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Client Alert: Board Diversity Efforts: Factors for Companies to Consider Given Growing Scrutiny

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In recent years, companies have paid significant attention to corporate board diversity. Many corporations have done so on their own initiative as part of their broader commitment to diversity, equity, and inclusion (DEI), while others have acted to comply with state mandates requiring a certain number of board members from underrepresented groups. Pressure from investors has also focused attention on board representation.[1] Research supports a strong business case for board diversity, which can counteract groupthink, enhance decision making, and lead to improved corporate governance and performance.[2]

At the same time, concrete efforts to diversify corporate boards have come increasingly under attack. For example, private litigants have successfully challenged under the State constitution California laws that mandate a particular number of diverse board members for California-based companies.[3] The Fifth Circuit Court of Appeals recently heard argument in a challenge to a NASDAQ rule that requires listed companies to disclose board-level diversity statistics, and, if they do not have at least two diverse directors, to explain why.[4] Most recently, in a decision issued last month, a New Jersey state court struck down the New Jersey State Bar Association's system of reserving board seats for members of particular underrepresented groups, holding that it violated the State's anti-discrimination law.[5] This challenge to a group's voluntary effort to increase board diversity is particularly notable and may foreshadow similar lawsuits against private companies.

Together, these challenges underscore the legal risk that many types of organizations face under federal and state law when they endeavor to diversify their boards. To be sure, not every private company and voluntary program is equally susceptible to legal challenge: board members typically are not considered employees and thus not subject to Title VII of the Civil Rights Act of 1964, which is a common hook for reverse discrimination claims challenging DEI programs. That said, race-conscious board initiatives might run afoul of other federal statutes, like Section 1981 of the Civil Rights Act of 1866, which prohibits race discrimination in the making and enforcing of contracts;[6] and companies that receive federal funds may face additional liability under other federal laws.[7]

Furthermore, as explained below, many state antidiscrimination laws have broader coverage than federal law and therefore present additional risk, even for private companies.

As companies seek to balance their diversity objectives with mounting legal risk, we urge them to consider the following best practices:

Consider Strategies That Expand Opportunities Rather Than Quotas. Quotas or numerical targets that aim to set aside a certain number of board seats for members of underrepresented groups have attracted the most judicial scrutiny and bring the greatest risk of private litigation. Many companies can avoid this potential problem by relying on strategies that expand opportunity in lieu of quotas.

Such efforts might include increasing the number of board seats, establishing shorter and fixed terms, and, perhaps most importantly, looking to a broader base of individuals as candidates for board seats. Companies might consider leaders in government and nonprofits and those who have served in a broader set of roles within corporations as potential candidates, rather than the more limited set of C-Suite executives who have historically populated corporate boards. Companies can mitigate the harm of likeness bias, which often occurs when existing board members rely on their own networks to recommend candidates, by using more formal processes by which to create a candidate pool, and ultimately, interview and select candidates.

In recent years, many corporations have adopted a version of the "Rooney Rule," in which they commit to considering at least one diverse candidate for an open board seat. While this strategy is not without legal risk, it may withstand challenge better than a strict numerical quota for board seats themselves. And while studies suggest that the Rooney Rule has not had the impact on outcomes that proponents hoped,[6] companies can and should continue to explore thoughtful approaches to expanding the pipeline for board seats to ensure that it includes qualified diverse candidates.

Pay Attention to State Anti-Discrimination Laws. When companies consider their legal risk under anti-discrimination laws, they often have federal law in mind. Yet state law can be especially important in this context. State antidiscrimination laws often have a broader reach than their federal counterparts, covering more types of organizations, relationships, and protected characteristics. In the New Jersey case discussed above, for instance, the court explained that the State's antidiscrimination law applied to the private state bar association because of a specific amendment to the law that makes it unlawful for a private club or association to discriminate against any member on the basis of listed protected characteristics including race and sex.[9] In addition, some states have relaxed standing requirements as compared to the requirements in federal court. For example, in a challenge brought in California state court to the board quota system, the state court allowed the challenge to proceed despite the lack of any injured plaintiff based on a taxpayer standing theory that is not cognizable in federal court.[10]

Employ a Broader Definition of Diversity that Does Not Rely Solely on Protected Characteristics. In order to realize the fullest benefits of diversity, corporations should strive to include various perspectives, backgrounds, and expertise on their boards. Holistic processes that evaluate candidates as individuals are far less vulnerable to the types of claims brought against quotas or numerical targets. Companies should consider using evaluation and selection criteria that prioritize diversity along the full range of human experiences, which can protect against allegations that they are making decisions solely based on race, gender, or any other protected characteristic. Further, companies can also consider factors such as a demonstrated commitment to diversity, experience working with diverse populations and stakeholders, and past involvement in DEI programs as they look to seat new board members.

