# FRAMING THE ISSUES: BOARD DIVERSITY AND CORPORATE PURPOSE

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*This article makes three key claims. First, Board diversity has a long pedigree and has long involved far more than gender, minority, and LGBTQ+ representation.*

*Second, corporate purpose–long described by state corporate law concepts such as those associated with* Dodge v. Ford *as a primary purpose to generate profits for shareholders–is wrongly conceived in a period dominated by federal securities and other statutes with broader social purposes, many of which do not emphasize shareholder profits. Properly conceived, corporate purpose today is an amalgam of state corporate law's primary objective of maximizing shareholder profits and federal social purposes which apply regardless of shareholder profitability, including wealth and income allocation through the tax system, environmental protection, labor and health laws, and mandatory disclosure, and independent directors on audit and compensation committees requirements under federal securities laws.*

*Third, much of the debate over greater board diversity is best understood by focusing on the hard question of how much of corporate social objectives is better achieved through regulatory means rather than changes on the board. Nonetheless, two types of diversity are most wisely pursued today: first, gender, minority, and LGBTQ+ representation and second, the creation of corporate boards in leading United States corporations entirely composed of outside or independent directors.*

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## INTRODUCTION

Board diversity is a more nuanced topic than recent new standards by California[1] and Nasdaq[2]—to add or strongly encourage female, under-represented minority, and LGBTQ+ directors—suggest. Part I of this article, describes several forms of board diversity that have been proposed or adopted in the 20th and 21st centuries. Part I emphasizes that not only are

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[1] Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity, 85 Fed. Reg. 80,472 (Dec. 4, 2020).

[2] CAL. CORP. CODE §§ 301.3(a)–(b), 2115.5 (West 2021).

proposals to increase board diversity themselves are diverse, but also the rationales for these proposals are quite different.

Part II urges that the frame by which different standards of board diversity should be analyzed is not state law with its traditional standard that the primary purpose of a corporation is to generate profits for shareholders. Rather, the purpose of a corporation is an amalgam of this primary purpose with a detailed panoply of federal legal standards which also emphasize social purposes such as wealth redistribution through taxation and Social Security; the safety and solvency of financial institutions through banking legislation; labor rights and protection of the environment; and federal securities laws with their mandatory disclosure and audit standards and required independent directors on audit and compensation committees.

Part III analyzes what would be the wisest new forms of board diversity to consider. This Part recognizes that many social goals are achieved through compliance with regulation alone rather than through greater board diversity. Two types of board diversity today have special claims. Responsiveness to female, underrepresented minority, and LGBTQ+ corporate concerns is unlikely to be effectively achieved without at least minority membership on the board to achieve "a place at the table." Concomitantly, board diversity should be pursued by adoption of requirements that the full board, like the modern audit and compensation committee, should be solely comprised of outside independent directors.

## I. Alternative Forms of Board Diversity

In 2018, California enacted SB 826[3] which added sections 301.3 and 2115.5 to the California Corporations Code requiring each firm headquartered in California to have a minimum number of female directors.[4]

Legislative findings made it unequivocally clear that the purpose of the new requirement was to add females to covered boards, stating "[i]f measures are not taken to proactively increase the numbers of women serving on corporate boards, studies have shown that it will take decades, as many as 40 or 50 years, to achieve gender parity among directors."[5] The first three courts to address these new requirements were divided as to whether the law

[3] 2018 Cal. Stat. ch. 954.

[4] Cal. Corp. Code §§ 301.3(a)–(b), 2115.5 (West 2021).

[5] *See* Meland v. Weber, 2 F.4th 838, 842 (9th Cir. 2021) (quoting 2018 Cal. Stat. ch. 954, § 1(f)). "By the end of 2019, a covered corporation must have 'a minimum of one female director on its board.'" *Id.* (quoting Cal. Corp. Code § 301.3(a) (West 2021)). "By the end of 2021, any covered corporation with six or more directors must have at least three female directors, any covered corporation with five directors must have at least two female directors, and any covered corporation with four or fewer directors must have at least one female director. *Id.* (quoting Cal Corp. Code § 301.3(b)(1)–(3) (West 2021)).

is constitutional under the California constitution, making the prospects of further appeals more likely.[6]

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[6] In *Meland*, the Ninth Circuit held that shareholder of a covered corporation had adequately alleged Article III standing to challenge the California statute on the ground that it requires or encourages discrimination based on sex. *Id.* at 847. On remand, the District Court declined to issue a preliminary injunction against SB 826. Meland v. Weber, No. 2:19-cv-02288-JAM-AC, 2021 WL 6118651 (E.D. Cal. Dec. 27, 2021). The court followed the intermediate standard for judicial review of "suspect classifications" which is less exacting than the strict scrutiny standard that applies to race-based discrimination. *Id.* at *4. The court stated in part:

> Plaintiff claims the state relies only on raw disparities to demonstrate women have suffered discrimination in corporate board selection processes. Further, according to Plaintiff, recent hiring trends undermine the legislature's determination that sex discrimination exists and must be remedied. To support this argument, Plaintiff relies heavily on the following footnote and studies contained therein: 'In 2018, 34% of new board hires across the country were women. In the first half of 2019, that number rose to 45%.' *See, e.g.*, Subodh Mishra, *U.S. Board Diversity Trends in 2019*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (June 18, 2019), https://corpgov.law.harvard.edu/2019/06/18/u-s-board-diversity-trends-in-2019/; *Equilar Q3 2018 Gender Diversity Index*, EQUILAR (Dec. 12, 2018), https://www.equilar.com/reports/61equilarq3-2019-gender-diversity-index.html. And as of September 2019, women had increased their representation on corporate boards for 7 straight quarters in a row. *See* Q2 *2019 Gender Diversity Index*, EQUILAR (Mar. 9, 2020), https://www.equilar.com/reports/67-Q2-2019-equilar-gender-diversity-index.html. But as Defendant points out, the Harvard published analysis and the 2019 Q2 Equilar report reflect data regarding women who secured their directorships in 2019, *after* SB 826 was enacted, and the data concern new hires only, rather than overall board composition. By contrast, Equilar's 2018 Q3 report, which reflects data from July to September 2018—that is, the data immediately prior to SB 826's enactment on September 30, 2018—shows only a 0.3 percent increase in percentage of women on Russell 3000 boards . . . .
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> The present record reflects an abundance of evidence supporting [California] legislature's determination that discrimination exists and the Defendant's contention that the 'stark lack of women on corporate boards is due to longstanding discrimination against women in the selection of corporate director seats . . . and the Legislature's purpose in enacting SB 826 is to remedy that discrimination.'

*Meland*, 2021 WL 6118651, at *4–5 (internal citations to court filings omitted).

In contrast, a California Superior Court held in *Crest v. Padilla* that Section 301.4 of the California Corporations Code violates the California Constitution. No. 19STCV27561, 2022 WL 1073294, at *19–20 (Cal. Super. Ct. Apr. 1, 2022). The statute established minimum representation requirements for members of underrepresented communities on the boards of directors of publicly held corporations with principal executive offices in California. CAL. CORP. CODE § 301.4(a)–(c) (West 2021). The statute defined underrepresented communities to encompass those self-identifying as Black, African American, Hispanic, Latino, Pacific Islander, Native American, Native Hawaiian, or Alaska Native as well as individuals self-identifying as gay, lesbian, bisexual, or transgender. *Id.* § 301.4_. The Court found that:

> Because Section 301.4 treats similarly-situated individuals differently based on race, sexual orientation, and gender identity, because that use of suspect categories is not justified by any compelling interest, and because the statute is not narrowly tailored to serve the interests offered, Section 301.4 violates the Equal Protection Clause of the California Constitution. Plaintiffs are entitled to a judgment declaring as much and an injunction preventing the expenditure of taxpayer funds on implementation of the measure.

*Crest*, 2022 WL 1073294, at *20.

