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Available at: https://repository.law.umich.edu/mbelr/vol11/iss1/5

https://doi.org/10.36639/mbelr.11.1.board

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BOARD DIVERSITY SHAREHOLDER SUITS:
DIVERGING MATERIALITY TESTS UNDER
RULES 10B-5 AND 14A-9

John C Friess*

ABSTRACT

Environmental, social, and governance (ESG) investing has grown significantly as an investment strategy over the past decade, leading to intensified demands among investors for more ESG disclosures from publicly listed companies. Perhaps the most high-profile example of this trend is the recent widespread demand among institutional investors, proxy advisory firms, and exchanges for more disclosure and compliance as it relates to board and workplace diversity. Given these efforts and the signals coming from the SEC that it intends to take a more proactive approach to ESG disclosure and compliance, issuers can expect an environment of more specific and detailed diversity disclosures. These increasingly comprehensive disclosures implicate the anti-fraud provisions of the federal securities laws, particularly Rules 10b-5 and 14a-9. While the Supreme Court has held that the materiality requirement under each of these rules is identical, this note argues that, in the case of securities fraud claims related to diversity disclosures, they require distinct evaluations and lead to different outcomes. Specifically, Rule 14a-9, with its focus on what is important to a reasonable investor’s voting decisions, is more favorable to plaintiffs than Rule 10b-5, which regulates information important to a reasonable investor’s buying and selling decisions. The divergent outcomes are due, in large part, to the combined effects of ownership concentration, passive investing, and the preference among investors for addressing ESG and diversity by voting their shares rather than by selling them. As a result, this note finds that Rule 14a-9 is an increasingly viable option for claims against issuers for false or misleading statements related to board diversity. Consequently, Rule 14a-9 may constitute a mechanism by which plaintiffs can motivate compliance with board diversity standards by making noncompliance too costly.

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Environmental, social, and governance (ESG) investing has been a leading focus in academic and professional circles for some time. The predominating argument today is that ESG factors are financially material and, therefore, should enter into investment decisions in order to minimize risk and maximize long-term returns.1 As this investment strategy has evolved, it has grown significantly in

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popularity and could be said to have garnered mainstream market acceptance.\textsuperscript{2} Despite the growing reliance on ESG, not all ESG information has been treated the same. For many years, the “social” components of ESG have been considered difficult to identify and incorporate. As a result, the “S” in ESG has taken a back seat to the more tangible ESG factors, such as environmental sustainability.\textsuperscript{3}

The events of 2020 led to a swift reversal of this trend. Amidst the COVID-19 pandemic and Black Lives Matter protests, investors have called into question how companies handle issues of race and inclusion—as well as how companies engage and manage relationships with key stakeholders, such as employees and customers—during crises.\textsuperscript{4} In particular, the demand among investors for more corporate accountability with respect to diversity has been perhaps the most prominent corporate-governance-related consequence of the events of 2020. These efforts have been directed at facilitating more comprehensive disclosure of diversity-related plans and metrics and have included warnings from institutional investors that they will vote against boards of directors that fail to adequately disclose or fail to maintain a minimum level of diversity at the board level.\textsuperscript{5}

The demands for more robust and standardized disclosure implicate federal securities law and the Securities and Exchange Commission (SEC). In fact, there has been increasing pressure on the SEC to create a mandatory uniform disclosure framework for ESG information.\textsuperscript{6} While the SEC has traditionally pushed back on these efforts,\textsuperscript{7} the Commission under the Biden Administration has signaled

\begin{thebibliography}{9}

\bibitem{3}See BNP PARIBAS, \textit{The ESG Global Survey 2019} 24 (2019) (finding that forty-six percent of investors considered social factors to be the most difficult ESG factors to incorporate into investment decisions); Jonathan Neilan, Peter Reilly & Glenn Fitzpatrick, FTI Consulting, \textit{Time to Rethink the S in ESG}, Harv. L. Sch. F. on Corp. Governance (June 28, 2020), https://corpgov.law.harvard.edu/2020/06/28/time-to-rethink-the-s-in-esg/


\bibitem{7}Former SEC Chairman Jay Clayton stated that he believed that the current, principles-based framework, which states that information should be disclosed if it is “material,” is preferable to the blanket approach that has been proposed. See \textit{A Conversation with SEC Chairman Jay Clayton}:
that it intends to take a more proactive approach to ESG reporting, which will likely include increased disclosure related to board diversity. As a result, it is almost inevitable that public companies will soon be required to make more specific and comprehensive disclosures related to diversity, principally at the board level. As such, they will become increasingly exposed to the federal securities laws, in particular, Rules 10b-5 and 14a-9.9

Rule 10b-5 prohibits fraud in the purchase or sale of securities.10 More precisely, Rule 10b-5 prohibits issuers from making any false or misleading statements that can be reasonably expected to reach investors in the trading markets.11 Rule 14a-9 more narrowly prohibits false or misleading statements in proxy statements.12 These rules have a number of different elements that must be shown at the pleadings stage; however, both rules require pleading that the allegedly false or misleading statement is material.13 This element has been perhaps the biggest hurdle facing plaintiffs making securities fraud claims related to ESG statements.14 While the statutes explicitly refer to materiality, they do not define “material,” which left the courts to define it on a case-by-case basis.

