seattle School District*

*Parents Involved in Community Schools v. Seattle School Dist. No. 1*, a case decided by the Supreme Court in 2007, examined whether public schools could assign students to schools solely on the basis of race for the purpose of achieving racial integration.<sup>84</sup> This case discussed the benefits of having a diverse student body and the positive impact diversity has on the education system.<sup>85</sup> The Court continued to express the underlying theme: race-conscious objectives used to achieve general diversity must be narrowly tailored, supporting an important interest.<sup>86</sup> In this case, the assignment to a particular school was solely based on race, even though evidence was lacking that the school districts implemented this policy for the purpose of working toward a specific diversity goal.<sup>87</sup> There was no individualized consideration of students, purely categorizing students by being “white” and “non-white,” thereby, making it a violation of the Fourteenth Amendment.<sup>88</sup> This reasoning was distinct from *Grutter*, where each applicant was analyzed as an individual at a holistic level, not simply because they were a part of a racial group.<sup>89</sup> Additionally, the schools failed to show that its objectives could not have been met with a non-race-conscious approach.<sup>90</sup> Based on the facts of the case, the Court

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<sup>80</sup> *Id.* at 343.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *See* *Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1*, 551 U.S. 701, 709-11 (2007).

<sup>85</sup> *See id.* at 725-726.

<sup>86</sup> *Id.* at 723.

<sup>87</sup> *See id.* at 746.

<sup>88</sup> *See id.*

<sup>89</sup> *Id.* at 734-35.

<sup>90</sup> *See id.*



opined that public schools may not assign students to schools solely based on race for the purpose of achieving racial integration, although the use of narrowly tailored, race-conscious objectives to achieve diversity in schools, like in *Grutter*, is still permissible.<sup>91</sup>

## 2. Recent Decisions

The Supreme Court heard two cases involving affirmative action in higher education during the October 2022 term and signaled that *Grutter*'s twenty-five-year expiration date is on the chopping block. This prediction was confirmed by the Court's opinions released on June 29, 2023. The two cases are *Students for Fair Admissions v. President and Fellows of Harvard College* and *Students for Fair Admissions v. University of North Carolina* (referred to here as the "FAIR cases").<sup>92</sup>

### a. *Students for Fair Admissions v. President and Fellows of Harvard College*

In 2014, a nonprofit called Students for Fair Admissions ("FAIR") sued Harvard University, alleging that its race-conscious admissions program discriminated against Asian-American applicants.<sup>93</sup> In sum, Harvard implemented an admission process where it was able to explicitly consider the race of an applicant at multiple points in the review process.<sup>94</sup> FAIR challenged Harvard's practices, claiming it was a violation under Title VI of the Civil Rights Act to engage in impermissible racial balancing, and not working towards the use of race-neutral alternatives.<sup>95</sup> Both the district court and the First Circuit concluded that Harvard did not engage in racial balancing or use race as a mechanical plus factor, emphasizing the multiple types of diversity Harvard pursues in its student body and the holistic nature of the school's review.<sup>96</sup> Regarding the intentional discrimination, the First Circuit concluded that Harvard's

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<sup>91</sup> *Id.* at 746.

<sup>92</sup> *See* *Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll.*, 600 U.S. 181, 213 (2023);

Adam Liptak, *Highlights: Supreme Court Hears Affirmative Action Cases From Harvard and U.N.C.*, N.Y. TIMES (Oct. 31, 2022), <https://www.nytimes.com/live/2022/10/31/us/affirmative-action-supreme-court>.

<sup>93</sup> Case Comment, *Equal Protection — Affirmative Action — First Circuit Holds that Harvard's Admissions Program Does Not Violate the Civil Rights Act* — *Students for Fair Admissions, Inc. v. President & Fellows of Harvard College*, 980 F.3d 157 (1st Cir. 2020), 134 HARV. L. REV. 2630, 2630 (May 10, 2021).

