January 4, 2021

J. Matthew DeLesDernier
Assistant Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: Proposed Nasdaq Rule Change to Adopt Listing Rules Related to Board Diversity [File Number SR–NASDAQ–2020–081]

Dear Mr. DeLesDernier:

I am pleased to provide these comments regarding the proposed Nasdaq rule change to adopt listing rules related to Board diversity.[1]

Introductory Comments

The Securities and Exchange Commission (hereinafter the "Commission" or the "SEC") should disapprove this proposed Nasdaq rule change.[2] If it does not disapprove the proposed rule, it should institute proceedings regarding the proposed rule.[3]

Invoking the imperatives of the "social justice movement"[4] and the "benefits to stakeholders of increased diversity,"[5] Nasdaq is seeking SEC approval to impose a corporate governance rule that would require all listed companies to appoint directors based on sex. Many of these companies would also have to appoint directors on the basis of race, ethnicity or sexual orientation.

Specifically, Nasdaq is proposing to require each of its listed companies, subject to certain exceptions, to provide statistical information regarding "diversity" among the members of its board, and to either have, or explain why it does not have, at least two "diverse" directors on its board.[6] "Diverse" would mean a director who self-identifies as female (without regard to the individual's designated sex at birth), an underrepresented minority, or LGBTQ+. Nasdaq defines an underrepresented minority as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities.[7]

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[1] "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.govinfo.gov/content/pkg/FR-2020-12-11/pdf/2020-27091.pdf.
[2] Approval is required by 15 U.S. Code §78s(b). See also 17 CFR § 240.19b-4.
[3] 15 U.S. Code §78s(b)(2)(B). See also 17 CFR § 240.19b-4.
[4] Proposed rule, p. 80472 (col.2).
[5] Ibid.
[6] Proposed rule, pp. 80473-80473, proposing a new Nasdaq Rule 5605(f) (regarding Diverse Board Representation) and new Nasdaq Rule 5606 (regarding Board Diversity Disclosure).
[7] Ibid.

Nasdaq's submission is a façade designed to cloak its political social justice objectives in the language of economics and securities regulation. Nasdaq's presentation of the empirical literature blatantly misrepresents the literature. Many of the "studies" or statements it selectively cites really rely on nothing more than unsubstantiated political preferences. The actual empirical peer reviewed economics literature is highly inconclusive with most studies showing little or no discernable effect on financial performance due to the sexual, racial or ethnic composition of corporate boards. All serious surveys of the literature reach this conclusion. This should be unsurprising since sex, race and ethnicity have nothing to do with competence. There are a few studies that find either positive or negative effects. A thorough examination of the literature and of the materials cited in Nasdaq's submission shows that its empirical assertions have virtually no basis in the literature. Furthermore, it misrepresents the content of some of the few supporting studies that are peer reviewed. Its submission is deeply misleading.

Nasdaq also embraces the stakeholder theory of business purpose in which shareholders, rather than being treated as the owners of the business, are reduced to just one more corporate interest group to be placated by a powerful and largely unaccountable management.

The proposed rule is inconsistent with the Commission's mission. The proposed rule neither protects investors, nor promotes the maintenance of fair, orderly, and efficient markets, nor facilitates capital formation.

More importantly, the proposed rule is inconsistent with the principles underpinning the Civil Right Act of 1964[8] which makes it an unlawful employment practice for an employer to "limit, segregate, or classify his employees"… "because of such individual's race, color, religion, sex, or national origin." It is also a violation of the equal protection principles of the United States constitution.[9] Quotas, such as those instituted by the rule, are particularly suspect constitutionally.[10] The discussion below does not pretend to be an exhaustive discussion of the complex Supreme Court jurisprudence regarding equal protection under the 5th and 14th amendments, disparate impact and the Civil Rights Act. It should, however, give the Commission pause regarding three things. The legal issues raised by the proposed rule are far outside the Commission's technical competence or its mission. The ethical issues raised by the proposed rule − which affirmatively discriminates on the basis of sex, race and ethnicity − are profound. The proposed rule may well be successfully challenged in court on both constitutional and Civil Rights Act grounds.[11]

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[8] Public Law 88-352 (https://www.govinfo.gov/content/pkg/STATUTE-78/pdf/STATUTE-78-Pg241.pdf). See especially section 703 (42 U.S. Code Sec. 2000e-2).

[9] 42 U.S. Code Sec. 2000e-2. See also discussion below under the heading "*The Proposed Rule is Inconsistent with the Principles of Equal Protection and the Civil Rights Act*."

[10] Ibid. See, for example, *Regents of Univ. of California v. Bakke*, 438 U.S. 265 at 291, 296 (1978); *Grutter v. Bollinger*, 539 U.S. 306 at 309 and 334 (2003); *Ricci v. DeStefano*, 557 U.S. 557 (2009) (Title VII prohibits intentional acts of employment discrimination based on race, color, religion, sex, and national origin.); *Richmond v. J. A. Croson Co.*, 488 U. S. 469 (1989); *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977 (1988); *Wygant v. Jackson Bd. of Education*, 476 U. S. 267 (1986).

[11] As discussed below, this will turn of whether Nasdaq as a regulator is deemed a state actor and whether directors are deemed employees for purposes of the Civil Rights Act. If either of these determinations are made, the rule will

Many, perhaps most, of the proponents of diversity, inclusion, social justice, critical race theory, multiculturism and identity politics reject, in their words, "the very foundations of the liberal order, including equality theory, legal reasoning, Enlightenment rationalism, and neutral principles of constitutional law."[12] They are engaged in a systematic and sustained effort to effectively change our national ethos from *E Pluribus Unum* to *De Uno, Multis*.[13] They seek to alter the "narrative" and to make sex, race, ethnicity and sexual orientation central to law, public policy and our self-understanding instead of individual achievement, merit, talent and the content of our character. They actively seek to discriminate on the basis of sex, race, ethnicity or sexual orientation rather than achieve a society in which such discrimination is unlawful and rare. They seek a faux diversity measured by group identity determined largely by immutable characteristics rather than true diversity that accounts for the rich tapestry of human experience. They seek to subordinate individual merit to group identity. The Commission should not go down this dubious path.

The Nasdaq proposed rule rests on a faulty premise. Nasdaq falsely asserts that shareholders are demanding the corporations that they own to discriminate on the basis of sex, race, ethnicity or sexual orientation. Shareholders are free to instruct management to do so or to pursue other environmental, social or governance (ESG) or social justice objectives via shareholder resolutions. When afforded the opportunity to do so, however, they rarely do. "None of the seven proposals on the subject [board diversity] that went to votes last year [2019] earned more than 3 percent" of the votes cast.[14]

The true agenda of social justice advocates, apparently including Nasdaq management, is to remake the purpose of business. Traditionally, the purpose of a business has been to earn a return for its owners by cost-effectively combining the capital of its owners with the labor and talent of its employees in a competitive environment to satisfy the wants and needs of its customers. The relationship between owners, management, workers, suppliers, and customers are, subject to certain broad constraints imposed by law, privately decided and voluntary.

With increasing stridency, there is a major effort under way to redefine the purpose of businesses to achieve various social or political objectives unrelated to earning a return, satisfying customers or treating workers or suppliers fairly. This is being done under the banner of social justice, corporate social responsibility (CSR), stakeholder theory, environmental, social and governance (ESG) criteria, socially responsible investing (SRI), sustainability, diversity,

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likely be held invalid. Moreover, there is no doubt that the Commission is subject to the equal protection provisions of the constitution.