See Public Statement, ESG Disclosure – Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets, John Coates, Acting Director, Division of Corporation Finance (Mar. 11, 2021), https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121 (describing that the SEC’s ESG policy going forward should include an ESG-specific disclosure system); Allison Herren Lee, Acting Chair, U.S. Sec. & Exch. Comm’n, A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC, (Mar. 15, 2021) (transcript available at https://www.sec.gov/news/speech/lee-climate-change) (“[W]e must also make progress on standardized ESG disclosure more broadly. That means working toward a comprehensive ESG disclosure framework. In the near term, it should also include considering where we can advance initiatives on a standalone basis now, such as offering guidance on human capital disclosure to encourage the reporting of specific metrics like workforce diversity, and considering more specific guidance or rulemaking on board diversity.”); Andrew Ross Sorkin et al., When Doing Well Means Doing Good, N.Y. TIMES (Mar. 15, 2021), https://www.nytimes.com/2021/03/15/business/dealbook/sec-esg-priority.html (noting statements by SEC Chairman Gary Gensler in his confirmation hearing as an indication that the SEC will likely implement a mandatory disclosure regime for ESG issues).

13. 17 C.F.R. § 240.10b-5(b); id. § 240.14a-9(b).
14. See, e.g., In re BP P.L.C. Secs. Litig., 843 F. Supp. 2d 712, 775–76 (S.D. Tex. 2012) (holding that BP’s sustainability disclosures were not material, as they consisted of “[g]eneralized, positive statements about the company’s competitive strengths, experienced management, and future...
The standard for materiality in Rule 14a-9 was established by the Supreme Court in *TSC Industries, Inc. v. Northway Inc*., which held that a statement of fact is material “if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”

Later, in *Basic, Inc. v. Levinson*, the Supreme Court expressly adopted this standard for Rule 10b-5 claims as well. This leads to an assumption that the materiality tests under Rules 10b-5 and 14a-9 should lead to similar conclusions. However, recent developments call this assumption into question.

As a result of the changing investment strategies among institutional and retail investors, securities fraud claims regarding diversity statements under Rules 14a-9 and 10b-5 arrive at different outcomes with respect to the materiality requirement. This is because materiality under Rule 10b-5 focuses on what a reasonable investor considers to be important in the context of a buying or selling decision, whereas Rule 14a-9 focuses on what a reasonable investor considers to be important in the context of a voting decision. While there are many situations in which a particular disclosure would be material to both a buying/selling and voting decision, this is not the case for diversity disclosures. This is because investors appear less likely to consider board diversity an important factor in their decisions to buy or sell stock in a company, despite how outspoken institutional and retail investors might be with respect to board diversity. This is evidenced, in part, by the actions of ESG’s biggest proponents, the world’s largest asset managers. These managers, including BlackRock, State Street Global Advisors, and Vanguard Group, principally manage passive funds, the composition of which they cannot alter according to diversity standards because the funds merely track an index. And, even in their active funds, these managers have not made any firm commitments to buying or selling securities based on the degree of diversity on company boards. Furthermore, among retail investors, while surveys suggest that they believe ESG is important, there is no indication that they
consider board diversity in their decisions to buy and sell company stock. Consequently, there is much more evidence to suggest that investors’ statements in support of board diversity are costless, nonbinding, unverifiable “cheap talk,” insofar as they relate to buying and selling decisions. Therefore, this note argues that disclosures related to board diversity would not be material under Rule 10b-5.

However, due to Rule 14a-9’s focus on voting decisions, it is becoming increasingly likely that disclosures related to board diversity are material under Rule 14a-9. While investors have not shown a willingness to address board diversity in buying and selling decisions, they are increasingly committing to address diversity via director elections. This is particularly true among institutional investors who, due to massive inflows into passive funds, now account for approximately 80% of the shareholder base of publicly listed companies in the U.S and, consequently, the overwhelming majority of shareholder votes. For example, State Street, which manages over $3 trillion, pledged in 2021 to vote against the Chair of the Nominating & Governance Committee at companies in the S&P 500 and FTSE 100 that do not disclose the racial and ethnic composition of their boards. And, in 2022, State Street pledged to vote against the Chair of the Nominating & Governance Committee at companies in the S&P 500 and FTSE 100 that do not have at least one director from an underrepresented community on their boards. Likewise, Glass Lewis and ISS, two proxy advisory firms that exert considerable influence on shareholder voting, recently indicated that they will generally recommend voting

18. “Cheap talk” is a concept in game theory that refers to communication between players that does not directly affect the payoffs of the game, meaning that it does not affect outcomes. See, e.g., Vincent P. Crawford & Joel Sobel’s Strategic Information Transmission, 50 ECONOMETRICA 1431 (1982) (providing the seminal paper on “cheap talk”).