<sup>94</sup> *Id.* at 2631.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 2633.

practices did not show bias against Asian-American applicants, agreeing with the district court's decision.<sup>97</sup>

The case then reached the Supreme Court where the Court heard the FAIR cases at the end of October 2022.<sup>98</sup> Again, the Court was tasked, like the lower courts, with determining whether the university was discriminating against Asian-American students by using a subjective standard to gauge traits like likability, courage, and kindness, and by effectively creating a ceiling for these students during the admissions process.<sup>99</sup> To note, Harvard is a private institution, subjecting the university only to the statute.<sup>100</sup> Therefore, if the Court determines that Harvard's admissions policies are discriminatory, the school would be in direct violation of Title VI of the Civil Rights Act of 1964. Importantly, even though Harvard does not receive funding like a public university, the school is still reliant on the federal government, receiving help in the form of grants.

In an opinion by Chief Justice Roberts, the Court held that the admissions programs at Harvard violate the Equal Protection Clause of the Fourteenth Amendment.<sup>101</sup> On June 29, 2023, the Court opined that the universities could not demonstrate their compelling interests in a measurable way, failed to avoid racial stereotypes, and did not offer a logical endpoint for when race-based admissions would cease.<sup>102</sup> As a result, the programs violated the Equal Protection Clause of the Fourteenth Amendment.<sup>103</sup>

b. *Students for Fair Admissions v. University of North Carolina*

In 2014, FAIR sued the University of North Carolina ("UNC") in federal district court and claimed that the University's use of race in undergraduate admissions violated the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.<sup>104</sup> To achieve diversity, UNC considers race as a factor in its admissions decisions, but each student still has the option to list their ethnicity on the application

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<sup>97</sup> *Id.* at 2633-34.

<sup>98</sup> *See* Liptak, *supra* note 93.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> *Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll.*, 600 U.S. 181, 213 (2023).

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *See* Dustin Hartuv et al., *Students for Fair Admissions, Inc. v. University of North Carolina*, LEGAL INFO. INST., (Oct. 31, 2022) <https://www.law.cornell.edu/supct/cert/21-707>.

form.<sup>105</sup> UNC uses a “Reading Document,” where it says that a student may receive a “plus” in the application process based on his or her race or ethnicity.<sup>106</sup> Only an underrepresented minority can receive this addition to their application.<sup>107</sup> The district court held that UNC’s admissions policies were constitutional as there is a compelling interest to enroll a diverse student body.<sup>108</sup> FAIR appealed this decision to the Fourth Circuit, but while the case was pending, FAIR petitioned the Supreme Court without waiting for a judgment from the Fourth Circuit.<sup>109</sup>

On the same day as the Harvard case, the Supreme Court heard the UNC case, where the plaintiffs argued that the university discriminated against white and Asian applicants by giving preference to Black, Hispanic, and Native Americans.<sup>110</sup> As a public university, UNC is bound by both the Constitution’s Equal Protection Clause and Title VI of the Civil Rights Act of 1964, which bars race discrimination by institutions that receive federal money.<sup>111</sup> Therefore, if the Court determines that UNC’s affirmative action policies are discriminatory, the school would be in direct violation of the Equal Protection Clause and Title VI. Public schools that receive federal funding cannot discriminate against applicants through the admission process, so UNC would have to cease their current process and use a neutral process.

Released on the same day as the Harvard decision, in an opinion by Chief Justice Roberts, the Court again held that the admissions programs at UNC violated the Equal Protection Clause of the Fourteenth Amendment for the same reasons as Harvard.<sup>112</sup>

### *B. The Court Should Not Liken Boards of Directors to Higher Education*

Affirmative action policies, and the rules surrounding board diversity may have similarities, but they are not identical. For the guaranteed survival of board diversity laws, it is imperative for the Court to lean away from grouping corporate boards with higher education policies.

Diversity within corporations is legally distinguishable from diversity within the education system, and because of that, the Court should not

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<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> Liptak, *supra* note 93.

<sup>111</sup> *Id.*

<sup>112</sup> *Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll.*, 600 U.S. 181, 230 (2023). The Harvard and University of North Carolina cases were consolidated and decided together.

liken boards to institutions of higher education. Corporations and institutions of higher education are subject to different levels of oversight from the federal government. Public universities receive federal funding, and are subject to the Equal Protection Clause, while private institutions are solely subject to Title VI of the Civil Rights Act of 1964.<sup>113</sup> The Court overturned affirmative action in higher education on the grounds that it violates the Fourteenth Amendment and Title VI,<sup>114</sup> making affirmative action policies used in higher education void. On the other hand, corporations can create their own policies regarding their board of directors, relying upon empirical data that shows the importance of diversity, their self-governance, or guidance from institutions like Nasdaq and the SEC.<sup>115</sup>