The *Crest* court interpreted Section 7 of Article 1 of the California Constitution—which prohibited the denial of equal protection of laws in a manner analogous to the 14th Amend-

In 2021, the Securities and Exchange Commission approved a Nasdaq Stock Exchange amendment to its Rule 5065(f)(2) requiring each Nasdaq-listed company, with specified exceptions, either to have or explain why it does not have at least two members of its board of directors who are diverse, including at least one director who identifies as female and at least one director who self-identifies as an underrepresented minority or LGBTQ+ individual.[7]

By late 2021, the number of women and underrepresented minority directors had dramatically increased.[8] Several institutions, including Nuveen, the asset manager for the Teachers Insurance and Annuity Association of America ("TIAA"), had successfully encouraged 325 of 450 companies that did not have a single woman on their Board to add a female director. State Street in 2021 announced that it would vote against the chair of the nominat-

ment to the United States Constitution—as demanding the application of strict scrutiny to any law that discriminates on the basis of race. *Id.* at *8. Similar to the application of strict Scrutiny under the 14th Amendment, the burden was on the state to demonstrate a compelling interest with some degree of specificity. *Id.* at *11. The *Crest* court concluded that the state failed to overcome this burden because it did not present convincing evidence of discrimination against underrepresented minorities. *Id.* at *14–15. The court further found that the state failed to produce evidence of any other compelling interest, such as the educational diversity interest recognized in *Grutter v. Bollinger*, 539 U.S. 306, 339 (2003). *Crest*, 2022 WL 1073294, at *16. Lastly, the court concluded that the state's chosen remedy was not narrowly tailored to address the discrimination California sought to remedy. *Id.* at *16–19.

Shortly after this decision, the portions of the California statute that required the presence of a minimum number of female directors on boards of directors were blocked by lower state courts on largely similar grounds as well. Crest v. Padilla, No. 19STCV27561, 2022 WL 1565613 (Cal. Super. Ct. May 13, 2022).

Despite these setback, the California's Secretary of State's office has not indicated if it intends to appeal this decision. Lauren Weber, *Judge Tosses California Law Mandating Diversity on Boards*, WALL ST. J. (Apr. 4, 2022), https://www.wsj.com/articles/judge-tosses-california-law-mandating-diversity-on-boards-11649078797.

[7] *See* Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, To Adopt Listing Rules Related to Board Diversity and To Offer Certain Listed Companies Access to a Complimentary Board Recruiting Service, 86 Fed. Reg. 44,424 (Aug. 12, 2021) (rule approval). Nasdaq characterized its proposal to the SEC as a disclosure based framework, not a mandate. *Id.* at 44,425. *But compare* Jesse M. Fried, *Will Nasdaq's Diversity Rules Harm Investors?*, 12 HARV. BUS. L. REV. ONLINE, art. 1, 2021, at 1, 1 (disputing Nasdaq claim that its diversity rule will benefit investors), *with* Richard W. Painter, Board Diversity: A Response to Professor Fried 6 (April 11, 2021), *https://ssrn.com/abstract=3824245* (arguing that Fried is sounding a false alarm: "Fried does not cite most of the very large body of scholarship on the contribution of board diversity to firm value").

[8] In 2019, a record 59% of directors added to S&P 500 boards were women or belong to a racial, ethnic, or minority group. Jared L. Landaw, *How Diverse Is You Board, Really?*, HARVARD BUS. REV. (June 11, 2020) https://hbr.org/2020/06/how-diverse-is-your-board-really; By late 2021, women held 30% of board seats on corporations in the S&P 500, substantially higher than 1% five years earlier. Olivia Wakefield, Ira T. Kay, and Paige Patton, *Viewpoint on Executive Compensation: Women on Boards,* PAYGOVERNANCE (2021), https://www.paygovernance.com/viewpoints/women-on-boards-the-u-s-corporate-journey-towards-gender-diversity. *See generally* Chris Brummer & Leo E. Strine, *Duty and Diversity*, 75 VAND. L. REV. 1 (2022) (discussing how corporate law duties can facilitate corporate attention to diversity).

ing committee at Fortune 500 companies that do not have at least one director from an underrepresented community.[9]

Now, BlackRock expects to see at least two female directors on every Board.[10] Vanguard announced in 2020 that it would vote against company directors who fail to support greater Board gender and ethnic diversity.[11] Goldman Sachs, starting in 2021, will no longer take a company public without at least one diverse Board member.[12] The New York City Employees' Retirement System generally will vote against members of a Nominating or Governance Committee if the Board lacks meaningful gender, racial, and ethnic diversity.[13]

In 2020, 26.1% of Fortune 500 board seats were held by women and 8.6% by African Americans. Of the Fortune 500 companies, whites held 83.9% of all board seats.[14]

By 2019, at least eleven states had enacted or considered Board Diversity statutes. Washington State requires each company subject to the Washington Business Corporation Act with shares registered with the SEC to have a gender-diverse Board with at least 25% women by January 1, 2022.[15] Other states including Colorado, Maryland, Illinois, and New York have enacted disclosure laws requiring or encouraging greater diversity.[16]

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[9] State St. Glob. Advisors, Guidance on Enhancing Racial & Ethnic Diversity Disclosures 3 (2021), https://www.ssga.com/library-content/pdfs/asset-stewardship/racial-diversity-guidance-article.pdf.

[10] BlackRock, Our Approach to Engagement on Board Diversity: Investment Stewardship 2 (2021), https://www.blackrock.com/corporate/literature/publication/blk-commentary-engaging-on-diversity.pdf

[11] Vanguard Funds, Proxy Voting Policy for U.S. Portfolio Companies 7 (2022), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/US_Proxy_Voting.pdf.

[12] Hugh Son, *Goldman won't take companies public without "at least one diverse board candidate," CEO Says*, CNBC (Jan. 23, 2020), https://www.cnbc.com/2020/01/23/goldman-wont-take-companies-public-that-dont-have-at-least-one-diverse-board-candidate-ceo-says.html.

[13] Brummer & Strine, *supra* note 8, at 11. Laura H. Posner, *Board Diversity is Critical to Protecting Shareholders, Bottom Line*, Bloomberg L. (Sept. 15, 2021), https://news.bloomberglaw.com/banking-law/board-diversity-is-critical-to-protect-shareholders-bottom-line; Sunitha Malepati, *The Future (Public Company Boardroom) is Female: From California SB 826 to a Gender Diversity Listing Standard*, 28 J. Gender, Social Polc'y & L., 493, 494, 516–517 (2020).

[14] See Brummer & Strine, *supra* note 8, at 11–14 (urging "[A]rguably the most important reason is that women and minorities are unlikely to have the social networks and relationships necessary for candidates seeking positions on boards. CEOs prefer individuals they can trust, know from direct personal experience are competent, and can collaborate with—and influence."); *see also* Lynnise E. Phillips Pantin*, Race and Equity in the Age of Unicorns*, 72 Hastings L. J. 1453, 1460–1465 (2021) (criticizing Silicon Valley for having a culture that perpetuates "the principle that white, connected and pedigreed founders are given primacy over others," noting that "[n]early half of private company boards are all male.").

[15] Wash. Rev. Code § 23B.08.120 (2022).

[16] Michael Hatcher & Weldon Latham, *States Are Leading the Change to Corporate Boards: Diversify!*, Harvard L. Sch. F. on Corp. Gov. (May 12, 2020), https://corpgov.law.harvard.edu/2020/05/12/states-are-leading-the-charge-to-corporate-boards-diversify/; Jacyln Jaeger, *Emerging State Board Diversity Laws Encourage Proactive Approach,*

The California and Nasdaq approaches to board diversity are the latest in a long history of generally unsuccessful earlier efforts, each of which had a different *raison d'être.*

The Securities and Exchange Commission's third Chair, William O. Douglas, famously decried *Directors Who Do Not Direct* in 1934[17] and as SEC Chair proposed professional paid directors.[18] The primary concern in regulating large corporations, Douglas insisted, was "[to avoid] or [make] impossible the vicious practice of having the board controlled or dominated by the managers."[19] While disparaging as well "inside" directors who were corporate executives subservient to senior management and "outside" or nonemployee directors chosen solely for their prestige, Douglas saw a solution in taking away control and dominance of the board from executive management and vesting it instead in an independent board with sufficient power and responsibility to "supervise those who [manage the enterprise] and [formulate] the general commercial and financial policies under which the business is to be conducted."[20] Douglas meant such directors to be "experts . . . sufficiently detached from the business to be able to see it in relation to its competitors, trade trends, etc.," not mere public representatives to serve as "corrective factors."[21] "Hence, they should have a position of dominance and power on the board rather than the subordinate position to which some reformers would relegate them."[22] As a "partial agenda" of means to create such a supervisory board, Douglas urged preventing management domination over corporate elections by withdrawing their control of the proxy machinery (by which shareholders who could not personally attend meetings were required to sign over their votes to incumbent management's representatives), barring nonvoting stock, and magnifying the opportunities for minority shareholders to express themselves through cumulative voting.[23]

While he was SEC Chair, Douglas delivered a related address, urging smaller boards made up of adequately paid directors, whose primary business would be to serve on the boards of a few corporations so that each director could "acquire a thorough knowledge of the corporations."[24] Douglas's concern was to break up inside management of the board. His concept of diversity was to install independent supervision of executive management.