[12] Richard Delgado and Jean Stefancic, *Critical Race Theory: An Introduction*, Third Edition (New York: New York University Press, 2017) under the heading "What is Critical Race Theory," p. 3; Kevin R. Johnson, "Richard Delgado's Quest for Justice for All," *Law & Inequality: A Journal of Theory and Practice*, Vol. 33, No. 2 (2015) https://scholarship.law.umn.edu/cgi/viewcontent.cgi?article=1213&context=lawineq ("A brief, simple commentary cannot do justice to Delgado's pioneering legal scholarship -- he is nothing less than a legend, a sort of LeBron James or Michael Jordan among legal academics."). See also Jonathan Butcher and Mike Gonzalez, "Critical Race Theory, the New Intolerance, and Its Grip on America," Heritage Foundation Backgrounder No. 3567, December 7, 2020 https://www heritage.org/sites/default/files/2020-12/BG3567.pdf.

[13] For this formulation of the problem, see Mike Gonzalez, *The Plot to Change America: How Identity Politics is Dividing the Land of the Free* (New York: Encounter Books, 2020).

[14] *Proxy Preview, 2020*, p. 66 https://www.proxypreview.org/2020/report-cover.

business ethics, common good capitalism or corporate actual responsibility.[15] These new objectives would be enforced by various means, including, as is the case here, regulation.

If successful, these attempts to redefine the purpose of business will have marked adverse social consequences. Management will be even less accountable to anyone since the metrics of success will become highly amorphous and constantly changing. Businesses will become less productive and less competitive. Jobs will be lost and wages will grow more slowly. The social welfare cost of going down this road will be considerable. It is also one more major step toward the federalization of corporate governance.

Lastly, if the SEC chooses to countenance diversity statistical reporting, it should require reporting of types of diversity that are more relevant to business success than the immutable racial, ethnic or sexual characteristics of its directors.

The Purpose of the Commission and the Securities Laws

The mission of the SEC is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[16] The proposed rule does not further these objectives.

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[15] Each of these terms, with the possible exception of the latter two which are of comparatively recent vintage, has evolved in meaning over time and have substantially – even dramatically – different meanings depending on the author or speaker. There is a voluminous literature discussing, but usually not defining, these concepts. In the case of 'social justice,' the term has changed meaning with the political and social situation for at least two centuries. In contemporary political parlance, it is associated with ideologies that, at the least, 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. I will not address the details of these various ideas in this comment letter except to say that Nasdaq's discussion in its proposed rule submission is typical. It 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. For a selection of recent, and more serious, discussions of these concepts from both critical and supportive perspectives, see Peter W. Wood, *Diversity Rules* (New York: Encounter Books, 2019); Brian Barry, *Why Social Justice Matters* (Cambridge, UK: Polity Press, 2005); Michael Novak, Paul Adams and Elizabeth Shaw, *Social Justice Isn't What You Think It Is* (New York: Encounter Books, 2015); David Miller, *Principles of Social Justice*, Revised edition (Cambridge: Harvard University Press, 2001); and Thomas Patrick Burke, *The Concept of Justice: Is Social Justice Just?* (New York: Bloomsbury Academic, 2011); Friedrich A. von Hayek, "The Atavism of Social Justice," in Friedrich A. von Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas*, Chapter 5 (Abingdon-on-Thames, U.K: Routledge, 1978). For historical context, see Leonard Trelawny, *The Elements of Social Justice* (London: George Allen & Unwin, 1922); John Bates Clark, *Social Justice Without Socialism* (Boston: Houghton Mifflin, 1914).

[16] U.S. Securities and Exchange Commission, "What We Do," http://www.sec.gov/about/whatwedo.shtml#intro. The statutory charge is: "Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." See Securities Exchange Act of 1934, Public Law 73–291, § 3(f), and Securities Act of 1933, Public Law 73–22, § 2(b).

The proposed rule does not protect investors in any sense. It does not increase their returns or protect them from losses. It does not protect them from fraud or misrepresentation. It does not protect them from an unaccountable management or board of directors acting in its own interest or pursuing political or social objectives at the expense of investors. Investors may require management and the board to implement board diversity (as defined by the proposed rule or in a similar fashion) but when afforded the opportunity to do so, they do not.[17] A very high percentage of the shareholder proposals submitted are submitted by government pension funds in their capacity as shareholders for political reasons.[18] Neither does the rule further fair, orderly, and efficient markets, or facilitate capital formation.

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.

To date, the Commission has only required diversity reporting in a responsible fashion.[19] It has not mandated quotas, has acknowledged that there are many kinds of diversity that may be

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[17] *Proxy Preview, 2020*, p. 66 https://www.proxypreview.org/2020/report-cover.
[18] For example, the New York City Comptroller's Office Board Accountability Project 3.0 campaign https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/boardroom-accountability-project-3-0/. See also Andrew Ramonas, "Illinois Treasurer Urges SEC to Adopt Diversity Mandates," *Bloomberg Law*, September 16, 2020 https://news.bloomberglaw.com/securities-law/illinois-treasurer-urges-sec-to-adopt-diversity-mandates.
[19] See "Regulation S-K, Questions and Answers of General Applicability" https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp htm#116-11.

Question 116.11

Question: In connection with preparing Item 401 disclosure relating to director qualifications, certain board members or nominees have provided for inclusion in the company's disclosure certain self-identified specific diversity characteristics, such as their race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background. What disclosure of self-identified diversity characteristics is required under Item 401 or, with respect to nominees, under Item 407?

Answer: Item 401(e) requires a brief discussion of the specific experience, qualifications, attributes, or skills that led to the conclusion that a person should serve as a director. Item 407(c)(2)(vi) requires a description of how a board implements any policies it follows with regard to the consideration of diversity in identifying director nominees. To the extent a board or nominating committee in determining the specific experience, qualifications, attributes, or skills of an individual for board membership has considered the self-identified diversity characteristics referred to above (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background) of an individual who has consented to the company's disclosure of those characteristics, we would expect that the company's discussion required by Item 401 would include, but not necessarily be limited to, identifying those characteristics and how they were considered. Similarly, in these circumstances, we would expect any description of diversity policies followed by the company under Item 407 would include a discussion of how the company considers the self-identified diversity attributes of nominees as well as any other qualifications its diversity policy relevant in selecting directors and has only required diversity reporting (in the Nasdaq sense) to the extent a reporting company has actually relied on these criteria. It should not go down the path that Nasdaq is asking it to.

Nasdaq Misrepresents the Economics Literature

There are strong theoretical reasons to doubt that a general mandate of a particular board composition by sex, race ethnicity or sexual orientation would improve financial performance. First, and most importantly, to the extent that a particular board composition is likely to improve financial performance, a company is likely to pursue that composition on its own initiative without any mandate. A company that purposively does not take advantage of talented, qualified women and minorities places itself at a competitive disadvantage and also risks anti-discrimination lawsuits, enforcement actions and reputational damage. Second, it is highly implausible that regulators will select a mandated board composition that is best for all reporting companies.[20] For example, it is highly implausible that the board composition of a retailer

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takes into account, such as diverse work experiences, military service, or socio-economic or demographic characteristics. [February 6, 2019]

Question 133.13

Question: In connection with preparing Item 401 disclosure relating to director qualifications, certain board members or nominees have provided for inclusion in the company's disclosure certain self-identified specific diversity characteristics, such as their race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background. What disclosure of self-identified diversity characteristics is required under Item 401 or, with respect to nominees, under Item 407?