An important reason board diversity litigation should not be tied into the constitutionality of affirmative action policies is due to the outcome of the FAIR cases that the Supreme Court recently heard. To distinguish, the essence of corporations and institutions of higher education are different to the federal government. Public universities receive federal funding, making them subject to the Equal Protection Clause, and private institutions are subject to Title VI of the Civil Rights Act of 1964. Therefore, affirmative action being struck down affects both public and private institutions. Corporations can implement their own policies involving the make-up of their own boards of directors. Even if statutes and rules mandating a certain number of diverse board members are struck down, it will not stop individual corporations from making their own policies regarding the composition of their board. These corporations are not at risk of losing federal funding like public universities, or even private universities. Corporations have the authority to select board members who they see fit for the job, applying requirements and standards of their own, which could be diversity related.

The rise and fall of the affirmative action policies in higher education rested upon on Justice O'Connor's opinion in *Grutter* referencing a time limit for the policies: "We expect that 25 years from now the use of racial preferences will no longer be necessary to further the interest approved

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<sup>113</sup> See Liptak, *supra* note 93.

<sup>114</sup> *Students for Fair Admissions, Inc.*, 600 U.S. at 230.

<sup>115</sup> See Business Roundtable, *Principles of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 8, 2016), <https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/> (discussing how the government provides companies with a public framework of laws and regulations that establish minimum requirements but also allow for the flexibility to implement customized practices that suit the companies' needs and to modify those practices in light of changing conditions and standards).

today.”<sup>116</sup> Justice Clarence Thomas furthered the idea of the expiration date, as he stated in his dissent, “I agree with the Court’s holding that racial discrimination in higher education admissions will be illegal in 25 years.”<sup>117</sup> On the other hand, progressive supporters of affirmative action interpreted the twenty-five-year horizon as conditional, claiming that if proportional representation of minorities is not reached by 2028, affirmative action will not end, it will just merely have to be reassessed.<sup>118</sup> On the contrary, strong arguments exist, and support, that Justice O’Connor intended for the deadline to be more than a mere suggestion.<sup>119</sup> As she further wrote, “Race-conscious admissions policies must be limited in time” and “all governmental use of race must have a logical endpoint.”<sup>120</sup> Justice O’Connor opined that institutions of higher education could use sunset provisions in race conscious admissions policies and periodic reviews to determine whether racial preferences are still necessary.<sup>121</sup>

The racial gap in education closed significantly during the mid-to-late-20th century, but in recent years that progress has slowed. Especially at the postgraduate level, where the rate of African-American achievement is disheartening.<sup>122</sup> According to the National Science Foundation, people who are “Black or African-American” earned barely 2% of PhDs in physical sciences and earth sciences in 2016. Universities awarded 1,730 doctorates in math and computer sciences in 2016, but only 78 of them went to black or African American individuals.<sup>123</sup>

Besides the statistics, scholars that argue affirmative action was not meant to be infinite have declared that Justice O’Connor intended to have a set time limit on affirmative action policies. Justice O’Connor set this time limit for a reassessment of the policies, and if the racial gap was not corrected, other avenues should be explored as this may mean the affirmative action policies were not effective.

Scholars on the other end of the spectrum have argued that sunset provisions are fundamentally within the hands of the legislature, not the judiciary, and therefore the FAIR cases should not have the authority to overturn affirmative action decisions.<sup>124</sup> When *Grutter* initially announced

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<sup>116</sup> See Mark Bauerlein, *The Clock Ticks for Affirmative Action*, WASH. EXAM’R (June 22, 2018, 4:06 AM), <https://www.washingtonexaminer.com/weekly-standard/the-clock-ticks-for-affirmative-action>.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

that the sun would set on affirmative action in 25 years, the policy's supporters excoriated that timeline as woefully aggressive and naïve.<sup>125</sup> Additionally, Justice Kennedy wrote: "As to the interpretation that the opinion contains its own self-destruct mechanism, the majority's abandonment of strict scrutiny undermines this objective."<sup>126</sup> Which seemingly intended to get the point across that Justice O'Connor's expectation could not be taken seriously.<sup>127</sup> Justice Kennedy also joined the dissent of Chief Justice Rehnquist, who argued that Justice O'Connor's "discussions of a time limit are the vaguest of assurances" and would "permit the Law School's use of racial preferences on a seemingly permanent basis."<sup>128</sup> Additionally, Justice Breyer's statement that "*Grutter* said it would be good law for at least 25 years" seemingly rejects the notion that Justice O'Connor imposed a 25-year sunset.<sup>129</sup>