COMPLIANCE WEEK (Nov. 3, 2020), https://www.complianceweek.com/boards-and-shareholders/emerging-state-board-diversity-laws-encourage-proactive-approach/29681.article.

[17] William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305 at 1307 (1934).

[18] *Pay for Directors Urged by Douglas; SEC Head Holds Posts Should be Made Professional to Prevent Scandals*, N.Y. TIMES, Jan. 10, 1939, at 31.

[19] Douglas, *supra* note 17, at 1307.

[20] *Id.* at 1314.

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] WILLIAM O. DOUGLAS, DEMOCRACY AND FINANCE 46–55 (1940).

From a quite different perspective, post-World War II Germany popularized codetermination, or *Mitbestimmung*, by which covered German corporations have two boards, a supervisory board for companies with more than 2,000 employees, with half of the board elected by labor, and a separate management board responsible for most corporate operational decisions.[25]

Several United States academics amplified Douglas and board codetermination alternatives to the United States system of selecting directors, including Harvard Law School's Abram Chayes,[26] Yale Political Sci-

[25] Detlev Vagts, *Reforming the "Modern" Corporation: Perspectives from Germany*, 80 Harv. L. Rev. 23, 30 (1966); Grant Hayden & Mathew Bodie, *Codetermination in Theory and in Practice*, 73 Fla. L. Rev. 321, 332 (2021); Simon Jäger, Shakked Noy & Benjamin Schoefer, *What Does Codetermination Do?* (Nat'l Bureau of Econ. Rsch., Working Paper No. 28921, 2021).

In Germany, corporations with fewer than 500 employees do not have a supervisory board including employee representatives and corporations with 500 to 2000 employees typically have one-third employee representation. Hayden et al., *supra*, at 332. Germany has the best-known system of codetermination, but other countries including Austria, Denmark, Finland, France, Norway, Poland, Denmark and Sweden also have codetermination systems of worker participation in corporate governance. *Id.* at 324; Jäger et al., *supra*, at 11.

Although several scholars including have questioned employee representation as less likely to secure efficiencies by, for example, asking "[w]hy do we seldom see labor directors where they are not mandated by law?", Luca Enriques, Henry Hansmann, Reinier Kraakman & Mariana Pargendler, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, *in* the Anatomy of Corporate Law 79, 106 (Reinier Kraakman et al. eds., 3d ed. 2017), Hayden and colleagues describe recent scholarship that has shown the impact of codetermination on corporate performance as mixed, with recent studies illustrating benefits in thwarting investment strategies "that represent private control benefits to large shareholders or management" resulting in a positive impact on corporate profitability, capital market valuation and capital formation. Hayden et al., *supra*, at 340, 352. In a comprehensive summary of research and event studies, Jäger, Noy, and Schoefer reported: "[r]ecent studies find either no effects, or very small positive effects, of board-level representation on wages and the sharing of profits with workers." Jäger et al., *supra*, at 6. They also reported that board-level codetermination does not affect voluntary separations and may slightly reduce involuntary separations. *Id.* at 7. They conclude that "the existing literature suggests that codetermination is a benign or at least not substantially harmful institution from the perspective of firm performance." *Id.* at 22.

Jäger, Noy, & Schoefer recognized that during the past years there has been a surge of interest in codetermination among progressive American policymakers, commentators and academics, *id.* at 39, but cautioned: "Given the plethora of institutional differences between American and European labor markets, it is hard to draw conclusions from the existing European evidence about the likely effects of American codetermination proposals." *Id.* at 44. In the United States, other systems of worker participation have achieved limited success. In 1980, Chrysler elected the United Auto Worker President to its board and a union member was elected at Pan Am in 1982. Jäger et al., *supra*, at 325–26. Employee Stock Option Plans ("ESOPs"), provide beneficial ownership to employees but control remains in trustees who usually are selected by corporate management. A rare exception was United Airlines when its ESOP purchased 55% of its stock in mid-1990s and two union representatives were elected to a twelve-person board. *Id.* at 326–27.

[26] Abram Chayes, *The Modern Corporation and the Rule of Law*, *in* The Corporation in Modern Society 25 (E. Mason ed., 1959). Professor Chayes echoed John Locke's principle that no authority is legitimate except that granted "the consent of the governed," arguing that employees and other groups substantially affected by corporate operations should have a say in its governance. *Id.* at 39–40.

ence Professor Robert Dahl,[27] and University of Southern California Law Professor Christopher Stone.[28]

A highwater mark in constituency directors was reached in 1976 when Ralph Nader, Mark Green, and Joel Seligman proposed in *Taming the Giant Corporation,* a Federal Incorporation Law, including:

> The homogeneity of the board can only be ended by giving each director, in addition to a general duty to see that the corporation is profitably administered, a separate oversight responsibility, a separate expertise, and a separate constituency so that each important public concern would be guaranteed at least one informed representative on the board. There might be nine corporate directors, each of whom is elected to a board position with one of the following oversight responsibilities:
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> - Employee welfare
> - Consumer protection
> - Environmental protection and community relations
> - Shareholder rights
> - Compliance with law
> - Finances
> - Purchasing and marketing
> - Management efficiency
> - Planning and research.[29]

Support for corporate management providing value to multiple constituencies has come from the Business Roundtable which in 2019 repudiated its 1997 statement that "corporations exist principally to serve shareholders"[30] and instead stated:

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[27] Robert Dahl urged: "[W]hy should people who own shares be given the privileges of citizenship in the government of the firm when citizenship is denied to other people who also make vital contributions to the firm?" ROBERT DAHL, AFTER THE REVOLUTION?: AUTHORITY IN A GOOD SOCIETY 138–39 (1970). Dahl explained: "The people I have in mind are, of course, employees and customers, without whom the firm could not exist, and the general public, without whose support for (or acquiescence in) the myriad protections and services of the state the firm would instantly disappear . . . ." *Id.* at 102–03. Dahl commended worker self-management. *Id.* at 107–09. He suggested consideration of codetermination statutes such as those enacted by West Germany and other European and South American countries under which shareholders and employees separately elect designated portions of the board. Robert Dahl, *Governing the Giant Corporation*, *in* CORPORATE POWER IN AMERICA 10, 10–11 (Ralph Nader & Mark Green eds., 1973).

[28] Professor Stone recommended that a federal agency appoint "general public directors" to serve on the boards of all the largest industrial and financial firms. CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 157–60 (1975). In extreme cases such as where a corporation repeatedly violates the law, Stone recommended that the federal courts appoint "special public directors" to prevent further delinquency. *Id.* at 174–78.

[29] RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION 124–25 (1976). *See generally id.* at 118–31.

[30] *See* Edward B. Rock, *For Whom is the Corporation Managed in 2020? The Debate Over Corporate Purpose*, 76 BUS. LAW. 363, 390 (2021).

While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to *all* of our stakeholders. We commit to:

• Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.

• Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.

• Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.

• Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.

• Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.

Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.[31]

[31] *Id*. at 364 (internal quotation marks omitted). The Delaware Supreme Court leading decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), took a slightly more cautious approach: "Although such considerations [of non-stockholder corporate constituencies and interests] may be permissible, there are fundamental limitations upon that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders." *Id.* at 182–83.

By 2021, 41 states had enacted statutes authorizing directors to take into account the interests of non-shareholder constituencies, including employees, suppliers, creditors and local communities, Rock, *supra* note 30, at 371. Most of the statutes were discretionary. CONN. GEN. STAT. § 33-756 (2018) is mandatory and 15 PA. CONS. STAT. § 1715 (2021) explicitly rejects considering any constituency such as shareholders as having a dominant interest. Many of the statutes applied only to corporate control transactions, *see* 5 LOUIS LOSS, JOEL SELIGMAN, & TROY PAREDES, SECURITIES REGULATION 206 (6th ed. 2021), although a few applied generally.

The initial corporate constituency statutes were criticized by the American Bar Association. *See* Am. Bar. Ass'n Comm. on Corp. L., *Report: Other Constituencies Statutes, Potential for Confusion*, 45 BUS. LAW. 2253, 2269 (1990) ("The confusion of directors in trying to comply with such statutes, if interpreted to require directors to balance the interests of various constituencies without awarding primarily to shareholder interests, would be profoundly troubling.") and by academics including Jonathan Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Executive Beneficiary of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 23–25 (1991).