Answer: Item 401(e) requires a brief discussion of the specific experience, qualifications, attributes, or skills that led to the conclusion that a person should serve as a director. Item 407(c)(2)(vi) requires a description of how a board implements any policies it follows with regard to the consideration of diversity in identifying director nominees. To the extent a board or nominating committee in determining the specific experience, qualifications, attributes, or skills of an individual for board membership has considered the self-identified diversity characteristics referred to above (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background) of an individual who has consented to the company's disclosure of those characteristics, we would expect that the company's discussion required by Item 401 would include, but not necessarily be limited to, identifying those characteristics and how they were considered. Similarly, in these circumstances, we would expect any description of diversity policies followed by the company under Item 407 would include a discussion of how the company considers the self-identified diversity attributes of nominees as well as any other qualifications its diversity policy takes into account, such as diverse work experiences, military service, or socio-economic or demographic characteristics. [February 6, 2019]

[20] See, for example, Friedrich A. Hayek, "The Use of Knowledge in Society," *The American Economic Review*, Vol. 35, No. 4 (September 1945), pp. 519–530, https://www.econlib.org/library/Essays/hykKnw.html; F. A. Hayek, The Fatal Conceit: The Errors of Socialism (Chicago: University of Chicago Press, 1988). See also James M. Buchanan, *The Collected Works of James M. Buchanan, The Logical Foundations of Constitutional Liberty*, Vol. 1 (Carmel, IN: Liberty Fund, 1999), p. 46. From a lecture originally given at the Institute for Advanced Studies in Vienna, Austria, in 1979: ("My primary title for this lecture, 'Politics without Romance,' was chosen for its descriptive accuracy. Public choice theory has been the avenue through which a romantic and illusory set of notions about the workings of governments and the behavior of persons who govern has been replaced by a set of notions that embody more skepticism about what governments can do and what governors will do, notions that are surely more consistent with the political reality that we may all observe about us. I have often said that public choice offers a 'theory of governmental failure' that is fully comparable to the 'theory of market failure' that emerged from the theoretical welfare economics of the 1930's and 1940's [sic].")

focusing on women's fashion or food products directed at minorities should have the same board composition as, for example, an oil and gas exploration company or a pharmaceutical company.

I do not take a position on whether, as an empirical matter, a particular board composition measured by the sex, race, ethnicity or sexual orientation improves or degrades corporate financial performance. Nor do I take a position on whether a particular board composition measured by other kinds of diversity such as a director's expertise, experience, approach to business or business philosophy, educational background, socio-economic background, ethical views, political views, integrity, geographic location and so on improves or degrades corporate financial performance. The empirical literature allows no such conclusion. Given the complexity and heterogeneity of modern business, it probably never will. It is, in my judgment, virtually certain that the proper board composition varies depending on the business and that this decision is best left to the private sector.

Nasdaq's presentation of the empirical literature blatantly misrepresents the literature. Many of the "studies" or statements it selectively cites really rely on nothing more than unsubstantiated political preferences. The actual empirical economics literature is highly inconclusive with most showing little or no discernable effect based on sexual, racial or ethnic board composition. Virtually all serious surveys of the literature reach this conclusion. This should be unsurprising since sex, race and ethnicity have nothing to do with competence. There are a few studies that find either positive or negative effects. A thorough examination of the literature and of the materials cited in Nasdaq's submission shows that its empirical assertions have virtually no basis in the literature. Furthermore, it misrepresents the content of some of the few supporting studies that are peer reviewed. Its submission is deeply misleading.

In addition, Nasdaq seems not to grasp the difference between correlation and causation. Even if there were a correlation between improved financial performance and board diversity (as defined by Nasdaq) – and the empirical literature does not even come close to supporting such a conclusion – that does not imply causation. In fact, a reasonable hypothesis is that such diversity is the corporate equivalent of a luxury good. If a firm is doing well financially, management can devote time to ancillary activities like getting good press and virtue signaling.

W. Gary Simpson, David A. Carter, and Frank D'Souza found that the evidence for the business case for women directors is mixed and tends to support the view that the ability of women directors to influence profitability and shareholder value is contingent on the specific circumstances of each company.[21] Deborah L. Rhode & Amanda K. Packel in an article sympathetic to diversity requirements conducted a reasonably comprehensive review of the literature up to 2014 and found that "[i]n sum, the empirical research on the effect of board diversity on firm performance is inconclusive, and the results are highly dependent on methodology."[22] The Government Accountability Office (GAO) study cited by Nasdaq did a very limited survey of the research and found that "[s]ome research has found that gender

[21] W. Gary Simpson, David A. Carter, and Frank D'Souza, "What Do We Know About Women on Boards?," *Journal of Applied Finance*, Vol. 20, No. 2, 2010 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693058.

[22] Deborah L. Rhode and Amanda K. Packel, "Diversity on Corporate Boards: How Much Difference Does Difference Make?," *Delaware Journal of Corporate Law*, Vol. 39, No. 2 pp. 377-426, 2014 https://ssrn.com/abstract=1685615.

diverse boards may have a positive impact on a company's financial performance, but other research has not. These mixed results depend, in part, on differences in how financial performance was defined and what methodologies were used."[23] A systematic literature search, involving data from 20 studies on 3097 companies published in peer-reviewed academic journals, by Jan Luca Pletzer, Romina Nikolova, Karina Karolina Kedzior and Sven Constantin Voelpel in 2015 found that "the mere representation of females on corporate boards is not related to firm financial performance if other factors are not considered."[24] Alice H. Eagly in her article "When Passionate Advocates Meet Research on Diversity, Does the Honest Broker Stand a Chance?" wrote:

> To illustrate the chasm that can develop between research findings and advocates' claims, this article addresses two areas: (a) the effects of the gender diversity of corporate boards of directors on firms' financial performance and (b) the effects of the gender and racial diversity of workgroups on group performance. Despite advocates' insistence that women on boards enhance corporate performance and that diversity of task groups enhances their performance, research findings are mixed, and repeated meta-analyses have yielded average correlational findings that are null or extremely small.[25]

David A. Carter, Frank P. D'Souza, Betty J. Simkins, and W. Gary Simpson did not find "a significant relationship between the gender or ethnic diversity of the board, or important board committees, and financial performance for a sample of major US corporations."[26] Jens Hagendorff, and, Kevin Keasey found "positive announcement returns to mergers approved by boards whose members are diverse in terms of their occupational background. By contrast, age and tenure diversity are associated with wealth losses surrounding acquisition announcements, while gender diversity does not lead to measurable value effects."[27] Nuria Reguera Alvarado, Joaquina Laffarga Briones and Pilar de Fuentes Ruiz found that "[g]ender diversity and business success are not related."[28]

Renée B. Adams, and Daniel Ferreira found that "the average effect of gender diversity on firm performance is negative" and that their results suggest that mandating gender quotas for directors

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[23] "Corporate Boards: Strategies to Address Representation of Women Include Federal Disclosure Requirements," Government Accountability Office, December 2015, p.5 [GAO-16-30] https://www.gao.gov/assets/680/674008.pdf.
[24] Jan Luca Pletzer, Romina Nikolova, Karina Karolina Kedzior and Sven Constantin Voelpel, "Does Gender Matter? Female Representation on Corporate Boards and Firm Financial Performance - A Meta-Analysis," PLoS ONE, Vol. 10, No. 6, 2015 https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0130005.
[25] Alice H. Eagly "When Passionate Advocates Meet Research on Diversity, Does the Honest Broker Stand a Chance?" *Journal of Social Issues*, Vol. 72, No. *2,* 2016, pp. 199-222.
David A. Carter, Frank P. D'Souza, Betty J. Simkins, and W. Gary Simpson, "The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance," *Corporate Governance: An International Review*, Vol. 18, No. 5, pp. 396-414, September 2010 https://ssrn.com/abstract=1677099.
[27] Jens Hagendorff and, Kevin Keasey, "The Value of Board Diversity in Banking: Evidence from the Market for Corporate Control, *The European Journal of Finance*, Vol. 18, No. 1, 2012, pp. 41-58.
[28] Nuria Reguera Alvarado, Joaquina Laffarga Briones and Pilar de Fuentes Ruiz, "Gender Diversity on Boards of Directors and Business Success," *Investment Management and Financial Innovations*, Vol. 8, No. 1, 2011, pp. 199-209 https://businessperspectives.org/images/pdf/applications/publishing/templates/article/assets/3868/imfi_en_2011_01c_Alvarado.pdf.

