

Fifth Circuit vacates Nasdaq board diversity mandate

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[Vacating the SEC's order approving Nasdaq's board diversity rules has implications for the climate rule.](#)

A split *en banc* Fifth Circuit (9 in the majority and 8 in the dissent) has issued a majority [opinion](#) vacating the SEC's [order](#) approving Nasdaq's board diversity mandate, holding that the "SEC failed to justify its determination that Nasdaq's Board Diversity Proposal is consistent with the requirements" of the Securities Exchange Act of 1934, or the Exchange Act, and that its finding that the diversity rules were related to the purposes of the Exchange Act was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" in violation of the Administrative Procedure Act.

After a detailed discussion of the purposes of the Exchange Act, the court concluded that the SEC failed to explain how Nasdaq's diversity rules have any connection with those purposes, finding that the three purposes the SEC argued were advanced by the diversity rules (namely, promoting just and equitable principles of trade, removing impediments to and perfecting the mechanism of a free and open market and a national market system, and protecting investors and the public interest, each as provided under Exchange Act Section 6(b)(5)) "bear no relationship to the disclosure of information about the racial, gender, and sexual characteristics of the directors of public companies."

The majority rejected arguments that any disclosure-based rule is related to the purposes of the Exchange Act, holding that "disclosure about any and all information about listed companies" is not among those purposes. Moreover, the majority opinion rejected the broad reading of the provision relating to protection of the "public interest", limiting that broad language to the stated purposes of the Exchange Act and relying on the statutory canon that a broad phrase must be limited by the words that surround it. The majority opinion criticized the SEC for relying only on the ground that board diversity information would satisfy the demands of some important investors, noting that satisfying the demands of investors for "any and every kind of information ... is not remotely similar to any of [the] stated purposes [of the Exchange Act]."

The court also found that the [major questions doctrine](#) confirmed its interpretation of the purposes of the Exchange Act, holding that "no part of the Exchange Act even hints at SEC's purported power to remake corporate boards using diversity factors." Interestingly, the majority focused on the fact that corporate governance is typically left to the states.

The court's decision means that Nasdaq-listed companies, including foreign private issuers, need not comply with Nasdaq's board diversity rules. A company may choose to continue to disclose board diversity data voluntarily for a variety of reasons, including policies on diversity adopted by large institutional investors as well as the influence of proxy advisory firms. In doing so, however, a company would enjoy more flexibility about the nature and extent of board diversity information to include in its SEC filings, on its website or in other public disclosures.

The majority's statutory analysis closely follows a line of recent Supreme Court cases in which the majority has focused on a close textual reading of the language and narrowed the scope of agency discretion. The majority's reasoning would apply equally to the SEC's [climate disclosure rule](#), which is currently being litigated in the Eighth Circuit, and could be viewed as persuasive precedent by those judges. It also may cause the FDIC, which had placed a diversity requirement in its [proposed corporate governance guidelines](#), to reconsider whether that language should remain in the guidelines.

We believe it is unlikely that an incoming Republican-controlled SEC will appeal the court's vacatur of its order approving the diversity rules, and it has been [reported](#) that Nasdaq will not seek review of the decision. The ruling may also impact

the litigation decisions that the new Republican-controlled SEC might take with respect to the climate rule.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Maurice Blanco

+55 11 4871 8402
+1 212 450 4086
maurice.blanco@davispolk.com

Nicole Brookshire

+1 212 450 4206
nicole.brookshire@davispolk.com

Ning Chiu

+1 212 450 4908
ning.chiu@davispolk.com

Joseph A. Hall

+1 212 450 4565
joseph.hall@davispolk.com

Michael Kaplan

+1 212 450 4111
michael.kaplan@davispolk.com

Yasin Keshvargar

+1 212 450 4839
yasin.keshvargar@davispolk.com

John B. Meade

+1 212 450 4077
john.meade@davispolk.com

Byron B. Rooney

+1 212 450 4658
byron.rooney@davispolk.com

Margaret E. Tahyar

+1 212 450 4379
margaret.tahyar@davispolk.com

Richard D. Truesdell, Jr.

+1 212 450 4674
richard.truesdell@davispolk.com

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