

Fifth Circuit Nullifies Nasdaq's Diversity Rule for Corporate Boards

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A federal circuit court recently vacated a U.S. Securities and Exchange Commission (SEC) order approving Nasdaq's diversity rule for boards of directors of public companies. The rule would have required corporate boards of Nasdaq-listed companies to have a minimum number of members from underrepresented demographic groups and to disclose information about the racial, gender, and LGBTQ+ characteristics of their directors.

Quick Hits

- The Fifth Circuit Court of Appeals invalidated an SEC order approving a Nasdaq rule that would have required public companies to maintain a certain number of board members from underrepresented demographic groups or explain why they failed to do so.
- The diversity rule never took effect while it faced legal challenges during the past three years.
- The SEC could appeal the Fifth Circuit's decision to the Supreme Court of the United States.

On December 11, 2024, the U.S. Court of Appeals for the Fifth Circuit [held](#) that the SEC did not have statutory authority to approve a [Nasdaq rule](#) that would have required Nasdaq-listed companies to disclose demographic data for members of their boards.

The court noted that a proposed exchange rule is not “consistent with the requirements of” the Securities Exchange Act of 1934 (Exchange Act) if it regulates matters that are not related to the law's purposes. It concluded that the diversity rule was not sufficiently related to the law's purposes, which include ensuring a fair and transparent market for investors and preventing fraud.

Background on the Nasdaq Diversity Rule

On August 6, 2021, the SEC approved Nasdaq's [proposed diversity rule](#) for companies listed on its exchange. The rule required Nasdaq-listed companies to (1) publicly disclose board-level demographic data annually and (2) have, or explain why they do not have, a certain number of diverse directors on their boards. Companies with more than five board members were required to have two members from an underrepresented group, including one female and one person who self-identifies as Black, Hispanic, Asian, Native American, Alaskan Native, Native Hawaiian, Pacific Islander, biracial, or LGBTQ+. The rule required boards with five or fewer members to have only one

member from an underrepresented group.

Nasdaq explained that information about board diversity was important to investors, and a rule to encourage companies to increase board diversity would improve corporate governance, influence corporate conduct, and increase opportunities for candidates from underrepresented groups. In approving the rule, the SEC reasoned that the rule could protect investors and the public interest by promoting just and equitable principles of trade and removing impediments to a free and open market, according to court documents.

On August 10, 2021, the Alliance for Fair Board Recruitment (AFBR), later joined by the National Center for Public Policy Research (NCPPR), filed a petition for review of the SEC's approval of the Nasdaq rule. The petitioners claimed the rule discriminated on the basis of sex and race in violation of the Fourteenth Amendment of the U.S. Constitution and violated the First Amendment's protections against coerced speech. They also claimed the rule exceeded the SEC's authority under the Exchange Act and the Administrative Procedure Act (APA).

On October 18, 2023, a three-judge panel of the Fifth Circuit ruled in favor of the SEC, stating that the SEC's approval of the rule complied with the Exchange Act and the APA. The court rejected the constitutional claims because Nasdaq is a private entity, not a government institution or state actor.

Thereafter, the court granted a petition for rehearing *en banc*. On December 11, 2024, the Fifth Circuit, sitting *en banc*, held in a 9–8 ruling that the diversity rule “[could] not be squared” with the Exchange Act.

With at least 3,300 companies listed, Nasdaq is the second-largest stock exchange in the world. It is a private limited liability company, wholly owned by Nasdaq, Inc., a publicly traded corporation.

Next Steps

The SEC could appeal the Fifth Circuit's decision to the Supreme Court of the United States. However, it is unclear how the new presidential administration taking office in January 2025 would impact the SEC's decision regarding an appeal and whether the Supreme Court would agree to hear the case if a petition for writ of certiorari were filed.

Absent a reversal of the Fifth Circuit's decision by the Supreme Court, companies listed on the Nasdaq exchange will continue to determine whether and to what extent to consider demographic diversity in nominating candidates for membership on their boards. Regardless of the composition of their boards, publicly held corporations can expect to continue to face scrutiny about how they design, communicate, and implement recruitment strategies for board members, as well as with respect to how they design, communicate, implement, or alter DEI initiatives affecting their employee population.

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