Given this evolving legal landscape, companies should consider taking proactive steps to protect their existing efforts to increase board diversity and should craft any new board diversity initiatives with the above considerations in mind. Jenner & Block has a deep commitment to diversity, equity, and inclusion and extensive experience supporting our clients' DEI efforts through litigation, investigations, and strategic counseling. In light of this commitment and experience, the firm has launched a task force—composed of leading attorneys serving a wide variety of industries—to develop creative, strategic, and tailored solutions for clients across industries to accomplish their DEI goals while minimizing legal risk. If you are interested in learning more about our work in this area, please contact Organizational Values and Strategy Task Force Co-Chairs Ishan Bhabha (ibhabha@jenner.com), Lauren Hartz (lhartz@jenner.com), and Kathryn Wynbrandt (kwynbrandt@jenner.com).

Footnotes

[1] For example, BlackRock's 2022 proxy voting guidelines state: "To the extent that, based on our assessment of corporate disclosures, a company has not adequately accounted for diversity in its board composition within a reasonable timeframe, we may vote against members of the nominating/governance committee for an apparent lack of commitment to board effectiveness." *BlackRock Investment Stewardship: Proxy Voting Guidelines for U.S. Securities* at 7 (eff. Jan. 2022), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf. Goldman Sachs will now take a company public only if the board has at least two diverse members, one of whom must be a woman. Corporate Board Engagement, Goldman Sachs, https://www.goldmansachs.com/our-commitments/diversity-and-inclusion/board-diversity/2022-update/index.html (last visited Dec. 13, 2022).

[2] *See, e.g.*, Jason M. Thomas & Megan Starr, *Global Insights: From Impact Investing To Investing For Impact* at 5, The Carlyle Group https://www.carlyle.com/sites/default/files/2020-02/From%20Impact%20Investing%20to%20Investing%20for%20Impact_022420.pdf (finding that the "average earnings growth of Carlyle portfolio companies with two or more diverse board members" was 12% greater and five times faster than for companies

that lack diversity); Chris Brummer & Leo E. Strine, Jr., *Duty And Diversity*, 75 Vand. L. Rev. 1, 33–37 (2022) (summarizing studies on the benefits of diversity in reducing groupthink and improving group decision making).

[3] *See Crest v. Padilla* ("*Crest – Underrepresented Communities*"), No. 20STCV37513, 2022 WL 1073294 (Cal. Super. Ct. Apr. 01, 2022); *Crest v. Padilla* ("*Crest – Women*"), No. 19STCV27561 (Cal. Super. Ct. May 13, 2022). The State is appealing both decisions. In addition, a federal case challenging these same California statutes mandating that a certain number of board seats be filled by members of underrepresented communities (racial minorities and members of the LGBT community) and women is currently being briefed before a district court. The court has already dismissed the claim challenging the female representation requirement, but the challenge to the numerical mandate for board members from underrepresented communities remains ongoing. *See Alliance for Fair Board Recruitment v. Weber,* No. 2:21-cv-01951 (C.D. Cal.).

[4] *Alliance for Fair Board Recruitment v. SEC*, No. 21-60626 (5th Cir. Aug. 29, 2022).

[5] Order, *Saadeh v. New Jersey State Bar Ass'n*, No. MID-L-006023-21 (N.J. Super. Ct. Law Div. Nov. 9, 2022).

[6] In its federal complaint challenging California's board diversity mandates, the Alliance for Fair Board Recruitment brought a Section 1981 claim in addition to the Equal Protection claims that only apply to state actors. *See* Complaint ¶¶ 56–58, *Weber*, No. 21-cv-01951 (C.D. Cal. July 12, 2021), ECF No. 1.

[7] *See, e.g.*, 42 U.S.C. § 2000d ("Title VI").

[8] *See* Jeff Green, *Corporate America's Love For The Rooney Rule Is Under Scrutiny*, Bloomberg Law (Mar. 21, 2022), https://news.bloomberglaw.com/daily-labor-report/corporate-americas-love-for-the-rooney-rule-is-under-scrutiny; Lila MacLellan, *More Than 90% Of S&P 500 Boards Disclose Racial Representation. But The Numbers Have Barely Budged*, Fortune (Nov. 2, 2022), https://fortune.com/2022/11/02/most-sp-500-boards-disclose-diversity-representation/ (Fifty percent of S&P 500 companies said "they've adopted a Rooney Rule-like policy mandating that boards include executives from underrepresented groups in candidate pools.").

[9] *Saadeh*, *supra* note 5, Order at 12-13 quoting N.J.S.A. 10:5-12(f)2.

[10] *Crest – Underrepresented Communities*, 2022 WL 1073294, at *5–6.

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