22. See Billy Nauman, State Street to Insist Companies Disclose Diversity Data, FIN. TIMES (Jan. 10, 2021), https://www.ft.com/content/2e512c76-4733-4821-8425-136ab9b98426. For statistical comparisons throughout this note, consider that the market capitalization for the New York Stock Exchange, the largest stock exchange in the world, is about $26 trillion. New York Stock Exchange, TRADINGHOURS.COM, https://www.tradinghours.com/markets/nyse.


24. Id.
against directors at corporations that do not meet certain minimum board diversity requirements.\textsuperscript{25}

These trends, among others to be discussed, represent a preference among investors to address board diversity via engagement and voting rather than via the “Wall Street walk.”\textsuperscript{26} As such, they indicate that a securities fraud claim under Rule 14a-9 for false or misleading diversity disclosures has a significantly better chance of being considered material than a similar claim under Rule 10b-5. Combined with the fact that Rule 14a-9 has no scienter requirement and a more generous test for loss causation relative to Rule 10b-5, a shareholder suit under Rule 14a-9 provides an increasingly viable option for plaintiffs seeking remedy for false or misleading statements related to diversity.\textsuperscript{27} This explains why several of the first securities fraud class actions related to board diversity against the likes of corporate giants Facebook, Oracle, and Qualcomm have been filed pursuant Rule 14a-9.\textsuperscript{28} While these claims do not address materiality using the same approach discussed in this note, they are on the right track by utilizing the most opportune rule. And, as the private sector proponents of ESG are joined by the SEC in their efforts to enact mandatory, uniform more detailed ESG and diversity disclosures, the materiality arguments made in such claims will gain strength. As a result, Rule 14a-9 may soon provide a mechanism by which plaintiffs can motivate compliance with board diversity standards by making noncompliance too costly.

This note contributes to the literature by suggesting a novel interpretation of the Supreme Court’s materiality standards under Rules 10b-5 and 14a-9 in the


\textsuperscript{26} The “Wall Street Walk” refers to shareholders selling their shares outright when they are unhappy with management rather than engaging with management to impact decisions within the firm. See Anat R. Admati & Paul C. Pfleiderer, The ‘Wall Street Walk’ and Shareholder Activism: Exit as a Form of Voice, 22 Rev. of Fin. Stud. 2645, 2646 (2009).

\textsuperscript{27} See infra Part III.A.

\textsuperscript{28} See Complaint, Klein v. Ellison, Case No. 20-cv-4439 (N.D. Cal. filed July 2, 2020); Complaint, Ocegueda v. Zuckerberg, Case No. 20-cv-04444 (N.D. Cal. filed July 2, 2020); Kiger v. Mollenkopf, No. 20-cv-01355-LAB-MDD (S.D. Cal. filed July 17, 2020); see also James E. Langston et al., Shareholder Complaints Seek to Hold Directors Liable for Lack of Diversity, Cleary Gottlieb (July 24, 2020), https://www.clearygottlieb.com/news-and-insights/publication-listing/shareholder-complaints-seek-to-hold-directors-liable-for-lack-of-diversity. Ocegueda v. Zuckerberg is the first ruling on a motion dismiss among cases seeking to hold corporate officers and directors accountable for failing to deliver on diversity-related promises. Jay Godoy, Facebook Directors Get Diversity Failure Lawsuit Tossed, Reuters Legal (Mar. 22, 2021) https://www.reuters.com/article/communications-law/fb-employment-diversity-lawsuit-tossed-idUSL1N2L2KTF. The case was dismissed, in part, on grounds that the plaintiffs failed to plead a materially false statement; specifically, the Court found that Facebook’s statement that it is “committed to building a diverse workforce” is aspirational and therefore immaterial. Order Granting Motion to Dismiss, Ocegueda v. Zuckerberg, Case No. 20-cv-04444 (N.D. Cal. Mar. 19, 2021). However, as this note argues, as issuers are increasingly pressured and potentially required to make more detailed disclosures related to diversity, the likelihood of such disclosures being considered aspirational will decrease.
context of ESG and diversity disclosures. Furthermore, it reveals the practical consequences of investor demands for ESG and diversity disclosure to the anti-fraud provisions of federal securities law. To date, the ESG literature has focused primarily on the financial materiality of ESG factors and on ESG’s corporate governance effects, without consideration of the direct implications of ESG on federal securities fraud claims. In addition, this note adds to the literature by identifying the implications of passive investing and ownership concentration on federal securities law. While the governance effects of passive investing and ownership concentration have been well documented, these studies have not considered the practical effects of these trends outside of a pure corporate governance context. In contrast, this note shows a very real and impending consequence of ESG, passive investing, and ownership concentration to securities class actions, which are the most litigated class action category in the U.S.