In 2018, Senator Elizabeth Warren proposed the Accountable Capitalism Act which would require the election of at least 40% of directors by employees in corporations with more than $1 billion per year in revenue.[32]

In 2010, the SEC pursued a different form of board diversity. SEC shareholder proxy rules had long allowed specified shareholder proposals for action but not board nominees to be included in the corporation's proxy materials without the proposing shareholders' expense.[33] Outside shareholders under federal securities law otherwise must pay their own proxy expenses when they nominate a candidate to the board.[34] In 2010, the Commission adopted Rule 14a-11 to permit a nominating shareholder or group holding at least 3% of the total voting power of a covered corporation to nominate one director or the number of nominees that represents 25% of the total number of the registrant's board of directors.[35] A nominating shareholder could not use former Rule 14a-11 to affect a change in control.[36]

Rule 14a-11 only operated when relevant state or foreign law did not prohibit shareholder nomination of directors.[37] The Commission characterized the Rule as necessary to achieve shareholders' traditional state law right to nominate directors which largely had been obviated by the growth of voting shareholders in many corporations to a large and dispersed electorate unable to meet in-person.[38]

Rule 14a-11 did not last long. In 2011, the Court of Appeals for the District of Columbia vacated Rule 14a-11 in *Business Roundtable v. SEC,* with Judge Douglas Ginsburg writing for a unanimous court that the Commission's adoption was "arbitrary and capricious for having failed once

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[32] S. 3348, 115th Cong. (2018); *see also* Rock, *supra* note 30, at 366, 389 (discussing the bill). Senator Bernie Sanders similarly proposed that 45% of directors in firms with at least $100 million in annual revenue and all publicly traded companies be elected by employees *and* each of these companies would transfer at least 2% of their stock each year until 20% would be held by employees in a Democratic Employee Ownership Fund. *See id.* at 366. Senator Tammy Baldwin proposed in section 3(c)(2) of Reward Work Act, S. 915, 116th Cong. (2019) that one-third of the board in each publicly listed company would be worker representatives.

[33] *See generally* Regulation 14A, 17 C.F.R. §§ 14a-1 to -104, 14b-1 to -2 (2021).

[34] Institutional investors, which in 2018 owned 62.4% of United States stock, can pay their own costs in an SEC regulated proxy contest and elect constituency directors as activist hedge fund Engine No. 1 demonstrated in 2021 when it elected 3 of Exxon's 12 directors by galvanizing support from leading institutional investors including Vanguard, BlackRock, State Street and the pension funds in California and New York who shared Engine No. 1's criticism of Exxon's unwillingness to reduce its carbon footprint. Michael J. de la Merced, *How a Small Hedge Fund Was Able to Beat Exxon in a Board Battle*, N.Y. Times (May 29, 2021), https://www.nytimes.com/2021/05/28/business/energy-environment/exxon-engine-board.html; Clifford Krauss, *Exxon Board to Get a Third Activist Pushing Cleaner Energy*, N.Y. Times (June 3, 2021), https://www.nytimes.com/2021/06/02/business/exxon-board-clean-energy.html; Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. Times (June 11, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html.

[35] Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,782, 56,785 (Sept. 16, 2010).

[36] *Id.* at 56,699–700.

[37] *Id.* at 56,678.

[38] *See generally id.* at 56,668 (adopting the rule); Loss et al., *supra* note 31, at 555–747 (discussing the rule and its implications).

again . . . adequately to assess the economic effects of a new rule."[39] The court was particularly critical of the Commission for rejecting numerous empirical studies that found election of dissident directors reduced shareholder value.[40]

This was a stinging defeat for the SEC, all the more remarkable because the 2010 Dodd-Frank Act earlier had empowered the Commission in to include "a requirement that a solicitation of proxy, consent, or authorization by (or on behalf of) an issuer include a nominee submitted by a shareholder to serve on the board of directors of the issuer."[41] The Commission neither appealed nor has further pursued shareholder nominations of directors through a new rule.[42]

Each of these approaches to board diversity, whether the approach focuses on female and/or minority representation, professional non-management directors, constituency directors, co-determination, or labor representation on the board, raises fundamental questions about who should run this nation's largest business corporations. Each poses fundamental questions about corporate governance. This article addresses two of these questions: (1) Should corporations be subject to new board membership requirements to achieve greater diversity? (2) If so, how should new board diversity standards be designed?

## II. Should Corporations be Subject to Board Membership Requirements?

Since 1970, Milton Friedman long has been the patron saint of the view that corporate executives have no social responsibility other than "to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical customs."[43]

In a 2021 interview with Ira Milstein and Leo Strine published in the *Business Lawyer*, Columbia Law Professor Eric Talley stated of Friedman's Doctrine: "In the fifty years since, his argument has become central to the way we think about corporations in society."[44] What was striking about this 2021 interview was the vehemence with which former Delaware Supreme Court Chief Justice Leo Strine and Ira Millstein, a senior partner at the law firm of Weil Gotshal & Manges and long time instructor at Columbia Law School, viewed the Friedman doctrine as spent. Strine explained: "The social compact has gone from being frayed to being torn . . . . [T]he driving

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[39] 647 F.3d 1144, 1148 (D.C. Cir. 2011).

[40] *Id.* at 1150–51.

[41] 15 U.S.C. § 78n(a)(2)(A).

[42] Loss et al., *supra* note 31, at 462–63, 715.

[43] Milton Friedman, *The Social Responsibility of Business Is to Increase its Profits*, N.Y. Times Mag., Sept. 13, 1970, at 33.

[44] Erin Talley, *Looking Back With a Legend: Ira Millstein Reflects on the Impact of Milton Friedman's Views on Corporate Governance*, 76 Bus. Law. 947 (2021).

issue is the profound change in gainsharing between workers and stockholders in the making of corporate profits."[45] Millstein was more vehement:

> Things went really wrong with the free market. It didn't work. It was a good idea to start with, but it swung too far in the wrong direction. The fact of the matter is, if you look at where we are presently as a country, we have gone way down the list in terms of livability. We have gone way down the list in terms of productivity, quality of life, and global competitiveness. That is a bad thing. Then come along the inequalities that you both cited. These inequalities – in wealth, education, ability to climb the ladder – are very real. And a whole host of people are just damn unhappy. That is why there is a marriage between the very far left and the Business Roundtable.[46]

Strine, Millstein, the Business Roundtable in 2019, and many others wrote after a sustained period of growing income and wealth disparity[47] and increased attention to climate change which was characterized as "the existential threat of our time."[48] In the last few years, there have been burgeoning movements in support of corporate social responsibility,

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[45] *Id.* at 18.

[46] *Id.*

[47] Leo Strine offered in *The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy: A Reply to Professor Rock*, 76 Bus. Law. 397, 418–21 (2021): "one of many stark examples, American productivity grew 69.6 percent from 1979 to 2018, while CEO compensation grew 940 percent and the S&P 500 grew by 2400 percent. For U.S. workers? A total increase of 11.6 percent." *Id.* at 419 n.67; "The top 1 percent by 2020 owned 56 percent of stocks, the bottom 90 percent owned 12 percent." *Id.* at 419 n.68.

[48] *See, e.g.*, Jennifer A. Dlouhy & Josh Wingrove, *Biden Calls Climate Change "Existential Threat of Our Time,"* Bloomberg Green (Dec. 19, 2020), https://www.bloomberg.com/news/articles/2020-12-19/biden-calls-climate-change-existential-threat-of-our-time. In May 2021, Biden issued Executive Order 14,030 which began in section 1:

> *Policy.* The intensifying impacts of climate change present physical risk to assets, publicly traded securities, private investments, and companies—such as increased extreme weather risk leading to supply chain disruptions. In addition, the global shift away from carbon-intensive energy sources and industrial processes presents transition risk to many companies, communities, and workers . . . . The failure of financial institutions to appropriately and adequately account for and measure these physical and transition risks threatens the competitiveness of U.S. companies and markets, the life savings and pensions of U.S. workers and families, and the ability of U.S. financial institutions to serve communities.

86 Fed. Reg. 27,967, 27,967 (May 25, 2021).

The UN International Panel on Climate Change in its Sixth Assessment Report, Climate Change 2021 described the physical science basis of climate change as widespread, rapid and intensifying, Intergovernmental Panel on Climate Change, *Climate Change 2021: Thy Physical Science Basis*, U.N. Doc. IPCC AR6 WGI (Aug. 7, 2021), a factor in prompting Harvard University President Lawrence Bacow to characterize climate change as "the most consequential threat facing humanity." Lawrence Bacow, *Climate Change: Update on Harvard Action*, Harvard Off. of President (Sept. 9, 2021), https://www.harvard.edu/president/news/2021/climate-change-update-on-harvard-action/.