During the oral arguments of the FAIR cases, the Court's originalist leaning justices focused their questioning on two counts: whether educational diversity can be achieved without directly taking account of race and whether there must come a time when colleges and universities stop making such distinctions.<sup>130</sup> The Court discussed Justice O'Connor's 2028 "deadline."<sup>131</sup> Justice Kavanaugh said the cutoff was looming, "The current admissions cycle is for the class of '27. It's going to be too late to do anything about that cycle. The next is the class of '28."<sup>132</sup>

Precedent setting affirmative action cases, including *Grutter*, mention the importance of race neutral policies for admissions, making a necessary goal to move away from race-based policies.<sup>133</sup> Through the current FAIR cases, this concept was also focused upon during oral arguments; Harvard and UNC should explore other alternatives.<sup>134</sup> And as anticipated, *Grutter*, and corresponding affirmative action cases, were struck down.

Affirmative action has met its expiration date. Therefore, it is essential for board diversity litigation to not tie themselves to the constitutional arguments of affirmative action policies within higher education.

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<sup>125</sup> *Id.*

<sup>126</sup> Ed Whelan, *Don't Take Justice O'Connor's 25-Year Expectation Too Seriously*, NAT'L REV. (Oct. 26, 2022, 11:43 AM), <https://www.nationalreview.com/bench-memos/dont-take-justice-oconnors-25-year-expectation-too-seriously/>.

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> See Liptak, *supra* note 93.

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> See *id.*

<sup>134</sup> See generally *id.*

#### IV. RECOMMENDATIONS ON HOW PROPONENTS OF BOARD DIVERSITY POLICIES SHOULD PROCEED

For board diversity related policies to withstand constitutional scrutiny, supporters should look towards extrajudicial support to ensure its survival. Board diversity proponents should rely upon empirical evidence; corporations and board could rely upon their own self-governance; and stakeholders, writ large, should lobby federal lawmakers and the SEC for legislative and regulatory intervention.

Chilton, in *Assessing Affirmative Action's Diversity Rationale*, analyzes the diversity rationale claims through empirical evidence.<sup>135</sup> This article studied whether citations to articles published by law reviews change after the review adopts a diversity policy.<sup>136</sup> Data was collected from law reviews of the top twenty law schools that adopted or changed diversity policies and on citations to all articles published in those journals between 1960 and 2018.<sup>137</sup> The study found that law reviews that adopted diversity policies saw median citations to their volumes increase by roughly twenty-five percent in the five years following the effective policy.<sup>138</sup> The article suggested that these findings could have widespread implications, as diverse groups of student editors perform better than nondiverse groups.<sup>139</sup> This arguably could lend credibility to the idea that diverse student bodies, faculties, and groups of employees perform better than groups that are lacking diversity.<sup>140</sup> The authors of this article concluded that these findings held implications for larger debates on affirmative action, resulting in constitutional ramifications.<sup>141</sup>

Corporate governance allows boards of directors to have managerial control, making these boards primary forces influencing the company's corporate governance structure.<sup>142</sup> Failure to take governance seriously casts doubt on a company's operations and profitability, which impacts the number of shareholders and investors involved with the company.<sup>143</sup> More than ever, shareholders and investors are looking for companies that are using their power of self-governance to have a positive impact on the

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<sup>135</sup> See Chilton et al., *supra* note 10.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at 337.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.* at 388.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.* at 397.

<sup>142</sup> James Chen, *Corporate Governance: Definition, Principles, Models, and Examples*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/corporategovernance.asp> (Oct. 31, 2023).

<sup>143</sup> See *id.*

environment, social issues, and overall ethical behavior.<sup>144</sup> Therefore, companies should use the tool of self-governance to promote diversity on their boards, as this is important to investors.