Part I of this note provides a background of the rise of ESG, the demands among investors for more ESG and diversity disclosures, and the federal securities fraud laws implicated by these disclosures. Part II describes a novel distinction between the materiality standards under Rules 10b-5 and 14a-9, which are the anti-fraud provisions most relevant to diversity disclosures. Finally, Part III addresses a number of other factors that make Rule 14a-9 the optimal anti-fraud provision for claims against issuers for false or misleading statements related to board diversity.

I. ESG INVESTING, DISCLOSURE, AND SECURITIES FRAUD LIABILITY

A. Evolution of ESG Investing

While ESG’s recent widespread market acceptance may lead to a misconception that it is a novel approach to investing, the idea of integrating

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29. This includes a reconsideration of the evolving definition of a reasonable investor, which is also addressed by Saad & Strauss. See Aisha I. Saad & Diane Strauss, The New “Reasonable Investor” and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation, 17 BERKELEY BUS. L.J. 397 (2020).


personal values and societal concerns into investment decision-making is not new. In fact, this approach to investing dates as far back as biblical times, in which Jewish law laid down numerous requirements for investing ethically. It continued through the seventeenth and eighteenth centuries, when Quakers avoided investing in enterprises that profited from products designed to kill or enslave, and Methodists taught that ethical use of money was one of the most important teachings in the New Testament. Perhaps the best modern example of religion’s influence on investment screening is the widespread avoidance of “sin stocks,” which include corporations in industries such as alcohol, tobacco, and gaming.

Values-based investing’s link to religion began to fade in the 1960s and 1970s as ethical screens became primarily influenced by social activism as opposed to religious doctrine and followed the principles of the broader social movements of the era, such as the anti-Vietnam War and anti-Apartheid movements. Furthermore, the new information regarding global warming that proliferated during this time period moved environmental concerns to the forefront of socially conscious investors’ minds, and the Chernobyl and Exxon Valdez catastrophes in the 1980s further galvanized investors around values-based investing. These events are considered some of the major catalysts in the rise of socially responsible investing (SRI), as this ethical screening process became formally known. At the core of this investing philosophy is the belief that “business organizations have societal obligations which transcend economic functions of producing and distributing scarce goods and services and generating a satisfactory level of profits for their shareholders.”

Despite this growing popularity, SRI was not considered a mainstream investment strategy. Instead, to traditional investors, SRI was considered a


35. See id. (“... the modern roots of social investing can be traced to the impassioned political climate of the 1960s.”); Blaine Townsend, From SRI to ESG: The Origins of Socially Responsible and Sustainable Investing, 1 J. IMPACT & ESG INV. at 2 (2020).

36. See Schueth, supra note 34, at 190; Townsend, supra note 35, at 6–7.


39. See id. (noting that socially and environmentally responsible investing accounts for about 13 percent of the total investment assets under professional management in the United States in 1999).
trade-off of "value for values," meaning that SRI sacrifices returns in exchange for a portfolio of investments that aligns with one’s personal values, and so it lacked conventional appeal.40

ESG investing evolved out of SRI in the 2000s. While SRI’s investment screens are still popular, ESG’s new formulation of socially conscientious investing has a distinguishing characteristic that has led ESG, as distinct from SRI, to widespread market acceptance. This unique characteristic is best exemplified by the investing approach purported at BlackRock, the world’s largest asset manager with $8.7 trillion in assets under management (AUM)41 and one of ESG’s most vocal and powerful proponents. BlackRock, which committed to making all active portfolios and advisory strategies fully “ESG integrated” by the end of 2020, explains that by integrating this non-financial but material information, it will be better positioned to understand a company’s long-term risk and return prospects.42 As Larry Fink, Chairman and CEO of BlackRock, in reference to the “E” in ESG, further specified, “I am not doing this for environmental reasons – I am a fiduciary responsible for other people’s money and climate change is affecting their investments.”43 Cyrus Taraporevala, CEO and President of State Street, made similar statements with respect to diversity, stating, “Diversity is an issue I am sure we all care about from a values perspective—but it is also recognized to have a material impact on companies and investors from a value perspective.”44 Taraporevala reiterated, in regards to

40. See Robert G. Eccles & Svetlana Klimenko, The Investor Revolution, HARV. BUS. REV. (Apr. 13, 2019), https://hbr.org/2019/05/the-investor-revolution (“Many corporate managers still equate sustainable investing with its predecessor, socially responsible investing (SRI), and believe that adhering to its principles entails sacrificing some financial return in order to make the world a better place.”); Pippa Stevens, Your Complete Guide to Investing with a Conscience, a $30 Trillion Market Just Getting Started, CNBC (Dec. 14, 2019, 8:15 AM), https://www.cnbc.com/2019/12/14 /your-complete-guide-to-socially-responsible-investing.html (“[Socially responsible investment strategies were] once a niche approach thought to come at the expense of return.”); Katherina Glac, Understanding Socially Responsible Investing: The Effect of Decision Frames and Trade-off Options, 87 J. BUS. ETHICS 41, 42 (2009) (explaining that socially responsible investors have a higher acceptance for return differentials between conventional and screened investments when compared to traditional investors, suggesting that socially responsible investors derive utility from non-financial characteristics of their investments).