Environmental, Social, Governance ("ESG") metrics[49] and Benefit Corporations authorized under state corporate law statutes which authorize for-profit corporations to pursue sustainability and other socially responsible goals at

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[49] *See, e.g.*, John C. Coffee, *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk* (Eur. Corp. Gov. Inst., Law Working Paper No. 541/2020, 2021); Lisa M. Fairfax, *Board Committee Charters and ESG Accountability* (Draft 2022) (on file with author); Thomas Lee Hazen, *Corporate and Securities Law Impact on Social Responsibility and Corporate Purpose*, 62 B.C. L. Rev. 851 (2021); Cynthia A. Williams & Donna M. Nagy, *ESG and Climate Change Blind Spots: Turning the Corner on SEC Disclosure*, 99 Tex. L. Rev. 1453 (2021); Andrew W. Winden, *Jumpstarting Sustainability Disclosures*, 76 Bus. Law. 1215 (2021); Virginia Harper Ho, *Modernizing ESG Disclosure, 2022* U. Ill. L. Rev. 277, Lewis Braham, *Struggling to Make Sense of ESG Investing? Here's Help*, Barron's (June 3, 2022), https://www.barrons.com/articles/esg-investing-definition-funds-stocks-51654269864. *See generally* ESG In the Boardroom: A Guidebook for Directors (Katayun Iris Jaffari & Stephen Pike eds., 2022) (discussing current ideas about ESG governance and directors' role with respect to ESG issues). For example, Williams and Nagy began their article:

> Over the last decade, a fundamental shift has taken place amongst global and U.S. institutional investors and asset managers such as BlackRock, Vanguard, State Street, and Goldman Sachs. Global assets under management with sustainability screens have risen 34% between 2016 and 2018 to $30.7 trillion in five major markets (the EU, United States, Canada, Japan, and Australia/New Zealand). Just under 40% of this total ($12 trillion) is held by U.S. investors and asset managers, comprising 26% of money under professional management in the United States, with the dominant strategy being integration of environmental, social, and governance (*ESG*) data into fundamental value analysis for portfolio selection and management. This shift has occurred because institutional investors have realized the financial value of ESG data integration. A recent Edelman Trust Barometer 2020 special report on institutional investors found that 98% of the top-100 institutional investors in the United States say they consider ESG data in the investment process and that 88% of them agree or strongly agree that 'companies that prioritize ESG initiatives represent better opportunities for long-term returns than companies that do not.'

Williams & Nagy, *supra*, at 1453–54.

Professor Fairfax conducted a survey of the Top 50 companies in the Fortune 100 list and found a sizeable increase during the last three years in the number of these corporations altering their board committee charters to account for enhanced board oversight of ESG activities. Fairfax defined ESG broadly:

> The term *ESG* encompasses three distinct categories: (1) "E" for environmental, which includes such issues as climate change, carbon neutrality, water usage, recycling and greenhouse gas emissions; (2) "S" for social, which includes by far the largest array of issues ranging from employee health and safety, employee demographics, diversity, equity and inclusion (*DEI*) initiatives, employee retention, promotion, and turnover, other human capital management issues, political spending and lobbying activities, pay equity, human rights, child labor, vendor relations and supply chain concerns; and (3) "G" for governance, which includes such issues as majority voting, proxy access, board declassification, elimination of supermajority voting provisions, special and virtual meeting policies, independent board chair, shareholder engagement and participation, board diversity and composition, and executive compensation.

Fairfax, *supra*.

She identified as the top ten categories specifically identified in her survey of board committee changes as summarized in table below. *Id.*

the sacrifice of corporate profits.[50] Even the United States Supreme Court has weighed in: "[W]hile it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so."[51]

Friedman's doctrine was never fully accepted in state corporate law decisions. In 1919, the much cited case of *Dodge v. Ford Motor Co.*[52] framed the business corporation's purpose as *primarily* for the profit of the stockholders with an ability to make incidental humanitarian expenditures of corporate funds for the benefit of the employees, "like the building of a hospital for their use and the equipment of agencies for the betterment of their condition."[53]

| **Category** | **Number of Charters in Which Identified** | **Percentage of Chargers in Which Identified** |
|---|---|---|
| Environmental | 31 | 81% |
| Political/Lobbying | 26 | 60% |
| Charitable Contributions | 18 | 42% |
| Diversity | 17 | 39% |
| Corporate Responsibility | 16 | 37% |
| Human Rights | 10 | 23% |
| Health and Safety | 10 | 23% |
| Governmental Relations | 9 | 20% |
| Corporate Culture | 8 | 18% |
| Ethics | 8 | 18% |
| Human Capital Management | 8 | 18% |

The SEC, to date, has issued Guidelines for ESG disclosure, but not mandated ESG disclosure requirements. *See, e.g.*, RECOMMENDATION FROM THE INVESTOR-AS-OWNER SUBCOMMITTEE OF THE SEC INVESTOR ADVISORY COMMITTEE RELATING TO ESG DISCLOSURE (2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf. However, SEC recently proposed to enhance and standardize ESG disclosure Standards primarily through amendments to the Investment Company and Investment Advisors Acts. *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (Apr. 11, 2022).

[50] Hazen, *supra* note 49, at 880–85. A majority of states now permit Benefit Corporations. *See, e.g.*, CAL. CORP. CODE §14.610 (West 2019); DEL. CODE ANN. tit. 8, §§ 362–368 (2022); N.Y. BUS. CORP. LAW §1706(b) (McKinney 2019); MODEL BUS. CORP. LAW §§17.01–.06 (AM. BAR ASS'N 2021).

[51] Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682, 711–12 (2014).

[52] 170 N.W. 668 (Mich. 1919).

[53] *Id.* at 684. In *A.P. Smith Mfg. Co. v. Barlow*, the New Jersey Supreme Court traced the common law rule that "those who managed the corporation could not disburse any corporate funds for philanthropic or other worthy public cause unless the expenditure would benefit the corporation." 13 N.J. 145, 149 (1953) (citing *Hutton v. West Cork Railway Co.*, 23 Ch. D. 654 (1883) (UK) and *Dodge*, 170 N.W. at 668). Subsequently, New Jersey statutes limited corporate charitable expenditures to 1% of capital and surplus of the corporation unless shareholders approved a larger amount. *See id.* at 155. The American Law Institute's PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS is a modern adumbration of *Dodge v. Ford*:

More consequentially, the federal securities laws defined the responsibilities of a business corporation far more broadly than the state law objective of maximizing profits for shareholders with limited dispensation for other purposes.

The 1929–1933 Stock Market Crash resulted in price declines for stocks listed on the New York Stock Exchange of 83%.[54] The ensuing Great Depression was concomitant with Roosevelt and the Democratic Party gaining control of the White House and both houses of Congress in 1932,the subsequent enactment of comprehensive taxation, banking, currency, housing, agriculture, labor, and Social Security legislation,[55] and the development of the modern regulatory state, with its "vast congeries of [federal] agencies."[56]

The Securities Act of 1933 and the Securities Exchange Act of 1934 mandate disclosure requirements including those that provide reporting of material facts about a corporation's business including business segments; research and development; legal proceedings including qualitative disclosure of management conflicts of interest and law violations; management discussion and analysis of financial condition and results of operations including known trends or known uncertainties concerning liquidity; capital resources and income and off-balance sheet arrangements; critical accounting policies; changes in or disagreements with accountants concerning accounting and financial disclosure; executive and director compensation, risk factors; and after the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, conflict minerals and resource extraction.[57]

Foreign and domestic questionable payments in the 1970s led to the enactment of the Foreign Corrupt Practices Act of 1977[58] which added section 13(b)(2) to the Securities Exchange Act to require each reporting corporation to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that . . . transactions are recorded as necessary . . . to permit preparation of financial statements in conformity

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> (a) . . . [A] corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.
>
> (b) . . .
>
> (1) Is obliged, to the same extent as a natural person, to act within the boundaries set by law;
>
> (2) May take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and
>
> (3) May devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.

§ 2.01 (1994).

[54] Joel Seligman, Misalignment: The New Financial Order and the Failure of Financial Regulation 380–94 (2020).