can reduce firm value for well-governed firms.[29] Kenneth Robinson Ahern and Amy Dittmar found that the 2003 mandate that 40 percent of Norwegian firms' directors be women caused a significant drop in the stock price at the announcement of the law and a large decline in Tobin's Q over the following years. The quota led to younger and less experienced boards, increases in leverage and acquisitions, and deterioration in operating performance.[30] Harald Dale-Olsen, Pal Schone and Mette Verner published a paper in *Feminist Economics* arguing that the "impact of the [Norwegian] reform on firm performance is negligible."[31]

Daehyun Kim and Laura T. Starks, found that "gender diversity in corporate boards could improve firm value because of the contributions that women make to the board by offering specific functional expertise, often missing from corporate boards. The additional expertise increases board heterogeneity" which can increase firm value.[32] Maelia Bianchi and George Latridis "found that companies with a higher proportion of women on their boards outperform those with a lower proportion in terms of return on sales and EBITDA margin."[33] Collins G. Ntim found that the South African stock market values diversity but values ethnic diversity more than gender diversity.[34]

The study "Board Diversity, Firm Risk, and Corporate Policies" by Gennaro Bernile, Vineet Bhagwat and Scott E. Yonker[35] is seriously mischaracterized by Nasdaq.[36] The study results "suggest that no single component of the diversity index drives our baseline inferences concerning the effect of aggregate board diversity." "In particular, we construct an index for demographic diversity, based on age, gender, and ethnicity, and one for cognitive diversity, based on educational background, financial expertise, and outside board experience. We then repeat the tests reported in Table 3 for each separate index. The OLS estimates in Panel C suggest that firm risk covaries negatively with board diversity along both the demographic and cognitive dimensions." In other words, the study does not support, as claimed, the Nasdaq conception of diversity but stands for the proposition that a much broader conception of diversity would better promote firm financial performance.

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[29] Renée B. Adams, and Daniel Ferreira, "Women in the Boardroom and Their Impact on Governance and Performance," European Corporate Governance Institute (ECGI) - Finance Working Paper No. 57/2004, October 22, 2008 https://ssrn.com/abstract=1107721.
[30] Kenneth Robinson Ahern and Amy Dittmar, "The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation," *Quarterly Journal of Economics*, Vol. 127, No. 1, 2012, pp. 137-197 https://ssrn.com/abstract=1364470.
[31] Harald Dale-Olsen, Pal Schone and Mette Verner, "Diversity among Norwegian Boards of Directors: Does a Quota for Women Improve Firm Performance?," *Feminist Economics*, Vol. 19, No. 4, October 2013, pp. 110-35.
[32] Daehyun Kim and Laura T. Starks, "Gender Diversity on Corporate Boards: Do Women Contribute Unique Skills?," *American Economic Review*, Vol. 106, No. 5, May 2016, pp. 267-271.
[33] Maelia Bianchi and George Latridis, "Board Gender Diversity and Corporate Financial Performance: Evidence from CAC 40," *Investment Management and Financial Innovations*, Vol. 11, No. 4, pp. 25-35, 2014 https://businessperspectives.org/images/pdf/applications/publishing/templates/article/assets/6059/imfi_en_2014_04_Bianchi.pdf.
[34] Collins G. Ntim, "Board Diversity and Organizational Valuation: Unravelling the Effects of Ethnicity and Gender," *Journal of Management and Governance*, Vol. 19, No. 1, pp.167-195 https://ssrn.com/abstract=2338073.
[35] Gennaro Bernile, Vineet Bhagwat and Scott E. Yonker, "Board Diversity, Firm Risk, and Corporate Policies," Journal of Financial Economics, Vol. 127, No. 3, March, 2018, pp. 588-612 https://ssrn.com/abstract=2733394.
[36] Proposed rule footnote 28 and accompanying text.

A thorough examination of the literature and of the materials cited in Nasdaq's submission shows that its empirical assertions have virtually no basis in the literature. Its submission is deeply misrepresentative.

SROs as Regulators

There are many so-called self-regulatory organizations (SROs).[37] Notable SROs include the Financial Industry Regulatory Authority (FINRA), the New York Stock Exchange and Nasdaq. They are regulators. Presently, SROs often are not "self" regulators since the regulated industry does not control the regulator.[38]

SROs are delegated a high degree of regulatory authority by the Commission and Congress.[39] Membership is mandatory if a firm wishes to do business and member firms must comply with SRO rules. Member firms are subject to potentially stiff fines and other sanctions for non-compliance with SRO rules. Many courts have held that they are therefore state actors. Others have differed. More often than not, courts hold that SROs are state actors when it is good for the

[37] For a partial list, see "Self-Regulatory Organization Rulemaking," Securities and Exchange Commission https://www.sec.gov/rules/sro.shtml.

[38] William A. Birdthistle and M. Todd Henderson, "Becoming a Fifth Branch," *Cornell Law Review*, Vol. 99, No. 1, 2013, pp. 1–69, http://cornelllawreview.org/files/2013/11/99CLR1.pdf ("SROs have been losing their independence, growing distant from their industry members, and accruing rulemaking, enforcement, and adjudicative powers that more closely resemble governmental agencies such as the Securities and Exchange Commission and the Commodity Futures Trading Commission.… This process by which these self-regulatory organizations shed their independence for an increasingly governmental role is highly undesirable from an array of normative viewpoints. For those who are skeptical of governmental regulation, deputizing private bodies to increase governmental involvement is clearly problematic."); Andrew F. Tuch, "The Self-Regulation of Investment Bankers," *George Washington Law Review*, Vol. 83, No. 1 (December 2014), pp. 101–175, http://www.gwlr.org/wp-content/uploads/2015/03/83-Geo-Wash-L-Rev-101.pdf; Hester Peirce, "The Financial Industry Regulatory Authority: Not Self-Regulation after All," Mercatus Center Working Paper, January 2015, https://www.mercatus.org/system/files/Peirce-FINRA_0.pdf; SEC Commissioner Daniel M. Gallagher, "Market 2012: Time for a Fresh Look at Equity Market Structure and Self-Regulation," Securities and Exchange Commission, October 4, 2012, https://www.sec.gov/News/Speech/Detail/Speech/1365171491376. Occupation licensing is often controlled by SROs or quasi-governmental organizations. On occupation licensing generally as a barrier to entry, see The White House, "Occupational Licensing: A Framework for Policymakers," July 2015, https://www.whitehouse.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf and Dick M. Carpenter et al., "License to Work: A National Study of Burdens from Occupation Licensing," Institute for Justice, May 2012, https://www.ij.org/images/pdf_folder/economic_liberty/occupational_licensing/licensetowork.pdf.

[39] David R. Burton, "Reforming FINRA," Heritage Foundation Backgrounder No. 3181, February 1, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3181.pdf; Roberta S. Karmel, "Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?" *Stanford Journal of Law, Business & Finance*, Vol. 14, No. 1 (Fall 2008) http://brooklynworks.brooklaw.edu/cgi/viewcontent.cgi?article=1376&context=faculty; Hester Peirce, "The Financial Industry Regulatory Authority: Not Self-Regulation after All," Mercatus Center Working Paper, January 2015, https://www.mercatus.org/system/files/Peirce-FINRA_0.pdf; Jonathan Macey and Caroline Novogrod, "Enforcing Self-Regulatory Organization's Penalties and the Nature of Self-Regulation," *Hofstra Law Review*, Vol. 40 (2012), pp. 963–1003, https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=5671&context=fss_papers; SEC Commissioner Luis A. Aguilar, "The Need for Robust SEC Oversight of SROs," Securities and Exchange Commission, May 8, 2013, https://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171515546.

SROs and do not do so when it is bad for the SROs. If an SRO is deemed a state actor, then constitutional protections apply as if the SRO were a government agency. If the SRO is not treated as a state actor, then they are subject to the same requirements as other private businesses or employers.

