

ARTICLES

Duty and Diversity

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In the wake of the brutal deaths of George Floyd and Breonna Taylor, lawmakers and corporate boards from Wall Street to the West Coast have introduced a slew of reforms aimed at increasing Diversity, Equity, and Inclusion (“DEI”) in corporations. Yet the reforms face difficulties ranging from possible constitutional challenges to critical limitations in their scale, scope, and degree of legal obligation and practical effects.

In this Article, we provide an old answer to the new questions facing DEI policy and offer the first close examination of how corporate law duties impel and facilitate corporate attention to diversity. Specifically, we show that corporate fiduciaries are bound by their duties of loyalty to take

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affirmative steps to make sure that corporations comply with important civil rights and antidiscrimination laws and norms designed to ensure fair access to economic opportunity. We also show how corporate law principles like the business judgment rule do not just authorize, but indeed encourage American corporations to take effective action to reduce racial and gender inequality and increase inclusion, tolerance, and diversity given the rational basis that exists connecting good DEI practices, corporate reputation, and sustainable firm value. By both incorporating requirements to comply with key antidiscrimination laws and enabling corporate DEI policies that go well beyond the legal minimum, corporate law offers critical tools with which corporations may address DEI goals that other reforms do not—and that can embed a commitment to diversity, equity, and inclusion in all aspects of corporate interactions with employees, customers, communities, and society generally. The question, therefore, is not whether corporate leaders can take effective action to help reduce racial and gender inequality—but will they?

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INTRODUCTION

Fifty years ago, Milton Friedman famously told corporate fiduciaries that they should narrowly focus on generating profits for stockholders. Less focused upon, but explicit, was his view that corporations should not have a “social conscience” or take action to “eliminat[e] discrimination,” which he trivialized as a “catchword[] of the contemporary crop of reformers.”¹ Since then, Friedman and his adherents have espoused this cramped vision of fiduciary duty within the debate over corporate purpose and, even worse, sought to erode the external laws promoting equality and inclusion.

Today, the problem Milton Friedman trivialized remains urgent. The inequality gap between Black and white Americans grew in the period in which Friedman’s views became influential with directors and policymakers, while the COVID-19 pandemic’s unequal impact on minorities has underscored the persistence of inequality. So have horrific instances of violence against Black people and other evidence of ongoing exclusion. Likewise, inequality in wages and opportunity continues to adversely affect women.

Demands are growing for corporate leaders to address these serious issues by promoting effective practices to treat their employees,

1. Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32. In that same passage, Friedman similarly belittled “providing employment” for workers and “avoiding pollution.” *Id.* Fifty years later, racial inequality, income and wage inequality, and environmental harm remain huge societal problems.

communities of operation and service, and customers with respect—and to take affirmative steps to ensure equal opportunity, create an inclusive and tolerant workplace, and embrace the diversity of humanity. This commitment to Diversity, Equity, and Inclusion (“Diversity” or “DEI” for short) is not just one corporations are being asked to make internally, but is also one requiring companies to evaluate how they treat their consumers and the communities in which they have an impact.

Although the immediate aftermath of the Floyd killing has tended to mute those who view corporate action to address issues like Diversity as an improper and illegitimate diversion from the pursuit of shareholder profits, history shows that will not last for long. Those who share Friedman’s worldview will argue that corporate fiduciaries are on unstable ground if they commit their companies to Diversity, Equity, and Inclusion policies that go beyond the legal minimum of nondiscrimination and will suggest they face possible legal risk for failing to focus solely on corporate profit. Indeed, even as issues of racial equality have been central and many leading members of the corporate community are recognizing their obligation to do better, some have openly taken Friedman’s position and have directed their employees to stay focused on profits and to avoid discussions of race at all costs. We fear that as the current moment wanes, attempts to twist corporate law will reemerge and argue that corporate leaders may not take action to assure that their companies go beyond the bare legal minimum to promote these important values, because by doing so they would be improperly diverting their focus from profit maximization.

In this Article, we explain why arguments of that type have no grounding in a proper understanding of corporate law, and in particular the important principles of fiduciary duty that govern the equitable expectations of corporate directors and officers. We show that, even under the nation’s most stockholder-focused corporate law, that of Delaware, Friedman’s normative view is not one that American corporate law embraces, and that corporate law presents no barrier to voluntary corporate efforts to increase equality and diversity.

In fact, a proper understanding of corporate fiduciary duties supports the ability of corporations to put in place effective DEI policies. Indeed, fiduciary duty requires boards to attend to DEI by monitoring company policies and practices that assure the company’s compliance with important laws that focus on the equal treatment of diverse applicants, employees, customers, communities, and business partners. Not only that, the fiduciary duty of loyalty requires affirmative efforts to promote the sustainable success of the corporation, and directors and managers must try to promote the best interests of the company. Substantial evidence exists that companies with good DEI practices will not only be less likely to face adverse legal, regulatory, worker, community, and consumer backlash from their conduct, but that their

boards and workforces will be more effective and their reputation with an increasingly diverse customer base and public will grow, as will trust from institutional investors increasingly focused on sustainable profitability and the avoidance of harmful externalities costly to their clients, who have diversified portfolios tracking the entire economy.

As a matter of fiduciary duty, therefore, corporate leaders not only have broad authority to promote an inclusive and diverse corporate culture, their affirmative obligation to act in the best interests of the corporation can be understood to require it, given the important legal requirements for corporations to avoid invidious discrimination and growing societal and investor expectations that business contribute to reducing racial and gender inequality. Even more, foundational corporate law principles like the business judgment rule protect and support directors and managers who believe that committing their companies to help improve Diversity, Equity, and Inclusion is the right way to do business. And that fiduciary duty imposes minimal guardrails and even floors of basic activity that must be undertaken to ensure that corporations honor societal laws protecting against discrimination.

This legal reality is important to ensuring that the accountability debate proceeds with clarity over whether corporate leaders, and the institutional investors who control public companies, are doing what they should to promote these values. All too often, the issue of Diversity is viewed as a cost center or something external to the mission of the modern firm—driving criticisms of Diversity-oriented corporate reforms as “virtue signaling at the expense of someone else.”² But this Article advances a different theory—that the pursuit of Diversity, Equity, and Inclusion is solidly authorized by the operation of traditional corporate law principles and can even be easily squared with the views of those who embrace what has come to be known as “shareholder primacy.” As such, our contribution does not debate what corporate law should be, but instead explores what corporate law already is. And it offers an old answer to the novel question of what tools and obligations managers and directors must contemplate when grappling with the challenge and opportunity of Diversity.

This Article proceeds as follows. In Part I, we document the demographic dilemma facing corporate boards and C-suites across the United States—namely, the striking gap between the demographics of the leadership of corporate America and the nation as a whole. We then explore the implications of the data in a post-George Floyd, post-

2. The Editorial Board, Opinion, *The Woke Nasdaq*, WALL ST. J. (Dec. 1, 2020, 6:39 PM), <https://www.wsj.com/articles/the-woke-nasdaq-11606865986> [<https://perma.cc/CLW5-65PK>]. Such criticisms have been embraced by some of the most respected regulatory voices as well. See, e.g., Arthur Levitt Jr., Opinion, *If Corporate Diversity Works, Show Me the Money*, WALL ST. J. (Jan. 20, 2021, 6:00 PM), <https://www.wsj.com/articles/if-corporate-diversity-works-show-me-the-money-11611183633> [<https://perma.cc/EX3P-N23R>] (arguing that “diversity requirements are political at their core”).

pandemic environment, in which demands for better corporate behavior and greater racial economic opportunity have both swelled and intensified.

Part II addresses the nexus between DEI and firm value. It starts with a survey of the empirical research associating diversity with financial performance and finds a mixed picture, but one that nonetheless has practical and legal importance for corporate decisionmakers weighing whether and how to address DEI issues. We find that as in many complex areas relevant to running a business, information is incomplete, at times defective, and a work in progress; nevertheless, the evidence from academic studies, and the logical arguments advanced by leading business consultants and thinkers, provide a rational basis for corporate fiduciaries to conclude that effective DEI policies are in the best interests of the corporation. Continuing this theme, we then turn our analysis to the long-running literature in organizational psychology that identifies cognitive diversity (and Diversity more generally) as prophylactics for groupthink and other social pathologies that can impair good decisionmaking and thus, in this context, endanger firm value. We then close this Part with what is perhaps the most compelling business case for Diversity—that of corporate reputation and its relationship to firm credibility and success. The Part investigates how DEI relates in a broader way to corporate success and highlights why attention to DEI is necessary for businesses to avoid the severe reputational harm, legal risk, and other downside consequences of being perceived as not being a business committed to treating all Americans with respect. We then connect that risk to the demographic realities facing firms seeking to preserve and maximize their returns. Because the available workforce, customer base, and strategic partners are diversifying both domestically and internationally, DEI considerations bear importantly on firms' reputation with these key stakeholders, and thus on their cost of capital, talent, and customer acquisition and retention. For all these reasons, we conclude that the requisite foundation for corporate policies advancing DEI exists, making the adoption of these policies, as we later address in more detail, eligible for the protection of the business judgment rule.

Part III examines current legislative and market initiatives to improve DEI within the corporate sector. To provide context, we start with an analysis of key federal laws that advance racial and gender equality in the business sector. We then catalogue a growing number of initiatives: investment fund activities where employee, environmental, social, and governance factors ("EESG") have been integrated into investment processes;³ California and New York state corporate law

3. Notably, these arrangements are described in the literature, and by the participants themselves, in different ways, though traditionally as "ESG" programs in light of the importance

reforms aiming for greater board diversity; proposed new listing rules for Nasdaq requiring disclosure of corporate board metrics; and a pledge made by Goldman Sachs to only assist companies meeting minimum diversity metrics when going public. These initiatives, we find, hold the prospect of potentially important upgrades to corporate Diversity. We conclude, however, that many face substantial constitutional challenges. As important, virtually all are board-level initiatives and do not cover private companies, which comprise an increasingly large share of economic activity. Nor do they address Equity and Inclusion, and by extension issues such as how corporations use contracted workers and interact with customer communities. They are thus, by definition, limited in their reach and robustness. For these reasons, if serious improvement in corporate practices is desirable, supplemental actions by corporations will be essential.

In Part IV, we provide a foundational theory of how the corporate law of fiduciary duty applies to corporate DEI policies. First, we explain the general principles underlying the duties of loyalty and care, and how the corporation's obligation to comply with the law is fundamental to the operation of corporate law. We show that the fiduciary duty of loyalty requires not only a negative responsibility to avoid harm to the corporation, but that it also requires the duty to take affirmative steps to advance the best interests of the corporation. This includes, as reflected in Delaware's famous *Caremark* decision, an obligation for fiduciaries to undertake active efforts to promote compliance with laws and regulations critical to the operations of the company.⁴ Importantly, we show that the most central role of *Caremark* is in the normative obligation it imposes on directors to try to avoid the regulatory penalties, managerial turnover, stakeholder backlash, and overall reputational and financial harm that occurs when companies violate laws essential to society. As we show, the very fact that a *Caremark* case is brought is usually a sign that the company has already lost, even if the directors do not ultimately face liability under *Caremark* itself. We also highlight the considerable discretion that the affirmative component of fiduciary duty law gives business leaders to pursue policies they rationally believe to be in the best interests of the corporation in terms of its sustained profitability and reputational integrity with its stakeholders, society, and regulators.

of environmental, social, and governance factors in investment decisions. We use the term "EESG" in this Article to highlight the additional emphasis many corporations and funds are placing on how corporations treat the constituency arguably most responsible for its success—the employees—with respect. See David Katz & Laura A. McIntosh, *Corporate Governance Update: EESG and the COVID-19 Crisis*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 31, 2020), <https://corpgov.law.harvard.edu/2020/05/31/corporate-governance-update-eesg-and-the-covid-19-crisis> [<https://perma.cc/C9TX-XQBV>] (noting increasing stakeholder and employee centric disclosures in response to the human capital impact of the COVID-19 crisis).

4. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

Part V takes the crucial step of showing how these general principles apply specifically to DEI. As to managers and directors skeptical about DEI, or those who fear it might be beyond their remit of responsibility as fiduciaries, we explain why fiduciary duty requires them to focus on antidiscrimination practices to some meaningful extent, and why failing to do so is riskier than making sure the company has effective DEI practices. We show how the legal expectation of lawful conduct, reflected in Delaware's *Caremark* decision, charges fiduciaries with preventative monitoring for compliance with antidiscrimination laws and legislation as a core feature of their duty of loyalty. Should they fail to do so, companies not only risk corporate liability accompanying such violations; they—along with their directors and top managers—also face the possibility of large reputational costs, stakeholder backlash, internal turnover at the top of management and on the board itself, and fines and injunctions from regulators, even if the follow-on derivative lawsuits are ultimately dismissed. From this standpoint, corporate law's fiduciary duty of compliance is not only important as a matter of "hard" law enforced by the threat of corporate and personal liability. It also defines what fiduciaries are expected by corporate law to do as normative "soft" law.⁵ These expectations go beyond what fiduciaries can be held liable for in damages and require them to protect the corporation from the financial, management, and reputational consequences of failing to comply with critical laws. And these consequences have been supercharged in the wake of George Floyd and Breonna Taylor and the inequality-revealing and exacerbating pandemic.

We then close by identifying why corporate managers and directors who wish to fulfill their normative duty of loyalty by taking affirmative steps to improve sustainable corporate profitability can safely embrace a commitment to Diversity, Equity, and Inclusion—i.e., more ambitious DEI policies that go beyond their duty under *Caremark* to monitor core antidiscrimination compliance obligations. In doing so, we emphasize that corporate fiduciaries do not need definitive evidence of DEI's impact on value to act. Because there is a rational basis for concluding that the promotion of DEI will improve the ability of corporations to function profitably in an increasingly diverse domestic and international economy, fiduciary duty law, and in particular the business judgment rule, provides authorization for corporate DEI policies and therefore leaves business leaders no corporate law reason not to adopt them, and some strong reasons to do so.

5. By soft law, scholars refer to norms or guidelines which, though perhaps not legally binding at all or, as in the case of *Caremark*, not easily enforceable by way of monetary damages for their violation, nonetheless carry high costs where they are violated. For more, see CHRIS BRUMMER, *SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM* 141 (2012) (noting how a poor reputation can hinder a regulator's ability to conduct economic diplomacy).

In forwarding this framework, this Article offers a doctrinally sound yet novel approach that will not be without its ideological detractors. For all of the attention now directed at DEI in corporate America, it is not usually talked about as a matter of long-standing corporate law principles. Indeed, from Friedman’s derision of reformist “catchwords” to a sensitivity even among some Black Lives Matter activists to belittling the significance of Diversity by reducing a moral call to action to one of business prerogatives, Diversity is most commonly understood as an external matter to the firm.

We believe, however, that the case for Diversity has both a strong moral *and* business rationale, making it relevant even as a matter of traditional corporate law principles. Moreover, the internal/external dichotomy of the Friedman view is highly misleading: the very DNA of corporate law’s most foundational duty, that of loyalty, is as much outwardly facing as it is inwardly facing in that it creates obligations to comply with all laws—including core civil rights legislation—that are of critical importance to the company, its stakeholders, and society. These clarifications enable important interventions for refining current reforms and enabling new ones within even our legacy corporate law framework. This important reality poses a substantial question to American business leaders and the institutional investors who wield power over them: If corporate law not only enables directors and the board to address important DEI issues, but also requires corporate attention to them, will they meet their duties head on, and even exceed them, or will they incur the high financial, reputational, and legal risks of ignoring them?

I. THE DEMOGRAPHIC DILEMMA: THE INEQUALITY AND REPRESENTATIONAL GAP IN CORPORATE AMERICA

Discussions about corporate law—whether in the context of mergers and acquisitions, proxy statements, or (much more rarely) Diversity—invariably focus on boards and management. This is in part because of the very peculiar governance challenges corporate leaders face vis-à-vis the corporation’s shareholders. It also reflects the concentrated power they wield collectively in making decisions that impact shareholders, employees, and broader society. Yet American corporate leadership is markedly unrepresentative of our nation’s diversity—a reality that stands in stark contrast to broad calls for fairer economic opportunity and participation. To this end, we provide an overview of the most recent data concerning the Diversity of U.S. corporate boards and management. We then situate the problem against the backdrop of severe racial wealth and income gaps underscored by the pandemic and calls across society in the wake of George Floyd’s brutal death to reform corporations in ways that not only

diversify corporate upper ranks, but that also embed a commitment to DEI in all corporate action affecting important corporate stakeholders.

A. Corporate Boards: Their Twenty-First Century Importance and the Representational Gap

Corporate boards are intended to help address three sorts of agency problems associated with corporate organizations: “those between managers and dispersed shareholders, between controlling and noncontrolling shareholders, and between shareholders and creditors.”⁶ And despite an earlier New Deal perception of corporate boards as part of a concentration of economic power catalyzing the rise of the large corporation, boards are today recognized as serving a key gatekeeping function given incentive problems that can arise in the separation of shareholder “ownership” and managerial “control,” especially apparent in public companies.⁷

On a less theoretical basis, corporate boards have also increased in importance because of real-world developments. Since concerns emerged about managerial improprieties in the 1970s, leading to the mandate for audit committees of outside directors, and the takeover boom of the 1980s, in which independent directors came to the fore as an answer to the problems hostile bids presented for management,⁸ corporate boards as an institution have become increasingly important in corporate governance.⁹ The board is now taken seriously as a governing instrument itself, distinct in important ways from day-to-day top managers; and corporate case law, Exchange rules,¹⁰ and statutory

6. Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1910 (2013).

7. See *id.*; see also ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) (identifying the separation of ownership and control as a master problem in corporate law and sociology). Though notably, for Berle and Means the idea of “managers” consisted of both the “board of directors and the senior officers of the corporation.” *Id.* at 202.

8. Martin Lipton’s iconic article, *Takeover Bids in the Target’s Boardroom*, 35 BUS. LAW. 101 (1979), by way of example, articulated the manner in which a board of directors should operate in the context of a takeover bid, with a strong role for the nonmanagement directors to deliberate among themselves and to oversee management’s conduct. See *id.* at 120–23. That article would then influence the Delaware Supreme Court in key cases like *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954–55 (Del. 1985), in encouraging a strong hand for independent directors and creating standards of review that shifted power away from management.

9. See Melvin A. Eisenberg, *The Board of Directors and Internal Control*, 19 CARDOZO L. REV. 237, 238 (1997) (“The board is not itself unflawed, but as an organ that is compact and cohesive, individualized to the corporation, and capable of being made relatively independent of management control, it is well situated to monitor management on an ongoing and close basis on the shareholders’ behalf.”).

10. The NYSE requires listed companies to “have a nominating/corporate governance committee composed entirely of independent directors.” N.Y. STOCK EXCH., NYSE LISTED COMPANY MANUAL § 303A.04(a) (rev. 2021), <https://nyseguide.srourules.com/listed-company-manual> [<https://perma.cc/F6LR-5XRJ>]. Nasdaq requires director nominees of listed companies “must either be selected, or recommended for the Board’s selection, either by: (A) Independent Directors constituting a majority of the Board’s Independent Directors in a vote in which only

reforms at the state and federal level have only acted to emphasize the salience of the role of the board.¹¹

Because of the increasing centrality of corporate boards, they have been the focus of a greater number of electoral and other challenges in recent decades, with institutional investors pressing for greater numbers of independent directors who would be more responsive to their demands and who have characteristics institutional investors favor.¹² But that focus on the composition of boards has not translated into boards representative of our nation; rather, corporate boards have fallen short of even minimal thresholds of racial or gender Diversity. African Americans comprise 13.4% of the U.S. population, for example, but as of the time of the writing of this article in late 2020, only 8.6% of the boards of Fortune 500 companies.¹³ See Figure 1.A. Meanwhile, the share of white people on boards far outstripped that of Blacks. On the boards of Fortune 500 companies, for example, whites reportedly comprise 83.9% of all members, over 28% higher than that of their percentage of the U.S. population.

As shown in Figure 1.B, women's representation on Fortune 500 boards, at 26.1%, has compared favorably to that of African Americans

Independent Directors participate, or (B) a nominations committee comprised solely of Independent Directors." NASDAQ, NASDAQ STOCK MARKET LLC RULES: RULE 5605(e) (rev. 2021), <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/> [<https://perma.cc/B5SZ-QYH6>].

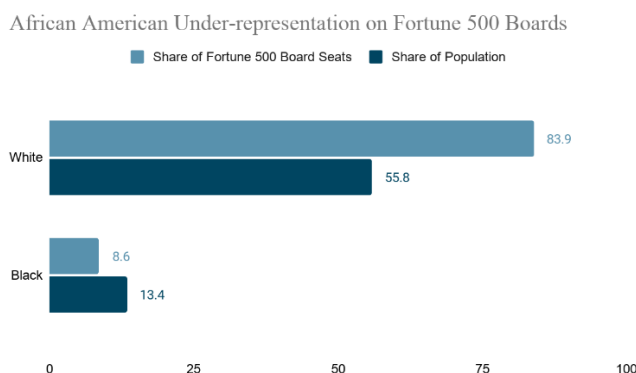
11. See, e.g., Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 952, 124 Stat. 1376, 1900–03 (2010) (codified at 15 U.S.C. § 78j-3); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, 116 Stat. 745, 775–77 (codified at 15 U.S.C. § 78j-1).

12. During the last two decades, the incidence of proxy fights, withhold campaigns, and other contested votes has markedly increased, as has the rate of success of those efforts in procuring, by agreement or ballot-box victory, what the insurgents wanted. See, e.g., John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 554–56 (2016) (identifying only fifty-two hedge fund activist campaigns over twenty consecutive months in 2005–2006 in contrast to 1,115 such campaigns between 2010 and early 2014, with 347 campaigns in 2014 alone).

13. Jeff Green, *Focus on Black Directors Has Latinos Asking: What About Us?*, BLOOMBERG (Sept. 18, 2020, 1:58 PM), <https://www.bloomberg.com/news/articles/2020-09-18/latinos-call-for-board-seats-left-out-of-efforts-to-promote-black-directors> [<https://perma.cc/46YE-X7BW>]. For Latinos, the numbers are even more skewed. Despite comprising roughly 18.3% of the U.S. population, Latinos only comprise 4.1% of Fortune 500 boards—less than a quarter of their representation among the wider population. DELOITTE & ALL. FOR BD. DIVERSITY, MISSING PIECES REPORT: THE BOARD DIVERSITY CENSUS OF WOMEN AND MINORITIES ON FORTUNE 500 BOARDS 19 (6th ed. 2021), <https://www2.deloitte.com/us/en/pages/about-deloitte/articles/press-releases/number-of-fortune-500-boards-with-over-40-percent-diversity-nearly-quadrupled-since-2010.html> [<https://perma.cc/3WAB-3UHP>]. Moreover, their participation does not appear to reflect the demographic changes facing the country. Since 1990, the Latino share of the U.S. population has more than doubled from 9% in 1990 to approximately 20% today. 1990s: *National Tables*, U.S. CENSUS BUREAU, <https://www.census.gov/data/tables/time-series/demo/popest/1990s-national.html> (last updated Oct. 8, 2021) [<https://perma.cc/J2EK-JH5R>] (open file for “Population Data” under the heading “Annual Population Estimates by Sex, Race and Hispanic Origin, Selected Years from 1990 to 2000”); *QuickFacts*, U.S. CENSUS BUREAU, <https://www.census.gov/quickfacts/fact/table/US#qf-headnote-b> (last visited Oct. 12, 2021) [<https://perma.cc/HQ4A-9596>]. But even with this exponential increase of over 10% in the last two decades, the percentage of Fortune 500 board seats held by Latinos increased in this time by less than 3%. DELOITTE & ALL. FOR BD. DIVERSITY, *supra*, at 20, 35.

and Latinos, who make up roughly only 12.5%. They are, however, as a group, still disproportionately underrepresented compared to their 50.2% share of the overall population.¹⁴ Within this demographic, white women have seen their share of board seats increase the most, from around 15.7% in 2004 to 22.5% in 2018, accounting for nearly 70% of board seats transferred from white men.¹⁵ See Figure 1.C. Minority women, meanwhile, saw virtually no increase in their board representation, with a gain of only 1%, from 3.2% to 4.6%. Minority men also experienced only minimal progress from 9.9% to 11.5%.¹⁶

FIGURE 1.A: AFRICAN AMERICAN UNDER-REPRESENTATION ON FORTUNE 500 BOARDS IN 2020



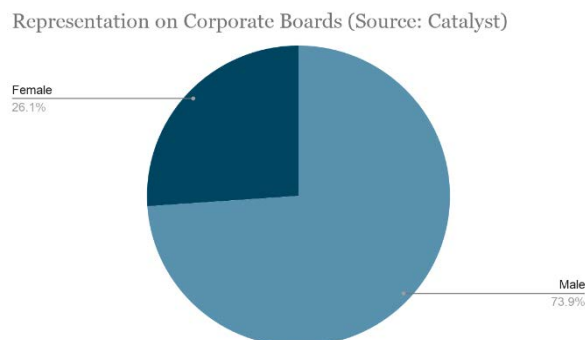
Source: Bloomberg

14. *Women on Corporate Boards: Quick Take*, CATALYST (Mar. 13, 2020), <https://www.catalyst.org/research/women-on-corporate-boards/> [<https://perma.cc/7X5Q-CMF6>].

15. On the other hand, minority men and women saw their share of board seats grow only 3.3%, from 12.8% to 16.1%. *We Know Diversity Is Good for Business, So Why Do Corporate Leaders Remain Predominantly White and Male?*, DIVERSITY JOBS (Nov. 10, 2020), <https://www.diversityjobs.com/2020/11/corporate-gender-ethnic-veteran-disability-lgbtqia-diversity/> [<https://perma.cc/S7YH-3YNH>].

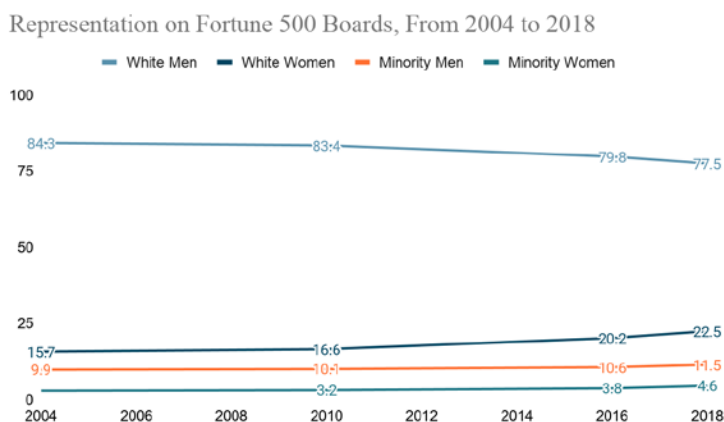
16. *Id.*

FIGURE 1.B: GENDER REPRESENTATION ON CORPORATE BOARDS IN 2020



Source: Catalyst

FIGURE 1.C: REPRESENTATION ON FORTUNE 500 BOARDS FROM 2004 TO 2018



Source: Diversity Jobs

An extensive literature has grown detailing the sources of the demographic shortcomings of corporate boards. The prospects for Black and female corporate board membership improved gradually in the aftermath of the civil rights movement of the 1960s. But progress has often been sporadic and slow.¹⁷

This literature identifies a number of common obstacles to board diversity, most relating to how board members are chosen. First, boards

17. Lisa M. Fairfax, *Clogs in the Pipeline: The Mixed Data on Women Directors and Continued Barriers to Their Advancement*, 65 MD. L. REV. 579, 580 (2006) (“[W]hile women have made substantial progress onto boards since 1934 as well as significant contributions to those boards, they confront considerable barriers to board membership that must be addressed proactively.”).

often lean towards candidates who have run business units or held operations posts—in short, chief executives from other companies who have served on an outside board—which translates into a pool of fewer female and minority candidates. Absent efforts to look for leaders with management experience in sectors of the economy—government, military, education, and legal—where minorities and women have made more inroads,¹⁸ corporate boards will tend to reflect the composition of corporate management ranks. Additionally, board seats for the country's largest companies are rarely available due to low turnover—and the number of candidates interviewed is often small and composed of candidates with prior board experience.¹⁹ As a result, opportunities for diversification are few, and, even where slots are open, minority candidates and women may not be interviewed at all.²⁰

But arguably 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.²¹ Often, this leads to the consideration of individuals who are already known within the social circles of C-suite executives or other board members. These dynamics disadvantage women and minorities who do not necessarily hail from or participate in the same cultural or socioeconomic networks as the white men who dominate corporate boards.²² Though for those

18. See, e.g., EILEEN PATTEN & KIM PARKER, PEW RSCH. CTR., WOMEN IN THE U.S. MILITARY: GROWING SHARE, DISTINCTIVE PROFILE 1 (2011), <https://www.pewresearch.org/wp-content/uploads/sites/3/2011/12/women-in-the-military.pdf> [<https://perma.cc/7PKW-YMW5>] (“The share of women among the enlisted ranks has increased seven-fold, from 2% to 14%, and the share among commissioned officers has quadrupled, from 4% to 16%.”); Dylan Jackson, *The Diversity Scorecard*, AM. LAW. (June 2020), <https://www.bal.com/wp-content/uploads/2020/05/TAL05272020449781Berry.pdf> [<https://perma.cc/T6RL-NKRW>] (“[M]inority attorneys have seen a 3.9% increase in representation among the country's largest firms.”); Hilary Burns, *Study: Higher Ed Could Be First Mass. Sector to Hit Gender Parity*, BOS. BUS. J. (Nov. 4, 2019, 6:22 AM), <https://www.bizjournals.com/boston/news/2019/11/04/study-higher-ed-could-be-first-mass-sector-to-hit.html> [<https://perma.cc/8M4N-6DSF>] (“Women make up 48% of all provosts in Massachusetts and 55% of all deans and senior leadership team members statewide.”).

19. J. Yo-Jud Cheng, Boris Groysberg & Paul M. Healy, *Why Do Boards Have So Few Black Directors?*, HARV. BUS. REV. (Aug. 13, 2020), <https://hbr.org/2020/08/why-do-boards-have-so-few-black-directors?registration=success> [<https://perma.cc/E868-FHLF>].

20. *Id.*

21. See generally Udi Hoitash, *Should Independent Board Members with Social Ties Disqualify Themselves from Serving on a Board?*, 99 J. BUS. ETHICS 399 (2011) (examining how social ties between directors and management may increase trust and information sharing).

22. We do not ignore the reality that corporate directors and managers are not representative of typical white men either. On balance, they come from far more privileged and elite backgrounds than typical white Americans. Indeed, in our view of Diversity, Equity, and Inclusion, efforts to include all Americans are important, and that includes white people who do not come from privileged backgrounds and who often face some of the same difficulties in opportunity and access as people of color with limited means. See Adia Harvey Wingfield, *How Organizations Are Failing Black Workers—and How to Do Better*, HARV. BUS. REV. (Jan. 16, 2019), <https://hbr.org/2019/01/how-organizations-are-failing-black-workers-and-how-to-do-better> [<https://perma.cc/L7XE-FJA7>] (finding that many organizations fill available director positions

underrepresented persons who do make it, they fit to form: a 2016 survey of over one thousand board directors indicated that over half of Black directors were known to a fellow board member before being appointed (as compared to 35% of white directors).²³ Similarly, white directors were more likely to be a current or former executive of the company. Nearly one-third were already known by the CEO by the time they were introduced to the board.²⁴

B. CEOs and C-Suite Officers: The Representational Chasm Deepens at the Top Management Level

General corporate statutes vest management, and in particular the chief executive officer, with making major corporate decisions and overseeing the operations and resources of a company.²⁵ CEOs are the most important single officers of corporations, and, in their management capacities, they are tasked with ensuring that the goals of the corporate board are pursued at lower levels of the firm. In practice, this means that CEOs hire other executives and staff, implement corporate policy and board instructions, and serve as the primary interface between the broader public and the corporation. CEOs are also primarily responsible for identifying how resources of the company are directed and for what purpose. They may also be responsible for implementing recruiting, retention, and promotion strategies at the firm and ensuring a workplace culture commensurate with the objectives of the company.

Even though what is required to be an effective CEO can vary considerably by industry, CEOs, like the board that is responsible for managing them, are a highly homogenous group. When it comes to CEOs of S&P 500 companies, only 9% are ethnic minorities.²⁶ Specifically, 3% are Latino, 2% are Indian, 1% are Asian, 1% are Middle Eastern, 1% are multiracial, and 1% are Black.²⁷

through social networks, similar to elite professional service firms that only hire from a few select, elite universities on the East Coast).