Board diversity is going to continue to grow and be of significance to institutions like Nasdaq and the SEC.<sup>145</sup> Therefore, companies should be prepared for the SEC to propose its own rules, apart from Nasdaq's, on the subject.<sup>146</sup> The SEC has endorsed Nasdaq's implemented rules but has plans to implement its own rules and set up mandatory disclosures for companies in the upcoming year.<sup>147</sup>

#### A. *Reliance on Empirical Evidence*

As stated throughout this note, the diversity rationale has received excessive criticism from multitudes of people and groups, from across every spectrum. Chilton's study lines up with Justice O'Connor and Justice Kennedy's predictions regarding potential gains from increased diversity.<sup>148</sup> Diversity in higher education focuses on aiming to promote better conversations among students within an institution.<sup>149</sup> This idea can be exemplified with the law review selection and editing process as it looks for types of collective work, which diverse groups would heighten the quality of work being produced.<sup>150</sup> The article explains the similarities between the law review selection process, which involves reasoning, deliberation, and analysis, and the characteristics that involve higher education.<sup>151</sup>

The study lends itself to suggest that the law review editors may be more effective at answering questions that could involve a spectrum of opinions, if the group assessing was diverse.<sup>152</sup> In the context of student editors accepting law review articles, the results provide evidence that increased diversity can offer meaningful benefits for institutions of higher education, benefits that are tied directly to the academic mission.<sup>153</sup> The

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<sup>144</sup> *See id.*

<sup>145</sup> *See* Breheny et al., *Annual Meeting and Corporate Governance Trends in 2023*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 13, 2022), <https://corpgov.law.harvard.edu/2022/12/13/annual-meeting-and-corporate-governance-trends-in-2023/>.

<sup>146</sup> *See id.*

<sup>147</sup> *See* Breheny et al., *supra* note 146; *see also* Lipton et al., *Thoughts for Boards: Key Issues in Corp. Governance for 2023*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 1, 2022), <https://corpgov.law.harvard.edu/2022/12/01/thoughts-for-boards-key-issues-in-corporate-governance-for-2023/>.

<sup>148</sup> *See* Chilton et al., *supra* note 10, at 345-46.

<sup>149</sup> *Id.* at 398.

<sup>150</sup> *See generally id.*

<sup>151</sup> *Id.* at 376.

<sup>152</sup> *Id.* at 398.

<sup>153</sup> *Id.* at 399.



article concludes by discussing the impending 2028 deadline suggested by Justice O'Connor for affirmative action policies and how the empirical data from this article could be used in evaluating the question in higher education.<sup>154</sup> Further, Chilton states that if the Supreme Court “does consider renouncing the diversity rationale—forcing universities, law schools, and even student-run law reviews to forego the benefits of diversity—it would do well to contemplate the evidence of this Article.”<sup>155</sup>

Empirical evidence about diversity in higher education, in particular the academic pursuit of law reviews, relates to the boardroom because it demonstrates the positive impact diversity can have on intellectual institutions and entities.<sup>156</sup> Corporate boards, as intellectual entities, are similar in nature to the institutions examined by Chilton, and therefore the findings could be similarly applied. Of course, one study is not enough to show an overwhelming amount of evidence in support of diversity related policies' positive impact, but it does show that in environments like those in higher education, there are undeniable benefits to having diverse students, and groups.<sup>157</sup>

These findings can be extended to corporate boards, because of the similarities between the idea selection processes undertaken by law reviews and the decisions boards of directors need to make for their companies. Law review executive boards review, analyze, and makes suggestions to members of the law review, the articles they are working on, and general pieces submitted for publication.<sup>158</sup> Corporate boards hold similar responsibilities on issues such as mergers and dividends, hiring senior personnel, setting pay, and overall looking out for the shareholders' interests. The boards review and provide advice regarding company decisions, like that of law review executive boards.

This article would be a helpful tool for supporters of board diversity related laws, as they begin to be litigated, as this article explains the benefits of intellectually diverse groups, and even has the data to support the claim.<sup>159</sup> For example, proponents should borrow from Chilton's methodology to the extent board diversity outcomes have been studied, which it has been with respect to company performance, particularly financial performance.<sup>160</sup> Importing and adapting Chilton's methodology

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<sup>154</sup> See Chilton et al., *supra* note 10, at 402.

<sup>155</sup> *Id.*

<sup>156</sup> See generally Chilton et al., *supra* note 10.