In *Jackson v. Metropolitan Edison Co.*, the Supreme Court held that in determining whether the actions of a private party constitute state action, "the inquiry must be whether there is a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself."[40] In *Blum v. Yaretsky*, the Supreme Court held that "a State normally can be held responsible for a private decision only when it has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State. [T]he required nexus may be present if the private entity has exercised powers that are 'traditionally the exclusive prerogative of the State.'"[41]

In an unpublished[42] 2015 opinion, the Second Circuit held that FINRA is not a state actor.[43] In a similarly unpublished 2011 opinion, the Eleventh Circuit raised, and then side-stepped, the issue by finding that even if FINRA were a state actor, FINRA had provided due process in the case being considered.[44] Courts determining whether FINRA's predecessor organizations, the NASD and the NYSE, were a state actor were divided (although a majority found in most contexts relating to due process that they were not).[45] These cases, however, are of uncertain relevance given the differences between FINRA, NASD or NYSE governance structures then and Nasdaq

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[40] *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 351, 95 S.Ct. 449, 42 L.Ed.2d 477 (1974).

[41] *Blum v. Yaretsky*, 457 U.S. 991, 1004-05, 102 S.Ct. 2777, 73 L.Ed.2d 534 (1982).

[42] See Federal Rules of Appellate Procedure (FRAP) 32.1, and John Szmer, Robert K. Christensen, and Ashlyn Kuersten, "The Efficiency of Federal Appellate Decisions: An Examination of Published and Unpublished Opinions," *The Justice System Journal*, Vol. 33, No. 3 (2012), p. 319, http://spia.uga.edu/faculty_pages/rc/law_pa_files/Pub12_JSJ_EfficiencyFedAppCourts.pdf, finding that three-quarters of federal appellate decisions are now unpublished (unreported) and given that FRAP 32.1, after January 1, 2007, allows attorneys to cite opinions "designated as 'unpublished,' 'not for publication,' 'non-precedential,' 'not precedent,' or the like," unpublished opinions are of greater importance.

[43] *Santos-Buch v. Financial Industry Regulatory Authority, Inc.*, U.S. Court of Appeals for the Second Circuit, No. 14-2767-cv, January 30, 2015, unpublished opinion http://www.leagle.com/decision/In%20FCO%2020150130104/SANTOS-BUCH%20v.%20FINANCIAL%20INDUSTRY%20REGULATORY%20AUTHORITY,%20INC

[44] *Busacca v. S.E.C*, U.S. Court of Appeals for the Eleventh Circuit, No. 10-15918, December 28, 2011, unpublished opinion https://www.sec.gov/litigation/opinions/2010/34-63312-appeal.pdf.

[45] *D'Alessio v. S.E.C.*, 380 F.3d 112, 120 n.12 (2d Cir. 2004) [discussing whether the NASD is a state actor, but asserting that a determination of that issue was not necessary in that case]; *D.L. Cromwell Investments v. NASD Regulation*, 279 F.3d 155 (2d Cir. 2002) [finding that NASD is not a state actor]; *Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999) [finding that NASD is not a state actor but recognizing that "private entities may be held to constitutional standards if their actions are 'fairly attributable' to the state"]; *Gold v. SEC*, 48 F.3d 987 (7th Cir. 1995) [finding that due process was provided and side-stepping the state action issue]; and *Intercontinental Industries, Inc. v. American Stock Exchange*, 452 F.2d 935 (5th Cir. 1971) ["The intimate involvement of the [American Stock] Exchange with the Securities and Exchange Commission brings it within the purview of the Fifth Amendment controls over governmental due process."]. The American Stock Exchange was acquired by the NYSE in 2008 and since 2012 has been called NYSE MKT. See also *Saad v. SEC*, 718 F. 3d 904 (D.C. Cir. 2013) [finding that the commission abused its discretion in failing to address several potentially mitigating factors when upholding a FINRA lifetime bar].

now, changes in the statutory and regulatory structure over time, and evolution in the judicial state action doctrine and the Supreme Court's separation of powers jurisprudence.

The IRS has found that "FINRA is a corporation serving as an agency or instrumentality of the government of the United States" for purposes of determining whether FINRA fines are deductible as a business expense.[46] A "penalty paid to a government for the violation of any law" is not deductible under Internal Revenue Code section 162(f).

Furthermore, courts have routinely held that FINRA and its predecessor organizations *are* government actors for purposes of immunity from private lawsuits against them.[47] For example, in *Standard Investment Chartered Inc. v. National Association of Securities Dealers*,[48] the Second Circuit held that:

> There is no question that an SRO and its officers are entitled to absolute immunity from private damages suits in connection with the discharge of their regulatory responsibilities. This immunity extends both to affirmative acts as well as to an SRO's omissions or failure to act.… It is patent that the consolidation that transferred NASD's and NYSE's regulatory powers to the resulting FINRA is, on its face, an exercise of the SRO's delegated regulatory functions and thus entitled to absolute immunity.… The statutory and regulatory framework highlights to us the extent to which an SRO's bylaws are *intimately intertwined with the regulatory powers delegated to SROs by the SEC* and underscore our conviction that immunity attaches to the proxy solicitation here.[49] (Emphasis added.)

Like Schrödinger's cat, simultaneously dead and alive, SROs are, under current rulings, both a state actor (for purposes of barring liability and for tax purposes) and, generally, not a state actor (for purposes of absolving them of constitutional due process, equal protection and other requirements, for Administrative Procedure Act purposes and for other purposes).

The Proposed Rule is Inconsistent with the Principles of Equal Protection and the Civil Rights Act

This section does not pretend to be an exhaustive or authoritative discussion of the complex labyrinth of Supreme Court jurisprudence regarding equal protection under the 5th and14th amendments, disparate impact and the Civil Rights Act. It should, however, give the Commission pause regarding three things. The legal issues raised by the proposed rule are far outside the Commission's technical competence. The ethical issues raised by the proposed rule

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[46] Internal Revenue Service, Memorandum No. 201623006, Office of Chief Counsel, June 3, 2016, http://brokeandbroker.com/PDF/IRSFINRAFines.pdf

[47] "The NYSE, as a[n] SRO, stands in the shoes of the SEC in interpreting the securities laws for its members and in monitoring compliance with those laws. It follows that the NYSE should be entitled to the same immunity enjoyed by the SEC when it is performing functions delegated to it." See *D'Alessio v. New York Stock Exchange, Inc.*, 258 F.3d 93 (2d Cir. 2001). See also *Sparta Surgical Corp. v. National Association of Securities Dealers, Inc.*, 159 F.3d 1209 (9th Cir. 1998), and *Weissman v. Nat'l Association of Securities Dealers, Inc.*, 500 F.3d 1293 (11th Cir. 2007).

[48] 637 F.3d 112 (2d Cir. 2011), cert. denied January 17, 2012.

[49] Ibid.

are profound. The proposed rule may well be successfully challenged in court on both constitutional and Civil Rights Act grounds.

The Civil Rights Act of 1964 makes it an unlawful employment practice for an employer to "limit, segregate, or classify his employees or applicants for employment" … "because of such individual's race, color, religion, sex, or national origin." Specifically, it reads as follows;

> Unlawful employment practices
>
> (a) Employer practices. It shall be an unlawful employment practice for an employer—
> (1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin; or
> (2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin.[50]

Classifying a worker as an employee or independent contractor can be notoriously difficult and different standards are used for different purposes at the federal and state level.[51] The Civil Rights Act statutory definition is effectively circular. EEOC guidance provides that board members *probably* will not be deemed an employee for purposes for purposes of the Civil Rights Act.[52] However, in California, for example, directors are explicitly deemed employees for some purposes.[53] While directors may not be deemed employees for Civil Rights Act purposes, the proposed rule certainly violates the principles of the Act and the proposed rule would most likely be a violation were directors deemed employees.