23. Cheng et al., *supra* note 19.

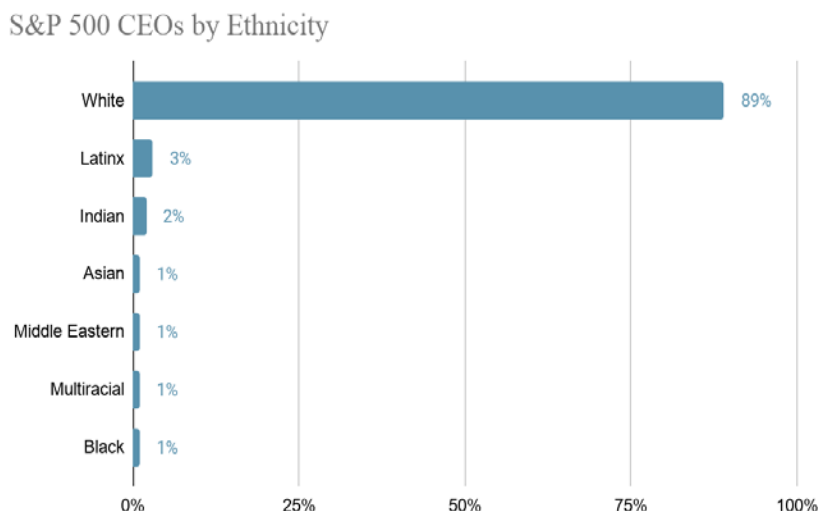
24. *Id.*

25. Adam Hayes, *Chief Executive Officer (CEO)*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/ceo.asp> (last updated July 1, 2020) [<https://perma.cc/6MCN-5X7Q>].

26. Te-Ping Chen, *Why Are There Still So Few Black CEOs?*, WALL ST. J. (Sept. 28, 2020, 10:16 AM), <https://www.wsj.com/articles/why-are-there-still-so-few-black-ceos-11601302601> [<https://perma.cc/HQ9C-K2GL>] (stating that African Americans represent only 3% of executive or senior-level roles among U.S. companies with one hundred or more employees).

27. *Id.*

FIGURE 1.D: S&P CEOs BY ETHNICITY



Source: MyLogIQ

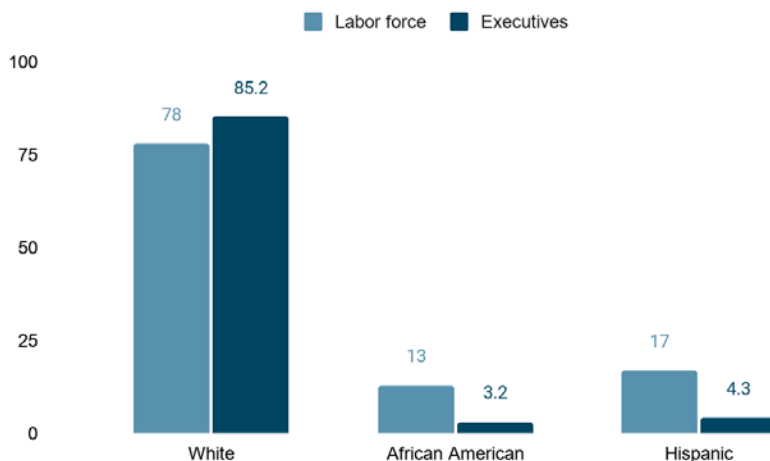
Things hardly get better when assessing the diversity of Fortune 500 C-suites, the most senior leaders of large companies that include the chief financial officer (“CFO”), chief operating officer (“COO”), and chief information officer (“CIO”). In this rarified group of officers, just 3.2% are African Americans.²⁸ Only 4.3% of Fortune 500 executives are Latino.²⁹ Meanwhile, an overwhelming majority—over 85%—are white.

28. CTR. FOR TALENT INNOVATION, BEING BLACK IN CORPORATE AMERICA: AN INTERSECTIONAL EXPLORATION 3 (2019), <https://coqual.org/wp-content/uploads/2020/09/CoqualBeingBlackinCorporateAmerica090720-1.pdf> [<https://perma.cc/33DY-P9CM>] (finding that despite the disparate numbers, African American professionals are more likely than white professionals to be ambitious; overall, 65% of African Americans were considered “very ambitious” in their careers, compared to 53% of their white counterparts).

29. J.D. Swerzenski, Donald Tomaskovic-Devey & Eric Hoyt, *This Is Where There Are the Most Hispanic Executives (and It’s Not Where You Think)*, FAST CO. (Jan. 28, 2020), <https://www.fastcompany.com/90456329/this-is-where-there-are-the-most-hispanic-executives-and-its-not-where-you-think> [<https://perma.cc/6T6Y-Q3WP>].

FIGURE 1.E: REPRESENTATION IN FORTUNE 500 C-SUITES BY ETHNICITY

Representation in Fortune 500 C-Suites by Ethnicity



Source: JD Swerzenski, *University of Massachusetts Amherst*

As in the case of corporate boards, there are more women occupying top executive roles than there are underrepresented minorities—167 at the country’s top three thousand companies.³⁰ And the data indicate that women have made progress among C-suite executives, growing from roughly 7% of top management to nearly 12% today.³¹ By comparison, of the 279 top executives listed at the fifty biggest companies in the S&P 100, only five are Black.³² Still, women remain overwhelmingly underrepresented when compared to their 50.2% share of the overall U.S. population.³³ Moreover, women hold only 6% of CEO positions among Fortune 500 companies, with ethnically diverse individuals faring similarly as 9% of the Fortune 500 CEO population.³⁴

30. Vanessa Fuhrmans, *Where Are All the Women CEOs?*, WALL ST. J. (Feb. 6, 2020, 10:34 AM), <https://www.wsj.com/articles/why-so-few-ceos-are-women-you-can-have-a-seat-at-the-table-and-not-be-a-player-11581003276> [https://perma.cc/Z3B6-DCZG].

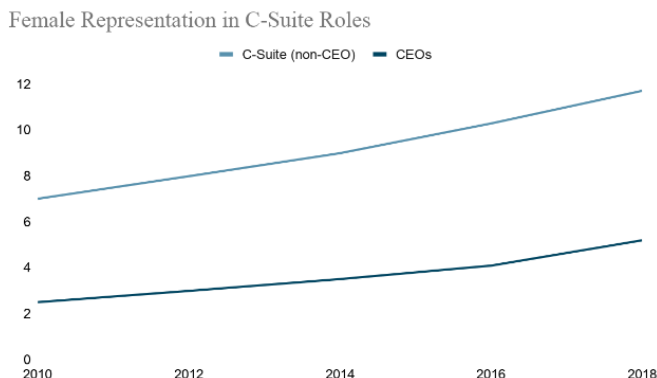
31. *Id.*

32. Jessica Guynn & Brent Schrotenboer, *Why Are There Still So Few Black Executives in America?*, USA TODAY, <https://www.usatoday.com/in-depth/money/business/2020/08/20/racism-black-america-corporate-america-facebook-apple-netflix-nike-diversity/5557003002/> (last updated Feb. 4, 2021, 8:54 AM) [https://perma.cc/38WW-8DPN].

33. Fuhrmans, *supra* note 30.

34. *Id.* (women comprise only 25% of all Fortune 100 C-Suite positions, with racially diverse individuals comprising only 16% of the Fortune 100 executive positions).

FIGURE 1.F: FEMALE REPRESENTATION IN C-SUITE ROLES



Source: *The Wall Street Journal*

As with corporate boards, researchers have identified exclusion from professional networks as a key driver of the imbalance in C-suites. Networking—and socializing—can make or break careers, and women and minorities can find it difficult to integrate into dominant corporate cultures and participate on equal footing with their white male colleagues. As a result, they are often unable to fully develop the relationships necessary for advancement.³⁵ The consequences can be important. Promotions in many companies are informally decided before jobs are ever posted, leaving members from underrepresented groups without the chance to compete and without sponsors in the corporate leadership to put their name forward.³⁶

Inadequate opportunities for advancement at earlier stages of careers play a role as well. CEOs, recruiters, and scholars routinely report that women and Black professionals face greater obstacles early in their career, including work-life balance and family responsibilities, and are viewed more critically than their colleagues.³⁷ And even if minorities and women make it close to the C-suite, they are rarely given the profit-and-loss positions that serve as stepping stones to the top jobs like CEO and CFO, and are instead more typically placed into roles such as marketing or human resources.³⁸ “A Wall Street Journal study of executives at . . . the biggest publicly traded firms by market value, shows that men,” occupying the most senior jobs in companies, “overwhelmingly get the management jobs in which a company’s profits

35. Chen, *supra* note 26.

36. *Id.*

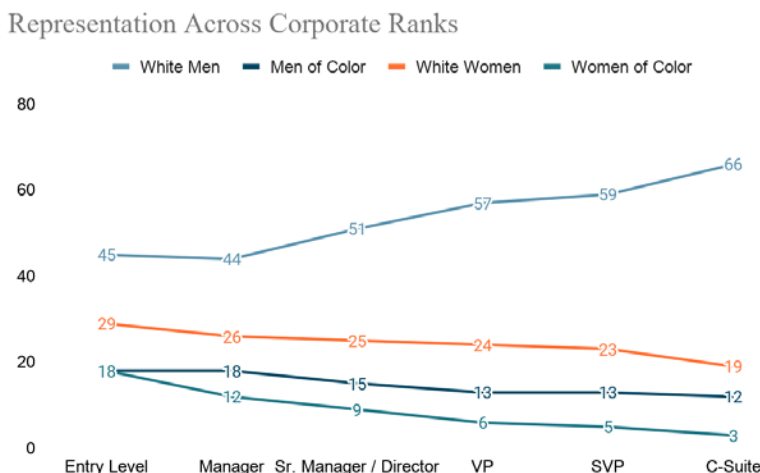
37. *Id.*

38. *Id.*

and losses hang in the balance.”³⁹ Women by contrast “often fill roles such as head of human resources, administration or legal, . . . the jobs [that] don’t have profit-generating responsibility” and that are not usually routes to running a company.⁴⁰

For nonwhite women, climbing the corporate ladder is even more difficult.⁴¹ In a 2019 survey of 329 major companies and more than sixty-eight thousand of their employees, women of color were less likely to say their bosses gave them opportunities to manage people and projects or helped them navigate corporate politics.⁴² They made up just 3% of C-suite roles, according to the research by McKinsey & Co. and LeanIn.Org, a nonprofit that promotes the advancement of women at work.⁴³

FIGURE 1.G: REPRESENTATION ACROSS CORPORATE RANKS



Source: McKinsey

In the end, an increasingly steep decoupling of white men from virtually all other groups arises as one moves up the corporate ladder. What is an initially modest gap in representation at the entry level of hiring arising between white men on the one hand, and women and

39. Fuhrmans, *supra* note 30.

40. *Id.*

41. Lisa Fairfax, *Some Reflections on the Diversity of Corporate Boards: Women, People of Color, and the Unique Issues Associated with Women of Color*, 79 ST. JOHN'S L. REV. 1105, 1116 (2005) (stating that non-white women “describe barriers to their success as a ‘concrete’ ceiling, as opposed to the ‘glass’ ceiling experienced by white women”).

42. Amber Burton, *Women of Color: Invisible, Excluded, and Constantly ‘On Guard,’* WALL ST. J. (Oct. 15, 2019, 12:01 AM), https://www.wsj.com/articles/women-of-color-invisible-excluded-and-constantly-on-guard-11571112060?mod=article_inline [<https://perma.cc/8MYR-9PEF>].

43. MCKINSEY & CO. & LEANIN.ORG, WOMEN IN THE WORKPLACE 8 (2020), https://wiw-report.s3.amazonaws.com/Women_in_the_Workplace_2020.pdf [<https://perma.cc/EPE3-EF6K>].

minorities on the other, jumps at every step across the corporate hierarchy. This demographic decoupling culminates in C-suite figures that do not come close to representing the demographics of the United States.⁴⁴ Instead, minorities and women lose ground as white men, predominately from relatively affluent backgrounds,⁴⁵ gain an ever-greater share of corporate leadership positions.

C. Corporate Law's Post-George Floyd, Pandemic Moment

Corporate America's demographic dilemma has attracted attention for decades, though scrutiny of the problem has intensified since the brutal death of George Floyd at the hands of Minneapolis police. The tragedy not only supercharged the then-nascent Black Lives Matter movement, but it also highlighted an array of societal inequities, from police brutality to the racial wealth and income gaps. As activists have delved into questions of legal meaning, entitlement, and democracy, a natural point of emphasis has been the racially disparate allocation of resources and opportunity in society.⁴⁶ The pandemic's unequal impact on people of color⁴⁷ has only doubled down on the focus,

44. *Id.* at 8–9 (the 2020 report focuses specifically on how the COVID-19 pandemic has affected women at work, including its unique impact on women of different races and ethnicities).

45. Richard L. Zweigenhaft, *Diversity Among CEOs and Corporate Directors: Has the Heyday Come and Gone?*, WHORULESAMERICA.NET (Dec. 2013), https://whorulesamerica.ucsc.edu/power/diversity_among_ceos.html [https://perma.cc/ZER5-S4MC] (examining corporate directors at elite companies and finding that they were overwhelmingly from upper class or upper-middle class backgrounds, including directors who were female or from non-Black minority groups).

46. See Veronica Root Martinez & Gina-Gail S. Fletcher, *Equity Metrics*, 130 YALE L.J.F. 869, 872 (2021) (observing that under the Black Lives Matter movement, “[c]onversations that initially focused on the appropriate role of police within American society turned into debates about, quite simply, everything”). The picture that emerges, according to an extensive review of hundreds of documents and interviews about George Floyd’s life, is one that underscores how systemic racism has calcified within many of America’s institutions, creating sharply disparate outcomes in housing, education, the economy, law enforcement, and health care. Toluse Olorunnipa & Griff Witte, *Born with Two Strikes: How Systemic Racism Shaped Floyd’s Life and Hobbled His Ambition*, WASH. POST, <https://www.washingtonpost.com/graphics/2020/national/george-floyd-america/systemic-racism/> (last updated Oct. 8, 2020, 7:47 AM) [https://perma.cc/3H4N-AVQ8].

47. For an important summary of the economic and health effects of the pandemic on Black workers, see Elise Gould & Valerie Wilson, *Black Workers Face Two of the Most Lethal Preexisting Conditions for Coronavirus—Racism and Inequality*, ECON. POL’Y INST. (June 1, 2020), <https://www.epi.org/publication/black-workers-covid/> [https://perma.cc/ZDC3-KRDW]. Women, especially Black, non-Hispanic women and Latinas, were also hit hard by the pandemic, as they are overrepresented in sectors—such as hospitality and retail—which experienced the brunt of pandemic-related job losses. Jasmine Tucker & Claire Ewing-Nelson, *COVID-19 Is Making Women’s Economic Situation Even Worse*, NAT’L WOMEN’S L. CTR. (Sept. 2020), <https://nwlc.org/wp-content/uploads/2020/09/PulsedataFS-1.pdf> [https://perma.cc/7ABK-UJJQ].

leading to an epistemic shift—or “Great Awakening”—in American consciousness.⁴⁸

Thus, the cruel events of 2020 made ignoring racial inequality impossible for most Americans, and especially for high-profile business leaders.⁴⁹ The facts on the ground led to new questions being asked of corporations about their role in contributing to the undeniable problem of persistent inequality and what actions they may and should take to address it. And for the first time, a mainstream conversation has arisen as to what the relative lack of Diversity has meant for not only Blacks, but also for society—and whether corporate governance might have a role in promoting more constructive corporate behavior.

This is not to say that there have not been scholars with an eye on what social externalities an absence of corporate Diversity could create. Research has found, for example, that corporations with less Diversity and fewer women are less likely to engage in philanthropic giving.⁵⁰ Similarly, recent events have highlighted how corporations with fewer powerful African Americans and Latinos on their boards and in their workforces are less likely to support causes relevant to Diverse communities—or to take social justice stands that reflect the values of Diverse minority communities.⁵¹ Even attention to issues like equitable

48. Van Jones, Opinion, *Welcome to the ‘Great Awakening,’* CNN, <https://www.cnn.com/2020/06/12/opinions/great-awakening-empathy-solidarity-george-floyd-jones/index.html> (last updated June 14, 2020, 11:21 PM) [<https://perma.cc/V6T7-SSP8>] (observing how George Floyd’s killing and the Black Lives Matter movement have birthed a “phenomenon infinitely larger than itself” that is best described as a “‘Great Awakening’ of empathy and solidarity, one without historical precedent”); see also Jose A. Del Real, Robert Samuels & Tim Craig, *How the Black Lives Matter Movement Went Mainstream*, WASH. POST (June 9, 2020), https://www.washingtonpost.com/national/how-the-black-lives-matter-movement-went-mainstream/2020/06/09/201bd6e6-a9c6-11ea-9063-e69bd6520940_story.html [<https://perma.cc/8ANX-NPE5>] (noting that the mainstreaming of the Black Lives Matter movement is happening against the backdrop of a global pandemic that, in the United States, has disproportionately hurt minorities).

49. See Natalie Sherman, *George Floyd: Why Are Companies Speaking Up this Time?*, BBC (June 7, 2020), <https://www.bbc.com/news/business-52896265> [<https://perma.cc/L8X4-X2EV>] (“For years, black deaths in the hands of police have gone unremarked in corporate America. But this time, as protesters pour into streets across the country set off by the killing of George Floyd, businesses are speaking out.”).

50. See Robert J. Williams, *Women on Corporate Boards of Directors and Their Influence on Corporate Philanthropy*, 42 J. BUS. ETHICS 1 (2003) (supporting the notion that firms that have a higher proportion of women serving on their boards engage in charitable giving to a greater extent than firms having a lower proportion of women serving on their boards).

51. The most obvious, and studied, recent case in point concerns the disparate responses from the National Basketball Association (“NBA”) and National Football League (“NFL”) to Colin Kaepernick’s protest of the American flag. The NBA—where Black players wield economic power—embraced social protests, and the NFL—where white owners wield economic power—largely eschewed them and ostracized Kaepernick for his demonstration. See, e.g., Michael Conklin & Christine Noel, *Unsportsmanlike Conduct? The NFL’s Response to the Kneeling Controversy*, 12 J. ETHICAL & LEGAL ISSUES 1, 3 (2019) (noting the higher percentage of Black players in the NBA and the larger number of Black viewers); see also John Branch, *Why the N.F.L. and the N.B.A. Are So Far Apart on Social Justice Stances*, N.Y. TIMES (June 22, 2018), <https://www.nytimes.com/2018/06/22/sports/nfl-nba-social-justice-protests.html>

environmental policy may be less likely where corporate boards and management lack Diversity and the attendant perspective to recognize problems and optimize solutions.⁵²

Still, what are perhaps the most direct and concerning implications of the data are the larger macroeconomic repercussions for the country's racial wealth and income gaps. In the decades since the height of the civil rights movement, corporate America has failed to consistently hire and promote women and historically underrepresented minorities, stalling many from rising above middle management.⁵³ The absence of diversity at the top of corporations is widely accepted in the organizational psychology literature as one key factor likely impeding diversity lower down the corporate hierarchy, where the bulk of employees work and the most interactions between the corporation, customers, and community occur.⁵⁴ The reasons are varied but generally start with hiring. Individuals, regardless of race, tend to like individuals who are similar to themselves and evaluate them more positively than those who are different. Because of this "affinity bias," managers may repeatedly favor individuals who are

[<https://perma.cc/PNW7-JFVT>] (noting that the NFL's lack of guaranteed contracts and the NBA's smaller and more unified workforce, where Black players are marketed, resulted in vastly different corporate responses).

52. The same issue is under intense scrutiny in the nonprofit sector, where there are parallels. See Ambika Chawla, *A Look at Why Environmentalism Is So Homogeneous—And How Organizations Might Cultivate Genuine Diversity*, ENSIA (July 28, 2020), <https://ensia.com/features/environmental-workforce-diversity-systemic-racism/> [<https://perma.cc/B6PU-WT3L>] ("[P]eople of color can offer unique perspectives on both why diversity is lacking in the green sector and what organizations can do to diversify the environmental workforce."); see also Victoria Bortfeld, *This 'Green' Space Shouldn't Be So White*, COLUM. CLIMATE SCH.: STATE OF THE PLANET BLOG (Aug. 21, 2020), <https://blogs.ei.columbia.edu/2020/08/21/environmental-sciences-anti-racism/> [<https://perma.cc/7U9P-8DXC>] ("[T]he institutional settings and professional workplaces that house and advance environmental work in some ways mirror the environmental injustices that unfold in our society."); Ihab Mikati, Adam F. Benson, Thomas J. Luben, Jason D. Sacks & Jennifer Richmond-Bryant, *Disparities in Distribution of Particulate Matter Emission Sources by Race and Poverty Status*, 108 AM. J. PUB. HEALTH 480 (2018) (finding that people of color are not only much more likely to live near polluters and breathe polluted air, but also that race has a stronger effect on exposure to pollutants than poverty, which indicates that something beyond the concentration of poverty among Black and Brown communities is at play).

53. As of July 15, 2020, less than 2% of the 279 top executives at the fifty largest companies in the United States were Black. Guynn & Schrotenboer, *supra* note 32. For a recent survey and analysis of the racial wealth gap, see Neil Bhutta, Andrew C. Chang, Lisa J. Dettling & Joanne W. Hsu, *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. (Sept. 28, 2020), <https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finance-20200928.htm> [<https://perma.cc/JR79-UNCJ>].

54. See Jill A. Gould, Carol T. Kulik & Shruti R. Sardeshmukh, *Trickle-Down Effect: The Impact of Female Board Members on Executive Gender Diversity*, 57 HUM. RES. MGMT. 931 (2018) (finding a trickle-down effect on female representation operating between the board and executive levels). See generally Rachel W. Flam, Jeremiah Green, Joshua A. Lee & Nathan Y. Sharp, *A Level Playing Field? Empirical Evidence That Minority Analysts Face Unequal Access to Corporate Managers* (rev. Dec. 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3622417 [<https://perma.cc/T37D-QWDC>] (finding that ethnic minority analysts face unique barriers to management access).

similar to themselves, viewing them as more trustworthy, intelligent, or qualified.⁵⁵ Meanwhile, women, and especially Black and Brown candidates, may be subject to “outsider bias,” the idea that those not part of a known circle of friends and associates must have values and interests foreign to your own.⁵⁶ In business, this and other affinity-based biases can have an especially large impact during the recruitment processes, where it presents itself as a lack of “culture fit,” an ambiguous evaluation employed to disqualify job candidates.⁵⁷ Perhaps not surprisingly, data from the National Academy of Sciences indicate that the rate of callbacks for Black candidates is generally lower than that of white candidates, and this rate has changed little since the 1970s.⁵⁸

Similar dynamics complicate the promotion of those Black and Brown people who are hired. “Confirmation bias,” the human tendency to selectively seek out, favor, and use information that confirms what you already believe, can in non-Diverse contexts stymie the progress of Black and Brown employees.⁵⁹ To the extent white leaders⁶⁰ of a firm expect Black employees to be less qualified, they will likely be more inclined to ignore new information proving otherwise, even where

55. Adwoa Bagalini, *3 Cognitive Biases Perpetuating Systemic Racism at Work—And How to Overcome Them*, WORLD ECON. F. (Aug. 19, 2020), <https://www.weforum.org/agenda/2020/08/cognitive-bias-unconscious-racism-moral-licensing/> [<https://perma.cc/ZNQ2-RBX7>] (highlighting how moral licensing, affinity bias, and confirmation bias are three types of cognitive biases that factor into producing unequal outcomes for people of color).

56. Cf. William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7, 47 (1988) (showing that individuals disproportionately stick with the status quo through a series of decisionmaking experiments); see also Amy Kristof-Brown, Murray R. Barrick & Melinda Franke, *Applicant Impression Management: Dispositional Influences and Consequences For Recruiter Perceptions of Fit and Similarity*, 28 J. MGMT. 27, 33–40 (2002) (offering evidence that when making hiring decisions, interviewers will unconsciously favor candidates whom they see as similar to themselves).

57. Bagalini, *supra* note 55.

58. Lincoln Quillian, Devah Pager, Arnfinn H. Midtbøen & Ole Hexel, *Hiring Discrimination Against Black Americans Hasn't Declined in 25 Years*, HARV. BUS. REV. (Oct. 11, 2017), <https://hbr.org/2017/10/hiring-discrimination-against-black-americans-hasnt-declined-in-25-years> [<http://perma.cc/P6QJ-X9TV>] (finding little evidence that conscious and unconscious forms of bias will diminish on their own).

59. Bagalini, *supra* note 55; see, e.g., Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1128 (1974) (discussing “anchoring” as one of several key judgmental heuristics and the biases it produces).

60. Or even minority leaders, given the evidence that implicit bias affects everyone, including Black people’s perceptions of other Black people. Theodore R. Johnson, *Black-on-Black Racism: The Hazards of Implicit Bias*, ATLANTIC (Dec. 26, 2014), <https://www.theatlantic.com/politics/archive/2014/12/black-on-black-racism-the-hazards-of-implicit-bias/384028/> [<https://perma.cc/E9JB-7ZQ2>] (“When blacks are asked about their predilections, they express a solid preference for their group over whites, but, in general, performance on the IAT [Implicit Association Test, an implicit bias test used by Project Implicit] suggests they subconsciously hold a slight preference for whites over blacks.”).

performance is high.⁶¹ Employees who come from underrepresented groups are consequently more likely to be negatively evaluated. Additionally, mentors and promoters at firms who may be positioned to elevate junior- and mid-level executives to positions of leadership may be disinclined to do so.⁶² For underrepresented groups, this means they may face competitive disadvantages vis-à-vis their white counterparts for promotion.

Another large factor impeded progress toward racial and gender equality. With an increased emphasis on short-term stockholder returns from institutional investors starting in the 1980s and accelerating since, the share of corporate profits that went into wage increases plummeted compared to previous generations.⁶³ This decline in fair gainsharing hit Black Americans particularly hard, because they had only gained labor rights in the 1960s, and were more likely to be working and lower middle class.⁶⁴ Growing inequality resulted for all

61. Bagalini, *supra* note 55.

62. *Id.*

63. See Anna Stansbury & Lawrence H. Summers, *The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy* (Nat'l Bureau of Econ. Rsch., Working Paper No. 27193, 2020), nber.org/system/files/working_papers/w27193/w27193.pdf [<https://perma.cc/48B3-5PXV>]; Lawrence Mishel, *The Decline in Unions Has Hurt Nonunion Workers Too*, ECON. POL'Y INST. (Sept. 1, 2016), <https://www.epi.org/publication/the-decline-in-unions-has-hurt-nonunion-workers-too/> [<http://perma.cc/7CX3-45BX>]; LAWRENCE MISHEL & JORI KANDRA, ECON. POL'Y INST., CEO COMPENSATION SURGED 14% IN 2019 TO \$21.3 MILLION (Aug. 2020), <https://www.epi.org/publication/ceo-compensation-surged-14-in-2019-to-21-3-million-ceos-now-earn-320-times-as-much-as-a-typical-worker/> [<https://perma.cc/S4Q9-BTVE>] (observing that as stockholders have tied CEO pay to stock returns, CEO compensation has increased while worker wages have stagnated); LAWRENCE MISHEL, LYNN RHINEHART & LANE WINDHAM, ECON. POL'Y INST., EXPLAINING THE EROSION OF PRIVATE-SECTOR UNIONS (Oct. 2020), <https://files.epi.org/pdf/211305.pdf> [<https://perma.cc/MLL7-EQDF>]; JOSH BIVENS, LAWRENCE MISHEL & JOHN SCHMITT, ECON. POL'Y INST., IT'S NOT JUST MONOPOLY AND MONOPSONY: HOW MARKET POWER HAS AFFECTED AMERICAN WAGES (Apr. 2018), <https://files.epi.org/pdf/145564.pdf> [<https://perma.cc/6G6E-GMC7>].

64. See David Leonhardt, Opinion, *The Black-White Wage Gap Is as Big as It Was in the 1950s*, N.Y. TIMES (June 25, 2020), <https://www.nytimes.com/2020/06/25/opinion/sunday/race-wage-gap.html> [<https://perma.cc/UN3T-GLZG>] (documenting that both the racial wealth and income gaps shrank after World War II because of rising wages due to strong unions, the inclusion of formerly excluded jobs that many Black workers held at the minimum wage by the Great Society legislation in 1966, and other policies that benefited all blue-collar workers, but that these gains then reversed from the 1980s forward); G. William Domhoff, *Wealth, Income, and Power*, WHORULESAMERICA.NET, <https://whorulesamerica.ucsc.edu/power/wealth.html> (last updated Apr. 2017) [<https://perma.cc/2V9B-JXBG>] (showing that Black people are far behind white people in income and that the gap is growing); Kristin McIntosh, Emily Moss, Ryan Nunn & Jay Shambaugh, *Examining the Black-White Wealth Gap*, BROOKINGS (Feb. 27, 2020), <https://www.brookings.edu/up-front/2020/02/27/examining-the-black-white-wealth-gap/> [<https://perma.cc/6558-Q4JP>] (showing the same); see also *Facts: Racial Economic Inequality*, INEQUALITY.ORG, <https://inequality.org/facts/racial-inequality/> (last visited Sept. 11, 2021) [<https://perma.cc/U2C7-JH9N>] (documenting median Black family net wealth of only \$3,500 compared to white median family wealth of \$147,000, and further noting that this gap has grown considerably since the early 1980s); PHILIP MATTERA, GOOD JOBS FIRST & JOBS WITH JUST. EDUC. FUND, GRAND THEFT PAYCHECK: THE LARGE CORPORATIONS SHORTCHANGING THEIR WORKERS' WAGES 1, 14–15 (June 2018), https://goodjobsfirst.org/sites/default/files/docs/pdfs/wagetheft_report_revised.pdf [<https://perma.cc/QV8Y-8DF8>] (documenting that wage theft affects Black and Latino workers

Americans, and the gains made by Black Americans during the period when the New Deal/Great Society consensus was in place began to reverse.⁶⁵ Public policy movements in the Friedman/Reagan direction also freed corporations from pressure to address DEI issues more assertively, a reality evidenced by the lack of progress in diversifying the boardroom and C-suite.⁶⁶

Collectively, these obstacles are all widely understood to contribute to sprawling differences in economic outcomes and opportunities, a key concern of civil rights activists. Statistics compiled by the U.S. Equal Employment Opportunity Commission in 2018 indicate that among white people, the ratio of lower-paid service workers and laborers compared with higher-paid senior-level management is roughly 7 to 1. But for Black people, the ratio balloons to 105 to 1.⁶⁷

These facts have a direct impact on racial wealth and income inequality. The net worth in 2016 of the typical white family (\$171,000) was nearly ten times greater than that of a Black family (\$17,150). Meanwhile, the gulf in median household incomes between white and Black Americans has grown after the Reagan era, with improvements during the 1960s and 1970s being reversed, so that the gap of \$23,800 in 1970 has now grown to roughly \$33,000 in 2018 (as measured in 2018 dollars).⁶⁸ Part of the gulf can be attributed to what has been described as the “Black Ceiling” that cuts career progression early. According to recent industry analysis, Black males reach their peak incomes much sooner than white males, at lower levels (\$43,859 at ages 45–49 for Black males and \$66,250 at 50–54 for white males).⁶⁹

For all these reasons, there are increasing calls by advocates and by corporate stakeholders themselves for corporations to address

disproportionately as they are overrepresented in the sectors that are the most penalized by courts for wage theft).

65. Equality in the United States, including for Black Americans, was rising until the Reagan Administration reversed the New Deal/Great Society consensus. *See The Productivity–Pay Gap*, ECON. POLY INST., <https://www.epi.org/productivity-pay-gap> (last updated Aug. 2021) [<https://perma.cc/355-NJ7S>] (“Since the late 1970s, [U.S.] policy choices have led directly to a pronounced divergence between productivity and typical workers’ pay.”).

66. *See, for example, William A. Wines, Title VII Interpretation and Enforcement in the Reagan Years (1980-89): The Winding Road to the Civil Rights Act of 1991*, 77 MARQ. L. REV. 645 (1994), detailing the Reagan Administration’s impact in reducing the effectiveness of enforcement of Title VII’s prohibition against racial and gender discrimination in employment.