41. Michael Mackenzie, BlackRock Assets Surge to Record $8.68tn, FIN. TIMES (Jan. 14, 2021), https://www.ft.com/content/53b335fee-a8c3-4a18-85ef-d7f2527d0ba0.

42. What is ESG Investing?, iSHARES BY BLACKROCK, https://www.ishares.com/ch /institutional/en/topics/sustainable-investing/esg-explained (“ESG metrics can provide investors with a rules-based, transparent mechanism for identifying companies that may be prone to major controversies and can subsequently help investors seek less portfolio volatility over time.”).

43. Gillian Tett, Wall Street’s New Mantra: Green is Good, FIN. TIMES (Jan. 29, 2021), https://www.ft.com/content/e9b57eel-e9ce-4c31-4f5d-9229-c8981b096d34?shareType=nongift; see also ESG Integration, BLACKROCK, https://www.blackrock.com/ch/individual/en/topics/sustainable-investing/esg-integration (stating that BlackRock’s ESG integration policy is not “a values-based exercise”).

ESG, “For us, it’s very important that you understand that this work has been about value, not values.” What is clear about this approach to ESG investing, which is emulated by major institutions and retail investors alike, is that ESG factors are relevant because they help investors manage risk exposure. In contrast to SRI, which distinctly prioritizes investment screens over shareholder returns in order to align one’s investments with one’s values, ESG investing purports to incorporate environmental, social, and governance factors into traditional Wall Street risk-return analyses in order to maximize long-term returns. However, in order to fully integrate ESG into investment strategies, investors are demanding access to company-specific ESG information. This has resulted in efforts by the investment community to mandate disclosure of ESG metrics and, in particular, diversity metrics and benchmarks.

B. Diversity Disclosures

Despite the dramatic rise of ESG investing strategies in recent years, companies have struggled to fully understand and implement the “S” in ESG, representing the “social” characteristics of a company. These include, for example, human rights, workplace health and safety, diversity and inclusion, and product safety and quality. Notwithstanding these issues, social factors have

45. Id.; see also Cyrus Taraporevala, CEO’s Letter on Our 2020 Proxy Voting Agenda, STATE ST. GLOB. ADVISORS (Jan. 28, 2020), https://www.ssga.com/library-content/pdfs/insights/CEOs-letter-on-SSGA-2020-proxy-voting-agenda.pdf (“Ultimately, [State Street] has a fiduciary responsibility to [its] clients to maximize the probability of attractive long-term returns. This is why we are so focused on financially material ESG issues.”).


47. See, e.g., Townsend, supra note 35, at 7 (“To institutional investors, ESG analytics promised to help identify long-term risk factors and/or identify investment opportunities based on these risks. ESG focused on risks that were likely not factored into traditional Wall Street analysis.”). Investment valuation is fundamentally concerned with the magnitude and risk of future cash flows. This is exemplified by discounted cash flow analysis (DCF), which is the valuation method that gets the most play in academia and comes with the best theoretical credentials. See Aswath Damodaran, Valuation Approaches and Metrics: A Survey of the Theory and Evidence, 1 FOUND. & TRENDS IN FIN. 693, 696 (2005); see generally Jason Fernando, Discounted Cash Flow (DCF), INVESTOPEDIA (Sept. 12, 2021), https://www.investopedia.com/terms/d/dcf.asp. Accordingly, if ESG factors affect the magnitude of an investment’s risks or future cash flows, as is suggested by its proponents, then it is an important component in investment valuation.

48. These demands are not universal. See, e.g., Eric Platt & Myles McCormick, Berkshire Hathaway Opposes Shareholder Call for Climate Disclosures, FIN. TIMES (Mar. 15, 2021), https://www.ft.com/content/adb9bf15-92f1-4302-ad9d-7ce0eadc2d0d (describing that Warren Buffet’s Berkshire Hathaway told investors that it does not consider a formal, mandatory evaluation of how it manages climate-related risk as “necessary”).