<sup>157</sup> See generally *id.*

<sup>158</sup> See generally *id.*

<sup>159</sup> See generally *id.*

<sup>160</sup> See Richa Joshi and Truvalue Labs, *Board Diversity: No Longer Optional*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 11, 2020), <https://corpgov.law.harvard.edu/2020/10/11/board-diversity-no-longer-optional/>.

creates the opportunity to add a dimension of creative performance to the picture. As understood from the arguments and opinions in the FAIR cases, the Court wants more than “diversity” as a label, it wants to know what diversity means and the substantive impact that it is having on institutions.<sup>161</sup>

### B. *The Self-Governance of Boards and Corporations*

Today, corporate governance can make or break the success of a corporation, and dedicating resources to good corporate governance is essential to the profitability of a company.<sup>162</sup> Corporate governance involves the structure of rules, practices, and processes to manage a company.<sup>163</sup> The board of directors control these aspects and therefore are the primary force influencing the company’s corporate government structure.<sup>164</sup> Failure to take governance seriously casts doubt on a company’s operations and profitability, which would make shareholders wary of investing and being involved with the corporation.<sup>165</sup> Today, shareholders and investors look for companies that understand the importance of self-governance in areas like the environment, ethical behavior, corporate strategy, compensation, and risk management.<sup>166</sup> Investors seek companies that take accountability seriously, are transparent, and fair.<sup>167</sup>

In an article recently published by Harvard Law School Forum on Corporate Governance, titled *Thoughts for Boards: Key Issues in Corporate Governance for 2023*, key trends and developments that boards should focus on in the coming year were listed.<sup>168</sup> Among trends like risk management, cybersecurity, cryptocurrency, ESG, and climate change, board diversity was also included on the list.<sup>169</sup> It was suggested that companies should focus on diversifying their boards, as board diversity continues to be an area of focus by major institutional investors, proxy advisors, and regulations.<sup>170</sup> Possibly most compelling is the composition of boards in recent years, where seventy-two percent of the incoming S&P 500 class of directors appointed in 2022 came from historically

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<sup>161</sup> See Liptak, *supra* note 93.

<sup>162</sup> See Chen, *supra* note 143.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> Lipton, *supra* note 148.

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

underrepresented groups.<sup>171</sup> Half of all S&P 500 boards have a policy like the “Rooney rule,” which essentially aims to include or interview candidates from underrepresented groups in the candidate pool when recruiting new directors.<sup>172</sup> Glass Lewis has begun to recommend against the chair of the nominating committee of a board that is not at least 30% gender diverse, especially if there is no commitment to diversify the board.<sup>173</sup> Additionally, institutional investors have made commitments to diversity by supporting the requirements that companies should be disclosing the racial and ethnic composition of boards.<sup>174</sup>

Corporate trends indicate that investors and shareholders look for companies that are investing in themselves.<sup>175</sup> The values of investors are what corporate boards should be concerning themselves with, and those values include diverse corporate boards. Therefore, even if board diversity related laws do not pass constitutional muster, corporations should be able to achieve diversity goals internally, and doing so should still be a priority. Boards of directors need to make their companies appealing to investors, and investors are looking for companies that have a strong, positive, self-governance structure.<sup>176</sup> Therefore, corporations do not need to be legally obligated to diversify their boards, the court of public opinion—investors—expect these companies to be making these steps to improve their boards, using self-governance.

### C. *Opportunities for Legislative Intervention and SEC Rulemaking*

The SEC approving Nasdaq’s rule does not limit them from implementing a rule of its own. It is clear that board diversity is going to continue to grow in significance in the upcoming years.<sup>177</sup> Companies should continue to be mindful of expectations of investors in relation to diversifying their boards. Companies should also be prepared for the SEC to propose its own rules, apart from Nasdaq’s, on the subject.<sup>178</sup> It was anticipated the SEC would announce new disclosures related to corporate board diversity by April 2023, none of which have been proposed.<sup>179</sup>

Pressured from institutional investors, many companies have expanded their public disclosures related to board diversity and are

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<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *See id.*

<sup>176</sup> *See id.*

<sup>177</sup> *See Breheny et al., supra* note 146.