67. Guynn & Schrotenboer, *supra* note 32.

68. Katherine Schaeffer, *6 Facts About Economic Inequality in the U.S.*, PEW RSCH. CTR (Feb. 7, 2020), <https://www.pewresearch.org/fact-tank/2020/02/07/6-facts-about-economic-inequality-in-the-u-s/> [<https://perma.cc/355K-NJ7S>].

69. DANA M. PETERSON & CATHERINE L. MANN, CITIGROUP, CLOSING THE RACIAL INEQUALITY GAPS: THE ECONOMIC COST OF BLACK INEQUALITY IN THE U.S. 5 (Sept. 2020), <https://ir.citi.com/%2FPRxPvgNWu319AU1ajGf%2BsKbjJjBJSaTOSdw2DF4xynPwFB8a2jV1FaA3Idy7vY59bOtN2lxVQM%3D> [<https://perma.cc/DZ2R-VA8W>].

inequality by undertaking more assertive and more comprehensive DEI policies that address all the important ways in which corporations affect their workers, consumers, business partners, communities of operation, and society as a whole. These demands are not just for symbolic actions, but for a top-down and bottom-up approach that embeds a commitment to equality in all aspects of corporate conduct.⁷⁰

II. DIVERSITY AND ITS CONNECTION TO SUSTAINABLE FIRM PROFITABILITY AND SHAREHOLDER VALUE

For all of the attention now directed at DEI in corporate America—and, as we shall later see, an increasing legislative and regulatory preoccupation with the diversity of corporate boards—Diversity is not usually talked about in terms of its relationship to long-standing corporate law principles. For those adopting the view of Milton

70. For a sample of some of the specific demands for corporate action and what they entail, see Jennifer Liu, *Companies Are Speaking Out Against Racism, but Here's What it Really Looks Like to Lead an Anti-racist Organization*, CNBC: MAKE IT, <https://www.cnbc.com/2020/06/15/what-it-means-to-be-an-anti-racist-company.html> (last updated June 15, 2020, 1:27 PM) [<https://perma.cc/5EDB-R798>] (urging organizations to acknowledge systemic racism in the workplace and implement changes at all levels); HARRY BAKER, CHLOE SPETALNICK, JONATHAN WILLMOT, KAJOL GUPTA & KEN MERRITT, DAYBLINK CONSULTING, CORPORATE DIVERSITY AND RESPONSES TO THE BLACK LIVES MATTER MOVEMENT 4 (Aug. 2020), <https://www.dayblink.com/corporate-diversity-and-responses-to-the-black-lives-matter-movement/> [<https://perma.cc/G7UD-KRB2>] (analyzing corporate America's response to the Black Lives Matter Movement in the sixty days following George Floyd's death); Peter Eavis, *Want More Diversity? Some Experts Say Reward C.E.O.s for It*, N.Y. TIMES (July 14, 2020), <https://www.nytimes.com/2020/07/14/business/economy/corporate-diversity-pay-compensation.html> [<https://perma.cc/A3W8-2B5P>] (reporting that “just 78 of roughly 3,000 companies said fulfilling diversity goals determined some portion of chief executives’ pay”); Nikhil Bumb, *Corporate Silence and Anti-Racism*, FSG: BLOG (July 2, 2020), <https://www.fsg.org/blog/corporate-silence-anti-racism> [<https://perma.cc/2Z2J-6YRD>] (advocating for meetings as one way to actively create spaces to listen to employees of color, customers of color, and other stakeholders of color, rather than putting the burden on people of color to raise their voices); *Business Roundtable Redefines the Purpose of a Corporation to Promote ‘An Economy That Serves All Americans,’* BUS. ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans> [<https://perma.cc/X9PF-EU7W>] (statement of the Business Roundtable redefining the purpose of a corporation and, in doing so, moving away from shareholder primacy to include a commitment to all stakeholders); Lauren Weber, *Companies Have Promised \$35 Billion Toward Racial Equity. Where Is the Money Going?*, WALL ST. J. (Dec. 21, 2020, 12:14 PM), <https://www.wsj.com/articles/companies-have-promised-billions-toward-racial-equity-where-is-the-money-going-11608570864> [<https://perma.cc/WJB6-SEJ8>] (stating that successful corporate initiatives require CEO commitment, among other things); and Judith Crown, *Supplier Diversity Needs to Focus on Industries of Today and Tomorrow*, CRAI'S CHI. BUS. (Dec. 18, 2020, 7:26 AM), <https://www.chicagobusiness.com/equity/supplier-diversity-needs-focus-industries-today-and-tomorrow> [<https://perma.cc/2FUF-8ECK>] (noting that previous supplier diversity programs “pigeonholed [Black companies] in low-margin endeavors such as janitorial, landscaping, delivery and construction” and arguing that supplier diversity programs must focus on engaging Black companies in higher margin businesses).

For a thoughtful consideration of how society's exclusion of Black Americans and women from full equality may have distorted and narrowed the historical American debate over corporate purpose and the role it should play in the current debate, see Veronica Root Martinez, *A More Equitable Corporate Purpose*, in RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 47 (Elizabeth Pollman & Robert B. Thompson eds., 2021).

Friedman, the pursuit of DEI is most commonly understood as an external matter to the firm, unassociated with shareholder profits, that should be addressed by external regulatory law, not internal corporate action. Notably, this understanding of Diversity is not entirely incongruous with that of many Diversity supporters to the extent to which they view corporate Diversity as part and parcel of social justice and fairness—and not (necessarily) a matter relevant to firm-level performance.⁷¹ Indeed, for some activists, associating Diversity with business concepts like profits inherently cheapens the moral imperative for reform.⁷²

Although we are sensitive to this latter argument and agree entirely with the strong moral imperatives behind Diversity and public law reforms, the case for Diversity has also had a strong business rationale for many years. That rationale has only grown stronger as societal concerns about equity and inclusion have entered the social and political mainstream at a breathtaking pace after last year’s conscience-raising.⁷³ Generational moral moments like the one in which we find ourselves have economic and legal repercussions for corporations which, as we highlight later in the Article, also offer a corresponding scope for moral action protected by the business judgment rule, especially when that action also makes good business sense.

But first, in this Part, we canvass the most cited building blocks of the business case for Diversity and its connection to firm success and long-term value. We start with a survey of the empirical research associating Diversity with financial performance and find a mixed picture, albeit one that is still important for corporate decisionmakers considering whether and to what extent to focus on DEI. We then turn our analysis to comparatively stronger qualitative and analytical arguments from the long-running literature in organizational psychology identifying cognitive diversity (and Diversity more generally) as a key ingredient for cognitively “smart” businesses. We then end with what is, in our view, the easiest way to understand the business argument for Diversity—its impact on the corporation’s reputation with regulators and key stakeholders and, by extension, on its cost of capital, access to talent and business partners, and its

71. See Aaron A. Dhir, *Towards a Race and Gender-Conscious Conception of the Firm: Canadian Corporate Governance, Law and Diversity*, 35 QUEEN’S L.J. 569, 591–99 (2010) (noting that some scholars contest the argument that diversity increases firm performance); Lisa M. Fairfax, *The Bottom Line on Board Diversity: A Cost-Benefit Analysis of the Business Rationales for Diversity on Corporate Boards*, 2005 WIS. L. REV. 795, 798–99 (noting that where rationales for diversity move away from moral or social justifications, those rationales may be wrongly interpreted as an acknowledgment of the illegitimacy of moral and social justifications).

72. Dhir, *supra* note 71, at 601 (“[B]y validating diversification initiatives with reference to wealth aggregation, the implication is that the worth of these efforts is contingent on stock value.”).

73. See BAKER ET AL., *supra* note 70, at 2 (explaining how today’s modern civil rights movement has been coined “Great White Awakening” and given corporations the opportunity to make tangible efforts towards DEI).

attractiveness to customers. Taken in total, this Part details what is most critical for the connection between corporate law and DEI: the rational basis for business leaders to conclude that attention to good DEI practices makes good business sense in terms of improving the likelihood that a corporation will be sustainably profitable.

A. The Empirical Debate

We start first with the numbers. Although Diversity has not been a focus of critical inquiry within corporate law, it has attracted substantial interest from scholars interested in its impact on the financial performance of businesses. This literature is extensive and can be summarized, albeit somewhat crudely, into two categories: (a) recent studies from a growing number of researchers whose work suggests that diversity has a positive impact on financial performance; and (b) studies, typically less recent, that find the evidence to be more ambiguous, or even conflicted. We begin with examples from the first category.

Some of the most highly cited work finding a positive relationship between Diversity and investment has come from top-tier financial services firms and consultants. The Carlyle Group, for example, has observed that its portfolio companies that had two or more diverse directors—defined as female, Black, Hispanic, or Asian—had on average earnings growth of 12.3% over the previous three years, compared to 0.5% among portfolio companies with no diverse directors.⁷⁴ McKinsey, too, has found that corporations with the most ethnically diverse executive teams are 33% more likely to outperform corporations than the least ethnically diverse teams in terms of profitability.⁷⁵ Similarly, a Citi report found that companies in the top quartile for both gender and ethnic diversity are 12% more likely to be more profitable than companies in the lower quartiles and that the gap increased by 36% compared to companies in the fourth quartile.⁷⁶ In addition to Diversity, Deloitte's research highlights the importance of Inclusion, which it describes as the feeling of being treated “equitably and with respect” and “feeling valued and belonging,”⁷⁷ in increasing

74. Jason M. Thomas & Megan Starr, *Global Insights: From Impact Investing to Investing for Impact*, CARLYLE GRP. 5 fig.5 (Feb. 24, 2020), https://www.carlyle.com/sites/default/files/2020-02/From%20Impact%20Investing%20to%20Investing%20for%20Impact_022420.pdf [<https://perma.cc/4P4C-A7Z2>] (analyzing Carlyle U.S. portfolio company data).

75. VIVIAN HUNT, SARA PRINCE, SUNDIATU DIXON-FYLE & LAREINA YEE, *DELIVERING THROUGH DIVERSITY*, MCKINSEY & CO. 1 (Jan. 2018), https://www.mckinsey.com/~media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity_full-report.ashx [<https://perma.cc/9JR7-MT76>].

76. PETERSON & MANN, *supra* note 69, at 36.

77. Juliet Bourke & Bernadette Dillon, *The Diversity and Inclusion Revolution: Eight Powerful Truths*, DELOITTE REV., Jan. 2018, at 82, 86.

performance.⁷⁸ The research finds that organizations with inclusive cultures are twice as likely to meet or exceed financial goals, three times as likely to be high performing, six times more likely to be innovative, and eight times more likely to achieve better business outcomes.⁷⁹

Perhaps the largest body of research has focused on gender.⁸⁰ Credit Suisse's Research Institute has, for example, found over a series of studies that companies with at least one woman on the board had on average a sector-adjusted return on equity of 12.2%, compared to 10.1% for companies with no female directors.⁸¹ It also found in 2013 price-to-book values of 2.4x for companies with female representation on their boards versus only 1.8x for those without, and a nine-year average for boards with women directors of 2.3x versus only 1.8x for companies with all-male boards.⁸² Similarly, MSCI observed in an analysis of director seats held by women over a five-year period in four global indexes that once U.S. companies achieved a "tipping point" of at least three women on their board, they experienced median gains in return on equity of 10% and earnings per share of 37%.⁸³ Meanwhile, companies that had no female directors showed reductions in return on equity of -1%, and reductions of -8% in EPS over the same five-year period.⁸⁴ Catalyst, a nonprofit advocacy group, likewise found in a series of reports comparing groups of firms that differed in the gender diversity of their corporate boards that companies with three or more women on their boards outperformed companies with none by 46% in terms of their return on equity.⁸⁵ Other industry studies make similar claims.⁸⁶

78. *Id.* at 85.

79. *Id.*

80. This is in part, we suspect, because of the seemingly boundless data available to be culled: women are, after all, everywhere, and in greater numbers than, say, African Americans, who may be concentrated in a few select countries.

81. JULIA DAWSON, RICHARD KERSLEY & STEFANO NATELLA, CREDIT SUISSE, THE CS GENDER 3000: WOMEN IN SENIOR MANAGEMENT 16 (Sept. 2014), <https://www.calpers.ca.gov/docs/diversity-forum-credit-suisse-report-2015.pdf> [<https://perma.cc/Y7BR-QJ9J>].

82. *Id.*

83. MEGGIN THWING EASTMAN, DAMION RALLIS & GAIA MAZZUCHELLI, MSCI, THE TIPPING POINT: WOMEN ON BOARDS AND FINANCIAL PERFORMANCE 6 (Dec. 2016), <https://www.msci.com/documents/10199/fd1f8228-cc07-4789-acee-3f9ed97ee8bb> [<https://perma.cc/A4GS-X5EU>] (analyzing U.S. companies that were constituents of the MSCI World Index for the entire period from July 1, 2011 to June 30, 2016).

84. *Id.*

85. Nancy M. Carter & Harvey M. Wagner, *The Bottom Line: Corporate Performance and Women's Representation on Boards (2004-2008)*, CATALYST 1-2 (2011), https://www.catalyst.org/wp-content/uploads/2019/01/the_bottom_line_corporate_performance_and_womens_representation_on_boards_2004-2008.pdf [<https://perma.cc/LNC2-WTM2>] (analyzing gender diversity data from Catalyst's annual Fortune 500 Census of Women Board Directors report series for the years 2005 to 2009, and corresponding financial data from Standard & Poor's Compustat database for the years 2004 to 2008).

86. In 2020, McKinsey found "a positive, statistically significant correlation between company financial outperformance and [board] diversity, on the dimensions of both gender and

Some research from the academy has echoed these findings. A Harvard study found that venture capital firms that increased their proportion of female partner hires by 10% saw, on average, a 1.5% spike in overall fund returns each year and had 9.7% more profitable exits—a deceptively impressive figure given that only 28.8% of all VC investments have a profitable exit.⁸⁷ Meanwhile, other studies from scholars at Oklahoma State University have found significant positive relationships between the fraction of women or minorities on the board and firm value after controlling for size, industry, and other corporate governance measures of Fortune 1000 firms.⁸⁸ Yet another inquiry studying performance data and the percentage of women and minorities on boards of directors for 127 large U.S. companies in 1993 and 1998 found the percentage of Caucasian females plus ethnic minority directors on the board to be positively related to both return on equity and return on assets.⁸⁹

But, as we highlighted, a second set of studies exists that has not found the same positive empirical results. For example, an international team of academic researchers in Germany found in a meta-analysis of literature from twenty studies covering 3,097 companies that female representation on corporate boards has a “small and non-significant” relationship with a company’s financial performance.⁹⁰ Moreover, they found that firm financial performance is not directly related, but depends on moderators, such as board size or

ethnicity,” with companies in the top quartile for board gender diversity “28 percent more likely than their peers to outperform financially,” and a statistically significant correlation between board gender diversity and outperformance on earnings before interest and taxation margin. VIVIAN HUNT, SUNDIATU DIXON-FYLE, SARA PRINCE & KEVIN DOLAN, MCKINSEY & CO., DIVERSITY WINS: HOW INCLUSION MATTERS 13, 48 (May 19, 2020), <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters> [<https://perma.cc/6Y4K-W2RL>] (analyzing 1,039 companies across fifteen countries for the period from December 2018 to November 2019).

In 2019, Moody’s found that greater board gender diversity is associated with higher credit ratings, with women accounting for an average of 28% of board seats at Aaa-rated companies but less than 5% of board seats at Ca-rated companies. Press Release, Moody’s Invs. Serv., Corporate Board Gender Diversity Associated with Higher Credit Ratings (Sept. 11, 2019), https://www.moody.com/research/Moodys-Corporate-board-gender-diversity-associated-with-higher-credit-ratings-PBC_1193768 [<https://perma.cc/YQ3L-V97C>] (analyzing 1,109 publicly traded North American companies rated by Moody’s).

87. Paul Gompers & Silpa Kovvali, *The Other Diversity Dividend*, HARV. BUS. REV., July–Aug. 2018, at 72, 75.

88. See, e.g., David A. Carter, Frank D’Souza, Betty J. Simkins & W. Gary Simpson, *The Diversity of Corporate Board Committees and Firm Financial Performance* 26 (Mar. 15, 2007) (unpublished manuscript), <http://ssrn.com/abstract=972763> [<https://perma.cc/3AJU-8QXH>]; see also David A. Carter, Betty J. Simkins & W. Gary Simpson, *Corporate Governance, Board Diversity, and Firm Value*, 38 FIN. REV. 33, 50–51 (2003) (finding that Tobin’s Q is positively related to both the percentage of female directors and the percentage of minority directors).

89. Niclas L. Erhardt, James D. Werbel & Charles B. Shrader, *Board of Director Diversity and Firm Financial Performance*, 11 CORP. GOVERNANCE 102, 107–08 (2003).

90. Jan Luca Pletzer, Romina Nikolova, Karina Karolina Kedzior & Sven Constantin Voelpel, *Does Gender Matter? Female Representation on Corporate Boards and Firm Financial Performance—A Meta-Analysis*, 10 PLOS ONE 1, 1, 13 (2015).

the time of data collection.⁹¹ Similarly, another team (including one of the Oklahoma researchers who had previously observed a positive relationship in terms of gender and firm value) found in its analysis of 541 S&P 500 companies from 1998 to 2002 that financial performance had no relationship to gender diversity or ethnic minority diversity, positive or negative, when Tobin's Q was used as the measure of financial performance.⁹²

Other studies offer more nuanced appraisals and are at times highly critical of the methodologies employed in the studies cited by Diversity advocates. Alice Eagly, in particular, has criticized studies like those produced by Catalyst and Credit Suisse for not revealing the strength of the relation between the participation of women and financial success and for lacking correlations relating the percentages of women on corporate boards to corporate outcomes or simple scatter plots of the relationships.⁹³ She also criticizes early studies for not raising questions about reverse causation from financial success to the inclusion of women and possible confounding of the percentage of women on boards with omitted variables.⁹⁴ Consequently, a number of unacknowledged correlations could be driving the data such as company resources derived from performance and an ability to invest in diversity.⁹⁵ Along similar lines, Renee B. Adams and Daniel Ferreira criticize previous studies that are not robust to endogeneity and find in their analysis of nearly two thousand S&P mid- and small caps from 1996 to 2003 that gender diversity can add to shareholder value, but generally only where governance is weak.⁹⁶ Likewise, Corrine Post and Kris Byron find a “near zero” relationship with a company's market performance, but a positive relationship with a company's accounting

91. *Id.*

92. David A. Carter, Frank D'Souza, Betty J. Simkins & W. Gary Simpson, *The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance*, 18 CORP. GOVERNANCE 396, 410 (2010) (analysis of 541 S&P 500 companies for the years 1998–2002).

93. Alice H. Eagly, *When Passionate Advocates Meet Research on Diversity, Does the Honest Broker Stand a Chance?*, 72 J. SOC. ISSUES 199, 200–02 (2016) (noting that few researchers of the connection between diversity and firm performance have addressed endogeneity in a manner that allows claims about causation).

94. *Id.* at 202.

95. For an overview and commentary, see AARON DHIR, CHALLENGING BOARDROOM HOMOGENEITY: CORPORATE LAW, GOVERNANCE, AND DIVERSITY (2015); Lissa Lamkin Broome & Kimberly D. Krawiec, *Signaling Through Board Diversity: Is Anyone Listening?*, 77 U. CIN. L. REV. 431, 432–33 nn.2–6 (2008) (reviewing studies); Dhir, *supra* note 71, at 591–99 (same); and Sabina Nielsen, Morten Huse, Alessandro Minichilli & Alessandro Zattoni, *Board Diversity and Firm Performance: An Empirical Investigation of the Mediating Effects of Board Processes and Task Performance*, ACAD. MGMT. PROC., no. 1, Aug. 2008.

96. Renée B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. FIN. ECON. 291, 291 (2009) (analyzing 1,939 S&P 500, S&P MidCaps, and S&P SmallCap companies for the period 1996 to 2003, measuring company performance by a proxy for Tobin's Q (the ratio of market value to book value) and return on assets).

returns.⁹⁷ The U.S. Government Accountability Office, meanwhile, has concluded that the mixed nature of various academic studies may be due to differences in methodologies, data samples, and time periods.⁹⁸

Conflicting assessments like these can invite paralysis and uncertainty and thus it is easy, but we think wrong, to interpret the overall direction of the literature as collectively taking the conversation on Diversity “nowhere.” Working with incomplete and imperfect data is the job of most corporate leaders (and, apparently, academics).⁹⁹ CEOs and boards make decisions every day with very little information, and often without the benefits of charts or regressions, whatever their statistical or scientific robustness. And in doing so, they take whatever data are available, discount them, and apply that information to the particulars of the firm they manage, and then act. That is why, in large part, the business judgment rule exists: to ensure that business leaders can proceed with confidence that their good faith decisions in a world of uncertainty are not second-guessed in litigation with the counterproductive effect of deterring them from managing their businesses in an effective manner.¹⁰⁰

From this standpoint, it is worthwhile noting that there are *several* studies suggesting that, at a minimum, diversity *may* have a positive impact on the financial operations of a company. And CEOs and boards are, in a world of incomplete information, entitled to also take into account the studies by firms—paid to assist them in making their companies more profitable—that take the clear position that effective DEI policies are positively associated with protecting and improving firm value. This may not mean much to academics, who may

97. Corinne Post & Kris Byron, *Women on Boards and Firm Financial Performance: A Meta-Analysis*, 58 ACAD. MGMT. J. 1546, 1558–59 (2014). In 2016, the same authors, based on a review of the results for eighty-seven studies, found a weak but significantly positive correlation between board gender diversity and corporate social responsibility. See Corinne Post & Kris Byron, *Women on Boards of Directors and Corporate Social Performance: A Meta-Analysis*, 24 CORP. GOVERNANCE 428 (2016). Commentators have cautioned, however, that “a significant correlational relationship does not prove causality.” *Research Review: Does Gender Diversity on Boards Really Boost Company Performance?*, KNOWLEDGE@WHARTON (May 18, 2017), <https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance/> [https://perma.cc/WB82-VN8N].

98. U.S. GOV’T ACCOUNTABILITY OFF., GAO-16-30, CORPORATE BOARDS: STRATEGIES TO ADDRESS REPRESENTATION OF WOMEN INCLUDE FEDERAL DISCLOSURE REQUIREMENTS 5 (2015), <https://www.gao.gov/assets/680/674008.pdf> [https://perma.cc/4XTG-Z5HF] (noting that research on the impact of gender diversity on firms is “mixed,” due in part to “differences in how financial performance was defined and what methodologies were used”).

99. See Jens Frankenreiter, Cathy Hwang, Yaron Nili & Eric Talley, *Cleaning Corporate Governance*, 170 U. PA. L. REV. (forthcoming 2021) (manuscript at 2), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3796628 [https://perma.cc/5CZ3-DV8R] (noting that “several of the most heavily relied-upon governance datasets suffer from inaccuracies so extensive as to call into question some of the landmark insights of the field”).

100. *E.g.*, Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 313–14 (Del. 2015) (“[J]udges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders).”).

consider the views of business consultants and investment banks to lack empirical rigor, especially when contrary evidence may also exist. But it is important for decisionmakers and, for that matter, for the operation of corporate law—a point we will return to in our detailed discussion later of the business judgment rule. For now, suffice it to say when faced with the body of the empirical work done thus far, a CEO and board could rationally conclude that, whatever the literature's weaknesses, it shows that a business case for Diversity is present. And the ability for the CEO and the board to do so rationally has enormous stakes for the legal protections and discretion that they will have in terms of the actions taken on that assessment.

Of course, corporate policy cannot be made in a vacuum consisting of only statistically validated and replicated studies that dictate with certainty the direction to take. Corporate leaders cannot wait for an academic consensus about a complex issue in a fast-changing world in which action is required in the here and now. They are expected to make the best judgment they can based on the information available to them, however imprecise and imperfect. In that calculus, they may also consider factors rationally contributing to the business case for Diversity, Equity, and Inclusion learned through lived experience, both as citizens and business professionals.

B. Governance and Risk Management

In a world of limited quantitative evidence, analytical arguments bolstered by organizational theory and case studies have emerged as important building blocks substantiating the business case for Diversity. For decades, organizational psychologists have held that cognitive diversity, properly constructed, can lead to superior problem solving and execution in groups and businesses.¹⁰¹ Cognitive diversity

101. Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363, 1391 (2002). The organizational literature has long suggested that heterogeneous groups tend to improve the quality of thinking where complex decisionmaking requires creativity and judgment. See Taylor H. Cox, Sharon A. Lobel & Poppy Lauretta McLeod, *Effects of Ethnic Group Cultural Differences on Cooperative and Competitive Behavior on a Group Task*, 34 ACAD. MGMT. J. 827, 839 (1991) (finding higher levels of cooperation by groups with more ethnic diversity); Janet A. Sniezek & Rebecca A. Henry, *Accuracy and Confidence in Group Judgment*, 43 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 1, 20 (1989) (finding that “[t]he more disagreements that group members reported, the more accurate were their group judgments”); David Rock & Heidi Grant, *Why Diverse Teams Are Smarter*, HARV. BUS. REV. (Nov. 4, 2016), <https://hbr.org/2016/11/why-diverse-teams-are-smarter> [<https://perma.cc/DUY7-XRY5>] (“In a nutshell, enriching your employee pool with representatives of different genders, races, and nationalities is key for boosting your company’s joint intellectual potential.”). See generally Susan E. Jackson, *Consequences of Group Composition for the Interpersonal Dynamics of Strategic Issue Processing*, 8 ADVANCES STRATEGIC MGMT. 345, 354–56 (1992) (discussing group composition and its relation to issue processing); ALAN C. FILLEY & ROBERT J. HOUSE, *MANAGERIAL PROCESS AND ORGANIZATIONAL BEHAV.* 115–16 (1969) (explaining how “decisions are made within the unique frame of reference or ‘psychological set’ of the decisionmaker”).

can be understood as the variance among people in terms of their perspective and how they process information—whether it be in terms of decisionmaking, conflict resolution, problem analysis, or problem solving.¹⁰² It is not necessarily predicted by factors such as gender, ethnicity, or age, though each of those factors can and often do shape the ways members of that group process information as compared to others outside the group.¹⁰³

One of the most popular case applications for cognitive diversity in the business literature is in corporate governance. Corporate governance manages the conflicts that arise among shareholders, boards, and managers. In doing so, it enables an efficient flow of information and rigor among decisionmakers,¹⁰⁴ increases transparency and accountability so that performance is rewarded and poor performance addressed,¹⁰⁵ and ensures that operations align with the company's mission. Governance is perhaps most commonly associated with divisions of power between corporate managers and owners. But it is not, however, only a structural feature of corporate operations. It also includes the safeguards embedded in a firm's approach to addressing all the complex issues that arise when human beings collaborate and when there is the potential for some to gain at the expense of the larger enterprise, a subject some refer to as managing human capital.¹⁰⁶ For example, corporate boards are largely required to have a minimum number of independent directors alongside inside directors. The idea is that independent directors are more likely to be impartial and vigilant in monitoring C-suite actions than are corporate insiders with dual roles as executives and directors.¹⁰⁷ Not only are they able to bring their own expertise to bear, but the logic says that they will be less directly beholden to the CEO in terms of their careers and livelihoods.

102. Alison Reynolds & David Lewis, *Teams Solve Problems Faster When They're More Cognitively Diverse*, HARV. BUS. REV. (Mar. 30, 2017), <https://hbr.org/2017/03/teams-solve-problems-faster-when-theyre-more-cognitively-diverse> [<https://perma.cc/JBJ4-4SBW>].

103. Rachel D. Godsil, *Why Race Matters in Physics Class*, 64 UCLA L. REV. DISCOURSE 40, 47–49 (2016).

104. Maria Aluchna & Tomasz Kuszewski, *Does Corporate Governance Compliance Increase Company Value? Evidence from the Best Practice of the Board*, 13 J. RISK & FIN. MGMT., Oct. 2020, at 14 (showing “a negative correlation between compliance with the code provisions on board practice and company value, . . . suggesting that investors do not find the adoption of board practice a plausible solution for the principal-principal conflict in an environment of concentrated ownership”).

105. *Id.*

106. Our own preference is to refer to human beings who labor for corporations as workers or employees, but we understand the business reason for the term.

107. Gregorio Sánchez-Marín, J. Samuel Baixauli-Soler & M. Encarnación Lucas-Pérez, *When Much Is Not Better? Top Management Compensation, Board Structure and Performance in Spanish Firms*, 21 INT'L J. HUM. RES. MGMT. 2778, 2792–93 (2010) (finding that, generally, “when the percentage of outsider directors is higher, the earnings of top managers are lower[, which] indicate that it is positive to allow the board greater independence through the inclusion of outsiders, so limiting the discretionary power of the top management team and moderating its earnings”).

Similarly, cognitive diversity—and, for that matter, Diversity—is often understood as a human-capital-based governance mechanism premised on the usefulness of “outsider” perspectives and interests. Most commonly, it is associated with reducing the social pathology of groupthink.¹⁰⁸ Groupthink is a phenomenon that arises when the urge to conform or the belief that dissent is itself harmful or unproductive leads a group of well-intentioned people to make irrational or non-optimal decisions.¹⁰⁹ In such circumstances, premature consensus and decisionmaking can arise as individuals self-censor their true opinions or ideas, and therefore the group accumulates few or no dissenting views.¹¹⁰

Groupthink is often explored in the context of corporate boards, where members may feel pressure to agree with one another or with the CEO.¹¹¹ In its classic iteration, members may not offer perspectives necessary for the board to achieve the corporation’s strategic interests or maximize shareholder value.¹¹² Instead, they submit themselves to the influence of an autocratic CEO/Chairman, or find themselves influenced by peer pressure inside the group.¹¹³ As a result, board members either succumb to apathy and simply go through the motions,

108. Irving Janis first defined “groupthink” in 1972 as “a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members’ strivings for unanimity override their motivation to realistically appraise alternative courses of action.” IRVING L. JANIS, *VICTIMS OF GROUPTHINK: A PSYCHOLOGICAL STUDY OF FOREIGN-POLICY DECISIONS AND FIASCOES 9* (1972). This, in turn, may lead to “incredibly gross miscalculations about both the practical and moral consequences of their decisions.” *Id.* at iv.

109. *Groupthink*, PSYCH. TODAY, <https://www.psychologytoday.com/us/basics/groupthink> (last visited Sept. 12, 2021) [<https://perma.cc/33XC-6WNT>].

110. Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24 ACAD. MGMT. REV. 489, 497–500 (1999) (developing a model that links board demography with firm performance); see also Letter from Anne Simpson et al., Dir. of Glob. Governance, Cal. Pub. Emps. Ret. Sys., to Elizabeth M. Murphy, Sec’y, SEC (Mar. 31, 2015), <https://www.sec.gov/rules/petitions/2015/petn4-682.pdf> [<https://perma.cc/7RRV-W4BR>] (letter from several state investment and pension plans to the Securities and Exchange Commission stating that diverse boards are beneficial because they “raise different ideas and encourage a full airing of dissenting views”).

111. But, as discussed below, psychologists examine groupthink in much more varied situations, and the issue is widely understood even in a corporate context to be one that can undermine decisionmaking from high-level executives to frontline workers. See, e.g., Marleen A. O’Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1257–93 (2003) (analyzing directors’ role in the Enron scandal to illustrate how intelligent individuals can succumb to cognitive biases prevailing in corporate cultures); Melanie B. Leslie, *Helping Nonprofits Police Themselves: What Trust Law Can Teach Us About Conflicts of Interest*, 85 CHI.-KENT L. REV. 551, 564 (2010) (discussing the unique dangers of groupthink in nonprofits); Melissa L. Breger, *Making Waves or Keeping the Calm?: Analyzing the Institutional Culture of Family Courts Through the Lens of Social Psychology Groupthink Theory*, 34 LAW & PSYCH. REV. 55, 67–82 (2010) (analyzing the institutional culture of family courts through the lens of groupthink).

112. Antoine Canet, *Groupthink in the Boardroom: The Good, the Bad and the Ugly 3* (June 10, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2839855 [<https://perma.cc/WX4D-6MWF>] (examining the phenomenon of groupthink in a corporate setting).