As discussed in the previous section, Nasdaq as a regulator may very well be deemed a state actor. Courts have so held. In that case, the equal protection provisions of the constitution are applicable. Certainly, the Commission in its capacity as a government agency approving the Nasdaq rule is subject to those constitutional provisions. Moreover, Nasdaq may be subject to

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[50] 42 U.S. Code Sec. 2000e-2. [Section 703 of the Civil Rights Act of 1964]
[51] David R. Burton, A Guide to Labor and Employment Law Reforms, Heritage Foundation Backgrounder No. 3535, October 9, 2020 https://www heritage.org/sites/default/files/2020-10/BG3535.pdf (See especially "Independent Contractors" section).
[52] EEOC Compliance Manual on "Threshold Issues." 2-III(A)(1)(d) https://www.eeoc.gov/laws/guidance/section-2-threshold-issues#2-III-A-1-d ("In most circumstances, individuals who are partners, officers, members of boards of directors, or major shareholders will not qualify as employees.")
[53] Cal. Labor Code § 3351(c) (The definition of employee includes "All officers and members of boards of directors of quasi-public or private corporations while rendering actual service for the corporations for pay.")

section 1983 liability.[54] Equal protection principles apply to federal agencies because they have been incorporated into the due process clause of the 5th amendment.[55]

The Supreme Court has held that "A racial classification, regardless of purported motivation, is presumptively invalid and can be upheld only upon an extraordinary justification."[56] "Absent searching judicial inquiry into the justification for such race-based measures, there is simply no way of determining what classifications are "benign" or "remedial" and what classifications are in fact motivated by illegitimate notions of racial inferiority or simple racial politics."[57] "Laws that explicitly distinguish between individuals on racial grounds fall within the core of the Equal Protection Clause's prohibition against race-based decision-making."[58] "Racial and ethnic distinctions of any sort are inherently suspect, and thus call for the most exacting judicial examination. … There is no principled basis for deciding which groups would merit "heightened judicial solicitude" and which would not. Courts would be asked to evaluate the extent of the prejudice and consequent harm suffered by various minority groups."[59] "The way to stop discrimination on the basis of race is to stop discriminating on the basis of race."[60]

Similar decisions generally prohibit discrimination on the basis of sex on equal protection grounds.[61] The Supreme Court has held that "the reviewing court must determine whether the proffered justification is 'exceedingly persuasive.' … The justification must be genuine, not hypothesized or invented post hoc in response to litigation. And it must not rely on overbroad generalizations about the different talents, capacities, or preferences of males and females."[62] The Supreme Court recently extended Title VII protections to gay and transgender persons by

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[54] 42 U.S. Code § 1983. ("Civil Action for Deprivation of Rights. Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress ..."). Admittedly, the qualified immunity doctrine poses a barrier to such liability. See, e.g., William Baude, "Is Qualified Immunity Unlawful?," 106 *California Law Review* 45 (2018) https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=13555&context=journal_articles. The Commission may have to think about liability under *Bivens v. Six Unknown Named Agents*, 403 U.S. 388 (1971) and its progeny.

[55] *Bolling v. Sharpe*, 347 U.S. 497 (1954); *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200 (1995). See also *Buckley v. Valeo*, 424 U.S. 1 (1976).

[56] *Shaw v. Reno*, 509 U.S. 630, 643-644 (1993). See also *Brown v. Board of Education of Topeka*, 347 U. S. 483 (1954); *Loving v. Virginia*, 388 U. S. 1 (1967); *Personnel Administrator of Mass. v. Feeney*, 442 U. S. 256, 272 (1979).

[57] *Richmond v. J. A. Croson Co.*, 488 U. S. 469, 493 (1989).

[58] *Miller v. Johnson*, 515 U.S. 900, 905 (1995).

[59] *Regents of Univ. of California v. Bakke*, 438 U.S. 265 at 291, 296 (1978).

[60] *Parents Involved in Community Schools v. Seattle School District No. 1*, 551 U.S. 701, 748 (2007) https://www.supremecourt.gov/opinions/boundvolumes/551bv.pdf.

[61] *Reed v. Reed*, 404 U.S. 71 (1971); *Frontiero v. Richardson*, 411 U.S. 677, 688 (1973) ("… classifications based upon sex, like classifications based upon race, alienage, and national origin, are inherently suspect and must therefore be subjected to close judicial scrutiny."); *Weinberger v. Wiesenfeld*, 420 U.S. 636 (1975); *Craig v. Boren*, 429 U.S. 190 (1976); *Califano v. Goldfarb*, 430 U.S. 199 (1977); *Kirchberg v. Feenstra*, 450 U. S. 455 (1981); *United States v. Virginia*, 518 U.S. 515 (1996); *Nevada Department of Human Resources v. Hibbs*, 538 U.S. 721 (2003).

[62] *United States v. Virginia*, 518 U.S. 515, 533 (1996).

holding that discrimination based on homosexuality or transgender status necessarily entails discrimination based on sex.[63]

The Proposed Rule Meets the Very Definition of Racist and Sexist; Morally, It Represents a Marked Step Backwards

> *I have a dream that my four little children will one day live in a nation where they will not be judged by the color of their skin but by the content of their character.*[64]
>
> Martin Luther King, Jr.

> *Sex, like race, is a visible, immutable characteristic bearing no necessary relationship to ability.*[65]
>
> Ruth Bader Ginsburg (in oral argument as an attorney in *Frontiero v. Richardson* (1973))

> *The Constitution abhors classifications based on race, not only because those classifications can harm favored races or are based on illegitimate motives, but also because every time the government places citizens on racial registers and makes race relevant to the provision of burdens or benefits, it demeans us all. Purchased at the price of immeasurable human suffering, the equal protection principle reflects our Nation's understanding that such classifications ultimately have a destructive impact on the individual and our society.*[66]
>
> Justice Clarence Thomas (*Grutter v. Bollinger)*

> Racism: A belief that race is a fundamental determinant of human traits and capacities.[67]

> Sexism: Prejudice or discrimination based on sex; behavior, conditions, or attitudes that foster stereotypes of social roles based on sex.[68]

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[63] *Bostock v. Clayton County*, 590 U.S. __ (2020) https://www.supremecourt.gov/opinions/19pdf/17-1618_hfci.pdf ("discrimination based on homosexuality or transgender status necessarily entails discrimination based on sex ... In Title VII, Congress adopted broad language making it illegal for an employer to rely on an employee's sex when deciding to fire that employee. … We do not hesitate to recognize today a necessary consequence of that legislative choice: An employer who fires an individual merely for being gay or transgender defies the law.")

[64] Martin Luther King, Jr., "I Have a Dream" Address Delivered at the March on Washington for Jobs and Freedom, August 28, 1963, Washington, D.C. https://kinginstitute.stanford.edu/king-papers/documents/i-have-dream-address-delivered-march-washington-jobs-and-freedom.

[65] Katherine Franke, "Symposium: The Liberal, Yet Powerful, Feminism of Ruth Bader Ginsburg," October 9, 2020 https://www.scotusblog.com/2020/10/symposium-the-liberal-yet-powerful-feminism-of-ruth-bader-ginsburg/; Robert Cohen and Laura J. Dull, "Supplemental Online Material for "Teaching About the Feminist Rights Revolution: Ruth Bader Ginsburg as 'The Thurgood Marshall of Women's Rights,'" https://tah.oah.org/november-2017/supplemental-online-material-for-teaching-about-the-feminist-rights-revolution-ruth-bader-ginsburg-as-the-thurgood-marshall-of/.

[66] *Grutter v. Bollinger*, 539 U. S. 306, 353 (2003) Thomas opinion (concurring in part and dissenting in part) https://www.supremecourt.gov/opinions/boundvolumes/539bv.pdf.

[67] Merriam-Webster online.

[68] Ibid.