<sup>178</sup> *See id.*

<sup>179</sup> *See* Lipton, *supra* note 148.

releasing more proxy statements to their investors on how they are working on matters of diversity, equity, and inclusion.<sup>180</sup> It is possible that the voluntary actions of some companies may pressure otherwise reluctant companies to disclose their board makeup without a requirement. In 2022, approximately ninety-three percent of S&P 500 companies disclosed the racial or ethnic composition of their boards, compared to sixty percent in 2021.<sup>181</sup> The reporting trend is expected to continue within the upcoming years due to the sustained investor interest in diversifying boards and the Nasdaq rules that are still in place.<sup>182</sup>

SEC rules could allow for board diversity related laws to create their own identity away from affirmative action policies in higher education. While courts look at the legal challenges regarding Nasdaq's rule, the SEC has argued in response that the government had no role in enforcing the rule, and therefore the rule's constitutionality is not in question.<sup>183</sup> The SEC supports requiring corporate boards to have a certain number of diverse members, and for that reason, the SEC should take the next step solidifying their support by implementing its own rules.

#### CONCLUSION

It is apparent that the trend to diversify corporate boards of directors is here to stay. As there are demands for gender, racial, and ethnic diversity in the boardrooms, many states and national exchanges that oversee these corporations have responded by implementing their own rules regarding board make-up.<sup>184</sup> These corporations are wasting no time in diversifying boards themselves. These corporations are doing this for a multitude of reasons, most importantly, to make themselves more appealing to institutional investors. Studies also show how the positive impact of placing women and minorities in the positions of board chair and nominating or governance chairs can pay immediate and future dividends for the promotion of board diversity.<sup>185</sup> Businesses are looking to captivate institutional investors and therefore to implement what is important to them. Additionally, these businesses have the data that demonstrates

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<sup>180</sup> *Id.*

<sup>181</sup> SPENCERSTUART, 2022 S&P 500 BOARD DIVERSITY SNAPSHOT 4 (2022), [https://www.spencerstuart.com/-/media/2022/june/diversitysnapshot/sp500\\_board\\_diversity\\_snapshot\\_2022.pdf](https://www.spencerstuart.com/-/media/2022/june/diversitysnapshot/sp500_board_diversity_snapshot_2022.pdf)

<sup>182</sup> *See generally id.*

<sup>183</sup> *See Breheny, supra* note 146.

<sup>184</sup> *See generally* Oven, *supra* note 1.

<sup>185</sup> *Id.*

diversity can increase profits.<sup>186</sup> The case for board diversity is not some new idea, and there are known benefits of diversity, which has prompted states and exchanges to follow public sentiment and institute their own related statutes to board diversity quotas.

Corporations have historically not been supportive of high levels of government oversight into their day-to-day operations. Which is why it was no surprise California's statutes related to board diversity and Nasdaq's similar rules were met with some hostility followed by legal action. Opponents to these rules claimed violations of the Equal Protection Clause of the Fourteenth Amendment, the California constitution, and to First Amendment protections.<sup>187</sup> As this is a newly litigated area of law, it is unclear where the courts will land on the issue, but the current climate on some issues, like affirmative action, could have an influence on the outcome.

While board diversity legal issues have an uphill battle in the courts, affirmative action policies are also facing litigation. Since the 1970s, the Supreme Court has heard cases involving affirmative action policies within higher education, laying the foundation for Fourteenth Amendment application in these scenarios. From *Bakke*, to *Grutter*, to *Parents Involved*, the Court decided that the consideration of race in admissions of higher education was a compelling governmental interest.<sup>188</sup> This, of course, came with limits; institutions could not only consider race, but it could be a factor that was considered through a holistic review of each candidate.<sup>189</sup> No decisions solely based on race were constitutional, but affirmative action policies that allowed race to be a factor among many supported student body diversity, which made it a compelling state interest with benefits to the students and institutions.<sup>190</sup> Since these initial decisions, affirmative action has made its way back to the docket of the Court, and this time did not pass constitutional muster. Through oral arguments in the FAIR cases, the justices focused their questioning on the

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<sup>186</sup> *Diversity matters even more: The case for holistic impact*, MCKINSEY & COMPANY (Dec. 5 2023), <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-matters-even-more-the-case-for-holistic-impact> ("A strong business case for ethnic diversity is also consistent over time, with a 39 percent increased likelihood of outperformance for those in the top quartile of ethnic representation versus the bottom quartile.").