113. *Id.*

or hubris comes to define their collective decisionmaking such that members believe every decision they make as a group will indubitably foster positive results.¹¹⁴

Against this backdrop, researchers have identified cognitive diversity, under the proper circumstances, as a prophylactic for groupthink pathologies. In culturally homogenous spaces, Diversity can help introduce competing interests, ideas, values, and perspectives into a more creative and higher quality decisionmaking process. When faced with complex strategic issues necessitating out-of-the-box thinking, cognitively diverse groups will be able to leverage a broader range of information and possible solutions for consideration than homogeneous groups.¹¹⁵ And where a board captured by groupthink may cut off early dialogue and questioning, a Diverse board, comprised of different personal, professional, and social backgrounds, might instead test hypotheses and policies brought up by managers and subject all ideas generated in the group to more rigorous review.¹¹⁶ This in turn can lead to vastly different interpretations of data points, along with more nuanced debate and consideration of alternative strategies and courses of action.¹¹⁷ Researchers consequently find that Diversity can lead to more communication on boards¹¹⁸ and even more accountability of management.¹¹⁹ Similarly, within the organization, diverse opinions

114. PSYCH. TODAY, *supra* note 109.

115. Jackson, *supra* note 101, at 361.

116. This observation has been made in the greater finance literature as well, where stock picking is viewed as at times highly complex art involving complex considerations. In one highly cited series of experiments conducted in Texas and Singapore, scientists put financially literate people in simulated markets and asked them to price stocks. The participants were placed in either ethnically diverse or homogenous teams. The researchers found that individuals who were part of the diverse teams were 58% more likely to price stocks correctly. Sheen S. Levine, Evan P. Apfelbaum, Mark Bernard, Valerie L. Bartelt, Edward J. Zajac & David Stark, *Ethnic Diversity Deflates Price Bubbles*, 111 PNAS 18524, 18528 (2014).

117. “Heterogeneous groups often invest more time resolving issues that require creativity and consensus building because of their members’ diverse vocabularies, paradigms, and possible objectives.” Dallas, *supra* note 101, at 1396; *see also* Donald C. Hambrick, Theresa Seung Cho & Ming-Jer Chen, *The Influence of Top Management Team Heterogeneity on Firms’ Competitive Moves*, 41 ADMIN. SCI. Q. 659, 660–82 (1996) (arguing heterogeneity enhances a variety of competitive behaviors). Variations of this theme have been echoed in the psychology literature, suggesting that such productive cognitive rigor can arise in settings well beyond the boardroom. For example, in a study published in the *Journal of Personality and Social Psychology*, scientists assigned two hundred people to six-person mock jury panels whose members were either all white or included four white and two Black participants. The people were shown a video of a trial of a Black defendant and white victims. They then had to decide whether the defendant was guilty. On diverse panels, white participants raised more facts related to the case than homogenous panels and made fewer factual errors while discussing available evidence. If errors did occur, they were more likely to be corrected during deliberation. One possible reason for this difference was that white jurors on diverse panels recalled evidence more accurately. Samuel R. Sommers, *On Racial Diversity and Group Decision Making: Identifying Multiple Effects of Racial Composition on Jury Deliberations*, 90 J. PERSONALITY & SOC. PSYCH. 597, 600–01, 606–07 (2006).

118. Dallas, *supra* note 101, at 1391 (suggesting that “heterogeneous groups share conflicting opinions, knowledge, and perspectives that result in a more thorough consideration of [policy]”).

119. Studies have, for example, found that the presence of gender diversity can lead to a more intense focus on whether management is improving the company’s profitability and stock price.

and perspectives can power reflection and critical thinking on the front lines of executing corporate policy.

Empirical evidence has also emerged that Diversity can serve as a useful risk mitigation tool.¹²⁰ Studies have argued that Diverse firms, especially those displaying gender Diversity on their boards, adopt less risky financial policies than their homogeneous counterparts.¹²¹ Researchers have also compiled data suggesting that gender Diversity is correlated with a lower likelihood of illegal and fraudulent behavior, fewer irregularities, and less opacity and vagueness in public filings and disclosure.¹²² Here again, Diversity may play a role through alternative explanations. It is possible that firms with resources to invest in gender Diversity may also have the resources (and inclination) to invest in compliance¹²³ or that women, as members of underrepresented groups, are more likely to have arm's-length relationships with CEOs and management, prompting more rigorous scrutiny of financial reports and policy.¹²⁴

Perhaps a more direct role for cognitive diversity is in the area of employment, where a commitment to good DEI practices can also

See, e.g., Maria Encarnación Lucas-Pérez, Antonio Mínguez-Vera, Juan Samuel Baixauli-Soler, Juan Francisco Martín-Ugedo & Gregorio Sánchez-Marín, *Women on the Board and Managers' Pay: Evidence from Spain*, 129 J. BUS. ETHICS 265, 278 (2014) (noting that gender diversity on boards is associated with connecting executive pay to company performance); *see also* Adams & Ferreira, *supra* note 96, at 292 (finding that "more diverse boards are more likely to hold CEOs accountable for poor stock price performance").

120. Gennaro Bernile, Vineet Bhagwat & Scott Yonker, *Board Diversity, Firm Risk, and Corporate Policies*, 127 J. FIN. ECON. 588, 602–03, 608 (2018) (stating that homogeneity of preferences and views among board members could lead to idiosyncratic decisions, free of scrutiny within the board). Results of this study indicate that both operating performance and asset valuation increase with board diversity, and the benefits of diverse perspectives among directors outweigh the potential costs.

121. *Id.*

122. A study conducted by Cumming, Leung, and Rui in 2015 found that the presence of women on boards was correlated with lower likelihood of securities fraud, and lower severity of securities fraud, in Chinese capital markets. Douglas Cumming, T.Y. Leung & Oliver Rui, *Gender Diversity and Securities Fraud*, 58 ACAD. MGMT. J. 1572, 1585–87 (2015). In another study, gender diversity was correlated with more transparency in terms of public disclosure. Ferdinand A. Gul, Bin Srinidhi & Anthony C. Ng, *Does Board Gender Diversity Improve the Informativeness of Stock Prices?*, 51 J. ACCT. & ECON. 314, 336 (2011). Along similar lines, researchers have found that companies with women directors commit fewer financial reporting mistakes and have fewer "irregularity-type [financial] restatements, which tend to be indicative of financial manipulation." Aida Sijamic Wahid, *The Effects and the Mechanisms of Board Gender Diversity: Evidence from Financial Manipulation*, 159 J. BUS. ETHICS 705, 721 (2019).

123. Wahid, *supra* note 122, at 722.

124. The management literature has found, for example, that gender-diverse boards "engage in better discussions because women are more willing to discuss issues which seem unpalatable to an all-male board." Yu Chen, John D. Eshleman & Jared S. Soileau, *Board Gender Diversity and Internal Control Weaknesses*, 33 ADVANCES ACCT. 11, 13 (2016). Diverse boards may as a result exhibit fewer information asymmetries and as such provide fewer routes for company insiders to engage in opportunistic behavior prior to public disclosure of material information. *See* Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity, 85 Fed. Reg. 80,472, 80,498–99 (Dec. 11, 2020).

help reduce the likelihood of risks that can arise in the context of employment discrimination. In 2019 alone, the EEOC reported 23,976 lawsuits on the basis of race and 23,532 claims of gender-based discrimination.¹²⁵ The average employment lawsuit costs a company \$200,000, of which \$80,000 goes to the employer's attorneys' fees, \$80,000 for the employee's attorneys' fees, and \$40,000 in settlement to the employee.¹²⁶ Moreover, employment discrimination can attract the kind of publicity and community activism that may negatively affect firm value through negative reputational feedback loops, a lesson learned by commercial giants like Texaco, Coca-Cola—and most recently, Tesla.¹²⁷

Employment discrimination may be less likely where there is a strong culture of inclusion and a highly Diverse workforce. Scholars have noted that initial reactions to allegations of racial discrimination can be defensive, precluding meaningful discussion of the harmful conduct or racial equity matters more generally.¹²⁸ Diverse corporate staff with experience in addressing such frustrations can minimize this risk. And to the extent to which DEI policies are written, reviewed, and implemented by individuals with diverse personal backgrounds and expertise in Diversity, they are more likely to be effective from the standpoints of both firm culture and liability-reducing mechanisms.

A similar logic is easily applied to many other situations involving racially insensitive and illegal behavior. By way of example, some major companies have faced both criticism and lawsuits for unlawful environmental practices because they have located operations that generate the most hazardous pollutants to human health in Black

125. Press Release, U.S. Equal Emp. Opportunity Comm'n, EEOC Releases Fiscal Year 2019 Enforcement and Litigation Data (Jan. 24, 2020), <https://www.eeoc.gov/newsroom/eeoc-releases-fiscal-year-2019-enforcement-and-litigation-data> [<https://perma.cc/LG7F-W7Y4>]. For a comprehensive list of summaries of significant cases regarding race and color discrimination brought by the EEOC, see *Significant EEOC Race/Color Cases (Covering Private and Federal Sectors)*, U.S. EQUAL EMP. OPPORTUNITY COMM'N, <https://www.eeoc.gov/initiatives/e-race/significant-eeoc-racecolor-casescovering-private-and-federal-sectors> (last visited Dec. 30, 2021) [<https://perma.cc/YPK6-6A9U>].

126. *What is the Average Employee Lawsuit Cost to a Company Business?*, NAKASE L. FIRM, <https://nakaselawfirm.com/employer-lawyer-employer-defense-attorney-near-me/what-is-the-average-employee-lawsuit-cost-to-a-company-business/> (last visited Dec. 30, 2021) [<https://perma.cc/K47P-2FLT>].

127. Cheryl L. Wade, *Racial Discrimination and the Relationship Between the Directorial Duty of Care and Corporate Disclosure*, 63 U. PITT. L. REV. 389, 395–97 (2002); see also Joe Hernandez, *Tesla Must Pay \$137 Million to a Black Employee Who Sued for Racial Discrimination*, <https://www.npr.org/2021/10/05/1043336212/tesla-racial-discrimination-lawsuit> (last updated Oct. 5, 2021, 1:56 PM) [<https://perma.cc/C9XC-VWX8>].

128. Wade, *supra* note 127, at 395–97; see also Jennifer S. Lerner & Philip E. Tetlock, *Accounting for the Effects of Accountability*, 125 PSYCH. BULL. 255, 257 (1999) (noting that accountability leads people to overrationalize the rightness of actions to which they are committed); Donald C. Langevoort, *Cultures of Compliance*, 54 AM. CRIM. L. REV. 933, 969 (2017) (noting how assignments of blame often lead to intense denial and defensive bolstering, making them seem unfair by the individual receiving the criticism).

neighborhoods and other communities with poorer populations.¹²⁹ Likewise, major financial institutions have been criticized for selective lending and banking practices that disadvantage Black consumers, practices that can also expose them to liability under federal and state statutes such as the Fair Housing Act (“FHA”) and the Equal Credit Opportunity Act (“ECOA”).¹³⁰ Even industries that the public largely approves of—like grocery chains—have faced adverse publicity for failing to serve urban communities of color and rural communities in poverty, thus depriving those communities of access to healthy, quality

129. Recently, the State of New Jersey filed twelve lawsuits against corporations, including Unilever, whose actions allegedly disproportionately harmed the health and safety of minority and lower-income communities. Press Release, Dep’t of L. & Pub. Safety, N.J. Off. of the Att’y Gen., Attorney General, DEP File 12 New “Environmental Justice” Lawsuits Targeting Polluters in New Jersey’s Lower-Income and Minority Communities (Aug. 27, 2020), <https://www.nj.gov/oag/newsreleases20/pr20200827b.html> [<https://perma.cc/TEP2-MPHY>]. In San Francisco, three environmental groups filed a lawsuit against Corteva, formerly owned by Dow Chemical, alleging that the company’s plant violated hazardous waste laws, contributing to the high levels of asthma and cardiovascular disease of the residents in the mostly Black and Latino communities near the plant. Press Release, Env’t Integrity Project, Groups File Federal Lawsuit Against Chemical Plant for Violating Hazardous Waste Laws (Dec. 19, 2019), <https://environmentalintegrity.org/news/groups-file-federal-lawsuit-against-chemical-plant-for-violating-hazardous-waste-laws/> [<https://perma.cc/4CQX-B4BG>]. Residents near a Marathon refinery in Detroit sued Marathon Oil Corporation and Marathon Petroleum Corporation, alleging air, noise, and odor pollution from the refinery. Virginia Gordan, *Residents Sue Marathon Refinery over Pollution*, MICH. RADIO (Feb. 23, 2016, 4:55 PM), <https://www.michiganradio.org/post/residents-sue-marathon-refinery-over-pollution> [<https://perma.cc/QL54-QYRD>]. The community residing in the area next to the refinery, which is one of the most polluted areas in the country, is a low-income, minority community. *Id.*

130. See *infra* notes 181–175 and accompanying text. Bank of America agreed to pay \$335 million to settle allegations brought by the Department of Justice that Bank of America’s subsidiary, Countrywide, charged higher fees and interest rates to more than two hundred thousand Black and Hispanic borrowers than white borrowers. Press Release, U.S. Dep’t of Just., Justice Department Reaches \$335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation (Dec. 21, 2011), <https://www.justice.gov/opa/pr/justice-department-reaches-335-million-settlement-resolve-allegations-lending-discrimination> [<https://perma.cc/KY4E-UJE6>]. Recently, Wells Fargo agreed to pay Philadelphia \$10 million to settle a lawsuit from 2017 that the city brought against the bank, alleging that the bank violated the FHA by offering more expensive and riskier mortgages to Black and Hispanic borrowers than to white borrowers, which led to foreclosures and reduced city property taxes. Caitlin McCabe, *Wells Fargo to Pay Philly \$10 Million to Resolve Lawsuit Alleging Lending Discrimination Against Minorities*, PHILA. INQUIRER, <https://www.inquirer.com/real-estate/housing/philadelphia-settles-lawsuit-wells-fargo-allegations-discriminatory-mortgage-lending-minorities-20191216.html> (last updated Dec. 16, 2019) [<https://perma.cc/846E-63M7>].

food choices.¹³¹ The retail industry has also drawn fire for racial discrimination and profiling practices against customers.¹³²

In each of these cases, it is rational to assume that the presence of racially or ethnically diverse corporate staff, coupled with equitable policies and an inclusive culture, might in many instances result in different outcomes. Personal experiences affect what facts individuals see and what problems they recognize. Individuals coming from racially and geographically diverse communities can share perspectives that might not be apparent for others. If they lived in, or had friends or family who lived in, urban or rural food deserts, they could communicate the human costs, as well as the potential economic upside of serving affected communities. Individuals with personal experiences with environmental racism, or racism more generally, might, by way of examples, be quicker to raise objections to locating factories and pollutants in Black and Brown communities, or recognize the likely reputational fallout and risks to shareholder value where their institutions employed lending or front-office practices that unfairly disadvantaged or mistreated minority communities.

But gender and racial diversity are not always sufficient to achieve superior outcomes in all situations. If minorities and women share the same age, socioeconomic, educational, and geographic backgrounds as other colleagues in their group, the group may not necessarily be cognitively diverse enough to achieve superior solutions

131. A study of the fifty largest metropolitan areas in the United States found that 17.7% of predominantly Black neighborhoods had limited access to supermarkets, while only 7.6% of predominantly white neighborhoods had limited access. Nathaniel Meyersohn, *How the Rise of Supermarkets Left Out Black America*, CNN, <https://www.cnn.com/2020/06/16/business/grocery-stores-access-race-inequality/index.html> (last updated June 16, 2020, 3:15 PM) [<https://perma.cc/5LUQ-4QDW>]. Critics have described this disparity as a result of “supermarket redlining” by grocery chains. *Id.* Kroger faced a boycott upon closing its stores in certain predominantly Black communities, following which these communities were at risk of becoming food deserts. Alexander Coolidge & Sharon Coolidge, *Jesse Jackson Calls to Expand Kroger Boycott over Its Shuttering of Stores in Minority Neighborhoods*, USA TODAY, <https://www.usatoday.com/story/money/nation-now/2018/04/10/jesse-jackson-kroger-protest/502688002/> (last updated Apr. 10, 2018, 7:24 PM) [<https://perma.cc/L99S-BT6L>].

132. Aimee Green, *‘Shopping While Black’ Lawsuits Accuse Portland Area Retailers of Discrimination*, OREGONIAN, https://www.oregonlive.com/portland/2018/06/shopping_while_black_lawsuits.html (last updated Jan. 30, 2019, 12:35 AM) [<https://perma.cc/C5MH-CYZM>] (reporting that a Black man filed a racial discrimination lawsuit against Walmart, alleging that the store clerk accused him of stealing); Neil Vigdor & Elisha Brown, *Walmart Says It Will No Longer Lock Up African-American Beauty Products*, N.Y. TIMES, <https://www.nytimes.com/2020/06/10/business/walmart-black-hair-beauty-products.html> (last updated Sept. 1, 2020) [<https://perma.cc/BV5B-8SZP>] (explaining that Walmart was also hit with a federal discrimination lawsuit for locking up beauty care products for Black women in glass cases, following which the company stated that it will end this practice); Nadra Nittle, *Moschino Has Been Accused of Using the Code Word “Serena” to Refer to Black Shoppers*, VOX (Jan. 16, 2019, 5:00 PM), <https://www.vox.com/the-goods/2019/1/16/18185696/moschino-code-word-serena-black-shoppers-racism> [<https://perma.cc/BAX2-YA7E>] (describing a former employee’s racial discrimination lawsuit against Moschino, alleging that the staff used code words for Black customers).

for certain problems.¹³³ It is for that reason we embrace Diversity in its fullest sense of drawing on the full range of talents in society, including white people from working and middle-class backgrounds and Americans from urban, suburban, and rural communities. Put simply, many kinds of diversity might be important, from socioeconomic status to professional training and education. Moreover, Diversity can only be operationalized as an organizational feature if it is accompanied by an equitable and inclusive culture. Only where people feel like their views are respected and welcome will they be willing to speak. In the absence of leadership and corporate structures to support the free exchange of ideas, members of underrepresented groups can be easily marginalized, especially when their presence in a large group is modest. In such circumstances, their very presence can be reduced to tokenism, and stereotyping could result in barriers to exert influence on decisions in the group as well as self-doubt.¹³⁴ In the absence of an inclusive culture, a corporation may have Diverse cognitive capital at its disposal, but it will not be able to deploy that capital in ways that maximize its success.¹³⁵

C. Corporate Reputation

The empirical literature highlighting Diversity and shareholder value is at times useful, but the evidence is mixed, and how cognitive diversity relates to Diversity, Equity, and Inclusion can be context dependent. Against this backdrop, it is plausible that a third business case for Diversity—that of reputational enhancement in light of an increasingly diverse world—is the most uncontroverted and compelling for corporate directors and managers. According to this view, many investors, customers, and employees value Diversity greatly, so much so that it informs their behaviors. Corporations should thus attempt to secure strong reputations in Diversity in order to help lower their cost of capital, secure top talent, and grow revenue.¹³⁶

Considerations of shareholder value often begin with a corporation's reputation, and for good reason. An important body of research indicates that “[r]eputation was, is, and always will be of immense importance to organizations, whether commercial,

133. See Adams & Ferreira, *supra* note 96, at 306.

134. ROSABETH MOSS KANTER, MEN AND WOMEN OF THE CORPORATION 238–40 (1977).

135. See John G. Oetzel, *Self-Constructs, Communication Processes, and Group Outcomes in Homogeneous and Heterogeneous Groups*, 32 SMALL GRP. RSCH. 19, 42, 44 (2001).

136. Damion Waymer & Sarah VanSlette, *Corporate Reputation Management and Issues of Diversity*, in THE HANDBOOK OF COMMUNICATION AND CORPORATE REPUTATION 471, 473 (Craig E. Carroll ed., 2013) (noting that the benefits of a favorable reputation include the ability for corporations “to charge premium prices, attract better applicants, enhance their access to capital markets, and attract investors”).

governmental, or not for profit.”¹³⁷ Reputations are the means by which stakeholders interpret corporate brands—and the concomitant attractiveness of a company’s goods and services to its customers and clients.¹³⁸ They inform how individuals investigate investment opportunities.¹³⁹ And they affect how many prospective employees judge employers,¹⁴⁰ where customers want to spend dollars, and the willingness of other businesses to form important alliances. In short, strong reputations can enable corporations to set premium prices, attract better job applicants, enhance their access to capital markets, and attract investors. Reputations thus have important implications for the profitability of corporations.¹⁴¹

Diversity, or the lack thereof, comprises one element of a company’s reputation.¹⁴² The reasons why companies may seek a reputation as being Diverse, Equitable, and Inclusive are varied, but many researchers often focus on the signaling function it may provide, especially to prospective employees. Having a diverse board or management may convey otherwise unobservable information to the

137. Tom Watson, *Reputation Models, Drivers, and Measurement*, in THE SAGE HANDBOOK OF PUBLIC RELATIONS 339, 339 (Robert L. Heath ed., 2010) (positing that reputation paves the organizational path to acceptance and approval by stakeholders).

138. “Reputation is[, critically,] multidimensional and can be rooted in a variety of different performance criteria.” Mary-Hunter McDonnell & Brayden G. King, *Order in the Court: How Firm Status and Reputation Shape the Outcomes of Employment Discrimination Suits*, 83 AM. SOCIO. REV. 61, 64 (2018) (citing Hayagreeva Rao, *The Social Construction of Reputation: Certification Contests, Legitimation, and the Survival of Organizations in the American Automobile Industry: 1895–1912*, 15 STRATEGIC MGMT. J. (SPECIAL ISSUE: COMPETITIVE ORGANIZATIONAL BEHAVIOR) 29, 30 (1994)). “The same organization can have a positive reputation in one domain, such as product quality, and yet have a weak or negative reputation in another domain, such as treatment of employees.” *Id.*; see also Michael L. Barnett, John Jermier & Barbara A. Lafferty, *Corporate Reputation: The Definitional Landscape*, 9 CORP. REPUTATION REV. 26, 34 (2006) (synthesizing prior definitive statements of corporate reputation to define corporate reputation explicitly and narrowly, distinguished from corporate identity, corporate image, and corporate reputation capital).

139. Scott Shane & Daniel Cable, *Network Ties, Reputation, and the Financing of New Ventures*, 48 MGMT. SCI. 364, 370–71 (2002) (holding that an entrepreneur’s reputation mediates the effects of social ties on venture finance decisions); Randolph P. Beatty & Jay R. Ritter, *Investment Banking, Reputation, and the Underpricing of Initial Public Offerings*, 15 J. FIN. ECON. 213, 217 (1986) (demonstrating that investment bankers, who have reputation capital at stake, enforce the underpricing equilibrium).

140. See, e.g., Daniel B. Turban & Daniel W. Greening, *Corporate Social Performance and Organizational Attractiveness to Prospective Employees*, 40 ACAD. MGMT. J. 658, 660 (1997) (noting that the image of an organization affects potential applicants’ initial job decisions).

141. See Waymer & VanSlette, *supra* note 136, at 479 (finding that the damage to reputation sustained by companies embroiled in diversity scandals is significant by conducting case studies of Deloitte, Lowe’s, and Abercrombie & Fitch). This is a point not lost in the literature. See John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listing and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002) (discussing how companies can signal sounder corporate governance by listing in the United States to achieve higher valuations).

142. See Waymer & VanSlette, *supra* note 136, at 472.

public, like how receptive the company is to a diverse workforce, or how open and inclusive the company's culture may be.¹⁴³

These kinds of signals are important for securing top talent. Industry surveys consistently show that workplace Diversity ranks high on job seekers' list of priorities when looking for a job, with nearly half of all Americans indicating that diverse workplaces are important to them. The pull of diversity is, however, strongest among Millennials and Generation Xers, who together account for over two-thirds of today's labor force.¹⁴⁴ In one recent survey by ZipRecruiter, 86% of respondents identified workplace diversity as a top consideration, placing it among the top three job search criteria, along with salary and schedule flexibility.¹⁴⁵ Millennials are even likely to stay nearly twice as long as their average 2.8-year tenure at a company that fosters DEI.¹⁴⁶ To some extent, this reflects the greater Diversity of younger-aged people in the United States, though not entirely. Although women tend to favor workplace Diversity more than men, and Black, Latino, and Asian employees more than whites, clear majorities of men and whites have been found in studies to consider DEI to be important workplace considerations.¹⁴⁷

Reputations for strong Diversity can also be helpful in securing and keeping customers and clients. At least part of many consumers' purchasing decisions comes from one's perception as to whether the

143. For a general overview of signaling theory, see Brian L. Connelly, S. Trevis Certo, R. Duane Ireland & Christopher R. Reutzel *Signaling Theory: A Review and Assessment*, 37 J. MGMT. 39, 40 (2011). *But see* Broome & Krawiec, *supra* note 95, at 448 (concluding that the signaling rationale for board diversity is at its strongest under particular conditions that may not exist in all corporations at all times).

144. MANPOWERGROUP, MILLENNIAL CAREERS: 2020 VISION 3 (2016), https://www.manpowergroup.com/wps/wcm/connect/660ebf65-144c-489e-975c-9f838294c237/MillennialsPaper1_2020Vision_lo.pdf?MOD=AJPERES [<https://perma.cc/E6AL-T4S7>] (studying nineteen thousand working Millennials and one thousand five hundred hiring managers across twenty-five countries between February and April 2016).

145. *Over 86% of Job Seekers Say Workplace Diversity Is an Important Factor When Looking for Job*, CISION PR NEWSWIRE (Nov. 25, 2019, 11:00), <https://www.prnewswire.com/news-releases/over-86-of-job-seekers-say-workplace-diversity-is-an-important-factor-when-looking-for-a-job-300964115.html> [<https://perma.cc/6CB4-6ETN>]; *see also* Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1295–98 (2020) (arguing that Millennials also want to work for companies whose values they share and are acting as employees to call for their companies to improve their commitment to social responsibility).

146. CISION PR NEWSWIRE, *supra* note 145.

147. In one Glassdoor survey, for example, 72% of women consider workforce diversity important versus 62% of men. It also found that 89% of Black respondents, 80% of Asians and 70% of Latinos said it was important to them. What's more, a large majority of white respondents say workforce diversity is important. Press Release, Glassdoor, Two-Thirds of People Consider Diversity Important When Deciding Where to Work (Nov. 17, 2014), <https://www.glassdoor.com/about-us/twothirds-people-diversity-important-deciding-work-glassdoor-survey-2/> [<https://perma.cc/4F3V-7SWJ>].

product or services provider aligns with their values.¹⁴⁸ This has become more important in today's world of social activism and with the younger consumers who are more likely to be "values-driven, not value-driven."¹⁴⁹ In a recent survey by Deloitte of both Millennials and Gen Zers, for example, nearly one-third of Millennial customers stated they have deepened or initiated relationships with retailers who balance doing "good" and making a profit.¹⁵⁰

Conversely, bad reputations can be damaging to the firm and shareholder value. Often this is reflected in lawsuits, a point long emphasized in the antidiscrimination literature. Litigation arising from contravening the values of Diversity can lead to the disrepute of the corporation, which undermines its ability to increase its sustainable profitability. Verdicts of culpability and liability shape public perceptions of a firm's commitment to equality. The publicity that flows from the very process of regulatory investigations and litigation produces information on the behavior of the corporation—and parties to the dispute.¹⁵¹ This information reaches third parties and affects the way that outsiders view the corporation and relevant actors regardless of and beyond the effects of direct legal outcomes. In other words, this information helps shape the market reaction to alleged misbehavior, even if the outcome is eventually favorable to the company.¹⁵² Savvy jobseekers research the company before applying, and workplaces facing several discrimination lawsuits often observe a chilling effect on recruiting as top candidates look to less controversial or more accommodating employers.¹⁵³ Investors may decide not to purchase shares of the company out of principle. Prospective customers may decide to take their business elsewhere. Other corporations may steer clear of joint ventures.

148. Olivia Valentine, *The Growing Importance of Brand Responses to Equality and Diversity*, WE ARE SOC.: BLOG (July 30, 2020), <https://wearesocial.com/blog/2020/07/the-growing-importance-of-brand-responses-to-equality-and-diversity> [https://perma.cc/853W-HZEP] (showing that at least part of consumers' purchasing decision comes from consideration of whether a brand aligns with their values).

149. Barzuza et al., *supra* note 145, at 1284 (arguing that a three-dimensional Millennial effect—as investors, customers and employees—is an important development with the potential to provide a counterweight to the wealth-maximization paradigm of corporate governance, and specifically arguing that institutional investors recognize that attention to issues like Diversity is attractive to the new generations whose capital they seek to attract).

150. *The Deloitte Global Millennial Survey 2020*, DELOITTE 21 (2020) <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/deloitte-2020-millennial-survey.pdf> [https://perma.cc/3DZ6-AX76] (exploring the views of more than 27,500 Millennials and Gen Zers to understand their perspectives on business, government, climate, and the pandemic, among other issues).

151. Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1, 12 (2015).

152. *Id.*

153. Tia Benjamin, *The Ways Discrimination Negatively Affects Businesses*, SMALL BUS. CHRON. <https://smallbusiness.chron.com/ways-discrimination-negatively-affects-businesses-36925.html> (last visited Sept. 4, 2021) [https://perma.cc/6LMB-WR6P].

Bad reputations do not, of course, only result from regulatory actions and litigation. Deloitte's surveys also made clear that young consumers will not "hesitate to penalize companies whose stated and practiced values conflict with their own."¹⁵⁴ And this is far from an empty threat in today's age of social media, where anyone can congregate and organize against firms, sometimes to devastating effect. Perhaps one of the most obvious instances of the harm that can possibly arise was observed in 2018 when Papa John's founder used a racial epithet on a conference call and criticized Colin Kaepernick and other athletes for protesting police brutality; the pizza chain's sales began to decline.¹⁵⁵ Competitors, such as DiGiorno and Pizza Hut, engaged in "Twitter wars" attacking Papa John's, and a white supremacist website crowned Papa John's as the "official pizza of the alt-right," bringing even more negative attention to the worsening reputation of Papa John's.¹⁵⁶ Sales dropped 7.1% for the year, and fourth quarter income dropped from \$22.8 million the prior year to \$4.6 million.¹⁵⁷ It was not the first time that year that reputational consequences would come to cost a major company: just three months prior, Starbucks had to delay a marketing push after two Black men were arrested in Philadelphia after wishing to use the restroom, an event watched over eight million times on Twitter. The ensuing criticism prompted the company to close its stores and conduct sensitivity training across many of its locations, hurting same-store sales and driving profits down over 9%.¹⁵⁸

Domestic demographic changes have worked with globalization and the free flow of information to increase reputational and business stakes. The U.S. population—the country's domestic consumer pool and workforce—is expected to become more racially and ethnically diverse, without a single racial majority or ethnic majority by 2055,¹⁵⁹ with Millennials and Gen Zers comprising the most diverse generational

154. DELOITTE, *supra* note 150, at 3.

155. Barzuza et al., *supra* note 145, at 1298.

156. *Id.*

157. *Id.* at 1299.

158. Tonya Garcia, *Starbucks Says Racial Bias Incident Delayed Its Marketing Push, Hurt Same-Store Sales*, MKT. WATCH (June 21, 2018, 8:20 AM), <https://www.marketwatch.com/story/starbucks-says-racial-bias-incident-delayed-its-marketing-push-hurt-same-store-sales-2018-06-20> [<https://perma.cc/E2Z3-G9MG>]; see also Jason Del Rey, *Amazon Employees Are Outraged by Their Company's Opposition to a Plan to Add More Diversity to its Board*, VOX (May 8, 2018, 12:09 PM), <https://www.vox.com/2018/5/8/17328466/amazon-jeff-bezos-board-diversity-proposal-shareholder-vote> [<https://perma.cc/6TS4-DX6Z>] (reporting that Amazon was the subject of recent criticism when its board recommended a vote against a proposal to implement a "Rooney Rule," which requires the initial list for new director nominees to include qualified women and minority candidates, citing complex considerations in the process for nominating director).

159. D'Vera Cohn & Andrea Caumont, *10 Demographic Trends Shaping the U.S. and the World in 2016*, PEW RSCH CTR. (Mar. 31, 2016), <https://www.pewresearch.org/fact-tank/2016/03/31/10-demographic-trends-that-are-shaping-the-u-s-and-the-world/> [<https://perma.cc/ME5B-Z2YN>].

cohort in U.S. history.¹⁶⁰ Furthermore, the North American workforce is expected to fall from 5 to 4% of the global workforce in the next two decades while the populations in sub-Saharan Africa and Latin America are set to explode.¹⁶¹ Experts consequently connect the pursuit of Diversity with not only cultivating new domestic consumers, workers, and investors, but also with engaging new foreign stakeholders with varied cultural values, experiences, and interests.