49. See Neilan et al., supra note 3; SUSTAINABILITY ACCT. STANDARDS BD., supra note 3.
been thrust into the spotlight with the events of 2020, including the COVID-19 pandemic and Black Lives Matter protests, which have called into question how companies handle issues of race and inclusion, as well as how companies engage and manage relationships with key stakeholders, such as employees and customers, during crises.\(^{50}\) Amidst these issues, it is becoming increasingly apparent to companies and investors that social issues present real risks for companies and are every bit as relevant as environmental or governance risks.\(^{51}\)

With this heightened awareness has come a dramatic increase in demand for tangible benchmarks and disclosures concerning how companies are addressing social issues.\(^{52}\) Of the social factors receiving increased attention, diversity and inclusion has experienced the most demand for more comprehensive disclosure. However, the SEC has traditionally pushed back on efforts to set up a mandatory ESG disclosure regime. The agency stated that it believes the current, principles-based disclosure requirements, with their focus on materiality, are adequate in addressing ESG disclosures, in the same way they address traditional, financial-oriented disclosures.\(^{53}\) According to former SEC Chairman, Jay Clayton, instead of lumping all ESG-related disclosures together into a rigid set of standards applied the same way across all public companies, the SEC’s commitment should remain “rooted in materiality.”\(^{54}\)

In light of these statements, public companies

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51 See Neilan et al., supra note 3 (stating that “factors relating to ‘S’ are now among the most pressing issues for companies globally”).


should continue to disclose ESG-related information, as they do all information, to the extent that it presents a material risk to the company’s business.

The SEC’s hands-off approach led to several high-profile efforts among private enterprises to influence companies to disclose more diversity metrics. For example, State Street’s Taraporevala, citing racial and ethnic diversity as one of State Street’s main stewardship priorities for 2021, has directed the firm’s $3.1 trillion investment arm to vote against the directors at companies in the S&P 500 and FTSE 100 that do not disclose the racial and ethnic composition of their boards. In addition, State Street committed to voting against directors at companies in the S&P 500 and FTSE 100 that do not have at least one director from an underrepresented community on their boards. State Street also notified board members of its portfolio companies that it expects disclosure of their specific goals and strategy related to racial and ethnic representation on their boards of directors and in the companies’ workforces. BlackRock, Vanguard and the NYC Comptroller’s Office have introduced similar measures.

Proxy advisory firms ISS and Glass Lewis, who together control over 90% of the proxy service market, have also addressed diversity in their 2021 voting recommendations. In regards to gender diversity, companies with no women on their boards will receive an adverse vote recommendation from ISS. In addition, ISS will highlight in its research reports those boards that lack racial and/or ethnic diversity and, starting in 2022, will issue adverse vote recommendations, generally voting against or withholding “from the chair of the nominating committee (or other directors on a case-by-case basis) where the board has no apparent ethnically or racially diverse members.”

55. Taraporevala, supra note 23.
56. See id.
60. INST’L S’HOLDER SERV., supra note 25, at 11–12.
61. Id. at 12.
board that has fewer than two female directors.62 Furthermore, Glass Lewis will evaluate disclosures in the proxy statement relating to board diversity in order to inform its assessment of a company’s overall governance and potentially serve as a contributing factor for recommendations.63 These actions are significant given the influence proxy advisors have over voting behavior in public companies.64

C. Nasdaq’s Comply-or-explain Requirement

Nasdaq, using its leverage as an exchange to address the issues of diversity and inclusion, submitted a proposal in December 2020 to the SEC requesting that the Commission permit the exchange to adopt new listing rules related to board diversity and disclosure.65 These rules would require all companies listed on Nasdaq’s U.S. exchange to disclose diversity statistics regarding their board of directors. In addition, the rules would require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+.66 Currently, only about one in three companies listed on the Nasdaq exchange would meet this criteria.67 Nasdaq expressed to the SEC that a primary goal of the proposal is to further the objectives of the Securities Act of 1933 and Securities Exchange Act of 1934 Acts by removing impediments to the free and open market, preventing fraudulent and manipulative acts and practices, and protecting investors and the public interest. Nasdaq also emphasized the strong link between diversity and financial performance, which has been supported in the academic and professional literature.68

63. Id.
67. Nauman, supra note 22.
68. See Nasdaq Proposed Rule Change, supra note 65, at 9–10. Though, the literature is not conclusive in regards to the correlation between board diversity and financial performance, which Nasdaq also recognizes in its proposal. Compare Gennaro Bernile, Vineet Bhagwat & Scott Yonker, Board Diversity, Firm Risk, and Corporate Policies, 127 J. FIN. ECON. 588 (2018) (finding that greater diversity on boards—including gender, ethnicity, educational background, age, financial expertise and board experience—is associated with increased operating performance, higher asset valuation multiples, lower stock return volatility, reduced financial leverage, increased dividend payouts to shareholders, higher investment in R&D and better innovation) and Meggin Thwing
In accordance with the comply-or-explain requirement, a company explaining why it does not have two diverse directors must provide the explanation in the company’s proxy statement or information statement for its annual meeting of shareholders or on the company’s website.69 Nasdaq would not assess the substance of the company’s explanation, but would verify that the company has provided one.70 However, explanations such as “the Company does not comply with the diversity rule” would not satisfy the requirement.71 Rather, the company should provide something akin to the following: “The Company is required to have at least two diverse directors. The Company has chosen to satisfy this rule by explaining its reasons for not meeting the diversity objectives of the rule, which the Company has set forth below.”72 Nasdaq provided examples of possible reasons in its proposal. For instance, the company may choose to explain that it does not meet the diversity objectives because it is subject to an alternative standard under foreign laws, or it “has a board philosophy regarding diversity that differs from the diversity objectives set forth in the rule.”73