[55] *See id*. ch. 3 for detailed discussion of the New Deal Revolution.

[56] *See id*. at 456–59.

[57] *See generally* Loss et al., supra note 31, at 241–285, 294–494.

[58] Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended in scattered sections of 15 U.S.C. ch. 2B). *See* Loss et al., *supra* note 31, at 598–615.

with generally accepted accounting principles"[59] as a means to prevent corporate officers or directors from making false or misleading statements or omitting material facts either to an outside accountant or in any report filed with the SEC.[60]

Separately, after corporate Board audit committee failures at Enron, WorldCom and other leading corporations, Congress, in the Sarbanes-Oxley Act of 2001, added section 10A(m) to the Securities Exchange Act requiring each covered corporation to include an audit committee entirely composed of independent directors authorized to hire in her or his own discretion independent counsel and other advisers.[61]

The 2007–2008 financial meltdown was the second greatest financial debacle of the past 100 years. The Dow Jones Industrial Average fell 54% between October 9, 2007 and March 9, 2009. Global stock market value declined $35 trillion; credit markets dried up for many individuals and firms; unemployment more than doubled from 4.5% in the summer of 2007 to 10.1% in October 2009 with total job losses of 8.8 million; and the annual federal deficit exploded from $459 million in 2008 to $1.413 trillion in 2009. For the United States economy, this was a near total meltdown, a dramatic failure of government and private institutions to prevent catastrophe or near catastrophe from occurring.[62]

The 2010 enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act also required the Board Compensation Committee to be composed of members independent of the corporate operating management.[63] With limited exceptions, the New York Stock Exchange requires each listed company to have a majority of independent directors.[64]

One can debate whether the social costs of the new federal laws outweigh the social benefits,[65] but what is not debatable is that federal law today requires compliance with taxation, environmental, labor, and securities laws, among others, that do not maximize corporate profits, but achieve different social purposes.

The objective of corporate law today is an amalgam of the state corporate law shareholder profit-making with limited opportunities for humanitarian and philanthropic purposes and federal social policy that mandates mandatory disclosure, audit, and independent directors as well as wealth sharing through taxation laws, environmental, labor, and occupational health laws, among others required by national law.

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[59] 15 U.S.C. 78m(b)(2).

[60] Loss et al., *supra* note 31, at 598.

[61] 15 U.S.C. § 78j-1(m); Loss et al., *supra* note 31, 615–31. Section 407 of the Sarbanes-Oxley Act also requires each covered corporation to have at least one audit committee financial expert. 15 U.S.C. § 7265.

[62] Seligman, *supra* note 54, at 2–3. *See generally id.* ch. 1.

[63] Dodd-Frank Wall Street Reform and Consumer Protection Act § 951, Pub. L. No. 111-203, 123 Stat. 1376, 1899 (2010); Seligman, *supra* note 54, at 468–71.

[64] NYSE Listed Company Manual § 303A.01 (N.Y. Stock Exch. 2009).

[65] *See, e.g.*, Macey, *supra* note 31.

## III. How Should Diversity be Achieved?

If federal law provides a basis for non-profit maximizing goals in a business corporation, how should diversity be achieved? The threshold question is: what kind of diversity? Should corporate law follow the model of the 2010 Dodd-Frank Act and former SEC Rule 14a-11 and permit shareholders to nominate without expense a minority of board members who will be elected if they secure sufficient shareholder votes?[66] Instead of refining our model of corporate governance, should we adopt one that nominates a board consistent both with shareholder profit maximization and federal social policies? Before we adopt any additional diversity requirement, it is worth stepping back and addressing fundamental legislative questions.

What is the need for any new standard? When I look back at the constituency representation proposal I jointly made in 1976,[67] I am struck by how uneven the case was for the nine idealized types of constituency representatives proposed. The last five arguably are fully achieved under current state corporate law as amplified by federal securities and other legal standards addressing compliance, accurate and honest financial disclosure, and senior management's innate tendency to seek higher profits, whether short or long term.[68]

The first four standards are a different matter. Employee or labor rights address gainsharing. But gainsharing for corporate employees begs a question. Is gainsharing in business entities a fundamental corporate law concern or is growing wealth disparity throughout society the greater concern? If wealth disparity is the fundamental concern, would we be better off addressing wealth disparity through the tax system rather than through corporate law?

Higher taxes with fewer loopholes are obvious ways to address wealth disparity. If there is not political support for these types of substantive reforms, would labor board membership on a company-by-company basis provide a second-best solution? Perhaps, but at what cost to the established United States labor statutes and rules which permit unions to negotiate for their members without taking into account shareholder profit maximization?[69]

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[66] *See supra* notes 33–41 and accompanying text.

[67] Nader et al., *supra* note 29.

[68] *See* Stone, *supra* note 28.

[69] *See generally,* Douglas, *supra* note 24*; see also* Jens Dammann & Horst Eidenmûller, *Codetermination: A Poor Fit for U.S. Corporations*, 3 Colum. Bus. L. Rev. 870, 940 (2020) ("[E]ven if one assumes mandatory codetermination to be an efficient choice for German firms, there are compelling reasons to believe that it would be less desirable for firms in the United States. Given the different institutional, social, and economic environment, some core beliefs of codetermination are unlikely to materialize in the United States. At the same time, some of the indisputable costs of codetermination likely would be much higher in the United States than they are in Germany.").

Consumer protection is a legitimate concern in many, but not all, corporations which have consumer relations. But many corporations do not. The 2010 enactment of the Dodd-Frank Act established a Bureau of Consumer Financial Protection which exercises authority under eighteen consumer laws.[70] This does not obviate, but reduces, the need for board diversity to address consumer protection.

Environmental protection, even with the existing federal agencies including the Environmental Protection Agency, has become an increasingly acute global concern. Virtually all corporations through operations or investment portfolios have a nexus to environmental concerns, albeit to varying degrees. A strong case can be made that individual corporations also should make an enhanced commitment to environmental protection. But the question reasonably can be posed as whether environmental protection is best achieved by new SEC disclosure requirements or board diversity or both?

In April 2022, the SEC issued a 140-page proposed rule outlining far-reaching new climate disclosure requirements, includiing proposed standards that addressed greenhouse gas emissions, carbon price and climate targets or goals of the country, progress toward such targets or goals, climate risks to the company, and disclosure of corporate governance climate risks and climate risk management processes.[71][72]

Affected community relations are a different case. Today the vast majority of states permit a corporation to take into account local communities, suppliers and creditors, and important local interests,[73] but most of the state statutes are discretionary and co-exist with state corporate law continuing to operate under the *Dodge v. Ford* rubric that a corporation primarily is managed for corporate profit.[74] It would not be wise to overthrow the general profit-seeking motivation of the business corporation, unless another purpose is specified in its incorporation documents. Shareholder profit maximization generates tax support for local, state, and the federal government, jobs, innovation, and new firms. This does not, however, obviate the desirability of enhanced corporate standards to require greater specified financial

[70] Cheryl R. Cooper & David H. Carpenter, Cong. Rsch. Serv., IF10031, Introduction to Financial Services: The Consumer Financial Protection Bureau (CFPB) 1–2 (2022).

[71] Derek Christensen, *To Disclose or Not to Disclose: Navigating Regulation S-K Environmental Disclosure Requirements*, 49 Sec. Reg. L. J. 81 (2021).

[72] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (Apr. 11, 2022). The European Commission similarly proposed rules requiring the disclosure of corporate climate change plans that are consistent with limiting global warming to 1.5° centigrade. *Proposal for a Directive of the European Parliament and the Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937, COM (2022) 71 final (Feb. 23, 2022).*

[73] *See supra* note 31.

[74] *See supra* note 31. The business judgment rule in most instances makes it unlikely that a director will be held liable if they negligently misconceive the corporate purpose. *See, e.g.*, Andrew Tuch, *A General Defense of Information Fiduciaries*, 98 Wash. U. L. Rev. 1897, 1913–1915 (2021).

support for local communities when solvent corporations above a specified size relocate facilities or a material number of jobs.

What, in retrospect, was most striking about the nine specified categories in this list I helped develop 45 years ago was the omission of requirements based on gender or underrepresented minorities, including individuals who self-identify as LGBTQ+. In recent years, California and Washington have embraced this as a concern on a mandatory basis, while a few other states have implemented similar policies on a disclosure or hortatory basis.[75] The Nasdaq and several foreign nations in Europe and Asia have also embraced this as a concern.[76]

Female and underrepresented minority representation in senior management and corporate boards is a societal concern, but unlike other constituencies has not been effectively addressed through regulatory standards. Women in senior management remain starkly underrepresented with women constituting only 5.6% of the CEOs in the Fortune 500 and S&P 500 in 2019, and 5.5% of CEOs among the 3000 largest companies.[77] Black and

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[75] *See supra* notes 15–17 and accompanying text.