The proposed rule is racist and sexist in that it mandates that firms establish quotas and discriminate based on sex, skin color, ethnicity or sexual orientation rather than making determinations based on individual achievement, talent, experience or competence. It defines diversity entirely in terms of these immutable characteristics instead of the myriad of other kinds of diversity such as a director's achievement, expertise, experience, approach to business or business philosophy, educational background, socio-economic background, ethical views, political views, integrity, geographic location, and so on.

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.

Faux Diversity

The type of diversity created by the proposed rule will be faux diversity — skin deep, if you will. It is a rejection of the kind of diversity that is most likely to enable a business to understand the true diversity of the American people and actually be relevant to business profitability such as a director's achievement, expertise, experience, approach to business or business philosophy, educational background, socio-economic background, ethical views, political views,[69] integrity, geographic location There is also strong reason to believe that those chosen under such a rule but who "self-identify" as women, a designated minority or LGBTQ+ will have been educated in the same handful of schools and come from the same coastal urban centers as most existing directors.

The Proposed Rule Rests on a Faulty Premise

The Nasdaq proposed rule rests on a faulty premise. Nasdaq falsely assert that shareholders demand the corporations that they own discriminate on the basis of sex, race, ethnicity or sexual orientation. Shareholders are free to instruct management to do so or to pursue other environmental, social or governance (ESG) or social justice objectives via shareholder resolution. When afforded the opportunity to do so, they very rarely do.[70] None of the seven proposals on the subject that went to votes in 2019 earned more than 3 percent of the vote.[71] A very high percentage of the shareholder proposals submitted are submitted by government pension funds in their capacity as shareholders for political purposes.[72]

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[69] It is probably not advisable to require reporting on the political ideology or the party affiliation of board members and management. The country is politicized enough. But the one study that I found on the subject appears to show a strong, statistically robust positive impact of political heterogeneity of boards on firm performance. Incheol Kim, Christos Pantzalis and Jung Chul Park, "Corporate Boards' Political Ideology Diversity and Firm Performance, *Journal of Empirical Finance*, Vol. 21, 2013 https://ssrn.com/abstract=2055800.
[70] See, e.g., Proxy Preview, 2020 https://www.proxypreview.org/2020/report-cover.
[71] Ibid at p. 66.
[72] For example, the New York City Comptroller's Office Board Accountability Project 3.0 campaign https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/boardroom-accountability-

Of course, entrepreneurs are today free to form benefit corporations or benefit limited liability companies that serve a social purpose as well as the purpose of making a profit. But relatively few businesses are so organized and relatively little investor capital flows to benefit corporations or LLCs. Individuals are free to invest in these companies but fiduciaries have no business investing other's money in such enterprises absent an explicit indication that investors agree with the social goals of the enterprise and are willing to accept a lower rate of return.[73]

Mutual funds and exchange trade funds devoted to socially responsible investing are growing. As these are voluntary and the terms of the investment are fully disclosed, this is perfectly fine. But such funds are still a very minor share of overall investment because most investors are unwilling to sacrifice returns to achieve "social justice" objectives.

The True Agenda: Remaking the Purpose of Business

This section is a very abbreviated discussion of the many issues regarding the purpose of business, theories of the corporation, corporate social responsibility and so on.[74] Traditionally, the purpose of businesses has been to earn a return for its owners by cost-effectively combining the capital of its owners with the labor and talent of its employees in a competitive environment to satisfy the wants and needs of its customers. The relationship between owners, management, workers, suppliers, and customers are, subject to certain broad constraints imposed by law, privately decided and voluntary.

With increasing stridency, there is a major effort under way to redefine the purpose of businesses to achieve various social or political objectives unrelated to earning a return, satisfying customers or treating workers or suppliers fairly. This is being done under the banner of social justice, corporate social responsibility (CSR), stakeholder theory, environmental, social and governance (ESG) criteria, socially responsible investing (SRI), sustainability, diversity, business ethics, common good capitalism or corporate actual responsibility.[75]

If successful, these attempts to redefine the purpose of business as the pursuit of ESG or social justice objectives will have marked adverse social consequences. Management will be even less accountable to anyone.[76] To the extent that firms make decisions based on considerations other than cost-effectively meeting the needs and wants of their customers, their costs will increase and they will become less productive and less competitive. Either returns will decline, wages will stagnate, prices will increase or the quality of the goods and services they provide will decline

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project-3-0/. See also Andrew Ramonas, "Illinois Treasurer Urges SEC to Adopt Diversity Mandates," *Bloomberg Law*, September 16, 2020 https://news.bloomberglaw.com/securities-law/illinois-treasurer-urges-sec-to-adopt-diversity-mandates.

[73] Comment Letter of David R. Burton regarding Financial Factors in Selecting Plan Investments, July 30, 2020 https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00595.pdf; Comment Letter of David R. Burton regarding Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, October 5, 2020 https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00232.pdf.

[74] I will address these issues more systematically in a forthcoming paper.

[75] See footnote 15 above.

[76] See next section.

(which is effectively a price increase). Because wages are closely tied to productivity over time, wages will grow more slowly or stagnate. As firms become less competitive, jobs will be lost. The value of retirement accounts of millions of people will be adversely affected. Similarly, the pensions of millions more that are funded by returns on equity investments will be endangered.

The Proposed Rule Would Lead to Less Management Accountability

In large, modern corporations there is a separation of ownership and control. There is a major agent-principal problem because management and the board of directors often, to varying degrees, pursue their own interest rather than the interests of shareholders. Profitability is, however, a fairly clear measure of the success or failure of management and the board. If a firm become unprofitable or lags considerably in profitability, the board may well replace management, shareholders may replace the board or another firm may attempt a takeover.

Systematic implementation of regulatory ESG or CSR requirements will make management dramatically less accountable since they will come at the expense of profitability but the metrics relating to success or failure of achieving ESG or CSR requirements will be largely unquantifiable. For that matter, ESG or CSR requirements themselves tend to be amorphous and ever changing. The same is true for "stakeholder capitalism." How and on what basis is management's allocation of resources to various stakeholders to be assessed? The entire effort will make businesses more akin to government or not-for-profit enterprises.

The Social Welfare Cost of ESG Requirements

The broader social costs associated with ESG requirements can, in principle, be quantified. This section provides an analytical framework that may be useful in analyzing the social welfare costs of ESG requirements.

To the extent ESG objectives are not pursued by businesses for the purpose of making a profit, $R > R_{ESG/CSR}$ where R is the rate of return on investment in the absence of ESG, CSR, sustainability requirements, diversity requirements or stakeholder theory implementation and $R_{ESG/CSR}$ is the rate of return after implementation of those requirements. The difference, $R - R_{ESG/CSR}$ is economically analogous to a tax. It is a reduction in return due to the pursuit of ESG objectives. Thus, $R - R_{ESG/CSR} = Tax_{ESG/CSR}$. This means that various techniques used in public finance to analyze the social welfare impact of taxes may be used to quantitatively analyze the social welfare cost of these provisions (i.e. $Tax_{ESG/CSR}$). A tax has an excess burden or deadweight loss that can be calculated.[77] By introducing a wedge ($Tax_{ESG/CSR}$) between, in this case, the gross return and the net return, ESG/CSR reduces the size the capital market and therefore output and employment. In a well-functioning market, the price of a capital asset should be equal to the present value of the expected future income stream generated by the asset net of taxes and

[77] Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy* (June, 1962), pp. 215-240; Alan J. Auerbach and James R. Hines, "Taxation and Economic Efficiency," Chapter 21 in *Handbook of Public Economics*, Martin Feldstein and A.J. Auerbach (Editors) (North Holland:2002); John Creedy, "The Excess Burden of Taxation and Why it (Approximately) Quadruples When the Tax Rate Doubles," New Zealand Treasury Working Paper No. 03/29, December, 2003 https://treasury.govt.nz/sites/default/files/2007-10/twp03-29.pdf. Also see, for example, N. Gregory Mankiw, *Principles of Economics*, 4th Edition (2006), Chapter 8 (or many other textbooks on price theory, microeconomics, or principles of economics).

depreciation.[78] Introducing a new tax (in this case $Tax_{ESG/CSR}$) will reduce the expected future income stream and therefore the price of the asset. It will also cause investment to flow out of the affected sector or jurisdiction.