There is also a growing recognition that collective action by the business sector to include more Americans in our economy's benefits can fuel overall growth for the economy and drive demand in a way that will increase corporate profits. Citi's report finds that if racial gaps had been closed twenty years ago, the U.S. economy could have benefited from as much as \$16 trillion of additional GDP.¹⁶² Based on this calculation, the report estimates that the closing of the gaps could add roughly \$5 trillion to U.S. GDP through 2025.¹⁶³ From a global perspective, Accenture similarly estimates that if the perception gap of gender equality between employers and employees was cut in half, global profits would increase by 33%, including an increase of over \$1 trillion by U.S. companies.¹⁶⁴ The businesses in the vanguard of driving this positive change are the ones most likely to improve their reputations and secure a larger share of the resulting gains. The acknowledgement of Diversity as a reputational asset is abundant. Magazines, from *DiversityInc* to *Working Mother*, release surveys sent to leading corporations from which they derive annual rankings on issues including recruitment and retention, specific ethnic groups, LGBTQ+ communities, work-life balance, and more.¹⁶⁵ And major companies submit materials to be evaluated by these independent raters and boast when they score well.¹⁶⁶

The importance of independent raters and high Diversity reputations has grown as institutional investors increasingly focus on social issues like DEI. As society has become more socially conscious, new investment funds have emerged, epitomized by the EESG movement, which attempts to identify corporations that, while profitable, embrace positive social values like DEI—and adjacent areas

160. Kasey Lobaugh, Bobby Stephens & Jeff Simpson, *The Consumer Is Changing . . . but Perhaps Not How You Think*, DELOITTE REV., July 2019, at 102.

161. Patricia Buckley & Daniel Bachman, *Meet the US Workforce of the Future*, DELOITTE REV., July 2017, at 47, 57.

162. PETERSON & MANN, *supra* note 69.

163. *Id.* at 7.

164. Julie Sweet & Ellyn Shook, *The Hidden Value of Culture Makers*, ACCENTURE (2020), https://www.accenture.com/us-en/about/inclusion-diversity/_acnmedia/Thought-Leadership-Assets/PDF-2/Accenture-Getting-To-Equal-2020-Research-Report.pdf [<https://perma.cc/8AVF-QHM3>].

165. Waymer & VanSlette, *supra* note 136, at 473 (noting Coca-Cola's past featuring of its Diversity rankings on its "About Us" tab on its webpage).

166. *Id.* at 474.

such as fair worker treatment, environmental responsibility, and sound governance. Spurred by high-net-worth clients and pension funds, fund managers have created offerings designed to allocate assets to investment funds that make a difference, usually with Diversity as one of the metrics for assigning scores of portfolio companies.¹⁶⁷ And in the future, the weighting of Diversity is likely to only increase.¹⁶⁸

Part of the impetus behind the EESG sector's growth has been financial: the returns thus far have been positive, with EESG funds largely outperforming the market.¹⁶⁹ But this growth also reflects an awareness that because investor preferences are themselves diverse, moral-driven choices can drive market activity and shareholder returns. Things once considered immaterial, like new information being introduced into the market concerning a company's Diversity performance, can push a company's stock price higher.¹⁷⁰

167. George Sarafeim, *Investors As Stewards of the Commons?*, 30 J. APPLIED CORP. FIN. 8, 10 (2017) (noting that when investors' pressures are not satisfied through private mechanisms, the investors will often engage publicly by filing shareholders' proposals: in 2015, 34% of all shareholder proposals were EESG related, led by socially responsible investment funds and public pension funds, followed by activist hedge funds and index funds); JENNA WEINBERG & SIMON GREER, DIVERSE ASSET MANAGERS INITIATIVE, FIDUCIARY GUIDE TO INVESTING WITH DIVERSE ASSET MANAGERS AND FIRMS (Apr. 2017), <https://www.sec.gov/files/amac-background-dam-fiduciary-guide.pdf> [<https://perma.cc/2BWL-NSQH>]. But see Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 386 (2020) (arguing that a trustee can engage in ESG investing only if "(1) the trustee reasonably concludes that the ESG investment program will benefit the beneficiary directly by improving risk-adjusted return; and (2) the trustee's exclusive motive for adopting the ESG investment program is to obtain this direct benefit").

168. See Lizzy Gurdus, *Diversity, Inequality Metrics Will See 'A Lot of Scrutiny' Next Year as ESG Investing Grows*, MSCI Says, CNBC (Dec. 19, 2020, 10:26 AM), <https://www.cnbc.com/2020/12/18/diversity-under-scrutiny-as-esg-investing-grows.html> [<https://perma.cc/M9PB-CZUG>] (noting how companies are going to get more creative about how they can better beef up their social credentials with investors).

169. Emiliano Rabinovich, *ESG Equity Index Performance in the US: Outperformance vs. the Benchmark During Market Volatility*, ETF TRENDS (Oct. 15, 2020), <https://www.etftrends.com/esg-channel/esg-equity-index-performance-in-the-us> [<https://perma.cc/VW7C-HCVP>] (noting that although the magnitude of the outperformance varies among the different ESG index providers, it is important to note that each has beaten the benchmark over time and has done so consistently, regardless of ESG methodology or ESG data provider).

170. One Stanford study canvassed shareholder reactions to nearly sixty gender Diversity announcements that publicly traded firms in the technology and finance sectors made between 2014 and 2018. The study measured each firm's stock returns on the day of the diversity announcement, controlling for total U.S. market returns:

In both sectors, stock prices increased more when announcements revealed a higher level of Diversity. Among tech companies, investors reacted even more positively when the Diversity numbers trumped those of Google, which researchers identified as the industry leader. "The results put hard evidence to something a lot of people have suspected but hadn't had the data to back up"

Katia Savchuk, *Do Investors Really Care About Gender Diversity?*, STAN. BUS. (Sept. 17, 2019) <https://www.gsb.stanford.edu/insights/do-investors-really-care-about-gender-diversity> [<https://perma.cc/M6ZX-VAT8>]; see also David Daniels, Jennifer Dannals, Thomas Lys & Margaret Neale, *Do Investors Value Gender Diversity In Firms?: Evidence from the Field and Lab*, SOC'Y FOR JUDGMENT & DECISION MAKING (2019), <https://www.sjdm.org/presentations/2019-Talk-Dannals-Jennifer-diversity-event-study.pdf> [<https://perma.cc/NE73-DCAP>]. It also tends to contradict long-

With demand for socially conscious offerings growing, EESG ratings have proliferated, and corporations face growing pressure to achieve and then maintain strong rankings or “scores.”¹⁷¹ If a company’s stock is designated an “unsustainable asset” due to its failure to adopt measures consonant with EESG credentials or priorities like Diversity, corporate officers and directors face the prospect of their company’s stock being excluded from investment portfolios.¹⁷² And for many companies, the consequences could be material. If a sufficient number of investors are then excluded from accessing the fund, or if a sufficient number of funds act in concert based on a score, or series of scores, the price of a company’s stock can fall as demand falls—or other investors could even short the company’s stock, putting downward pressure on its share price.¹⁷³

* * *

For all the reasons we have addressed, we therefore believe that a plausible, indeed sound, business rationale exists for businesses to cultivate collaboration by diverse minds; value merits-based factors instead of social origins; and welcome working with customers, communities, and partners from all segments of society and the globe. These businesses will be better positioned to thrive in what is itself an increasingly diverse world economy.

III. AN OVERVIEW OF CURRENT REFORMS TO ENCOURAGE CORPORATE DIVERSITY, EQUITY, AND INCLUSION

The private sector’s growing awareness of the business advantages of Diversity, the ethical values of business leaders, and the anticipation of the demographic changes coming in the United States have already led some corporations to adopt voluntary DEI policies. But it has been above all the national reckoning with the death of George Floyd and the disparate effects of the COVID-19 pandemic that have led to concrete policy initiatives being announced across the country aimed at increasing Diversity, Equity, and Inclusion within corporate organizations. Widespread moral outrage and a cultural awakening has

standing arguments that social disclosures are merely “therapeutic” and not useful to investors. See Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1797 (2011).

171. Richa Joshi, *Board Diversity: No Longer Optional*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 11, 2020), <https://corpgov.law.harvard.edu/2020/10/11/board-diversity-no-longer-optional/> [<https://perma.cc/3XWP-BW97>] (discussing results of pressure to improve board diversity through recent laws and institutional investors).

172. See Robert Eccles & Svetlana Klimenko, *The Investor Revolution*, HARV. B. REV., May–June 2019, at 106 (observing that as it “becomes clear that the people who decide whether to buy or sell a company’s stock have internalized ESG into their calculations, the business leaders will be forced to do the same within their companies”).

173. See Chris Sloley, *How Ethical Is It to Short the Bad Boys of ESG?*, CITYWIRE SELECTOR (Oct. 22, 2019), <https://citywireselector.com/news/how-ethical-is-it-to-short-the-bad-boys-of-esg/a1283784> [<https://perma.cc/Z5KE-E395>] (examining whether investors should actively short such stocks to further punish socially problematic players).

catalyzed both new government activism and corporate action to improve the DEI of corporate America.

In this Part, we survey the most high-profile efforts to jumpstart DEI within corporate America. We start, however, with an analysis of the limitations of legacy antidiscrimination laws geared towards advancing racial and economic equality. We then catalogue a growing number of corporate Diversity initiatives: California state reforms aiming for diversity, Nasdaq's board diversity initiative, and capital markets initiatives spearheaded by pension and investment funds. As will be seen below, most reforms are aimed at either reforming perceived inadequacies in corporate law to reflect the potential value of Diversity or leveraging securities law to enable greater transparency of board-level Diversity. We explain, however, that although these initiatives represent fresh and much-needed thinking about the demographic dilemma facing corporations, they offer in practice limited and incomplete answers to the profound challenge of corporate inequality and fail to address the full range of DEI issues involved in corporate conduct toward all stakeholders.

A. Federal Antidiscrimination Laws

Calls for reform of corporate entities are not arising in a vacuum, and it is important to understand the preexisting legal backdrop against which they operate. Critically, a range of federal laws require corporations, as a matter of basic compliance, to implement policies and practices that attend to DEI, which are supplemented by comparable state laws.¹⁷⁴ For example, the Equal Pay Act of 1963 ("EPA"), which amended the Fair Labor Standards Act of 1938, prohibits employers from sex-based wage discrimination between men and women who are in substantially equal positions.¹⁷⁵ One year later, Congress passed the Civil Rights Act of 1964 which further broadened the scope of federal antidiscrimination laws and banned practices that have a disparate impact on protected groups, unless these practices can be justified by a legitimate business reason. Title VII of the Civil Rights Act of 1964 ("Title VII") in particular prohibits discrimination not only based on sex but also based on race, color, religion, or national origin, and applies to any employer who has fifteen or more employees.¹⁷⁶ In addition, Title II

174. Most states, and some cities, have their own antidiscrimination laws, which extend prohibitions against discriminatory conduct to additional categories of protected persons. The New York State Human Rights Law, for example, prohibits discrimination on the basis of sexual orientation, military status, familial status, marital status, domestic violence victim status, and arrest and conviction status. *See, e.g.*, N.Y. EXEC. LAW § 296 (McKinney 2021).

175. Fair Labor Standards Act of 1938, 29 U.S.C. § 206(d). Substantially equal positions are positions that require "equal skill, effort, and responsibility, and which are performed under similar working conditions." *Id.*

176. Civil Rights Act of 1964 § 7, 42 U.S.C. § 2000e.

of the Civil Rights Act of 1964 prohibits discrimination based on race, color, religion, or national origin that denies a person “the full and equal enjoyment of the goods, services, facilities, privileges, advantages, and accommodations of any place of public accommodation.”¹⁷⁷ Public accommodation is defined broadly to include facilities such as hotels, restaurants, and theaters.¹⁷⁸

The Civil Rights Act of 1991 then strengthened antidiscrimination laws in the wake of several controversial decisions,¹⁷⁹ giving plaintiffs the right to trial by jury and compensatory and punitive damages for intentional discrimination under Title VII. In addition to federal laws, employers must adhere to the antidiscrimination laws that have been adopted by most states.¹⁸⁰

In response to systemic racial segregation and in the wake of Martin Luther King, Jr.’s, assassination, Congress passed the FHA in 1968 to prohibit discrimination in housing transactions based on race, color, religion, and national origin, and, as amended, sex, disability, and family status.¹⁸¹ The U.S. Department of Justice and the U.S. Department of Housing and Urban Development (“HUD”) enforce the FHA, and individuals may file lawsuits under the FHA as well.¹⁸² In addition to the FHA, Congress passed the ECOA in 1974, which, as amended, prohibits creditors from discriminating against applicants based on race, color, religion, national origin, sex, family status, or age.¹⁸³ Despite the FHA and ECOA, housing discrimination against Black Americans continued as financial institutions used the deposits they accepted from inner cities to lend and invest in other neighborhoods.¹⁸⁴ The practice of denying credit to an eligible applicant based on the neighborhood in which the applicant resided, referred to

177. *Id.* § 2000a(a).

178. *Id.* § 2000a(b).

179. An analysis of the Supreme Court cases is beyond the scope of this Article, but for a brief history on the genesis of the Civil Rights Act of 1991, see Roger Clegg, *Introduction: A Brief Legislative History of the Civil Rights Act of 1991*, 54 LA. L. REV. 1459 (1994); and David A. Cathcart & Mark Snyderman, *The Civil Rights Act of 1991*, 8 LAB. LAW. 849 (1992).

180. For a state-by-state summary of antidiscrimination laws, see *State Employment-Related Discrimination Statutes*, NAT’L CONF. OF STATE LEGISLATURES (July 2015), <https://www.ncsl.org/documents/employ/Discrimination-Chart-2015.pdf> [<https://perma.cc/MB3A-EWDQ>].

181. Fair Housing Act of 1968, 42 U.S.C. § 3604 (also known as Title VIII of the Civil Rights Act of 1968); *History of Fair Housing*, U.S. DEPT OF HOUS. & URB. DEV., https://www.hud.gov/program_offices/fair_housing_equal_opp/aboutfheo/history (last visited Dec. 30, 2021) [<https://perma.cc/S7FD-8FTC>]. For a discussion on the effectiveness of the FHA since its enactment in 1968, see Paula A. Franzese & Stephanie J. Beach, *Promises Still to Keep: The Fair Housing Act Fifty Years Later*, 40 CARDOZO L. REV. 1207 (2019).

182. Aleatra P. Williams, *Lending Discrimination, the Foreclosure Crisis and the Perpetuation of Racial and Ethnic Disparities in Homeownership in the U.S.*, 6 WM. & MARY BUS. L. REV. 601, 612 (2015).

183. 15 U.S.C. § 1691.

184. See Griffith L. Garwood & Dolores S. Smith, *The Community Reinvestment Act: Evolution and Current Issues*, 79 FED. RES. BULL. 251, 251 (1993) (discussing the historical background leading to the CRA’s enactment).

as “redlining,” led to the enactment of the Community Reinvestment Act (“CRA”) in 1977 to encourage financial institutions to meet the credit needs of the communities in which they are located.¹⁸⁵

Notably, the damages from violating these rules can be substantial. Most employment discrimination cases under Title VII, for example, can be brought under traditional class actions under Rule 23 of the Federal Procedure Act along with violations of ECOA.¹⁸⁶ Meanwhile, violations of the EPA are brought as collective actions, which though requiring that all plaintiffs consent, can be larger monetarily, as can administrative actions taken by agencies like the EEOC to punish actors for systemic discrimination.¹⁸⁷

For the purposes of corporate diversity, however, the reach of federal civil rights laws is subject to considerable constraints, especially as it pertains to corporate boards. Although the Civil Rights Act of 1964 makes it illegal to discriminate in employment practices, it does not apply to corporate board membership because board members, with the exception of the corporate insiders who serve,¹⁸⁸ are usually not employees.¹⁸⁹ In fact, courts routinely hold that the statute does not apply to corporate directors. As the U.S. Court of Appeals for the Seventh Circuit has put it: “Directors are traditionally employer rather than employee positions.”¹⁹⁰

The upshot is that nondiscrimination laws apply to firms, and to hiring and promotion, but as one moves toward top-level corporate governance, where in some instances board Diversity may be most important, it ceases to have as much applicability. It does, however, apply to the C-suite, though as discussed above, other issues including

185. *See id.*

186. For a summary of selected actions brought by the EEOC alleging systemic discrimination in hiring, see *Selected List of EEOC Systemic Hiring Resolutions and Filings Since 2005 (as of 4/18/12)*, U.S. EQUAL EMP. OPPORTUNITY COMM’N, <https://www.eeoc.gov/selected-list-eeoc-systemic-hiring-resolutions-and-filings-2005-41812> (last visited Dec. 30, 2021) [<https://perma.cc/2A2W-ZMME>].

187. For data on the total number of EPA charges filed with the EEOC, see *Equal Pay Act Charges (Charges Filed with EEOC) (Includes Concurrent Charges with Title VII, ADEA, ADA, and GINA) FY 1997 – FY 2020*, U.S. EQUAL EMP. OPPORTUNITY COMM’N, <https://www.eeoc.gov/statistics/equal-pay-act-charges-charges-filed-eeoc-includes-concurrent-charges-title-vii-adea-ada> (last visited Dec. 30, 2021) [<https://perma.cc/749H-5C27>].

188. James A. Fanto, Lawrence M. Solan & John M. Darley, *Justifying Board Diversity*, 89 N.C. L. REV. 901, 902 (2011).

189. As Fanto et al. have noted, the Supreme Court has set forth guidelines for determining when a board member should be considered an employee. *Id.*; see also *Clackamas Gastroenterology Assocs., P.C. v. Wells*, 538 U.S. 440, 449–51 (2003). A typical board member will not be considered an employee. See Stephanie Greene & Christine Neylon O’Brien, *Who Counts?: The United States Supreme Court Cites “Control” as the Key to Distinguishing Employers from Employees Under Federal Employment Antidiscrimination Laws*, 2003 COLUM. BUS. L. REV. 761, 787 (“The language in the EEOC guidance indicates that principals must overcome a presumption that they are employers.”).

190. *Chavero v. Loc. 241, Div. of the Amalgamated Transit Union*, 787 F.2d 1154, 1157 (7th Cir. 1986).

social networking and internal advancement obstacles have been found to stymie women and ethnic minorities as a group in terms of both getting hired by, and climbing, corporate hierarchies.

In response to these gaps, Congress has weighed in on the importance of improving board transparency on DEI issues. In 2017, Representative Carolyn Maloney introduced the Gender Diversity in Corporate Leadership Act of 2017, which would require public companies to provide proxy disclosure regarding the gender Diversity of directors and nominees.¹⁹¹ In November 2019, the U.S. House of Representatives, with bipartisan support, passed the Corporate Governance Through Diversity Act of 2019, which requires certain registrants to annually disclose the racial, ethnic, and gender composition of their boards and executive officers, as well as the veteran status of any of those directors and officers, in their proxy statements.¹⁹² The bill also requires the disclosure of any policy, plan, or strategy to promote racial, ethnic, and gender Diversity among these groups. Legislators have proposed a companion bill in the U.S. Senate.¹⁹³

B. SEC Board Diversity Disclosure Rules

Like Congress, the SEC has attempted to address the issue of DEI in corporate governance. In 2009, the SEC adopted a rule designed to assess individual companies' commitment to establishing and maintaining Diversity on their board.¹⁹⁴ Under the rule, public companies are required to disclose whether diversity is a factor in considering candidates for nomination to the board of directors and how the company assesses how effective the policy has been.¹⁹⁵ But, as Laurence Trautman has explained, companies and the SEC diverged in terms of their interpretations of the rule, with the majority of companies differentiating "consideration" of Diversity and Diversity "policy."¹⁹⁶

191. Gender Diversity in Corporate Leadership Act of 2017, H.R. 1611, 115th Cong. § 2(b) (2017).

192. Improving Corporate Governance Through Diversity Act of 2019, H.R. 5084, 116th Cong. § 2 (2019).

193. Improving Corporate Governance Through Diversity Act of 2019, S. 360, 116th Cong. (2019).

194. For an excellent overview of the 2009 rule, see Laurence Trautman, *Corporate Boardroom Diversity: Why Are We Still Talking About This?*, 17 SCHOLAR: ST. MARY'S L. REV. ON RACE & SOC. JUST. 219 (2015).

195. *Id.*; see also Luis A. Aguilar, Comm'r, Sec. & Exch. Comm'n, Keynote Speech at the Hispanic Association of Corporate Responsibility—Corporate Directors Summit: An Update on Diversity and Financial Literacy (Apr. 30, 2011), <https://www.sec.gov/news/speech/2011/spch043011laa.htm> [<https://perma.cc/Q2DU-6GX5>] (discussing the 2009 Rule).

196. Thomas Lee Hazen & Lissa Lamkin Broome, *Board Diversity and Proxy Disclosure*, 37 U. DAYTON L. REV. 39, 74 (2011).

A decade later, the Commission revisited the rules by establishing new Compliance and Disclosure Interpretations (“C&DI”).¹⁹⁷ The revisions did not, however, provide a definition of Diversity, leaving issuers free to refrain from disclosing the race, ethnicity, or gender of their directors or nominees.¹⁹⁸ Instead of identifying what criteria constitute Diversity, a non-exhaustive list of examples of Diverse characteristics was provided, including “race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background.”¹⁹⁹ Meanwhile, the issuer’s description of a company’s Diversity policy would be relied on as an explanatory tool providing “a discussion of how the company considers the self-identified diversity attributes of nominees as well as any other qualifications its diversity policy takes into account, such as Diverse work experiences, military service, or socioeconomic or demographic characteristics.”²⁰⁰

Currently, Item 401(e)(1) of Regulation S-K requires a company to “briefly discuss the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director.”²⁰¹ The C&DI clarifies that if a board considered a director’s self-identified Diversity characteristics (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background) during the nomination process, and the individual consents to disclose those Diverse characteristics, the Commission “would expect that the company’s discussion required by Item 401 would include, but not necessarily be limited to, identifying those characteristics and how they were considered.”²⁰²

Along with requiring companies to indicate whether Diversity is considered when identifying director nominees (and if so, how), Item 407(c)(2)(vi) of Regulation S-K requires companies to indicate if the board or nominations committee has adopted a Diversity policy, describe how the policy is implemented, and assess its effectiveness.²⁰³ The Commission’s logic was one that sought maximum flexibility for firms given the fact that

companies may define diversity in various ways, reflecting different perspectives. For instance, some companies may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill and other individual qualities and

197. For an overview of the C&DI, from which this discussion is partially based, see Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity, Exchange Act Release No. 90547, 2020 WL 7226158 (Dec. 4, 2020).

198. *Id.*

199. *Regulation S-K: Compliance & Disclosure Interpretations*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm> (last updated Sept. 21, 2020) [<https://perma.cc/8AVH-QDNJ>].

200. *Id.*

201. 17 C.F.R. § 229.401(e)(1) (2019).

202. U.S. SEC. & EXCH. COMM’N, *supra* note 199.

203. *Id.*

attributes that contribute to board heterogeneity, while others may focus on diversity concepts such as race, gender and national origin.²⁰⁴

In the view of the Commission, and in light of such diversity in Diversity, companies should be allowed to define Diversity in ways that they consider appropriate.

Critics have, however, asserted that the flexibility provided under the rule has rendered it, if not meaningless, then gravely ineffective. For one, the self-executing nature of the disclosures, combined with the substantive voluntariness of embracing Diversity policies, has meant that the data reported have been unreliable and of minimal utility to investors. Not only have public companies failed to disclose much information about their boards, but there has been little uniformity in what is reported or the definitions of Diversity characteristics across companies. Some policymakers have, as a consequence, urged reforms of Regulation S-K to require data and reporting regarding gender and racial diversity on corporate boards.²⁰⁵

C. State Law Initiatives

In addition to federal rules, states have turned their attention to laws that go beyond antidiscrimination. The legislatures in Michigan,²⁰⁶ Pennsylvania, Hawaii, and Massachusetts are working on bills that, if passed, would nudge (and in some instances require) employers to increase Diversity in leadership positions, especially boards of public corporations. Only two states, California and New York, have passed legislation imposing such duties. Below, we examine their key features.

1. California's Board Diversity Laws

California has passed two separate board diversity statutes, one aimed at gender diversity, the other focused on racial, ethnic, and sexual orientation diversity. First, on September 30, 2018, then-California Governor Jerry Brown approved Senate Bill 826 ("SB 826"), which mandated "female representation on California-based

204. Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,344 (Dec. 23, 2009) (codified at 17 C.F.R. §§ 229.401, .402, .407).

205. See Allison Herren Lee, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at the Council of Institutional Investors Fall 2020 Conference: Diversity Matters, Disclosure Works, and the SEC Can Do More (Sept. 22, 2020), <https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922> [<https://perma.cc/T8DR56UA>] (arguing that the materiality-based disclosure system is "not standardized, not consistent period to period, not comparable across companies, and not necessarily reliable").

206. S. 115, 2019 Leg., 100th Sess. (Mich. 2019) ("[A] publicly held domestic corporation or foreign corporation whose principal executive offices, according to the corporation's SEC 10-K form, are located in this state must have a minimum of 1 female director on its board.").

companies' corporate boards.”²⁰⁷ Two years later, California Governor Gavin Newsom approved Assembly Bill 979 (“AB 979”), mandating a similar requirement whereby public companies headquartered in California must “diversify their boards of directors with directors from ‘underrepresented communities.’”²⁰⁸ Both SB 826 and AB 979 apply to publicly held companies which are headquartered in the state of California, and both impose mandatory Diversity requirements beyond merely disclosing board composition.

SB 826 requires that, by the end of 2021, every

publicly held domestic or foreign corporation whose principal executive offices . . . are located in California . . . adhere to a schedule whereby boards of six or more have three or more female directors; boards of five have two or more female directors, and boards of four or fewer have one or more female directors.²⁰⁹

The legislation grants the California Secretary of State authority to enforce violations of the law by either (1) publishing a list of companies who are compliant or non-compliant or (2) imposing fines on companies who failed to disclose board composition. In the case of monetary fines, the quantum to be assessed for an initial violation is \$100,000; \$300,000 is to be assessed for every subsequent violation.²¹⁰

AB 979 is a parallel law with similar provisions, though with a broader scope. Specifically, AB 979 defines “director from underrepresented community” as “an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender.”²¹¹ Its mandatory quotas state that

[publicly held corporations with executive offices in California] must have at least one director from an underrepresented community on their boards by December 31, 2021. By December 31, 2022, covered corporations with boards of nine or more directors must have a minimum of three directors from underrepresented communities on their boards, and covered corporations with boards of more than four but less than nine directors must have a minimum of two directors from underrepresented communities.²¹²

AB 979’s two enforcement mechanisms are identical to those of SB 826.

207. Christopher J. Riley, *An Equal Protection Defense of SB 826*, CALIF. L. REV.: BLOG (July 2020), <https://www.californialawreview.org/equal-protection-defense-sb826/> [https://perma.cc/7L38-VCF2].

208. Amy Frenzen & Michael Thomas, *AB 979 Requires California-Based Publicly Held Corporations To Diversify Their Boards of Directors*, JD SUPRA (Oct. 1, 2020), <https://www.jdsupra.com/legalnews/ab-979-requires-california-based-17002/> [https://perma.cc/LT97-BDA4].

209. Riley, *supra* note 207 (footnotes omitted) (internal quotation marks omitted).

210. *Id.*

211. Frenzen & Thomas, *supra* note 208.

212. *Id.*

2. New York's Board Diversity Study and Disclosure Mandate

In December 2019, New York Governor Andrew Cuomo signed Senate Bill 4278 (“SB 4278”), which enacts the “Women on Corporate Boards Study.”²¹³ Similar to the California bills, SB 4278 mandates that “domestic and foreign corporations ‘authorized to do business’ [in New York]” abide by board composition reporting mandates. Under the law, both private and public corporations—regardless of whether they are headquartered in the state—must disclose the number of directors they appoint to their board and how many of those directors are female. “The information will be collected as part of the corporation’s filing statement required by the Business Corporation Law.”²¹⁴ New York’s Department of State and Taxation and Finance Departments are then charged with studying the number of women directors who serve on each board of directors of domestic corporations and foreign corporations licensed to do business in New York state.

The initial results of the study will be published on February 1, 2022, likely leading to more concrete action. In its current state, the bill does not impose any quotas and does not mandate a specific number of women to be on the boards of corporations that do business in New York.

D. Market “EESG” Initiatives

Private market participants are also driving the debate on corporate Diversity. As shown, people have shown increasing interest in participating in markets—as either consumers or investors—in ways that conform with their values.²¹⁵ This interest has in turn pushed varying market participants to adopt practices and stances that reflect these changing, and intensifying, preferences, especially given the data-driven nature of investment products such as Diversity-specific indices and broader EESG funds.²¹⁶

213. Teri Wilford Wood & Anna Broccolo, *New York Enacts Legislation Related to Board Diversity*, NAT’L L. REV. (Jan. 17, 2020), <https://www.natlawreview.com/article/new-york-enacts-legislation-related-to-board-diversity> [<https://perma.cc/A75Q-5REP>].

214. John Whittaker, *Act Requires Report Stating No. of Women on Boards*, POST-J. (July 15, 2019), <https://www.post-journal.com/news/page-one/2019/07/act-requires-report-stating-no-of-women-on-boards/> [<https://perma.cc/B7QQ-26K6>].

215. Barzuza et al., *supra* note 145, at 1249–50:

When it comes to investment preferences, Millennials are markedly different than their predecessors. The literature and market research unanimously concludes that, compared to prior generations, Millennials are less interested in investment returns and more interested in their investments reflecting their social values;

id. at 1289–94 (citing studies supporting this conclusion).

216. Dave Michaels, *SEC Urged to Help Diversify Asset-Management Industry*, WALL ST. J., <https://www.wsj.com/articles/sec-criticized-for-inaction-in-diversifying-asset-management-industry-11594945813> (last updated July 16, 2020, 8:37 PM) [<https://perma.cc/Y7F2-D5EC>]. Notably, however, other compelling theories are emerging as to just why funds should consider Diversity as a matter of portfolio theory. See Jeffrey N. Gordon, *Systemic Stewardship* 34 (Eur.

1. Investment Company Initiatives

Pension funds and investment companies have shown increasing interest in the topic of Diversity during this century, especially as to gender.²¹⁷ As early as 2009, the SEC sought comment on whether to amend Item 407(c)(2)(vi) of Regulation S-K to require disclosure of whether a nominating committee considers Diversity when selecting a director for a position on the board.²¹⁸ Of the more than 130 comment letters on its proposal, most were submitted in favor of the proposal by groups with a specific interest in Diversity or by institutional investors, including mutual funds, pension funds, and socially responsible investment funds.²¹⁹ Several years later, in 2015, nine large public pension funds who at the time collectively supervised \$1.12 trillion in assets petitioned the SEC to require registrants to disclose information related to, among other things, the gender, racial, and ethnic Diversity of the registrant's board nominees.²²⁰ In 2017, Human Capital Management Coalition, which described itself as a group of institutional investors with \$2.8 trillion in assets at the time, made a similar petition to the Commission.²²¹

Corp. Governance Inst., Working Paper No. 566/2021, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3782814 [https://perma.cc/ML5U-8GEU] (observing that “[h]igh end talent is valuable and scarce; elimination of barriers to its discovery and utilization will create value across a portfolio”).