[76] *See* Richa Joshi, *Board Diversity No Longer Optional*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Oct. 11, 2020), https://corpgov.law.harvard.edu/2020/10/11/board-diversity-no-longer-optional/; June D. Bell, *Corporate Board Diversity: Moving Beyond Lip Service*, H.R. MAG.: ALL THINGS WORK (June 16, 2021), https://www.shrm.org/hr-today/news/all-things-work/pages/boosting-corporate-board-diversity.aspx. June Bell explained:

> BlackRock Inc., the world's largest money manager, told its portfolio companies in 2018 that it wants boards to have at least two female directors. Vanguard Group last year began asking the boards of companies it invests in to report back on the gender, age and race of their board members. And Goldman Sachs announced that starting July 1, 2020, it would no longer underwrite initial public offerings of American and European companies that were not diverse.

Bell, *supra*, at 4.

Western Europe is the leader in board gender diversity. Norway by 2017 had 42% female directors; France, 40%; Sweden, 31.7%. INT'L FIN. CORP., BOARD GENDER DIVERSITY IN ASEAN 16 (2019), https://www.ifc.org/wps/wcm/connect/21f19cfe-9cce-4089-bfc1-e4c38767394e/Board_Gender_Diversity_in_ASEAN.pdf?MOD=AJPERES. The number of women in countries who were members of the Organisation for Economic Co-Operation and Development ("OECD") doubled between 2010 and 2016. *Id.* at 2–16. Several countries led by Norway in 2005 established mandatory quotas. *Id.* at 21. Other countries including Canada and the United Kingdom adopted a comply or explain approach. *Id.* at 21–22. Female board diversity in the United Kingdom increased from 18.2 to 26.3% between 2012 and 2016. *Id.* at 22. In B. Espen Eckbo, Knut Nygaard & Karin S. Thorburn, *Valuation Effects of Norway's Board Gender Quota Law Revisited*, MGMT. SCI. 1 (2021), three scholars explored whether Norway's requirement of gender-balanced boards led to lower firm value, as earlier studies had found, or gender balance increased the efficiency of board elections by reducing the influence of male director "old boys" network and by increasing director independence and monitoring. *See also* K.P. Ahern & A. Dittmar, *The Changing of the Boards: The Impact on Firm Valuation of Female Board Representation*, 127 Q.J. ECON. 137 (2012). The Eckbo, Nygaard, & Thorburn article concluded that the valuation effect of the mandatory gender member announcement was close to zero and that there was no impact on operating profitability. Eckbo et al., *supra*, at 1.

[77] CRIST/KOLDER ASSOCS., VOLATILITY REPORT 2019 at 40 (2019), https://www.cristkolder.com//media/2438/volatility-report-2019-americas-leading-companies.pdf; Increasing Women in Executive Leadership Positions in 2021, ROBERT F. SMITH (June 25, 2021), https://robertsmith.com/increasing-women-in-executive-leadership-positions-in-2021/. See also Brummer & Strine, *supra* note 8, at 15, who reported that 9% of CEOs in 2019 in the S&P 500

Hispanic CEOs equaled only 1% and 4% of the 2019 Fortune 500 and S&P 500, respectively. Black CEOs equaled 5% in private industry in the United States in 2018.[78]

How Congress, states, or regulators choose to implement new standards for gender, racial or LGBTQ+ rights is a critical question. To date, California and the Nasdaq have chosen to adopt standards that either require or strongly encourage minority, female, racial, or LGBTQ+ representation. Implicitly, this recognizes that corporate profitability should be a primary objective. It is not accurate to suggest that female, underrepresented minority, and LGBTQ+ representatives will be inconsistent with the goal. The empirical data on the relationship between gender diversity and corporate performance, net earnings, and net worth often has been positive.[79]

The case for greater gender and underrepresented minority diversity is based on more than the long-standing underrepresentation of women and minorities in the Boardroom, and recent studies have shown either a positive correlation between greater financial performance or a small and insignificant relationship between diversity and financial performance. Companies

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companies were ethnic minorities (3% Latino, 2% Indian, 1% Asian, 1% Middle Eastern, 1% Black).

[78] Crist/Kolder Assocs., *supra* note 77; Statista Rsch. Dep't, *CEOs in the U.S. —Racial and Ethnic Diversity 2004–2018*, Statista (Jan. 11, 2022), https://www.statista.com/statistics/1097600/racial-and-ethnic-diversity-of-ceos-in-the-united-states/. The largest study on the state of women in corporate America, with some 750 companies participating, reported in 2021 that since 2016, women of color had lost ground at every step in the pipeline from entry level to the C Suite. McKinsey & Co., Women in the Workplace 7 (2021), https://www.mckinsey.com/featured-insights/diversity-and-inclusion/women-in-the-workplace.

[79] Brummer & Strine, *supra* note 8, at 28–33 (summarizing several studies finding a positive relation between diversity and financial performance including studies by the Carlyle Group, McKinsey, Citi, Credit Suisse's Research Institute, MSCI, Harvard, and Oklahoma State). Other studies have found either a small or insignificant relationship between diversity and a firm's financial performance, Jan Luca Pietzer, Romina Niklova, Karisa Karolina Kedziot & Sven Constantin Voelpel, *Does Gender Matter? Female Representation on Corporate Boards and Firm Financial Analysis – A Metes Analysis*, 10 Plos One 1 (2015); *see also* David A. Carter, Frank Disouza, Betty Simkins, & Gary Simpson, *The Gender and Ethnic Diversity of U.S. Boards and Board Committees and Firm Financial Performance*, 18 Corp. Governance 306 (2010). *See generally* Joshi, supra note 76 ("Several studies have established that there is a correlation between diversity and companies' financial performance."). In 2018, McKinsey's report found that Diverse companies are 33% more likely to have greater financial returns than their less-diverse industry peers. McKinsey & Co., Delivering Through Diversity 1 (2018), https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Organization/Our%20Insights/Delivering%20through%20diversity/Delivering-through-diversity_full-report.ashx. In another study, the Boston Consulting Group reported that companies with above-average diversity at the management level generate 19% higher innovation revenues than companies with below average diversity. Rocío Lorenzo et al., *How Diverse Leadership Teams Boost Innovation*, Bos. Consulting Grp. (Jan. 23, 2018), https://www.bcg.com/en-us/publications/2018/how-diverse-leadership-teams-boost-innovation; *See also* Robert F. Smith , *supra* note 77 ("It is reported that companies where at least 30% of leaders are women can expect to add more than 1% to their net margin compared with other companies with no to limited female leadership."). This does not prove that female directors *cause* higher financial returns. It does demonstrate that in many studies, a correlation between female directors and lower financial results cannot be demonstrated. *See* Malepati, *supra* note 13, at 519–22.

have sought greater diversity because of the increased preferences of customers, employees, and institutional investors for gender and minority diversity.[80]

This leaves out shareholders, the traditional board electorate. How should their rights be addressed? The concern of the federal securities laws, especially the mandatory disclosure and proxy voting requirements was that free markets did not adequately address senior management cupidity or ineptitude. Recent law developments including audit and compensation committees with requirements of independent directors and strengthening of the independence on audit functions of outside auditors in part address this concern.

Applicable federal securities law or corporate law standards should be revised to require that boards in covered corporations be composed entirely of outside independent directors who would have adequate staff and choose their Chair.[81] The purpose of such a thoroughgoing reform would be to best harmonize the corporation's primary profit maximizing objective with reduction of its historical greatest weakness, senior management self-interest.

This does not mean that the role of the board should be to function as a "rival branch of government,"[82] but it does mean that an outside, independent board should:

•Establish and monitor procedures that assure that operating executives are informed of and obey applicable federal, state, and local laws;[83]

•Approve or veto all important executive management business proposals such as corporate by-laws, mergers, or dividend decisions;

•Hire and dismiss the chief executive officer and be able to disapprove the hiring and firing of the principal executives of the corporation; and

•Report to the public and the shareholders how well the corporation has obeyed the law and protected the shareholders' investment.