Comply-or-explain requirements such as these are commonplace across Europe, where they serve as the foundation for corporate governance law.74 However, this technique has generally failed to gain traction in the United States, with the most notable exception being Section 406 of the Sarbannes-Oxley Act of 2002, which requires firms to disclose whether they have a code of ethics for...
senior officers or to explain why they do not. Observers in Europe emphasize the fact that comply or explain requirements utilize market enforcement as means of promoting good governance and informed markets. For instance, if the statements associated with the requirements appear untrue or are misleading, consequences may follow. These consequences may take the form of reputational damages that manifest in sold shares or proxy contests; but they can also take the form of legal liability, especially in the United States where securities class actions are much more prevalent. The risk of legal liability is particularly relevant in the context of diversity disclosures because diversity information, due to its nonfinancial nature, is not of the type that securities law has been designed to address. Therefore, there is significant uncertainty from a legal liability perspective regarding how diversity information will be treated in the courts once public companies are effectively required to disclose information related to board diversity plans and benchmarks.

Nasdaq’s proposal, together with the efforts of institutional investors, proxy advisory firms, and exchanges, represents a rapid and substantial shift in emphasis among ESG factors. Social issues, which were previously considered too intangible to deserve much focus, are now a priority, and the market is sending signals to issuers that it expects them to increase diversity disclosures and meet diversity benchmarks, or potentially face repercussions. Furthermore, despite its persistent reluctance to initiate a separate disclosure regime for ESG factors, the SEC under the Biden Administration has finally joined these efforts and expressed its intention to take a more proactive approach to ESG, making the approval of Nasdaq’s proposal or the enactment of similar measures by the SEC increasingly likely. These trends indicate that more specific and voluminous diversity disclosures, especially as it relates to board diversity, are an inevitability for publicly listed companies in the U.S. As a result, these companies should expect greater exposure to the federal securities fraud laws.

D. SEC Disclosure Regulations and Anti-Fraud Provisions

The importance of disclosing accurate and adequate information in securities markets is well documented. One of the most essential benefits of disclosure is that it protects investors, particularly unsophisticated investors, from fraudulent, opportunistic behavior by insiders with access to private information. Disclosure produces this benefit by providing the entire investing public with the information

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76. See, e.g., Wymeersch, supra note 74, at 8.
77. See David H. Kistenbrocker, Joni S. Jacobson & Angela M. Liu, Dechert LLP, Global Securities Litigation Trends 15 (2020) (describing the U.S. as the leader in securities and collective litigation),
78. See Sorkin, supra note 8.
necessary to determine the risk-return prospects of any given company. If a publicly traded company truthfully discloses to the investing public the company-specific details needed to make this determination, then corporate insiders or investment professionals with access to superior information absent disclosure are not able to take advantage of this information asymmetry to the detriment of outside investors. As a result, investor confidence is enhanced, thus preserving the well-functioning, if not the very existence, of the securities markets.

Since the Securities Act of 1933, the federal government has regulated information disclosure in securities markets. In order to facilitate effective disclosure, the Securities Exchange Act of 1934 created the Securities and Exchange Commission (SEC) and empowered it to require periodic disclosures of information by publicly-traded companies and to discipline market actors for false or misleading statements and omissions in relation to such disclosures. By utilizing these tools, the SEC ensures that investors have the “timely, accurate, and complete information they need to make confident and informed decisions about when and where to invest.”

In addition to determining disclosure regimes for public companies, the SEC is tasked with enforcing federal securities laws. This includes enforcement of anti-fraud provisions, which prohibit false or misleading statements or omissions by participants in the securities markets. However, via a private right of action,

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80. This is a formulation of the efficient markets hypothesis (ECMH). The seminal article on ECMH as a legal construct is Ronald J. Gilson & Reinier H. Kraakman, The Mechanisms of Market Efficiency, 70 VA. L. REV. 549 (1984). The theory states that a variety of forces impound available information into stock prices fast enough that arbitrage opportunities cannot be exploited systematically. Donald C. Langevoort, Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited, 140 U. PENN. L. REV. 851, 851 (1992). In other words, share prices reflect all public information, so that no one with public information can consistently beat the market. The theory has been very influential within the SEC and in the courts. For example, the Supreme Court effectively endorsed ECMH in Basic, Inc. v. Levinson, 485 U.S. 224 (1998). In addition, Judge Frank Easterbrook has written that “[t]he [SEC] believes that markets correctly value the securities of well-followed firms, so that new sales may rely on information that has been digested and expressed in the security’s price.” Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 510 (7th Cir. 1989) (emphasis added). The SEC’s approach to insider trading prosecutions, exemplified by former SEC enforcement director Robert Khuzami’s statement that the SEC canvases the hedge fund industry looking for funds with “aberrational performance,” further exemplifies the prominence of EMH as an explanatory theory. See Roger Lowenstein, The War on Insider Trading: Market-Beaters Beware, N.Y. TIMES MAG. (Sept. 22 2011), https://www.nytimes.com/2011/09/25/magazine/in-the-insider-trading-war-market-beaters-beware.html?.