217. The reality is that it took the sad events of 2020 to move the major institutional investors to make a focus on racial Diversity a priority. See, e.g., Larry Fink & Rob Kapito, *Our Actions to Advance Racial Equity and Inclusion*, BLACKROCK (June 22, 2020), <https://www.blackrock.com/corporate/about-us/social-impact/advancing-racial-equity> [https://perma.cc/GQA9-ZWJA]; Letter from Richard F. Lacaille, Glob. Chief Inv. Officer, State St. Glob. Advisors, to Ronald P. O'Hanley, Bd. Chairman, State St. Glob. Advisors (Aug. 27, 2020), https://www.ssga.com/library-content/pdfs/global/letterhead_racial_equity_guidance.pdf [https://perma.cc/EQ7W-P77Z]; *Vanguard Investment Stewardship Insights: Diversity in the Workplace*, VANGUARD (Dec. 2020), https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/ISWORK_122020.pdf [https://perma.cc/4M6M-H6KH]. The reasons for this lag warrant exploration, but for present purposes, we just note the positive development that racial Diversity has now emerged as a stated institutional-investor priority. We also note, however, that there is still more work that institutional investors should do to combat racial injustice, such as casting their proxies for proposals requiring corporations to disclose political spending, as such spending often supports candidates and political issues that are contrary to the interests of minorities. See Eleanor Bloxham & Bruce F. Freed, *It's Time for Boards and Institutional Investors to Act on Racial Justice*, BARRON'S (June 19, 2020: 7:00 AM), <https://www.barrons.com/articles/its-time-for-boards-and-institutional-investors-to-act-on-racial-justice-51592527239> [https://perma.cc/9TRU-NZ4X].

218. See 17 C.F.R. § 229.407(c)(2)(vi) (2021).

219. See Hazen & Broome, *supra* note 196, at 51 & n.82 (citing the comment letters).

220. Letter from Anne Simpson et al. to Elizabeth M. Murphy, *supra* note 110.

221. See Letter from Meredith Miller, Chief Corp. Governance Officer, UAW Retiree Med. Benefits Trs., on behalf of the Hum. Cap. Mgmt. Coal., to William Hinman, Dir., Div. of Corp. Fin., Sec. & Exch. Comm'n (July 6, 2017), <https://www.sec.gov/rules/petitions/2017/petn4-711.pdf> [https://perma.cc/62VY-928Y] (petition for rulemaking “to require issuers to disclose information about their human capital management policies, practices and performance”).

Nearly a half decade later, pressured by not only its members facing investor pressure and enhanced interest in EESG funds, but also by ratings companies seeking to design systems for categorizing firms, the investment community is once again calling for more information on diversity from companies. In October 2020, the Illinois Treasurer spearheaded an initiative along with twenty other investor organizations, calling on all companies in the Russell 3000 Index to disclose the composition of their board, including each board member's gender, race, and ethnicity.²²² That same month, BlackRock Inc., the world's largest asset manager, announced plans for 2021 to push companies for greater ethnic and gender Diversity for their boards and workforces, and disclosed that it will vote against directors who fail to act to promote that goal. The money manager, which oversees more than \$7.8 trillion of assets, is asking U.S. companies to disclose the racial, ethnic, and gender makeup of their employees—data known as EEO-1—as well as measures they're taking to advance diversity and inclusion.²²³ It will also make explicit pushes for Diversity in select jurisdictions.²²⁴ Meanwhile, Vanguard—with over \$7.2 trillion in assets under management—has said it plans to vote against company directors who fail to push for greater racial and gender diversity on their boards.²²⁵ State Street Global Advisors, which manages about \$3 trillion for clients, has committed to ask companies about their metrics and goals to boost racial Diversity within their ranks.

Against this backdrop, the ICI, the trade association for U.S. and international investment companies like mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts, has likewise announced plans to push for greater Diversity. Initial priorities include measuring industry demographics at both the board and workforce

222. See Press Release, Off. of the Illinois State Treasurer, Illinois State Treasurer Frerichs Calls on Russell 3000 Companies to Disclose Board Diversity Data (Oct. 28, 2020), https://illinoistreasurer.govprod.blob.core.usgovcloudapi.net/twocms/media/doc/october2020_russe1l3000.pdf [<https://perma.cc/VLS6-BCNB>].

223. Saijel Kishan, *BlackRock to Push Companies on Racial Diversity in 2021*, BLOOMBERG, <https://www.bloomberg.com/news/articles/2020-12-10/blackrock-plans-to-push-companies-on-racial-diversity-in-2021?sref=rBZlhbhK> (last updated Dec. 10, 2020, 9:06 AM) [<https://perma.cc/DJ95-YU9V>]; see also Fiona Hathorn, *Cultural Diversity on Boards Is a Global Issue*, WOMEN ON BDS. (Oct. 26, 2020), <https://www.womenonboards.net/en-au/impact-media/news/cultural-diversity-on-boards-is-a-global-issue> [<https://perma.cc/WS6F-TDV8>].

224. For example, BlackRock U.K. companies are to adopt the Hampton-Alexander Review target for female directors in the U.K.'s top businesses—the minimum threshold for this target is 33% female board composition or greater. Tessa Hastie & Ariel White-Tsimikalis, *Findings of the Final Hampton-Alexander Review*, JD SUPRA (Feb. 25, 2021), <https://www.jdsupra.com/legalnews/findings-of-the-final-hampton-alexander-1380319/> [<https://perma.cc/USS6-A69F>].

225. Saijel Kishan, *Vanguard to Push Companies on Racial Diversity Next Year*, BLOOMBERG (Dec. 15, 2020, 10:47 AM), <https://www.bloomberg.com/news/articles/2020-12-15/vanguard-to-push-companies-on-racial-diversity-next-year> [<https://perma.cc/8HVV-G6M5>]; see also John Galloway, *A Continued Call for Boardroom Diversity*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 19, 2020), <https://corpgov.law.harvard.edu/2020/12/19/a-continued-call-for-boardroom-diversity> [<https://perma.cc/47FC-AQCJ>].

levels through mandatory surveys of members.²²⁶ This information will then be used to develop benchmarks to improve Diversity in the future. Once these benchmarks are eventually implemented, it is expected that there will be more explicit reporting guidelines, and perhaps requirements, for board diversity similar to those proposed by other securities industry participants.

2. Nasdaq Listing Requirements

Nasdaq's new rule (the "Rule") mandates certain board diversity requirements for public companies listed under its exchange.²²⁷ The Rule was submitted on December 1, 2020, for SEC approval, and the SEC approved the rule August 4, 2021.²²⁸ Under the Rule, each Nasdaq-listed company faces two sets of requirements. First, each listed company would have to annually disclose in a uniform format, either in the company's annual proxy statement or on the company's website, statistical information regarding its directors' self-identified gender, race, and self-identification as LGBTQ+. Additionally, companies listed on the Nasdaq Global Select tier or Global Market tier would have to have (or explain why they do not have) at least one Diverse director within two years of SEC approval, and at least two Diverse directors within four years of SEC approval. Smaller-cap companies listed on the Nasdaq Capital Market tier must have (or explain why they do not have) at least one Diverse director within two years of SEC approval, and at least two Diverse directors within five years of SEC approval.

Nasdaq's rule would presumably have a broad impact, encouraging thousands of companies listed on its stock exchange to include women, racial minorities, and LGBTQ+ individuals on their boards, in what is one of the most forceful moves yet to bring greater diversity to U.S. corporations. Notably, more than three-quarters of its listed companies would, in the absence of changes to their board, fall short of the proposed requirements.²²⁹ Although 80 to 90% of companies have at least one female director, only approximately one-quarter had at the time of the rule's initial proposal a second director who would

226. See Hathorn, *supra* note 223 (calling for a "new government-led review" to "ensure a renewed impetus to continue progress on both ethnicity and gender").

227. Ron S. Berenblat & Elizabeth Gonzalez-Sussman, *Nasdaq Proposes New Listing Rules Relating to Board Diversity*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 13, 2020), <https://corpgov.law.harvard.edu/2020/12/13/nasdaq-proposes-new-listing-rules-related-to-board-diversity/> [https://perma.cc/7Y6Q-JNNQ].

228. Alexander Osipovic, *Nasdaq's Board-Diversity Proposal Wins SEC Approval*, WALL ST. J., <https://www.wsj.com/articles/nasdaqs-board-diversity-proposal-faces-sec-decision-11628242202> (last updated Aug. 6, 2021, 3:48 PM) [https://perma.cc/XL5W-YNGV].

229. Alexander Osipovich & Akane Otani, *Nasdaq Seeks Board-Diversity Rule That Most Listed Firms Don't Meet*, WALL ST. J., <https://www.wsj.com/articles/nasdaq-proposes-board-diversity-rule-for-listed-companies-11606829244> (last updated Dec. 1, 2020, 5:26 PM) [https://perma.cc/3QGK-5QNT].

meet the Diversity requirements.²³⁰ Overall, smaller companies tended to have less Diverse boards and will need to do more to respond to the Rule.²³¹

3. The Goldman Sachs IPO Pledge

In February 2020, Goldman Sachs announced that it will only underwrite IPOs for U.S. and European private companies that have at least one Diverse board member.²³² This rule became effective on July 1, 2020, and starting in 2021, Goldman Sachs will raise its target to “two diverse candidates for each of [its] IPO clients.”²³³ The Diversity requirement is mandatory, but it is implied that there is discretion as to what qualifies as “Diverse.” The commitment statement cites Goldman Sachs’ own board of directors, where the lead director is a Nigerian man and four of the eleven board seats are held by women.

E. The Limitations of External Regulation and the Corresponding Need for Corporate Action

Collectively, current U.S. proposals designed to increase corporate Diversity do so in largely unprecedented ways, with particular emphasis falling most squarely on corporate boards. They do so along two basic dimensions: either (a) state law reforms or (b) reforms that leverage capital markets infrastructures and services providers.

There are, however, a number of important limitations with the current trajectory of reforms. First are possible constitutional challenges.²³⁴ California’s SB 826 has already been challenged on equal-protection grounds in several lawsuits.²³⁵ “In *Meland v. Padilla*, a

230. Though even here, the data were reportedly difficult to measure because of inconsistencies in the way companies report such data. *Id.* Nasdaq defined underrepresented minorities as individuals self-identifying as Black, Hispanic, Asian, Native American, or belonging to two or more races or ethnicities. *Id.*

231. *Id.*

232. *Goldman Sachs’ Commitment to Board Diversity*, GOLDMAN SACHS (Feb. 4, 2020), <https://www.goldmansachs.com/what-we-do/investing-and-lending/launch-with-gs/pages/commitment-to-diversity.html> [https://perma.cc/6CZK-2Z7M].

233. *Id.*

234. For a summary of possible constitutional challenges to statutes of this kind, see generally Joseph A. Grundfest, *Mandating Gender Diversity in the Corporate Boardroom: The Inevitable Failure of California’s SB 826* (Rock Ctr. for Corp. Governance at Stan. Univ., Working Paper No. 232, 2018), <https://ssrn.com/abstract=3248791> [https://perma.cc/K4MC-NRWT] (analyzing constitutionality of AB 826). See also Stephen M. Bainbridge, *California Corporate-Board Quota Law Unlikely to Survive a Constitutional Challenge*, WASH. LEGAL FOUND. (Oct. 2, 2018), <https://www.wlf.org/2018/10/02/wlf-legal-pulse/california-corporate-board-quota-law-unlikely-to-survive-a-constitutional-challenge/> [https://perma.cc/MT8J-PWMW] (arguing that AB 826 is unconstitutional under the internal affairs doctrine).

235. David A. Bell, Dawn Belt & Jennifer J. Hitchcock, *New Law Requires Diversity on Boards of California-Based Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 10, 2020),

conservative legal organization [unsuccessfully] claimed on behalf of a public company shareholder that, in requiring a female board member, the law prevented that shareholder from voting as he desired.”²³⁶ In another case, *Crest v. Padilla*, the plaintiff sought to prevent the California Secretary of State, Alex Padilla, “from spending taxpayer money to enforce the law on the grounds that it violated the California constitution by imposing an unconstitutional gender-based quota. In June, [2020,] a state Superior Court judge overruled Padilla’s argument that the plaintiffs lacked standing.”²³⁷ The matter is currently in ongoing litigation, and the Secretary of State’s office will be required to answer the complaint.

AB 979 will likely be challenged on similar grounds.²³⁸ Opponents of the laws may argue that male candidates, or non-Diverse candidates, are denied fundamental rights under the Equal Protection Clause as a result of mandatory diversity quotas. Notably, these challenges will likely trigger strict scrutiny of these race- and gender-based laws and thus, though remedial in nature and designed to address a long-standing history of discrimination, the laws will, as we discuss below, face an uncertain future before the right-wing majority of the U.S. Supreme Court, and that reality will create dilemmas for corporate decisionmaking. To the extent to which the law imposes substantive board requirements on corporations that may be headquartered in California but incorporated elsewhere, the law could additionally be challenged on the basis of the internal affairs doctrine, which provides that the state of incorporation should have the authority to regulate a corporation’s internal affairs (such as corporate governance and composition and election of boards).

The Nasdaq reforms create far less uncertainty insofar as they, although expressing clear objectives, do not introduce mandatory reforms to boards. Instead, listed firms are required to comply or explain why they did not meet listing standards. Theoretically, however, challenges could nonetheless arise if a qualified candidate seeking a position on a public company’s board argued that he was deprived of a property interest by being denied a board position primarily for not meeting “Diverse” criteria under the Rule. Alternatively, the Rule might be challenged under the internal affairs doctrine. Under this logic, Nasdaq should not be able to impose federal guidelines about board composition when state corporate law should govern its makeup.

<https://corpgov.law.harvard.edu/2020/10/10/new-law-requires-diversity-on-boards-of-california-based-companies/> [https://perma.cc/L8HN-XA9P].

236. *Id.*

237. *Id.*

238. *Id.*

Still, the most obvious limitation of Nasdaq's new listing rules—along with that of the ICI—is that they are ultimately not mandatory. Instead, a company can choose whatever course of action it wants, unless other legal constraints arise in some other corner.

Additionally, Nasdaq's rules, along with the engagement of the ICI and Goldman Sachs, apply exclusively to public companies. None apply to private companies. From a public policy perspective, and from the standpoint of racial equity, this limited scope is problematic. There are only about half as many public companies in the United States today as there were in the late 1990s.²³⁹ And promising start-ups are tending to stay private longer, with elite investors capturing even more of the biggest gains.²⁴⁰ By extending only to public companies, the capital markets-based reforms miss companies where the most value is created. They also fail to affect firms at a point in time when the introduction of Diverse boards might likely prove most transformative. Diversity experts agree that the easiest means of ensuring that firms are diverse is by making sure that they take steps toward diverse hiring early on.²⁴¹ It is, in short, much easier to ensure Diversity by hiring Black and Brown people early on, than it is to achieve by scaling and then taking on Diverse board members with the hope that they can retroactively change the demographics and culture of the firm.²⁴²

Critically, Nasdaq's reforms, like virtually all of the major reforms thus far introduced, focus exclusively on boards. None target the Diversity of senior and middle management—or the broader workforce as a whole. The most charitable reading of their scope would be that they speak to the holes in federal employment discrimination law. But the bulk of opportunity that corporations provide for Americans to improve their lives, engage in fulfilling work, and interact with customers and communities is at the other levels of the firm—where line workers, middle managers, and contracted workers collaborate to serve the company's customers. For reforms at the board level alone to effectively change corporate demographics at all, they would at best involve slow, incremental, and not transformational change—and for even that to occur, consistent board oversight and involvement must drive the deeper and more comprehensive action required to ensure that corporate policies toward all stakeholders embrace respect for Diversity, Equity, and Inclusion.

239. Tara Siegel Bernard, *Opening the Door to Unicorns Invites Risk for Average Investors*, N.Y. TIMES (Jan. 4, 2020), <https://www.nytimes.com/2020/01/04/your-money/investing-private-market-startups.html> [https://perma.cc/MP4K-UBQA].

240. *Id.*

241. See Brian Nordli, *How to Make Diversity A Hiring Priority at the Startup Stage*, BUILT IN, <https://builtin.com/diversity-inclusion/small-business-diversity-and-inclusion-hiring-strategy> (last updated July 8, 2021) [https://perma.cc/XW48-2R7E] (“It’s so hard to course correct once you go from 50 people to 150-300 . . .” (internal quotation marks omitted)).

242. *Id.*

Many of the reforms rely on quotas as drivers of reform. And while we applaud decisive action at establishing clear goals for organizations and compelling corporate boards to open long-denied doors of opportunity, the threat of constitutional challenge is clear.²⁴³ And the outcome, given recent Supreme Court jurisprudence, is uncertain.²⁴⁴ Quotas are also gameable. In many instances, the numerical thresholds are minimal—sometimes just one Diverse director—and the capaciousness and sheer number of factors that qualify as Diverse present the opportunity for employers to selectively target people coming from groups that may be more socially or personally palatable to hirers instead of from those who are most historically or demographically underrepresented. Thus, to the extent they represent check-the-box exercises, quotas allow companies to meet minimal numerical thresholds and, upon doing so, can unintentionally encourage them to relax or disengage from further board reform.²⁴⁵ As at least currently contemplated, they risk being “half measures.”

Finally, none of the reforms speak to closely allied, but importantly distinct, concepts of Equity and Inclusion, the “E” and “I” in DEI.²⁴⁶ As a result, the reforms do not provide the tools to address

243. A learned colleague posed this hypothetical: Imagine a California-based corporation that is subject to the “at least three women requirement,” and that has only two women on the board. A vacancy arises. May or must the board limit its search to only women candidates? Even assuming it may do so without running afoul of antidiscrimination statutes because directors are likely not employees covered by those statutes, may the board do so consistent with the federal Constitution if it is doing so by mandate of state law? As a matter of law compliance, the board would have to consider its obligations not just under state law, but under federal constitutional law, and make a difficult calculus about whether these statutes can be applied validly in a context like this where compliance would literally require only considering women candidates to the exclusion of all males. And, of course, similar situations could arise to the extent that statutes were to require a certain percentage of minority representation, or of a particular minority, such as Black people.

244. As a matter of recent constitutional jurisprudence, the U.S. Supreme Court has displayed little tolerance for federal and state law efforts to remediate past discrimination. Prominent examples include its decision in *Shelby County v. Holder*, 570 U.S. 529 (2013), striking down key provisions of the Voting Rights Act that had been extended by overwhelming bipartisan majorities, and its decision in *Parents Involved in Community Schools v. Seattle School District No. 1*, 551 U.S. 701 (2007), striking down a school district’s plan to continue efforts to promote desegregation and racial balance in its schools after being relieved of federal court supervision. *Shelby*, 570 U.S. at 556–57 (holding that the Voting Rights Act’s coverage formula and preclearance requirement, which required covered jurisdictions to demonstrate that proposed voting law changes were not discriminatory, was unconstitutional); *Parents Involved*, 551 U.S. at 729–32 (plurality opinion) (finding that the use of racial classification to create a racially diverse environment was racial balancing and thus unconstitutional).

245. We stress, however, that how and under what context quotas are applied matters. Leaving the constitutional question aside, quotas can plausibly serve to forward a number of Diversity goals because it is often difficult to make progress on a long-standing inequity without a reasonable target to aim for and against which to measure the effectiveness of efforts. The application of strict numerical goals thus far leaves, however, open questions as to whether or not ostensibly muscular measures like quotas would over time make a measurable impact on the representation of the most historically underrepresented or persecuted groups.

246. As Nancy Leong recognizes in a similar context, “striving for numerical diversity, without more,” may result in awareness of diversity “only in its thinnest form—as a bare marker of

issues beyond board personnel, like ensuring an inclusive environment to support communication and innovative ideas from Diverse pockets of the workforce. Goldman Sachs has taken the laudable step of effectively constraining itself via a voluntarily adopted quota system in which it will only assist companies with IPOs that meet a basic board-level diversity threshold.²⁴⁷ But this new positive standard does not address less quantifiable issues of corporate culture toward DEI. For example, Goldman Sachs advised the highly successful crypto exchange Coinbase in going public, despite moves by Coinbase to limit Black Lives Matter protests and other communications about racial equity issues within its workplace,²⁴⁸ and despite evidence published about the widespread pay inequity allegedly suffered by Coinbase's Black and female employees.²⁴⁹

Our point is that it is, of course, useful and important to increase the Diversity of corporate boards and the C-suite. But these issues are just the beginning, not the end, of the conversation. Unfortunately, legislating bright line, ex ante commitments to workforce-wide inclusion, to fairness and equity, to treating fellow employees and customers with respect regardless of their identity, and to providing equal service to all communities is difficult. And, perhaps for that reason, the pending reforms also do not even purport to address issues like these. They are also silent on other important issues such as the willingness of corporations to provide their services and products to all communities who can benefit from them, be they urban communities with major minority populations or struggling, predominately white rural communities.²⁵⁰ They evade any interrogation of issues like

difference and a signal of presence.” Nancy Leong, *Racial Capitalism*, 126 HARV. L. REV. 2151, 2155 (2013). Diversity could then be merely a useful word for nondiverse corporations to use to “acquire social and economic benefits” of listing or incorporation while “avoiding more difficult questions of racial [and gender] equality.” *Id.*; see also Derrick Bell, *Diversity's Distractions*, 103 COLUM. L. REV. 1622, 1622 (2003) (arguing that diversity can be used in ways to avoid questions on race and class); Stephen M. Rich, *What Diversity Contributes to Equal Opportunity*, 89 S. CAL. L. REV. 1011, 1098 (2016) (arguing that the rationale of *Grutter v. Bollinger*, 539 U.S. 306 (2003), underserves equal opportunity “by deferring to institutional constructions of diversity’s benefits,” naively equating the achievement of numerical diversity with the accomplishment of those benefits).

247. See GOLDMAN SACHS, *supra* note 232.

248. Eric Volkman, *Goldman Sachs Reportedly Picked to Lead Coinbase IPO*, NASDAQ (Dec. 19, 2020, 1:23 AM), <https://www.nasdaq.com/articles/goldman-sachs-reportedly-picked-to-lead-coinbase-ipo-2020-12-19> [<https://perma.cc/3MFz-G5DY>]; Gregory Barber, *The Turmoil Over 'Black Lives Matter' and Political Speech at Coinbase*, WIRED (Oct. 5, 2020, 7:00 AM), <https://www.wired.com/story/turmoil-black-lives-matter-political-speech-coinbase/> [<https://perma.cc/39RY-PQV5>].

249. Nathaniel Popper, *Cryptocurrency Start-Up Underpaid Women and Black Employees*, *Data Shows*, N.Y. TIMES (Apr. 15, 2021), <https://www.nytimes.com/2020/12/29/technology/coinbase-pay-employees.html> [<https://perma.cc/2455-BC4A>] (“[W]omen at Coinbase were paid an average of \$13,000, or 8 percent, less than men at comparable jobs and ranks within the company” and “[Black employees] were paid \$11,500, or 7 percent, less than all other employees in similar jobs.”).

250. See *supra* Part III.

corporate recruitment policies, and whether and how corporations should extend searches to not only historically Black universities but also to community colleges. And they do not begin to contemplate DEI commitments corporations should expect or require of the businesses that they contract with.

For all these reasons, we find it improbable that external law alone will induce the full scope of required corporate action. At least as currently conceived, external regulation does not have a method to bake into the bones of corporations a deep commitment to equality, inclusion, and tolerance or an ethos of valuing all employees, customers, business partners, and communities, regardless of race, gender, religion, or sexual orientation.²⁵¹ At best, they encourage boards themselves to be a bit more representative, which is worthy but should not be oversold as close to sufficient.

IV. THE FUNDAMENTAL PRINCIPLES OF FIDUCIARY DUTY GOVERNING CORPORATE DIRECTORS AND OFFICERS

As iconic scholars like Adolf Berle and cutting-edge thinkers like Elizabeth Anderson have made clear, corporations occupy a central role in the lives of most Americans.²⁵² Much of our lives are spent under the dominion of our employers.²⁵³ Whether we are respected and are treated as worthy of equal respect with each other during our time at work is critical to whether we have a life that is fulfilling. Likewise, for better or worse, the United States is a commercial nation, and the respect with which we are treated by the businesses we depend on for products and

251. Although the purpose of this Article is not to spell out the positive actions corporations can take across these important dimensions, we note that there is a growing body of recommendations that corporate leaders can take advantage of. *See, e.g.*, Greg Hills, Lakshmi Iyer, Michael McAfee, Josh Kirschenbaum & Martin Whittaker, *A CEO Blueprint for Racial Equity*, FSG, POLICYLINK & JUST CAP. (July 2020), https://www.policylink.org/sites/default/files/CEO_Blueprint.pdf [<https://perma.cc/9EJ6-N2KY>]; SUNDIATU DIXON-FYLE, KEVIN DOLAN, VIVIAN HUNT & SARA PRINCE, MCKINSEY & CO., *DIVERSITY WINS: HOW INCLUSION MATTERS* (May 2020), <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters> [<https://perma.cc/CX9R-623H>]; PETERSON & MANN, *supra* note 69; Leo E. Strine, Jr., *Toward Racial Equality: The Most Important Things the Business Community Can Do*, (U. Pa. Inst. for L. & Econ., Rsch. Paper No. 20-56, Colum. L. & Econ. Working Paper, Paper No. 635, 2020), <https://ssrn.com/abstract=3723950> [<https://perma.cc/66TR-XZX4>].

252. *See infra* note 254 and accompanying text.

253. The role that corporations play in creating an environment that is tolerant and inclusive is especially important given that Americans spend a major part of their lives at work: in 2019, an American worked, on average, 7.7 hours per day at his or her workplace and a total of 1,779 hours annually. BUREAU OF LAB. STAT., U.S. DEP'T OF LAB., USDL-21-1359, *AMERICAN TIME USE SURVEY — MAY TO DECEMBER 2019 AND 2020 RESULTS 1* (July 2021), <https://www.bls.gov/news.release/pdf/atus.pdf> [<https://perma.cc/YE76-GETZ>]; *Average Annual Hours Actually Worked Per Worker*, ORG. FOR ECON. CO-OPERATION & DEV., <https://stats.oecd.org/Index.aspx?DataSetCode=ANHRS> (last visited Oct. 18, 2021) [<https://perma.cc/M4EQ-YWAW>].

services matters greatly not just for how we feel about ourselves and our society, but for corporations themselves. For that reason, thinkers like Berle and Anderson have, from different perspectives in different centuries, come to the powerful conclusion that the fulfillment of the American ideal cannot occur unless powerful corporations themselves embed a commitment to equality and respect in their way of doing business.²⁵⁴

The expanding universe of state corporate law reforms and public company disclosure requirements surveyed in the previous Part is sparking a much-needed conversation about Diversity, business, and the proper role of corporations in society. But, as we addressed, they are unlikely, in isolation, to achieve the comprehensive changes to broader corporate culture needed to assure positive corporate reputations, to protect all corporate stakeholders from discrimination and inequity, and to capitalize on the business advantages of Diversity, Equity, and Inclusion for investors.

The authority, and indeed, impetus, provided by corporate fiduciaries under corporate law offers an important additional tool for moving the dial. In this Part, we begin to connect the dots by providing a foundational theory of how corporate law of fiduciary duty applies to corporate DEI policies. Specifically, we situate fiduciary duty along a spectrum of mandatory and discretionary actions that speak to fiduciaries' core obligations to pursue the best interests of shareholders and the corporation.

In a first step, we explain the foundational directive embedded in the corporate duty of loyalty as one that—while comprising a substantive body of legal duties, norms, decisions, and traditions—is not a field of law operating in hermetic isolation from others. Instead, it is as much outwardly facing as internal, creating obligations to take affirmative steps to comply with laws that are of critical importance to the company and society.

In a second step, we then outline another key element of corporate law important to any social question relevant to corporations:

254. As production in the United States became concentrated in corporations, Berle observed that the dominance by corporations of the American economic scene changed the relationship between corporations and the modern state. Adolf A. Berle, Jr., *Constitutional Limitations on Corporate Activity—Protection of Personal Rights from Invasion Through Economic Power*, 100 U. PA. L. REV. 933, 942–43 (1952). Large corporations amassed sufficient economic power to materially invade an individual's constitutional rights, and therefore, as creations of the state, corporations have to carry out functions, such as applying the Bill of Rights and the Fourteenth and Fifteenth Amendments, “for which in modern life by community demand the government is held ultimately responsible.” *Id.* at 943. Berle described that this doctrine “constitutionalizes” corporations. *Id.*

Philosopher Elizabeth Anderson takes a Berle-like perspective on the need for corporations to embed constitutional values of equality and tolerance in their treatment of their workers in particular. ELIZABETH ANDERSON, *PRIVATE GOVERNMENT: HOW EMPLOYERS RULE OUR LIVES (AND WHY WE DON'T TALK ABOUT IT)* 61–71 (2017). As Anderson shows, Americans spend a huge portion of their lives in environments controlled by their employers, and unless these employers create a workplace that allows them to feel respected and valued, regardless of their origin, the full promise of equality cannot be realized. *See id.*

the wide discretion afforded to fiduciaries under the business judgment rule to go beyond mere law compliance. We show that this discretion provides a safe harbor for corporate leaders to embrace effective and ambitious DEI strategies. Within that safe harbor, fiduciaries have wide discretion to take action they believe will ensure their corporations' respectful engagement with all stakeholders; improve corporate decisionmaking, productivity, and reputation; and enhance the firm's sustained profitability and long-term value.

A. The Legal Pursuit of Profit

1. The Negative and Positive Components of the Duty of Loyalty

Although corporate law practitioners, judges, and scholars often enjoy complicating the fiduciary duties owed by the directors and managers of corporations, the foundational principles are, in fact, quite focused. Indeed, it can be fairly said that there is really one fiduciary duty—that of loyalty—and that properly understood, even the duty of care itself can be understood as a subsidiary requirement of the basic duty of loyalty, as we shall explain. In any event, both the duty of loyalty and duty of care have important implications for corporations addressing DEI, as both duties impose certain mandatory obligations that fiduciaries must take to address DEI, and both enable them to take discretionary actions to implement effective DEI policies if they believe that is in their company's best interest.

To understand why, a brief review of the duty of loyalty is necessary. The duty of loyalty prohibits the director and officer from self-dealing, bad faith, and fraud at the expense of the corporation—a negative check on director infidelity. But even more, the duty of loyalty has a positive or affirmative component demanding that directors and officers make a good faith effort to promote the sustained profitability of the corporation and the welfare of its stockholders.²⁵⁵ Thus, a loyal fiduciary must make a good faith effort to attend carefully to corporate affairs and make sound decisions. For that reason, the duty of care flowing from that obligation has itself emerged as the other most salient duty in corporate jurisprudence.

The duty of care's implications for corporate fiduciaries are meaningful, even if the damages club to enforce it is comparatively weak. Under common corporate law formulations, the normative duty of care requires directors and officers to exercise "that amount of care which ordinarily careful and prudent [people] would use in similar

255. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345 (Del. 1987) (the duty of loyalty "embodies not only an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage").

circumstances” towards the corporation and its shareholders.²⁵⁶ This normative duty was largely just that for most of corporate law history, because there were no cases holding directors liable for monetary damages for breaches of the duty of care.²⁵⁷ But the duty of care was always important because normative duties, even without liability potential, still had an important effect on behavior, and that is particularly so for reputationally and mission-driven people like corporate directors.²⁵⁸

But, in the last century, the “soft law” operation of the duty of care was buttressed by the “stick approach” adopted in *Francis v. United Jersey Bank* and *Smith v. Van Gorkom*, and monetary liability was imposed on directors for a lack of due care.²⁵⁹ Even though *Van Gorkom* set the liability bar at gross negligence for the purpose of avoiding directors being too risk-averse because of liability risk, the decision in *Van Gorkom* still generated great controversy over the fairness and wisdom of holding independent directors liable for negligence-based conduct.²⁶⁰ The Delaware General Corporation Law was therefore amended to provide corporations with the ability to adopt charter provisions exculpating directors from liability for even gross negligence.²⁶¹ Most other states took similar action and institutional investors supported corporations in adopting them, so such provisions

256. *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963).

257. *See, e.g.*, William T. Allen, *The Corporate Director's Fiduciary Duty of Care and the Business Judgment Rule Under U.S. Corporate Law*, in *COMPARATIVE CORPORATE GOVERNANCE* 307, 324 (Klaus J. Hopt et al. eds., 1998) (“The long history that was inconsistent with courts directly imposing liability on corporate directors for violation of the objective standard of care was interrupted by the decision of the Delaware Supreme Court in *Smith v. Van Gorkom*.”); Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 *YALE L.J.* 1078, 1099 (1968) (“The search for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack.”).

258. One of corporate law's long-standing techniques, exemplified by *Caremark*, which we will discuss, is to use normative duties to drive behavior even when there is no personal monetary consequence for the fiduciary in failing to live up to those obligations. For an interesting discussion of the importance of norms in corporate governance, see Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 *U. PA. L. REV.* 1619 (2001).