Outside independent directors should not be required to be full time professional directors as SEC Chair Douglas urged,[84] but there should be limits on the number of covered corporate boards on which an individual may serve as director.[85] The board will also require a small staff to aggregate information, follow up on board questions, and coordinate with senior

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[80] *See supra* notes 38 and 43 regarding institutional investors; Brummer & Strine, *supra* note 8, at 41–43.

[81] Loss et al., *supra* note. 31; SEC v. Transamerica Corp., 163 F.2d 511, 518 (3d Cir. 1943) ("The control of great corporations by a very few persons was the abuse at which Congress struck in enacting Section 14(a).").

[82] A clumsy phrase I co-wrote in 1976. *See* Nader et al., *supra* note 29, at 119.

[83] *Cf. In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996) (finding that Delaware corporate law requires directors to assure that an adequate corporate information and reporting system or monitoring system is in place in some circumstances); *see also* Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) (applying and extending *Caremark*).

[84] *See* Douglas *supra* note 24, at 7–8.

[85] Current mandatory disclosure and legal compliance standards alone have created substantial time commitments for the board to effectively perform its job.

management. The role of the staff would be to serve the board, not act as an operating executive.

There are two risks in any system of independent directors. First, that such a system will undermine the ability of corporate management to effectively address corporate objectives. To put this another way, the full-time independent board invites the criticism that it will unjustifiably add expense or disturb corporate harmony. As recent data on codetermination in Germany and elsewhere suggests, the cost to a corporation of a fully staffed independent outside board could only be determined by comparing the expense of such with the savings resulting from the reduction of corporate conflicts of interest, waste, and litigation.[86] The European data does not suggest negative consequences often occur.[87]

Disturbing the harmony of the board is a real concern of many corporate senior leaders, but no one can reasonably urge that an independent board should not intervene when senior executives are violating the law or should not ask the probing questions that board monitoring entails. Senior executives do not like this type of oversight. It is preferable to a harmonious but ineffectual board.

Within the monitoring model, the role of an effective independent board is a delicate one. Let me illustrate: In recent years, I served on the Board of Directors of Eastman Kodak and the Board of Governors of the Financial Industry Regulatory Authority. In both instances, I was denominated as an outside independent individual for the purpose of the audit and compensation committees. I usually was supportive of corporate management. But when troublesome events occur such as they did with Kodak's inability to equal or near its earnings projections,[88] or FINRA's failure to effectively detect Bernie Madoff's corrupt operation,[89] my role and the role of outside directors shifted to one demanding answers and, when appropriate, seeking independent factual review and/or replacement of responsible senior management. An independent director's job is not to be liked but to be effective.

The role of an independent director is more complicated than these two examples suggest. In a significant number of instances, outside shareholders seek control of a corporation and have sharp differences with senior management.[90] Given the tendency of many directors, denominated independent or

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[86] *See supra* note 25.

[87] *See supra* note 25.

[88] In 2012, Kodak filed for bankruptcy reorganization under Chapter 11 of the U.S. Bankruptcy Code. *In re* Eastman Kodak Co., 479 B.R. 280, 286 (Bankr. S.D.N.Y. 2012).

[89] *See* SELIGMAN, *supra* note 54, at 83–86 for discussion of Madoff's 65 billion dollar fraud.

[90] *See generally* LOSS ET AL., *supra* note 31, at 3–241 for discussion of corporate contests; *see also* John C. Coffee, Jr., Robert J. Jackson, Jr., Joshua Mitts & Robert E. Bishop, *Activist Directors and Agency Costs: What Happens when an Activist Director Goes on the Board?*, 104 CORNELL L. REV. 381 (2019).

not, to support the management with whom they work,[91] a diverse board with a minority of independent directors is less likely to be effective.[92]

A second risk of boards with a minority of diverse members is freeze-out. Under applicable state corporate counsel governance standards, senior management can, to a considerable degree, delegate effective control in a corporation to an executive committee devoid of independent board members or informally do so by not sharing decisions or critical data with the board.[93] This concern is lessened today given current federal securities law mandatory disclosure requirements, internal auditing, corporate audit committees[94] and prohibition of corporate officers fraudulently misleading or manipulating outside auditors.[95] But freezeout may prove to be a concern with the California, Washington, and Nasdaq approaches to minority, gender, and underrepresented board membership.

## Conclusion

The ultimate question is not whether the board of directors in our largest corporations should be more diverse. An emerging convergence largely of federal securities law standards, the California, Washington, and Nasdaq standards, and institutional investor actions supports greater diversity.

But what kind of diversity and why? The best approach is one that involves balance. Diversity standards should be linked to applicable corporate objectives which should be based both on the principle of corporate profit-making, to support job creation and fund taxation, and social objectives that address wealth reallocation through federal and state taxation, employees, the environment, local communities, and gender and underrepresented minority rights, among other topics.

A balanced approach to diversity recognizes that many social objectives often can be effectively achieved through regulation rather than board membership. Female and underrepresented racial and LGBTQ+ minorities generally have been an exception to the ability to address a social issue through regulation.

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[91] *See Miller v. Register & Tribune Syndicate, Inc.*, 336 N.W.2d 709 (Iowa 1983); *see, e.g.*, James Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of Zapata and the ALI Project*, Duke L.J., 959, 962 (1982) ("The natural empathy and collegiality that this board engenders makes an adverse judgment of a colleague's behavior distasteful at best"); *see also* Coffee et al., *supra* note 49.

[92] For an article reflecting skepticism that an all independent board is wise, see Lisa Fairfax, *The Uneasy Case for the Insider Director*, 96 Iowa L. Rev. 127 (2010) (arguing that the value of independent directors has been vastly overstated while the inside director has been underappreciated).

[93] *See* Del. Code Ann. tit. 8, § 141 (2022); *cf.* Stone, *supra* note 28, for discussion of freezing out of independent directors.

[94] *See supra* notes 57–64 and accompanying text.

[95] *See* the Sarbanes-Oxley Act § 303, 15 U.S.C. § 7242; *see also* Loss et al., *supra* note 31 at 433–38.

A balanced approach to board diversity also should take into account that the experience of a minority of public directors often has not been effective in securing the social objectives they were appointed to pursue. For this reason, an effective new diversity norm should begin with an all outside independent board. Achieving greater board diversity will involve consideration of a number of practical questions.

Which corporations should be subject to enhanced standards? At least initially, a strong case can be made either for limiting heightened diversity standards either to SEC reporting companies[96] or companies above a specified minimum size. The difficulty with limiting enhanced diversity standards to SEC reporting companies is that a growing number of companies in recent years are exempt from SEC standards. There were, for example, in December 2021, 473 unicorns or non-reporting exempt firms with assets above $1 billion.[97]

Couldn't greater diversity standards continue to be achieved through the actions of the states? If ever there was an issue likely to precipitate a "race to the bottom," this would be it. Without a national mandatory standard, some states would follow the well-trod example of Delaware which for close to 100 years has sought to increase State revenues by making its state corporate law attractive to business corporations.[98]

Then why not rely on institutional investors to continue the enthusiasm of Nuveen, TIAA, CalPERS, BlackRock, and Goldman Sachs, and encourage or require firms that each invests in to have at least a minority of female, LGBTQ+, or underrepresented minority board members. This is helpful but inadequate to address gender and minority exclusion and the need for an entirely independent board. Many institutions have not pursued these objectives. These institutional investors that have sought greater diversity do so through somewhat inconsistent approaches.

A different question that received a great deal of attention in Norway is how do you achieve gender diversity–by replacing existing directors or expanding the size of the board? Either approach can work, but California's phase-in of gender and minority standards may prove particularly effective given the reality that board seats in the United States are subject to annual or staggered elections over three years.

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[96] *See* Loss et al., *supra* note 31, ch. 6.B. Currently either those corporations listed on a National Securities Exchange such as the New York Stock Exchange or with total assets of $10 million and 2000 or more shareholders of record are SEC reporting companies under the Securities Exchange Act. *Reporting Company*, Thomson Reuters Practical L. (Jan. 2022), https://1.next.westlaw.com/2-382-3758?__lrTS=20210221212321508&transitionType=Default&contextData=%28sc.Default%29.

[97] George S. Georgian, *The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences and Reforms*, 18 N.Y.U. J. L. & Bus. 221 (2021).

[98] Joel Seligman, The Transformation of Wall Street: The Securities and Exchange Commission and Modern Corporate Finance 42–44 (3d ed. 2003).

Inevitably, there will be other questions in implementing a new enhanced diversity standard. The long history of corporate and federal securities laws well illustrates the capacity of these laws to accommodate change.[99]

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[99] *See generally id.*