Who bears the actual economic burden of the corporate income tax is an open question.[79] The analysis of who bears the burden of $Tax_{ESG/CSR}$ would be the same. One thing is certain: It cannot be corporations. A corporation is a legal fiction, and legal fictions do not pay taxes—people pay taxes. The corporate tax could be borne by corporate shareholders in the form of lower returns;[80] owners of all capital (again in the form of lower returns);[81] corporate customers in the form of higher prices;[82] or employees (in the form of lower wages).[83] It is, almost certainly, some combination of these.[84] The economics profession has changed its thinking on this issue several

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[78] See Robert E. Hall and Dale Jorgenson, "Tax Policy and Investment Behavior," *American Economic Review*, Vol. 57, No. 3 (June, 1967), pp. 391-414 for the basic user cost of capital analysis with taxes. See also Dale W. Jorgenson, *Investment: Capital Theory and Investment Behavior* (The MIT Press:1996) and John Creedy and Norman Gemmell, "Taxation and the User Cost of Capital: An Introduction," New Zealand Treasury Working Paper No. 04/2015, March, 2015 https://www.victoria.ac.nz/sacl/centres-and-institutes/cpf/publications/pdfs/2015-pubs/WP04_2015_Taxation-and-User-Cost.pdf.

[79] In the economics literature, this question is usually phrased as "What is the incidence of the corporate income tax?"

[80] Government estimators are among the few who cling to the view that shareholders bear most of the burden. Joint Committee on Taxation, "Modeling the Distribution of Taxes on Business Income," JCX-14-13, October 16, 2013 https://www.jct.gov/publications.html?func=download&id=4528&chk=4528&no_html=1 (25 percent labor); Julie Anne Cronin, Emily Y. Lin, Laura Power, and Michael Cooper, "Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology," *National Tax Journal*, March 2013 https://www.ntanet.org/NTJ/66/1/ntj-v66n01p239-62-distributing-corporate-income-tax.pdf (18 percent labor).

[81] The non-corporate sector can be affected because competition will eventually cause wages, prices, and after-tax returns in the corporate and non-corporate sectors to be the same. For a more detailed explanation, see Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, Vol. 70, No. 3 (June 1962), pp. 215–240.

[82] The focus of the economics profession to date has been almost exclusively the impact on capital and labor rather than customers.

[83] Arnold C. Harberger, "The ABCs of Corporation Tax Incidence: Insights into the Open-Economy Case," in *Tax Policy and Economic Growth* (Washington, DC: American Council for Capital Formation, 1995); Arnold C. Harberger, "The Incidence of the Corporation Income Tax Revisited," *National Tax Journal*, Vol. 61, No. 2 (June,2008), pp. 303–312 http://www.ntanet.org/NTJ/61/2/ntj-v61n02p303-12-incidence-corporation-income-tax.pdf; Matthew H. Jensen and Aparna Mathur, "Corporate Tax Burden on Labor: Theory and Empirical Evidence," *Tax Notes*, June 6, 2011 https://www.aei.org/wp-content/uploads/2011/06/Tax-Notes-Mathur-Jensen-June-2011.pdf; Kevin A. Hassett and Aparna Mathur, "A Spatial Model of Corporate Tax Incidence," American Enterprise Institute, December 1, 2010 https://www.aei.org/wp-content/uploads/2011/10/-a-spatial-model-of-corporate-tax-incidence_105326418078.pdf; Robert Carroll, "The Corporate Income Tax and Workers' Wages: New Evidence from the 50 States," Tax Foundation Special Report No. 169, August 3, 2009 https://taxfoundation.org/corporate-income-tax-and-workers-wages-new-evidence-50-states/; Desai Mihir, Fritz Foley, and James Hines, "Labor and Capital Shares of the Corporate Tax Burden: International Evidence," December 2007; and Jason J. Fichtner and Jacob M. Feldman, "Why Do Workers Bear a Significant Share of the Corporate Income Tax?" in *The Hidden Cost of Federal Tax Policy*, Mercatus Center, 2015, Chapter 4 https://www.mercatus.org/system/files/Fichtner-Hidden-Cost-ch4-web.pdf. For a contrary view, see Kimberly A. Clausing, "In Search of Corporate Tax Incidence," *Tax Law Review*, Vol. 65, No. 3, 2012, pp. 433–472 http://ssrn.com/abstract=1974217.

[84] It requires extreme, implausible assumptions about elasticities of demand for, or supply of, factors for this not to be the case. Alan J. Auerbach, "Who Bears the Corporate Tax? A Review of What We Know," National Bureau of

times over the past four decades, but the latest —and highly plausible —consensus is that workers probably bear more than half of the burden of the corporate income tax because capital is highly mobile.[85] Labor's share of the corporate tax burden is potentially as high as three-quarters.[86] Shareholders (investors) probably bear most of the remainder.[87] Initially (i.e. in the short run), the impact on shareholder returns will be greater. Adjustments take time. In the long run, ESG requirements ($Tax_{ESG/CSR}$) would have a disproportionately negative impact on labor due to capital factor mobility.

Federalizing Corporate Governance

Traditionally, corporate governance is a function of state law and private decision-making. The Nasdaq rule is one more large step towards the federalization of corporate governance. Jurisdictional competition and freedom of action by private actors is much more likely to lead to desirable outcomes than one-size fits all mandates by national regulators.

Diversity Statistical Reporting

If the Commission decides to mandate or allow SROs to mandate diversity reporting greater than what is currently required under Regulation S-K, then it should require reporting on the many kinds of diversity that are important to business success not merely the race, ethnic origin, sex and sexual orientation of its board members. Diversity reporting should include:

(1) experience (job titles, responsibilities and functions, notable achievements);
(2) other board positions held (in the past and currently);
(3) industries worked in;
(4) education (degrees conferred, subject matter studied, schools attended and school location);
(5) professional certifications, accreditations and awards;
(6) relevant cultural, charitable, policy, public service or similar activities;
(7) geographic location of residence and business (country, state or region and city); and
(8) other factors considered by the corporation when selecting the board member.

Economic Research Working Paper No. 11686, October, 2005 http://www.nber.org/papers/w11686.pdf; William M. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax," Department of the Treasury, Office of Tax Analysis, OTA Paper No. 101, December, 2007 https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-101.pdf; and Stephen J. Entin, "Tax Incidence, Tax Burden, and Tax Shifting: Who Really Pays The Tax?" Heritage Foundation Center for Data Analysis Report No. 04-12, November 5, 2004 http://s3.amazonaws.com/thf_media/2004/pdf/cda04-12.pdf.

[85] In a competitive market, capital will flow from jurisdictions with a relatively low expected after-tax return to jurisdictions with a relatively high expected after-tax return until the expected after-tax returns are equal. Social and legal barriers reduce labor mobility relative to capital mobility. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax"; William C. Randolph, "International Burdens of the Corporate Income Tax," Congressional Budget Office, August, 2006 https://cbo.gov/sites/default/files/cbofiles/ftpdocs/75xx/doc7503/2006-09.pdf; and R. Alison Felix, "Passing the Burden: Corporate Tax Incidence in Open Economies," Federal Reserve Bank of Kansas City, October, 2007 https://www.kansascityfed.org/Publicat/RegionalRWP/RRWP07-01.pdf.

[86] Ibid.

[87] As opposed to non-corporate capital and customers.

Sincerely,

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