259. *See Francis v. United Jersey Bank*, 432 A.2d 814, 826–29 (N.J. 1981) (holding the estate of a director of an insurance company liable for her failure of due care in monitoring the corporation's officers, who included her husband and her sons, and detecting that the sons were engaged in improper practices to the detriment of the corporation's clients); *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985) (finding outside directors liable for monetary damages because they were allegedly grossly negligent in their approval process of a premium-generating merger).

260. *Van Gorkom* was met with strong criticism for narrowing the business judgment rule and the resulting consequences. *See, e.g.*, Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 *BUS. LAW.* 1437 (1985) (explaining that directors will be less likely to take risks and less willing to serve on corporate boards post-*Van Gorkom*); Lynn A. Howell, *Post Smith v. Van Gorkom Director Liability Legislation with a Proactive Perspective*, 36 *CLEV. ST. L. REV.* 559, 560 (1988) (observing that *Van Gorkom* was considered to have “triggered the dramatic increases in the number of shareholder suits filed, director and officer (hereinafter D & O) insurance policy cancellations, skyrocketing premiums, and the flight of the outside directors” (footnote omitted)).

261. *DEL. CODE ANN.* tit. 8, § 102(b)(7) (2021).

are now ubiquitous and render due-care damages remedies against directors rare to nonexistent.²⁶²

But, as a matter of director reputation and public scrutiny, the directors' normative duty to act with due care still has great importance. It is critical when independent directors' deliberative process and efforts are important to the standard of review applied in transactions involving conflicts of interests of management,²⁶³ contested takeover attempts,²⁶⁴ or sales of corporate control.²⁶⁵ Moreover, and as we will discuss, directors' actions in exercising care—again, the deliberative process in which they engaged—bear on their state of mind and whether they acted in good faith to fulfill their duty of loyalty. For these reasons, complying with both the duty of loyalty and the duty of care is constantly the focus of corporate boards, officers, and their advisers.

In case law, the negative component of the duty of loyalty has typically attracted most of the attention because it addresses the important obligation for fiduciaries to avoid causing harm to the corporation by acts such as unfair self-dealing²⁶⁶ or the usurpation of corporate opportunities.²⁶⁷ The intention is to prevent any possible self-interest exercising an influence that interferes with discharging one's duty to the best interests of the corporation and shareholders. Indeed, it is in these negative loyalty cases where the independent directors' obligation of care has often been the subject of most attention.²⁶⁸

262. Cory A. McKenna, *FDIC v. Rippy: Due Care and the Business Judgment Rule in the Fourth Circuit and the Potential Implications for the Banking Industry*, 20 N.C. BANKING INST. 189, 215 (2016); see also MODEL BUS. CORP. ACT ANN. § 2.02, Statutory Comparison, n.6 (2017).

263. See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (applying the business judgment rule standard of review to a merger between a controlling stockholder and its subsidiary where the merger was approved from the beginning by a committee of independent directors and an informed vote of a majority of the minority stockholders).

264. *E.g.*, *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (finding that the directors' show of good faith and reasonable investigation was enhanced by the approval of a board of directors that was comprised of a majority of independent directors).

265. *E.g.*, *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 44 (Del. 1994) (noting that "the role of outside, independent directors becomes particularly important because of the magnitude of a sale of control transaction and the possibility, in certain cases, that management may not necessarily be impartial").

266. Gareth Jones, *Unjust Enrichment and the Fiduciary's Duty of Loyalty*, 84 LAW Q. REV. 472 (1968). For an iconic Delaware case involving this principle in the conflicted merger context, see *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

267. Eric Talley & Mira Hashmall, *The Corporate Opportunity Doctrine*, U.S.C. INST. FOR CORP. COUNS. 1 (Feb. 2001), <https://weblaw.usc.edu/why/academics/cle/icc/assets/docs/articles/iccfinal.pdf> [<https://perma.cc/E5BM-ACTQ>]. For the classic Delaware case, see *Guth v. Loft*, 5 A.2d 503 (Del. 1939).

268. For recent cases where the diligence of a special committee was relevant to a duty of loyalty claim against conflicted parties, see *In re Rural Metro Corp.*, 88 A.3d 54 (Del. Ch. 2014); and *In re S. Peru Copper Corp.*, 52 A.3d 761 (Del. Ch. 2011).

The importance of the negative component's role in addressing conflicts of interests and self-dealing has, however, left the affirmative component too often overlooked. Although it is widely understood that fiduciaries should refrain from conduct that harms the corporation—such as by unfair self-dealing or entrenching of themselves in office—the fiduciary duty of loyalty demands more: that directors and officers make a good faith effort to advance the best interests of the corporation and its stockholders.²⁶⁹ This affirmative component is not new but has long been understood as central to the duty of loyalty in the corporate law.²⁷⁰

This affirmative obligation has at its core the requirement that directors and officers act to promote the best interests of the corporation and its sustained profitability, within the limits of their legal discretion and their sense of ethics.²⁷¹ This obligation of loyalty does *not* in fact put the pursuit of profit above all else. Rather, the most fundamental requirement is that the directors and officers be loyal to the corporation's basic license from society, which allows the corporation to seek profit, but only conducting lawful business by lawful means.²⁷² “Law compliance . . . comes ahead of profit-seeking as a matter of the corporation's mission, and directors owe a duty of loyalty to that hierarchy.”²⁷³ Thus, “one cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey.”²⁷⁴

269. *In re Walt Disney Co. Derivative Litig. (Disney III)*, No. Civ.A. 15452, 2004 WL 2050138, at *5 n.49 (Del. Ch. Sept. 10, 2004) (quoting *BelCom, Inc. v. Robb*, No. CIV.A. 14663, 1998 WL 229527, at *3 (Del. Ch. Apr. 28, 1998)) (the “‘duty of loyalty . . . imposes an affirmative obligation to protect and advance the interests of the corporation’”).

270. *E.g.*, 1 THOMAS W. WATERMAN, A TREATISE ON THE LAW OF CORPORATIONS OTHER THAN MUNICIPAL 420, 613 (N.Y., Baker, Voorhis & Co. 1888) (“‘A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporations, whose affairs they are conducting.’”). *See generally* Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffrey M. Gorris, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 633 n.9, 635 n.10 (2010) (gathering sources demonstrating the lineage of this affirmative duty).

271. *See, e.g.*, *TW Servs., Inc. v. SWT Acquisition Corp. (In re TW Servs., Inc.)*, Nos. 10427, 10298, 1989 WL 20290, at *7 (Del. Ch. Mar. 2, 1989) (fiduciary duty of loyalty requires “manag[ing] the corporation within the law, with due care and in a way intended to maximize the long-run interests of the shareholders”).

272. *See, e.g.*, Strine et al., *supra* note 270, at 651.

273. *Id.* For an important application of this insight to the law of sexual harassment, see Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583, 1630 (2018), which explains how courts have recognized that illegal corporate conduct is not loyal corporate conduct and can usually only be justified as a matter of necessity. That said, as the authors note, scholars including Stephen Bainbridge have observed that a “*de minimis*” principle may apply. *See id.* at 1630.

274. *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003); *see also* *Metro Commc'n Corp. BVI v. Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 131, 163–64 (Del. Ch. 2004) (“Metro claims that certain [] defendants breached their duty of loyalty by executing a plan to bribe metropolitan officials in Brazil in order to obtain permits for Fidelity Brazil. . . . These allegations are sufficient to state a claim for breach of fiduciary duty of loyalty”); *Roth v. Robertson*, 118

This affirmative obligation to honor society's laws is the foundation that permits the principled use of the enabling form of current American general corporation statutes. Even under the capacious flexibility of the Delaware General Corporation Law, the most important example of an enabling statute, the law is not just enabling, but, at the same time, prescriptive, allowing corporations only to “conduct or promote any *lawful* business or purposes.”²⁷⁵ Similarly, certificates of incorporation may enable corporations to engage in any business line or activity, but subject to an important bottom line: law compliance. Thus, certificates of incorporation may provide that the corporation may engage in any “lawful act or activity for which corporations may be organized”²⁷⁶ and “all lawful acts and activities shall be within the purposes of the corporation.”²⁷⁷ At the same time, charters can be revoked when there is an abuse of the corporate privilege.²⁷⁸

2. *Caremark* Legal Compliance, Norms, and Their Relationship to Corporate Value and Reputation

Corporate law's emphasis on law compliance is more than a recitation of ultra vires doctrine and requires more than that directors and officers not consciously cause the corporation to break the law in pursuit of profit. The duty of loyalty demands that the directors make a good faith effort—i.e., genuinely “try”—to ensure that the corporation has in place compliance and ethics policies that promote adherence to the laws constraining its conduct.²⁷⁹

This duty is famously associated with Chancellor Allen's decision in *Caremark*²⁸⁰ and is now central to the functioning of any effective board of directors and management team.²⁸¹ The case is

N.Y.S. 351, 353 (Sup. Ct. 1909) (explaining that where directors commit unlawful acts and cause corporate loss, they are liable).

275. DEL. CODE ANN. tit. 8, § 101(b) (2021) (emphasis added).

276. *Id.* § 102(a)(3) (2021).

277. *Id.*

278. See *Craven v. Fifth Ward Republican Club, Inc.*, 146 A.2d 400, 402 (Del. Ch. 1958) (“Continu[ing] serious criminal violations by corporate agents in the course of the discharge of their duties could very well constitute the misuse of a charter.”).

279. For incisive discussions of the importance of law compliance to proper fiduciary behavior, see Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013 (2019); and Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709 (2019).

280. See *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

281. For literature on the importance of *Caremark*, see generally Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 967 (2009):

Even though the Delaware Supreme Court did not formally adopt Allen's approach until over a decade later, lawyers and compliance providers responded to *Caremark* by expanding the level of services available to help directors ensure that proper systems were in place to prevent and detect criminal violations;

canonical, though the underlying facts still bear repeating. A health care company had been indicted for felony violations.²⁸² Following the indictment, Caremark stockholders initiated several derivative class actions claiming Caremark's directors failed to adequately supervise or correct the conduct of Caremark employees, thereby allowing a situation to develop and continue, exposing Caremark to enormous fines and liability.²⁸³

To provide context for his opinion considering the parties' presentation of a settlement, Chancellor Allen first evaluated the stockholder claims, cited various examples of the kind of conduct satisfying this standard, and then made note of Caremark's installation of a monitoring system—the publication of an updated guide designed to ensure compliance with applicable laws and implementation of a policy requiring officers directly approve certain contractual relationships in order to ensure compliance with federal regulations.²⁸⁴

Chancellor Allen took an innovative approach to this important fiduciary responsibility. He intentionally eschewed a negligence-based approach to liability for a board's failure to monitor the company's law compliance, placing it out of the reach of *Van Gorkom*'s gross negligence standard and requiring plaintiffs to prove more to obtain relief.²⁸⁵ To do that, he formulated a standard based on the affirmative obligation of directors to make an effort to act in the best interests of the corporations.²⁸⁶ Thus, he held that liability for failing to monitor would turn on whether the directors failed to make a good faith effort to set up and attend to a rational system of monitoring.²⁸⁷ If they did not, directors violated their duties of good faith to the corporation,²⁸⁸ and by extension, their duty of loyalty.²⁸⁹

Claire A. Hill, *Caremark as Soft Law*, 90 TEMP. L. REV. 681 (2018) (understanding *Caremark* as a "soft law" that promotes social interests and corporate social responsibility); Pollman, *Corporate Oversight and Disobedience*, *supra* note 279, at 2023 (noting that *Caremark* and its subsequent case law led to the evolution of the doctrines of oversight and obedience within the duty of good faith); Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 IOWA L. REV. 1885 (2021) (explaining the close linkage of EESG to *Caremark*'s duty to implement and monitor compliance programs and the utility of integrating these efforts); and Hemel & Lund, *supra* note 273, at 1630 (discussing how *Caremark* duties can prove significant in sexual harassment claims).

282. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 960 (Del. Ch. 1996).

283. *Id.* at 963–65.

284. *Id.* at 963.

285. *See id.* at 971.

286. *See id.* ("[I]n my opinion only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.").

287. *Id.*

288. *Id.* at 968.

289. *See Strine et al.*, *supra* note 281, at 1897. ("Indeed, despite the fact that *Caremark* cases rarely result in legal liability, leading corporate counsel regularly remind directors of this duty. And recent *Caremark* decisions denying the defendants' motions to dismiss have resulted in renewed attention to directors' oversight obligations.").

For the court, however, satisfying such claims involves advancing one of the most difficult theories “in corporation law upon which a plaintiff might hope to win a judgment.”²⁹⁰ And when applying the standards to the facts at hand, the court held that the record showed no evidence that the director defendants were guilty of a sustained failure to exercise their oversight function.²⁹¹ To the contrary, the court observed, the corporation’s information systems represented a good faith attempt to be informed of relevant facts. Thus, Chancellor Allen concluded, if the directors did not know the specifics of the activities that lead to the indictments, they could not be faulted.²⁹²

Though ultimately ruling in favor of the defendants, the *Caremark* decision’s doctrinal importance is substantial. Under the preexisting standard established under *Graham v. Allis-Chalmers Manufacturing Co.*, directors’ duties were “say no evil, see no evil”: as long as no problems were flagged for directors, they could assume everything was fine with no threat of liability.²⁹³ *Caremark* institutes an explicit affirmative duty, resuscitating foundational duty of loyalty principles to be proactive in compliance efforts.²⁹⁴ Additionally, *Caremark* makes clear that corporate law comprises a substantive body of legal duties, norms, decisions, and traditions, and is not a field of law operating in hermetic isolation from others. Instead, the very DNA of corporate law’s most foundational duty, that of loyalty, is outwardly facing and designed to operate symbiotically with the legal constraints and dictates of society to confine corporations to conduct that does not harm society. Loyalty flows to the corporation’s legally chartered mission, which is predicated on a statutory requirement that the company will only do lawful business by lawful means.²⁹⁵ Fidelity to that statute mandates that fiduciaries make a good faith effort to identify and understand the laws that are of material relevance to the company and how its operations affect the legally protected interests of its stakeholders, communities of operation, and society. And the duty of loyalty therefore creates the prospect of liability arising from the breach of such duties falling squarely on the independent directors as monitors. Thus, although external social welfare laws are not incorporated by reference into corporate law itself, the act of incorporation imposes compliance duties that cannot be disregarded, especially where they

290. *Caremark*, 698 A.2d at 967.

291. *Id.* at 972.

292. *Id.*

293. 188 A.2d 125 (Del. 1963).

294. Roy Shapira, *A New Caremark Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857 (2021).

295. DEL. CODE ANN. tit. 8, § 102(a)(3) (2021); *see also* MODEL BUS. CORP. ACT ANN. § 3.01(a) (AM. BAR ASS’N 2016) (“Every corporation incorporated under this Act has the purpose of engaging in any lawful business under a more limited purpose is set forth in the articles of incorporation.”).

relate to key functions, operations, or activities of the firm that may have material effects on others.

In the more than two decades since *Caremark*, Delaware courts have largely required that in order to satisfy a claim against directors for a failure to monitor, a stockholder plaintiff must show one of two forms of deficient board effort to carry out their law compliance responsibilities. One option is that the plaintiff demonstrate that the board “utterly failed to implement any reporting or information system or controls.”²⁹⁶ Alternatively, plaintiffs must demonstrate that the board, having implemented controls, “consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.”²⁹⁷ These are both ways of showing bad faith disloyalty: the first by showing a bad faith lack of effort to address corporate compliance at all, the second by showing a conscious failure to monitor corporate activities.

These standards are routinely acknowledged by Delaware courts as difficult to satisfy—echoing Chancellor Allen’s statement to that effect in *Caremark* itself. They are not impossible, however, and recent suits have met the basic pleading threshold.²⁹⁸ In the 2019 case *Marchand v. Barnhill*, for example, the Delaware Supreme Court held that a derivative action brought under the first *Caremark* prong could proceed against the directors of Blue Bell Creameries, one of the nation’s largest ice cream manufacturers, after the company had been fined and the CEO had been indicted on various criminal charges following a deadly 2015 listeria outbreak.²⁹⁹ The court in *Marchand* ruled that the shareholder complaint had alleged facts from which it could be inferred that Blue Bell’s directors had failed to institute any board-level oversight system for food safety—which was “mission critical” for the monoline company—and, as a result, had not received official notices of food safety concerns for several years.³⁰⁰ The *Marchand* parties ultimately agreed to a \$60 million settlement, ten days before trial was set to commence. Since *Marchand*, there have been at least three additional *Caremark* cases Delaware courts have permitted to proceed past initial pleading stages—in cases ranging from

296. *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

297. *Id.*

298. *E.g.*, *Marchand v. Barnhill*, 212 A.3d. 805 (Del. 2019).

299. *Id.* at 824; see also Meredith Kotler, Pamela Marcogliese & Marques Tracy, *Recent Delaware Court of Chancery Decision Sustains Another Caremark Claim at the Pleading Stage*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 25, 2020), <https://corpgov.law.harvard.edu/2020/05/25/recent-delaware-court-of-chancery-decision-sustains-another-caremark-claim-at-the-pleading-stage/> [https://perma.cc/K65V-DD2X]. The company later pled guilty to crimes and paid a large fine. Press Release, U.S. Dep’t of Just., Blue Bell Creameries Agrees to Plead Guilty and Pay \$19.35 Million for Ice Cream Listeria Contamination – Former Company President Charged (May 1, 2020), <https://www.justice.gov/opa/pr/blue-bell-creameries-agrees-plead-guilty-and-pay-1935-million-ice-cream-listeria> [https://perma.cc/54HB-WW69].

300. Kotler et al., *supra* note 299.

failing to oversee the clinical trial of a company's flagship lung cancer drug³⁰¹ to another's alleged failure to monitor financial statements and related-party transactions.³⁰² In each, the defendant corporation's management faces the prospect of removal or other penalties. Additionally, the defendant corporations are faced with the prospect of millions of dollars of additional fines, along with harmful consumer and public backlash. As important, failures in law compliance have subjected corporations to huge corporate fines, management removals, and reputational damage.³⁰³

We do not want to overestimate the liability club of *Caremark*, however, nor do we believe that is *Caremark*'s sole or necessarily most important function. Rather, like Chancellor Allen himself, we believe that *Caremark*'s primary value is in the incentives it provides to corporate fiduciaries to take proactive, preventative action to ensure that the corporation complies with society's fundamental expectations.³⁰⁴ When a company's board faces a *Caremark* case, the company has almost always already suffered severe reputational, stakeholder, and regulatory costs. By way of example, in cases where a board managed to get a *Caremark* case dismissed, the record reveals that the company had already experienced management replacements, adverse publicity harmful to its reputation for integrity with key constituencies like customers, and regulatory fines and injunctions.³⁰⁵

301. *In re Clovis Oncology, Inc. Derivative Litig.*, C.A. No. 2017-0222, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

302. *Hughes v. Xiaoming Hu*, C.A. No. 2019-0112, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

303. *See, e.g., Dean Seal, McKesson Settles Derivative Suit Over DOJ Fine For \$175M*, LAW360 (Apr. 22, 2020, 2:21 PM), <https://www.law360.com/articles/1266395/mckesson-settles-derivative-suit-over-doj-fine-for-175m> [<https://perma.cc/2NFE-3U6S>] (reporting that the DOJ hit McKesson with a \$150 million fine for allegedly violating the Controlled Substances Act, following which the shareholders filed a *derivative* suit that settled for \$175 million); Nandita Bose, *Walmart to Pay \$282 Million to Settle Seven-Year Global Corruption Probe*, REUTERS (June 20, 2019, 11:47 AM), <https://www.reuters.com/article/us-walmart-fcpa-idUSKCN1TL27J> [<https://perma.cc/X6VA-99AL>] (Walmart agreed to pay \$282 million—\$144 million to the SEC and \$138 million to the DOJ—to settle investigations related to the Foreign Corrupt Practices Act and its alleged failure to maintain a sufficient anti-corruption compliance program).

304. Chancellor Allen's view that normative duties of care can be important in influencing behavior and his view that going too far in enforcing the duty of care by actions for monetary damages is reflected at length in William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449 (2002).

305. *See, e.g., In re MetLife Inc. Derivative Litig.*, C.A. No. 2019-0452, 2020 WL 4746635, at *10, 19 (Del. Ch. Aug. 17, 2020) (dismissing *Caremark* claims against MetLife for failing to monitor its compliance with its obligations to pay annuitants in a timely and complete manner, even though the company had failed to pay retirement benefits in a timely way to 13,500 retirees, overstated its earnings substantially as a result and had to restate, paid regulatory fines, and replaced its CEO); Mike Leonard, *MetLife Board Dodges Lawsuit Over \$500 Million Annuity Error*, BLOOMBERG L. (Aug. 18, 2020, 10:00 AM), <https://news.bloomberglaw.com/corporate-governance/metlife-board-dodges-lawsuit-over-500-million-annuity-error> [<https://perma.cc/TY48-Z3GS>] (MetLife paid a \$10 million fine to resolve related SEC charges); Lananh Nguyen & Katherine Chiglinsky, *MetLife Names Khalaf CEO, Replacing Kandarian After Stock Slump*,

These costs usually only grow with litigation, which may be more likely over time. Scholars and practitioners have taken note of the uptick in the successful number of cases escaping motions to dismiss and searched for explanations for it. One factor cited for the trend is the greater use of section 220 of the Delaware General Corporation Law, which grants stockholders a qualified right to inspect the corporation's books and records.³⁰⁶ Delaware courts have long advocated that plaintiffs in a derivative suit use this tool before bringing a complaint, so that they can meet their pleading burden under doctrines like *Caremark*.

Given evolutions in how boards do business, this tool assists plaintiffs' lawyers in accessing valuable information in seeking support for a *Caremark* claim, especially given that a petitioner in a section 220 action only has to show a credible basis to infer fiduciary wrongdoing to get access.³⁰⁷ With boards of directors acting in more informal ways and the ease of information flow by electronic means, the books and records relevant to investigating a potential *Caremark* claim have expanded, not just in form, but in utility. For that reason, petitioners have been able to procure emails, text messages, and other more informal communications when a petitioner shows that the board in question relied on those means to conduct its business.³⁰⁸ Given that *Caremark* requires good faith efforts, corporate books and records that are devoid of efforts can themselves help a plaintiff meet its burden to plead facts supporting an inference that the defendants failed to make the good

BLOOMBERG (Jan. 8, 2019), <https://www.bnnbloomberg.ca/metlife-names-khalaf-ceo-replacing-kandarian-after-stock-slump-1.1194913> [<https://perma.cc/VK7U-8WQG>] (MetLife's CEO resigned following the company's stock price tumble caused by investigations in connection with which the company publicly acknowledged material weakness in its internal controls); *In re Gen. Motors Co. Derivative Litig.*, C.A. No. 9627, 2015 WL 3958724, at *9 (Del. Ch. June 26, 2015) (dismissing *Caremark* claim for failing to monitor where ignition switches in cars were unsafe, had to be recalled, multiple deaths occurred, and the company suffered over \$1 billion in financial losses and a \$35 million fine, which was the highest fine paid as a result of a National Highway Traffic Safety Administration investigation into a recall); see also *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 113, 139 (Del. Ch. 2009) (dismissing *Caremark* claim for failing to oversee company's participation in the subprime markets where it was undisputed that the company suffered billions of dollars of losses as a result of underwater loans); Dan Wilchins & Jonathan Stempel, *Citigroup CEO Prince to Resign: Reports*, REUTERS (Nov. 2, 2007, 6:05 PM), <https://www.reuters.com/article/us-citigroup-boardmeeting/citigroup-ceo-prince-to-resign-reports-idUSN0233640620071103> [<https://perma.cc/7BT8-W2J3>] (Citigroup's CEO resigned as the bank's losses from the subprime mortgage crisis continued to grow).

306. For an incisive discussion of the relevance of section 220 to *Caremark* suits, see Shapira, *supra* note 294.

307. *AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund*, 243 A.3d 417, 428 (Del. 2020) ("But where a stockholder meets this low burden of proof from which possible wrongdoing or mismanagement can be inferred, a stockholder's purpose will be deemed proper under Delaware law."). Some scholars view the Delaware courts as having relaxed this standard even more in practical terms. Shapira, *supra* note 294, at 18.

308. *KT4 Partners LLC v. Palantir Techs. Inc.*, 203 A.3d 738, 758 (Del. 2019) (holding that the trial court abused its discretion by excluding email communications from the stockholder's demand for the company's books and records given that the company conducted formal corporate business through informal electronic communications).

faith effort at monitoring required to identify and address key compliance risks in the first instance, or were aware of a major compliance issue and failed to make a good faith effort to address it.³⁰⁹ Of important note is another reality: Even if a complaint is not sufficient to support an inference of bad faith and does not survive, public revelation of corporate monitoring practices that fall short of best practices can be embarrassing for the defendants and harmful to the corporation's reputation.

In fact, it has long been understood that corporate law decisions, even ones that ultimately find no liability, can reflect poorly on corporate fiduciaries in ways that are hard to shake.³¹⁰ Given the increasing focus of investors on EESG and other issues of social responsibility—which typically arise in areas where the corporation most affects others and thus are integrally related to issues of legal compliance—boards are likely to be under continuing pressure to put in place effective monitoring policies and to actively address material legal risks that could endanger the company's value and reputation.³¹¹ Not only that, to the extent that regulators take a more assertive enforcement posture during the Biden Administration than during the Trump Administration, the salience of preventive compliance by directors and managers may grow even more.

B. Fiduciary Law's Safe Harbor for Rational Business Judgments

Corporate law goes beyond requiring corporate fiduciaries to ensure that adherence to the law is taken seriously. The business judgment rule gives them substantial room to create a corporate culture with higher standards of integrity, fairness, and ethics than the law demands if they believe that will increase the corporation's value, enhance its reputation, or otherwise rationally advance the best interests of the corporation and its stockholders.³¹² So long as the

309. For example, in *Marchand*, the absence of records showing the board had any reporting or other policies to ensure the company was acting to ensure its compliance with food safety laws helped the plaintiffs convince the Delaware Supreme Court they had stated a claim. *Marchand v. Barnhill*, 212 A.3d. 805, 822–23 (Del. 2019).

310. A distinguished scholar addressed this well and in depth a generation ago. See Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997). Professor Shapira has amplified this reality, and its role in the *Caremark* context, in his valuable recent work. Shapira, *supra* note 294.

311. Strine et al., *supra* note 281, at 1902 (“A variety of domestic and international sources have put pressure on companies to adopt corporate policies and plans for sustainable governance.”).

312. See PRINCIPLES OF THE L. OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (AM. L. INST. 1994) (observing that business decisions made based on ethical considerations are “not only appropriate, but desirable”); see also Christine A. Hemingway & Patrick W. MacLagan, *Managers' Personal Values as Drivers of Corporate Social Responsibility*, 50 J. BUS. ETHICS 33 (2004) (considering that personal values make a difference in the adoption and implementation of corporate social responsibility initiatives). A recent survey found that the

directors believe in good faith that such standards are in the best interests of the corporation, the business judgment rule protects them from judicial second-guessing at the instance of a complaining stockholder.

For example, under Delaware law, the test under the business judgment rule is the lenient one of bare rationality.³¹³ This forgiving test means boards have wide discretion to promote corporate norms that treat employees and consumers with respect and that promote a reputation for integrity and fairness for long-term sustained profitability. Thus, under Delaware law, if the board believes that action benefiting stakeholders like workers or creditors has a rational relationship to the best interests of the stockholders,³¹⁴ the business judgment rule protects the board from stockholders seeking to overturn their judgment in litigation.

This discretion bears emphasis. That the empirical evidence is mixed on an issue, or even tilts the other way on a decision, does not deprive that decision of the protection of the business judgment rule. Rather, so long as there is a rational basis for the board's decision, it must be respected. Perhaps the most controversial illustration of that principle came in the high-profile drama over Time's decision to stick to buying Warner Communications for a premium rather than accepting a gigantic \$200 per share offer from Paramount, a bid that involved a premium exceeding \$75 per Time share. In his decision—known as *Time-Warner*—denying Paramount's bid for an injunction, Chancellor Allen famously said:

It may be that in a well-developed stock market, there is no discount for long-term profit maximizing behavior except that reflected in the discount for the time value of money. It may be the case that when the market valued the stock of Time at about \$125 per share following the announcement of the merger, an observer blessed with perfect foresight would have concurred in that value now of the future stream of all returns foreseen into eternity. Perhaps wise social policy and sound business decisions ought to be premised upon the assumptions that underlie that view. But just as the Constitution does not enshrine Mr. Herbert Spencer's social statics, neither does the common law of directors' duties elevate the theory of a single, efficient capital market to the dignity of a sacred text.

Directors may operate on the theory that the stock market valuation is "wrong" in some sense, without breaching faith with shareholders. No one, after all, has access to more information concerning the corporation's present and future condition. It is far from

values of the majority of Americans align with supporting DEI, as documented by their response that corporations should promote DEI policies in the workplace. Jill Mizell, *The American Public Wants Companies to Take Action on Advancing Racial Equity – Especially Black Americans*, JUST CAP. (July 9, 2020), <https://justcapital.com/news/the-american-public-wants-companies-to-take-action-on-advancing-racial-equity-especially-black-americans/> [<https://perma.cc/S6LE-XYP4>]. For that reason, business leaders who have similar beliefs would be applying an ethical perspective that is shared by many in the American public.

313. *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000).

314. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986).

irrational and certainly not suspect for directors to believe that a likely immediate market valuation of the Time-Warner merger will undervalue the stock.³¹⁵

Chancellor Allen recognized that there was a strong chance that the Time stockholders would be disadvantaged by the board's decision not to abandon the combination with Warner and accept the lucrative \$200 offer from Paramount, but held that the directors' fiduciary judgment had to be respected even under the heightened reasonableness standard of *Unocal*, stating:

The value of a shareholder's investment, over time, rises or falls chiefly because of the skill, judgment and perhaps luck—for it is present in all human affairs—of the management and directors of the enterprise. When they exercise sound or brilliant judgment, shareholders are likely to profit; when they fail to do so, share values likely will fail to appreciate. In either event, the financial vitality of the corporation and the value of the company's shares is in the hands of the directors and managers of the firm. The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm.³¹⁶

On appeal, Chancellor Allen was affirmed in a decision that went even further in emphasizing the deference that courts had to give to boards' decisions about debatable issues, even in the less forgiving context of reviewing their actions defending against a takeover.³¹⁷

Time-Warner emphasizes our core conclusion that the business judgment rule provides a corporate law safe harbor for directors to pursue their own vision for what is good for the company so long as there is a rational basis for their course of action. Even more than in cases involving heightened scrutiny, the business judgment rule commands that courts not intrude on decisions about a corporation's business philosophy and strategy. For that reason, Stephen Bainbridge has rightly called the business judgment rule an abstention doctrine,³¹⁸ which leaves stockholders dissatisfied with the board with recourse to the corporate ballot box, not the courthouse.

Distilled down, these principles support this succinct summary of the duty of loyalty under Delaware law:

The duty of loyalty requires fidelity to the corporation's best interests, which requires a good faith effort to:

- i) first and foremost, ensure that the corporation honors its charter to conduct only lawful business within lawful means;

315. *Paramount Comm'ns Inc. v. Time Inc.*, Nos. 10866, 10670, & 10936, 1989 WL 79880, at *19 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1989).

316. *Id.* at *30.

317. 571 A.2d at 1154 ("Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.").

318. See generally Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004).

- ii) within the limits of its legal discretion and ethical judgment, seek to promote the sustainable profitability of the company for the best interests of its stockholders.

And properly understood, the obligation to try to act with skill and prudence—i.e., to exercise due care—is itself a fundamental requirement of the duty of loyalty. “A faithful fiduciary is duty-bound to try to act with care.”³¹⁹

Delaware law also provides directors and officers protection if they take good faith action that unintentionally causes the corporation to be found to have overstepped its legal bounds. For starters, any suit for damages for a breach of the duty of care is governed by a forgiving gross negligence standard, one selected specifically to free corporate leaders from fearing that their good faith actions will be subject to liability at the instance of second-guessing litigants and courts.³²⁰ And, as we discussed, liability under that standard is likely to be unavailable for plaintiffs because of the prevalence of exculpation provisions barring due care damages actions against directors.