<sup>187</sup> *See* *Crest v. Padilla*, No. 19-STCV-27561, 2022 WL 1565613, at \*1 (Cal. Super. Ct. May 13, 2022); *see also* *Crest v. Padilla*, No. 20-STCV-37513, 2022 WL 1073294, at \*1 (Cal. Super. Ct. Apr. 1, 2022).

<sup>188</sup> *See* *Regents of Univ. of Cal. v. Bakke*, 438 U.S. 265, 266, 279 (1978); *see also* *Grutter v. Bollinger*, 539 U.S. 306, 311 (2003); *see also* *Parents Involved in Cmty. Schs. v. Seattle Sch. Dist. No. 1*, 551 U.S. 701, 722 (2007).

<sup>189</sup> *See id.* at 740-41.

<sup>190</sup> *See id.* at 723.

time limit Justice O'Connor discussed in *Grutter*, making one infer that the justices believe that this time limit intended to be a hard stop.<sup>191</sup> Additionally, the justices highlighted that it is important that these institutions of higher education find race-neutral alternatives for their admission process, and without putting an end to current affirmative action policies, universities may not be able to do this.<sup>192</sup> In the end, the Court struck down affirmative action policies with their rulings.

On its face, the intended effects of affirmative action policies and board diversity related statutes have elements in common. These policies both have end goals to diversify their respective institutions. Therefore, there is the possibility that affirmative action constitutional arguments could be available for use as board diversity related statutes have started to face legal trouble. But this may not be as successful as affirmative action policies have received an expiration date from the Court.<sup>193</sup>

Fortunately, for board diversity related statutes and rules, board diversity statutes are different from affirmative action policies, as the respective institutions are regulated differently.<sup>194</sup> This gives board diversity statutes the opportunity to survive past the demise of affirmative action policies. Affirmative action policies rise and fall at the hands of the Court, and the way colleges admit students to diversify will forever change. While corporations can create their own policies regarding their boards of directors, they should rely upon empirical data that shows the importance of diversity, self-governance, or guidance from institutions like Nasdaq and the SEC.<sup>195</sup>

Essentially, the outcome of the FAIR cases regarding the fate of affirmative action policies does not necessarily seal the same fate for diversifying boards. As corporations and institutional investors have shown increased support for board diversity, there are extrajudicial avenues these supporters may explore if the courts continue to push back. There is a great deal of empirical evidence to back up the benefits of having diverse groups. Studies showing that affirmative action policies and policies that promote diversity in general are in the best interest of institutions of higher education and law reviews.<sup>196</sup> To that point, it is not far off to claim that it could have the same impact on corporate boards. These corporations could participate in the use of self-governance and create their own individualize policy regarding board diversity.<sup>197</sup> Many

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<sup>191</sup> See Bauerlein, *supra* note 117.

<sup>192</sup> *Id.*

<sup>193</sup> See *id.*

<sup>194</sup> See Business Roundtable, *supra* note 116.

<sup>195</sup> *Id.*

<sup>196</sup> See Chilton et al., *supra* note 10.

<sup>197</sup> See Chen, *supra* note 143.

corporations have begun to do work on this, hiring more diverse board members, as well as disclosing this information in proxy statements for potential investors and shareholders.<sup>198</sup> Finally, the SEC could take its endorsement of Nasdaq's rule further and implement a rule of its own, showing more serious support for board diversity rules.<sup>199</sup> Corporations and their boards are not placed inside the same legal box as institutions of higher education, and there are more opportunities to expand board diversity, even outside of the court system.

It is a different world now than it was a few decades ago. The court of public opinion on issues like board diversity are steps ahead of the courts, with the legal system seemingly playing catch-up. Businesses are not going to sit around and wait months, especially not years, for a court decision on the legality of board diversity statutes. These entities do not want to be playing catch-up if these laws are upheld, and corporations want to respond to what their investors want. The most important factor for businesses to consider is their success, this is measured in the form of profits, and investors and customers place their money with businesses that reflect the values that they deem important. Board diversity has left the station and corporations need to jump on now before they are left behind.

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<sup>198</sup> See Lipton et al., *supra* note 148.

<sup>199</sup> *Id.*