In many other states, both the flexibility and, by extension, the protections afforded fiduciaries are even greater. Statutes exist that allow directors to govern their corporations in a multi-stakeholder manner in which constituencies such as workers, communities, and customers can be treated as equal ends of corporate governance.³²¹ In these jurisdictions, even the weak rational relationship test of Delaware law connecting action benefiting stakeholders to stockholder welfare need not be satisfied. Similarly, there is an emerging for-profit entity form, the Public Benefit Corporation (“PBC”), that requires boards to govern in a way that is socially responsible and respectful of all stakeholders. Under these statutes, directors have a “shall” duty toward society and stakeholders, and actions can be brought to enforce that duty.³²² In addition, under the Delaware PBC statute and statutes like it, a PBC director is afforded the full protections of the business judgment rule and deemed to have satisfied the director’s fiduciary duties if such choices are “both informed and disinterested and not such

319. Strine et al., *supra* note 270, at 636 (emphasis omitted).

320. Chancellor Allen’s discussion of the policy basis for limiting due care liability and for the business judgment rule in *Gagliardi v. TriFoods International, Inc.*, 683 A.2d 1049 (Del Ch. 1996), is one of the most coherent and convincing. For similar reasoning, see *In re Lear Corp. S’holder Litig.*, 967 A.2d 640, 651–52 (Del. Ch. 2008).

321. Lucian Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 93 S. CAL. L. REV. (forthcoming 2021) (finding thirty-three states with constituency statutes in force during the period from 2000 to 2019); *see also, e.g.*, N.Y. BUS. CORP. LAW § 717(b) (McKinney 2021); 805 ILL. COMP. STAT. 5/8.85 (2021); FLA. STAT. § 607.0830(6) (2021); GA. CODE ANN. § 14-2-202(b)(5) (2021).

322. DEL. CODE ANN. tit. 8 § 365(a) (2021); *see also Why Pass Benefit Corporation Legislation*, BENEFIT CORP., <https://benefitcorp.net/policymakers/why-pass-benefit-corporation-legislation> (last visited Dec. 30, 2021) [<https://perma.cc/JK9S-WQFF>] (noting that thirty-eight states, including the District of Columbia, have passed PBC legislation).

that no person of ordinary, sound judgment would approve.”³²³ This statutory standard affords substantial discretion to PBC directors in making decisions and is widely understood as enabling them to balance the promotion of public benefits, fair stakeholder treatment, and shareholder value in good faith, without fear of judicial intrusion.³²⁴ As a result, outside of Delaware, and in PBCs in Delaware and elsewhere, fiduciary duty law is more, not less, supportive of other-regarding corporate policies like those calling for more Diversity, Equity, and Inclusion.

V. CORPORATE LAW’S VALUE FOR CORPORATE EFFORTS TO PROMOTE DIVERSITY, EQUITY, AND INCLUSION

The affirmative obligations underpinning the corporate duty of loyalty, along with the discretion afforded to directors and managers in the exercise of their duties and pursuit of the best interests of shareholders and the corporation, have important implications for corporate Diversity policy. First, the corporation is charged with an expectation of lawful conduct—and Delaware corporate law explicitly identifies legal compliance as a core feature of the duty of loyalty. As such, it requires fiduciaries to ensure corporate compliance strategies exist to assure compliance with key civil rights legislation and antidiscrimination mandates that go to the heart of their operations. Fiduciaries are also not excused from ignoring red flags indicating widespread discrimination; should they do so, not only do companies risk liability accompanying such violations, but directors too face possible derivative suits and liability.

Second, the business judgment rule affords directors who view Diversity, Equity, and Inclusion as important values with enormous flexibility to advance such goals, and to do so on firm legal footing as a matter of corporate law. Simply put, beyond the moral call to right past wrongs, or the statutory and *Caremark*-based interests in ensuring that corporate policies do not fall afoul of antidiscrimination and civil rights laws, there are rational evidentiary and logical arguments for believing that there is money to be made, and saved, for corporations that take DEI seriously. There is the required nexus to the best interests of stockholders Delaware law mandates. This business rationale for effective DEI policies invokes the protections of the business judgment rule and enables a wide range of policy reforms that go beyond statutory minimal protections embodied in long-standing civil rights laws—or the

323. DEL. CODE ANN. tit. 8 § 365(b) (2021); *see also* MODEL BUS. CORP. ACT § 8.30 (AM. BAR ASS’N 2017); N.Y. BUS. CORP. LAW § 1707 (McKinney 2021); CAL. CORP. CODE § 5231 (West 2021).

324. Jesse Finfrock & Alfredo Silva, *COVID’s Impact on PBC Fiduciary Duties: Understanding Director Obligations in an Economic Downturn*, JD SUPRA (June 23, 2020), <https://www.jdsupra.com/legalnews/covid-s-impact-on-pbc-fiduciary-duties-83482/> [<https://perma.cc/8NGD-JVPS>].

recently announced targeted reforms—to address the full range of equity issues in which corporations affect their stakeholders and society.

A. Corporate Law's Antidiscrimination Obligations

Given the obvious materiality to society of civil rights laws and the reputational and economic harm that arises where they are ignored, there is no rational basis to argue that *Caremark* duties do not require good faith efforts to comply with them. Some, like Title VII of the Civil Rights Act, require that companies avoid discriminating on the basis of race, sex, sexual orientation, and other bases not relationally connected to hiring or serving the consuming public. Similar laws also apply in many of the global markets in which American corporations operate and constrain corporate discrimination.³²⁵

As such, these laws are foundational and affect the corporation's employment practices and its relationships with customers and contractors. So do laws like the ECOA or FHA that require corporations to provide equal access to important services, such as banking and credit, and to not discriminate in the provision of those services.³²⁶ As such, they lie at the heart of capital access, and in doing so, target business operations, practices, and strategies at the core of regulated markets or industries in which companies operate. Virtually all impose penalties and fines where they are ignored, or can form the basis of class action litigation. They also, as discussed earlier, carry the potential of serious reputational damage, especially in this moment where customers, clients, and workers are more willing than ever to hold corporate actors to account for failures in equal treatment. The adverse publicity and regulatory scrutiny that attend these kinds of violations can cause obvious harm to a corporation and its shareholder value.³²⁷

325. E.g., 2013 OECD Recommendation of the Council on Gender Equality in Education, Employment and Entrepreneurship, ORG. FOR ECON. CO-OPERATION & DEV. (2017), <https://doi.org/10.1787/9789264279391-en> [<https://perma.cc/MQ9N-5SA4>]. The 2013 Gender Recommendation also calls on members to cooperate with relevant stakeholders, including the public and private sectors, to elaborate and implement guidelines and practices to promote gender equality. *Id.* More recently, the OECD Council adopted the Recommendation of the Council on Gender Equality in Public Life, which focuses on greater accountability and oversight for gender equality in employment in the public sector. 2015 OECD Recommendation of the Council on Gender Equality in Public Life, ORG. FOR ECON. CO-OPERATION & DEV. (2016), <https://doi.org/10.1787/9789264252820-en> [<https://perma.cc/XZG7-378C>].

326. See *supra* notes 170–173 and accompanying text.

327. See Elizabeth Pollman, *Corporate Social Responsibility, ESG, and Compliance*, in CAMBRIDGE HANDBOOK OF COMPLIANCE (Benjamin van Rooij & D. Daniel Sokol eds., 2021) (compiling business literature showing the potential utility of high-quality EESG practices in mitigating risks from lawsuits and regulators, and consumer and employees backlash, and lowering cost of capital). Indeed, Jamillah Williams has presented evidence suggesting that civil rights law, with a deeper historical, political, and moral grounding, appears to exert a stronger normative influence than larger “business case”-backed arguments for Diversity. Jamillah

To comply with their *Caremark* duties, corporate boards must make a good faith effort to ensure the company has policies in place to monitor compliance with the laws requiring corporations to provide equal opportunities to job applicants, employees, contractors, and customers regardless of their race, gender, or sexual orientation.³²⁸ For all major corporations, by way of example, Title VII prohibits discrimination based on not only race, color, and sex (including pregnancy, sexual orientation, or gender identity), but also national origin, disability, and genetic information (including family medical history).³²⁹ Employers must also create a poster informing employees of their rights and respond promptly and consistently to discrimination complaints.³³⁰ Employers may additionally be required to provide reasonable accommodations (changes to the way things are normally done at work) because of an applicant's or employee's religious beliefs³³¹ or disability.³³² *Caremark* requires good faith efforts by directors to ensure their companies have policies designed to promote compliance with these legal requirements.

In other instances, *Caremark* compliance may require monitoring systems tied to a company's industry-specific DEI legal duties.³³³ For financial institutions, for example, the ECOA prohibits discriminating against borrowers based on race, color, religion, national origin, sex, family status, or age, and its prohibition comprises a core feature of the very business of banking. It also imposes a range of disclosure requirements, including notices for applicants of consumer and business credit to ensure that they are aware of the ECOA's prohibitions and communications informing them as to reasons why they were denied credit. For firms engaged in retail lending, from deposit-taking institutions to marketplace lending platforms, the ECOA's substantive requirements and disclosure obligations imposed on creditors are part of their business; failure to incorporate and comply can expose companies to stiff punitive sanctions that can reach up to 1% of the creditor's net worth in class actions.³³⁴ Compliance with these important duties thus comprises an essential aspect of protecting the long-term value of any lender. *Caremark* would thus require systems

Bowman Williams, *Breaking Down Bias: Legal Mandates vs. Corporate Interests*, 92 WASH. L. REV. 1473, 1473–1513 (2017).

328. See generally Cheryl L. Wade, *Racial Discrimination and the Relationship Between the Directorial Duty of Care and Corporate Disclosure*, 63 U. PITT. L. REV. 389, 403–04 (2002).

329. Civil Rights Act of 1964 § 7, 42 U.S.C. § 2000e.

330. Many labor laws include a requirement that employers post notices about employees' rights in the workplace. For various posting requirements, see *Workplace Posters*, U.S. DEP'T OF LAB., <https://www.dol.gov/general/topics/posters> (last visited Sept. 4, 2021) [<https://perma.cc/8F48-XYJX>].

331. 42 U.S.C. § 2000e.

332. Americans with Disabilities Act of 1990, 42 U.S.C. §§ 12101–12213.

333. See *Marchand v. Barnhill*, 212 A.3d 805, 821 (Del. 2019).

334. CHRIS BRUMMER, *FINTech LAW IN A NUTSHELL* 336 (2020).

for ensuring that proper disclosure practices are adhered to, and that the board was able to, and did, monitor the information gleaned from those systems or reported to them.

Along similar operational lines, *Caremark* requires boards of financial institutions to establish monitoring systems for any obligations they face under the Community Reinvestment Act, a federal law requiring federal regulators to assess how well banks fulfill obligations to service low- and moderate-income neighborhoods. Like the ECOA, compliance with the CRA is a core feature of effective banking operations, in large measure because federal regulators develop scores to evaluate applications for future approval of bank mergers, charters, acquisitions, branch openings, and deposit facilities.³³⁵ Banks are required to inform customers of their scores when such information is requested, and their scores are also publicly available online in a Federal Reserve database, thereby creating significant pressure for banks to comply given public relations pressures.³³⁶ Additionally, failure to meet CRA obligations exposes banks to a range of penalties, including curbs on new branch openings or otherwise growing their business. The degree to which a bank adheres to the CRA as a result can directly harm a bank's reputation, profits, and overall shareholder value. Fiduciaries, by extension, are thus required to ensure that a system for CRA compliance exists, and that material developments and information generated from it can be shared with and disseminated to them.

Corporations have increasingly recognized that effective DEI compliance efforts are required by *Caremark* and are increasingly expected by all corporate stakeholders. This confluence has itself given rise to new legal theories by corporate plaintiffs' lawyers, arguing that fiduciaries have not only failed to comply with *Caremark* in their DEI policies, but have misled investors by overstating their adherence to their own stated DEI goals.

Thus, in a spate of new complaints, stockholder plaintiffs have alleged that companies are making untrue statements about their commitment to DEI in their public disclosures and thereby violating securities law.³³⁷ In some of these complaints, the plaintiffs also allege

335. See Jorge Sun, *Is CRA Compliance Enough for Community Banks?*, BANKING EXCH. (Dec. 1, 2020, 12:37 PM), <https://www.bankingexchange.com/community-banking/item/8493-is-cra-compliance-enough-for-community-banks> [<https://perma.cc/UB82-6HBR>].

336. See FFIEC *Interagency CRA Rating Search*, FED. FIN. INSTS. EXAMINATION COUNCIL, <https://www.ffiec.gov/craratings/> (last updated Nov. 10, 2020, 3:02 PM) [<https://perma.cc/ER56-AFFH>].

337. Eight board diversity lawsuits were filed in 2020. Most were filed against technology companies with operations based in California (such as Oracle, Qualcomm, and Facebook), although there were lawsuits filed involving non-technology companies and companies located outside California as well (such as Danaher Corporation). See, e.g., Complaint, *Falat v. Sacks*, No. 20-cv-01782 (C.D. Cal. Sept. 18, 2020); Complaint, *City of Pontiac Gen. Emps.' Ret. Sys. v. Joyce Jr.*, No. 20-cv-02445 (D.D.C. Sept. 1, 2020); Complaint, *Lee v. Fisher*, No. 20-cv-06163 (N.D. Cal. Sept. 1, 2020); Complaint, *Esa v. Pilette*, No. 20-cv-05410 (N.D. Cal. Aug. 5, 2020); Complaint,

that directors have breached their fiduciary duties by failing to ensure that their corporations had in place effective compliance programs and efforts addressing key nondiscrimination laws.³³⁸ Along with monetary damages, the lawsuits typically seek a variety of remedial measures, including adding African American directors to the defendant company's board, creating a fund to promote diversity and inclusion in the defendant company's workforce, tying executive compensation to specific hiring goals, and instituting periodic board diversity training.³³⁹ Thus, not only the claims, but the forms of relief sought, are novel for corporate and securities law cases.³⁴⁰

We want to emphasize again that allegations are just that—allegations—and that most of the claims that have been filed in California but involve Delaware corporate law will fail to survive motions to dismiss, as most plaintiff suits do.³⁴¹ And in many if not most cases, plaintiffs face significant pleading challenges not only for derivative lawsuits based on duty to monitor failures, but also for claims premised on defendants making untrue statements of material fact—and which by extension require plaintiffs to plead with particularity facts indicating defendants' states of mind.

But the allegations underscore our earlier observations that deserve highlighting. Plaintiffs are picking up on the fact that

Kiger v. Mollenkopf, No. 20-cv-01355 (S.D. Cal. July 17, 2020); Complaint, Ocegueda v. Zuckerberg, No. 20-cv-04444 (N.D. Cal. July 2, 2020); Complaint, Klein v. Ellison, No. 20-cv-04439 (N.D. Cal. July 2, 2020). The last of the lawsuits was filed against Cisco Systems on September 23, 2020, just days before California Governor Gavin Newsom signed AB 979 into law. *See* Complaint, City of Pontiac Gen. Emps.' Ret. Sys. v. Bush, No. 20-cv-06651 (N.D. Cal. Sept. 30, 2020). One commentator speculates that the enactment of the California legislation seems to have interrupted the filings of the lawsuits, perhaps because the new statute requires at least part of the relief the claimants sought in filing the suits. *See* Kevin LaCroix, *The Top Ten D&O Stories of 2020*, D&O DIARY (Jan. 4, 2021), <https://www.dandodiary.com/2021/01/articles/director-and-officer-liability/the-top-ten-do-stories-of-2020/> [<https://perma.cc/U42A-HPU4>].

338. In *Ocegueda v. Zuckerberg*, for example, plaintiffs sued Mark Zuckerberg and the board of Facebook alleging that the company's directors had violated their fiduciary duties by their inaction on diversity and inclusion issues. Complaint at 79, No. 20-cv-04444 (N.D. Cal. July 2, 2020). The complaint alleges a range of other corporate law violations relating to an alleged failure to implement and monitor a reasonable system of internal controls and policies relating to compliance with a HUD complaint against Facebook alleging that Facebook violated the FHA by allowing advertising on its platform which discriminates based on race, ethnicity, gender, and other protected categories. *Id.* at 5, 16, 30, 50.

339. *See* LaCroix, *supra* note 337.

340. The plaintiffs in most of the lawsuits are forwarding a novel and quite aggressive breach of fiduciary claim on the basis of what is ultimately a failure to diversify, and argue that it constitutes a "conscious failure to perform their fiduciary obligations." Yet, the plaintiffs seem to disclaim that these claims arise under *Caremark*. The plaintiffs instead argue that the defendants know they should be taking more assertive action to promote diversity, but have consciously failed to do so. *See, e.g.*, Complaint at 50–55, *Ocegueda v. Zuckerberg*, No. 20-cv-04444 (N.D. Cal. July 2, 2020). This is a theory that comes into stark tension with the business judgment rule. The proxy disclosure claims have their own difficulties, and will require a showing of intent, loss, causation, and damages under the federal securities law precedent in order to be successful.

341. *Ocegueda*, for example, was recently dismissed for misstating underlying facts—perhaps most importantly by missing the fact that two of Facebook's nine directors are Black. *Ocegueda v. Zuckerberg*, No. 20-cv-04444, 2021 U.S. Dist. LEXIS 52465, at *26 (N.D. Cal. Mar. 19, 2021).

compliance with civil rights laws is important for corporations not only as a moral matter, or as a function of a company's public law obligations, but also *as a matter of corporate law*. Civil rights laws comprise material, systemically important bedrock rules that are essential for corporations to honor as a function of their fiduciary duties and due to their charters from society to conduct only lawful business by lawful means.

The consequences of noncompliance are as varied as the facts (and damages) that can exacerbate it. What is certain, though, is that the press will often cover claims of failed civil rights compliance intensively, that the defense will be expensive, and that there is the potential for additional unfavorable information arising that will compound the harm already suffered as a result of the underlying issues that had previously drawn adverse attention.

But for our purposes, suits like these underscore the point that for the risk-averse fiduciary who is simply trying to avoid negative consequences for the company and herself, fiduciary duty law requires attention to a range of DEI issues. Failure to try to ensure that the company complies with core antidiscrimination laws not only exposes the company to fines and other regulatory harm if there are violations, but also exposes fiduciaries to *Caremark* suits in Delaware or similar duty of loyalty claims forwarded in other jurisdictions. To dwell just on whether or not the plaintiffs prevail misses our basic point and that of *Caremark* itself. By the time cases like these are brought, the corporation has already lost, through adverse regulatory action, internal tumult, and a damaged reputation.

For these reasons, the prudent, risk-averse director seeking to promote the best interests of the corporation will engage at the board level to make sure that the board and management are working together to comply with DEI-relevant laws requiring corporations to provide equal treatment of their workers, customers, and communities of operation.

B. Corporate Law's Protections—and Transformative Potential

We now address another important role of corporate law principles: supporting corporate DEI policies that go beyond mere good faith efforts at law compliance and embrace a comprehensive approach that makes Diversity, Equity, and Inclusion integral to the company's business strategy, culture, and stakeholder relationships. That is, we address corporate leaders who genuinely support Diversity and believe that their companies should embrace it fully, but who might harbor concern that attention to DEI is somehow improper as a matter of fiduciary duty. For academics, the concern may seem remote, but for practitioners it can be very real. For many generations now, some have argued that boards of directors should be narrowly focused on maximizing corporate profits, who at best may grudgingly accept that

corporate boards have to devote some attention to law compliance, but nothing more. Instead of spending any time on DEI, boards should just get hell-bent for leather to increase profits, do the legal minimum, and let external regulation be the sole impetus for social progress.³⁴² Corporate fiduciaries should not worry whether their companies have higher-than-required ethical standards and try to make profits in a manner respectful of employees, customers, and the communities in which they operate. That is, we cannot avoid dealing with those who adhere to the narrowly profit-focused perspective of Milton Friedman.

But this blinkered view is not even persuasive under the corporate law of Delaware, the state corporate law largely understood to be most focused on stockholder welfare. As we have explained, Delaware law not only requires directors to put law compliance ahead of profits, it gives directors wide discretion to determine what is in the long-term best interests of stockholders.³⁴³ Directors are entitled to govern on the view that a corporation that has hiring and promotional practices seeking to tap the full potential of the available workforce and to include people of Diverse backgrounds, perspectives, and talents will have an employee base that is more creative, more capable of relating to Diverse customers, more content, and therefore more likely to productively increase the firm's effectiveness. Directors are entitled to take the view that customers, strategic allies, and institutional investors will be more likely to want to have an ongoing relationship with a company they perceive as committed to high standards of inclusion and nondiscrimination and that is more representative of

342. Commentators and scholars continue to hew to Milton Friedman's view that companies should focus narrowly on profit, and not issues like their own environmental or broader social impact. See, e.g., Bradford Cornell & Aswath Damorodan, *Valuing ESG: Doing Good or Sounding Good?* 20 (March 10, 2020) (unpublished manuscript), <https://ssrn.com/abstract=3557432> [<https://perma.cc/BM7J-ZQW8>]. Typically, they argue that addressing issues like climate change or DEI should be the province of external laws, not voluntary corporate action. *Id.* But they typically ignore the role corporate power has had in eroding external protections for stakeholders, including workers, and the reality that without internal change within corporations, the political dynamic to make sure there are robust, across-the-board protections for society will not exist. In fact, Friedman himself opposed the New Deal and the civil rights laws of the 1960s, rendering his nod to external laws a thin beard for his support of nineteenth-century economics and social policies. See MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 111, 115 (1962) (opposing civil and labor rights legislation). For more discussion about Friedman's opposition to civil rights and labor rights legislation and the flaws in his doctrine, see Leo E. Strine, Jr. & Joey Zwillinger, *What Milton Friedman Missed About Social Inequality*, N.Y. TIMES (Sept. 10, 2020), <https://www.nytimes.com/2020/09/10/business/dealbook/milton-friedman-inequality.html> [<https://perma.cc/JRT8-72NU>] ("Not only that, Mr. Friedman sought to weaken the rules of the game by opposing basic civil rights legislation, unions, the minimum wage and other measures that protected workers, Black people, and the environment."); and Colin Mayer, Leo E. Strine, Jr. & Jaap Winter, *The Purpose of Business Is to Solve Problems of Society, Not to Cause Them*, PROMARKET (Oct. 9, 2020), <https://promarket.org/2020/10/09/purpose-business-solve-problems-society-not-cause-them-friedman/> [<https://perma.cc/9EBT-E9VU>].

343. *Paramount Comm'ns., Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989); *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 93 (Del. Ch. 2011).

society's overall Diversity. Directors are entitled to take the view that the harm that can flow from poor DEI practices far outweighs the costs of committing their company to doing things the right way and spending the costs necessary to do so.

Under the business judgment rule in Delaware, judgments of this kind are protected, as they have a rational relationship to stockholder welfare. In states that allow boards to govern with a multi-stakeholder focus, there is even less basis for an argument that promoting good DEI practices is improper, as directors in these states need not put profit ahead of customers and workers.³⁴⁴ And under the emerging public benefit corporation model and its "shall" obligation to treat all stakeholders with respect, a failure to have sound DEI policies itself exposes the board to possible suit for injunctive relief.³⁴⁵

The logic and rationale for DEI is not only a matter of cost avoidance. Rather, as we have shown, there is, at a minimum, a rational basis for business leaders to conclude that effective DEI policies will help them create and sustain smart, thoughtful, resilient, respected, and thus sustainably profitable corporations. The information base suggests that attention to DEI issues does not conflict with a proper respect for stockholders' interest in a sound, long-term return; indeed, given the evidence, there is a basis to infer that inattention and insensitivity to important DEI issues bearing on corporate relationships with employees, customers, and business partners is what risks firm value in the twenty-first-century economy.³⁴⁶

These empirical and logical arguments are also supported by market behavior. As we have noted, institutional investors representing diversified investors acknowledge that corporate DEI practices bear on their ability to create sustainable profits in a domestic and international economy, where the diversity of the available workforce, consumers, and strategic partners is growing, not narrowing. Investors not only expect companies to embrace the full range of talent, consumers, and possible partners available to maximize value creation, but to also avoid the harm that comes from being perceived as adverse to inclusion.³⁴⁷ Without consumers, corporate profits are hard to come by, and we have also shown that consumers, and particularly the younger consumers who will determine the long-term fate of today's businesses, increasingly want to buy from companies that share their values.³⁴⁸

Corporate law supports corporate leaders in acting on this information. Even in shareholder-friendly Delaware, the business

344. See, e.g., N.Y. BUS. CORP. LAW § 717(b) (McKinney 2021); 805 ILL. COMP. STAT. 5/8.85 (2021); FLA. STAT. § 607.0830(6) (2021); GA. CODE ANN. § 14-2-202(b)(5) (2021).

345. See DEL. CODE ANN. tit. 8, §365 (2021).

346. For this reason, former CFTC Commissioner Sharon Bowen has advocated including the *absence* of diversity as a risk factor for companies in the public and periodic disclosures.

347. See *supra* Section III.D.

348. See *supra* Section II.A.

judgment rule affords directors substantial room to determine the best way to create value and to put in place a corporate culture with higher standards of integrity, fairness, and ethics than the law demands. Corporate law also gives fiduciaries protection if they decide that the best way to avoid violations of law and negative reputational harm to the corporation and achieve longer-term value is for the corporation to embrace policies and goals that go beyond the legal minimum and to strive for the exemplary, even at the cost of short-term shareholder value. Fiduciaries may reasonably conclude that in order to create a prudent safety margin against law violations, a robust DEI program is necessary to instill trust in regulators and the public that can help if there is a situational lapse in compliance and promote confidence in the workforce and customer base that will inspire their loyalty and greater productivity.

Other protections deserve note as well. Importantly, Delaware treats a *Caremark* claim for failure to make good faith efforts to comply with key antidiscrimination laws like Title VII differently than if a corporation's good faith effort to achieve Diversity, Equity, and Inclusion results in an unintentional violation of law. If a board failed to make any good faith effort to ensure corporate compliance with civil rights laws, and thereby exposed the firm to lawsuits crippling the company, that would expose them to *Caremark* liability and no exculpation or indemnification would be available because the conduct involved bad faith and disloyal action not subject to statutory immunization. By contrast, when a corporation takes good faith action to redress long-standing inequality, corporate law principles provide protection to the directors and officers against personal liability; indeed, Delaware law provides directors and officers protection if they take good faith action that causes the corporation to be found to have overstepped its legal bounds. This is relevant as it is, of course, conceivable that a corporation that undertook a comprehensive DEI strategy designed to promote greater inclusion of women and minorities in the company's workforce could face suit if someone who did not get hired or promoted alleged that particular programs or policies resulted in unlawful "reverse" discriminatory practices. Under Delaware law, directors and officers may be indemnified so long as their actions were intended to benefit the corporation, even in a criminal case, so long as there was no reasonable cause to believe their actions were unlawful. In defending themselves in litigation and in seeking indemnification, corporate directors are entitled to rely upon advice they receive from expert advisers in management and from outside advisers, such as law firms and firms that specialize in human resources issues, as evidence of their good faith.³⁴⁹ For these reasons, corporate leaders who address DEI

349. DEL. CODE ANN. tit. 28, § 141(e) (2021).

issues in a thoughtful way, with the advice of key managers and qualified advisers, have no rational basis to fear liability.

In a very real sense, then, corporate law empowers fiduciaries to adopt ambitious policies aimed at achieving greater Diversity, Equity, and Inclusion that they believe are in the corporation's best interests. This empowerment does not just extend to issues within the workplace but authorizes action to embed a commitment to DEI in all the company's relationships with its stakeholders.³⁵⁰ Corporate leaders may—and some have already acted to—embed a commitment to DEI in all the company's relationships.³⁵¹

Notably, such conduct would be voluntary. But nonaction would not be free of market consequences insofar as business rationality may in fact compel a faithful fiduciary who seeks to promote the sustainable profitability of the company to focus on good DEI policies and practices. As we have shown, there is a rational basis to conclude that companies which have more diverse workforces and boards perform better, and at least as well, as those which do not.³⁵² We have also shown that the racial and ethnic diversity of workforce and customer bases is growing, and there is thus a rational basis to conclude that companies that access all avenues of talent and can relate to a broader array of stakeholders and partners will be more successful.³⁵³ As a pure matter of business, directors cannot blind themselves to change in a dynamic world, and the trends toward globalization and domestic diversity are economic realities that a director faithful to his affirmative duty of loyalty must bear in mind.

Put bluntly, there is money to be made by companies that take DEI seriously, expand their hiring and promotional pools, and increase their customer base by seeking in an equal and inclusive way to get the most out of their workforces and profitably expand their services and product sales to as many customers and communities as feasible. Furthermore, there is evidence that corporate action to promote equality will increase overall economic growth by generating more

350. The purpose of this Article is not to advocate best practices for how to do that. But others have done so and have argued for: embedding DEI and other EESG goals in executive compensation, special efforts to make cross-racial group meetings integral to corporate decisionmaking, recruiting at educational institutions that serve more minority and less affluent students, and working to ensure that the company serves all communities with equal respect. *See, e.g.,* Eavis, *supra* note 70; Strine et al., *supra* note 270. And, in an incisive new article, scholars have argued that institutional investors should hold companies accountable for moving toward quality DEI practices and outcomes, and have suggested useful metrics to enable that more successfully. *See* Martinez & Fletcher, *supra* note 46.

351. For an example of a successful company who believes that a commitment to DEI is fully consistent with its duties to its stockholders, see the policies of JPMorgan Chase & Co. *Racial Equity Commitment*, JPMORGAN CHASE & Co., <https://www.jpmorganchase.com/impact/racialequity> (last visited Oct. 18, 2021) [<https://perma.cc/WNJ4-ZS7J>].

352. *See supra* Section II.A.

353. *See supra* Section II.C.

consumers and consumption and create a more virtuous environment for long-term wealth creation, to the benefit of corporate profits. For this reason, a loyal fiduciary may conclude that it is duty-bound to make a good faith effort to foster good DEI policies and practices as an integral part of a rational strategy to promote a sustainably profitable corporation.³⁵⁴

CONCLUSION

The clarification of corporate law that this Article offers will not, in itself, cure the lack of representativeness of American corporate boards and management teams. Nor does it provide a simple answer to the broader equity challenges that must be met if the corporate sector is to meet the growing expectation to treat all its stakeholders with equal respect. It is, however, a piece of a larger puzzle and a vital legal and policy tool to help our nation live up to its ideals in vital economic activities essential to human freedom and dignity. Internal corporate action can address critical issues that current external reforms either overlook or will be unable to solve without operating in concert with internal corporate action. We applaud in principle the emerging external law efforts to spur greater Diversity, Equity, and Inclusion in the behavior of American companies. But, as we have explained, these external efforts have important limitations in terms of their application only to public companies, their inability to address the full range of issues where sensitivity to DEI issues is important to corporate treatment of stakeholders, and the difficulty any external regulation has in embedding values and norms in a complex organization, unless the leaders of that organization support that themselves. The full promise of DEI in creating not only a fairer nation, but stronger, more resilient, and sustainably profitable American businesses can only be realized if corporations themselves embrace these values in all the important ways in which they affect their stakeholders and society. Our goal in this Article is therefore focused, but important. We hope to have shown that corporate law itself has a positive role to play in supporting corporations in taking ambitious actions to promote DEI and contributing to a more inclusive and fair economy and nation.

For too long, corporate law has been misunderstood when it comes to important social matters that happen to make business sense. Diversity is one area where a course correction is needed. In the current

354. See DELOITTE, *supra* note 150, at 24:

Leaders . . . should recognize purpose-led actions taken by their organizations can have a threefold impact: Those initiatives can not only help society—they can help business and have a positive influence on employees' concerns. Some potential activities: . . . Ensuring diversity and inclusion across the organization, and promoting compensation structures that reduce income inequality and create a fair distribution of wealth.

moment, that is being slowly recognized by businesses themselves. But history shows that our ability to stay focused on issues of inequality is erratic, and there remains substantial resistance to DEI in our society. What we demonstrate is this important reality: corporate law is no island to itself, and the corporate law of fiduciary duty does not constrain directors and managers from promoting DEI. If anything, fiduciary duty pushes corporate managers legally, financially, and reputationally to focus on these important issues as part of their duty to promote the best interests of the corporation, increase its sustainable profitability for the benefits of its stockholders, and ensure that the corporation honors the laws of the society that chartered it.

In sum, corporate law allows and in fact encourages corporate leaders to do the right thing. Whether they do it is up to them and the institutional investors to which they owe their positions—fiduciary duty law leaves them with no excuses for failing to do so. Thus, the ultimate question is not whether business leaders *can* implement effective Diversity, Equity, and Inclusion policies, but *will* they?