private investors defrauded in the securities markets are also able to enforce anti-fraud provisions. For the purpose of this note, the two most notable provisions giving rise to private rights of action for fraudulent statements made by public companies are Rules 10b-5 and 14a-9.

1. Rule 10b-5

Section 10(b) of the Securities Exchange Act of 1934 prohibits fraud in the purchase or sale of securities. Specifically, the statute states, “It shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security, . . . any manipulative or deceptive device or contrivance . . . .” Pursuant to its authority granted under this statute, the SEC promulgated Rule 10b-5. Rule 10b-5 is considered the catch-all anti-fraud provision of the federal securities laws, and the Supreme Court determined that it can be enforced via an implied private right of action. As such, it represents the most widely-used securities anti-fraud provision for private plaintiffs and is considered the most significant regulatory consequence of the ‘34 Act. Rule 10b-5 states the following:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Based upon this provision, the courts have established elements of a cause of action under Rule 10b-5, in which “[p]laintiffs bear the burden of showing: (1) a material misstatement, (2) scienter, (3) reliance, and (4) loss causation.”

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87. 15 U.S.C. § 78j(b) (emphasis added).
89. See CHOI & PRITCHARD, supra note 88, at 111, 243.
91. CHOI & PRITCHARD, supra note 88, at 273.
First, a plaintiff must plead that a misstatement or omission is material. According to the Supreme Court in *Basic, Inc. v. Levinson*, materiality “depends on the significance the reasonable investor would place on the withheld or misrepresented information.” More specifically, to fulfill the materiality requirement, “there must be a substantial likelihood that the disclosure of the omitted fact [or accurate disclosure of a misrepresented fact] would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information available.” By referencing a theoretical “reasonable investor,” the Supreme Court established an objective materiality test that must be satisfied by the plaintiff.

Second, a plaintiff must plead scienter. In the context of a Rule 10b-5 action, “‘scienter’ refers to a mental state embracing intent to deceive, manipulate, or defraud.” The Private Securities Litigation Reform Act of 1995 (PSLRA) and Rule 9(b) require plaintiffs to plead scienter with particularity. Specifically, the PSLRA requires that pleadings give rise to a “strong inference” of scienter. The Supreme Court has determined that a “strong inference” of scienter in a securities fraud complaint is something more than “reasonable” or “permissible;” instead, a “strong inference” must be “cogent and compelling . . . in light of other explanations.” Essentially, in an attempt to deter frivolous securities lawsuits, the PSLRA and the subsequent definition of “strong inference” established by the Supreme Court created a heightened pleading standard for scienter that must be met by private plaintiffs.

Third, a plaintiff must plead reliance. In *Basic, Inc. v. Levinson*, the Supreme Court held that there is a presumption of reliance upon misstatements made by a corporation under a fraud-on-the-market theory. This theory posits that “in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company in its business.” Accordingly, misleading statements will defraud purchasers and sellers of stock even if the purchasers and sellers do not directly rely on the

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93. 485 U.S. at 240.
94. *Id.* at 231–32 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).
95. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976) (“The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor.”)
98. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322, 324 (2007) (holding that the inquiry under the PSLRA pleading requirements for scienter is “whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard”).
misstatements. This is because the impact of misstatements gets incorporated in the stock price, the accuracy of which the purchasers and sellers directly relied. Using this line of reasoning, the Supreme Court has determined that reliance is presumed under a Rule 10b-5 action.101

Finally, a plaintiff must plead loss causation. According to the PSLRA, plaintiff shall have the burden of proving that “the act or omission of the defendant alleged to violate [Section 10(b)] caused the loss for which the plaintiff seeks to recover damages.”102 Therefore, in the context of an allegedly fraudulent misrepresentation, a plaintiff must plead that a company’s misrepresentation proximately caused stock price movements according to which the plaintiff incurred actual economic loss.103 Together, the elements of materiality, reliance, scienter, and loss causation form the basis of the most actively litigated anti-fraud provision by private plaintiffs.

2. Rule 14a-9

Shareholders in the US have the right to vote on a basic set of issues at least once a year at the annual shareholders meeting, including the right to vote for directors on the corporation’s board.104 The SEC governs communication between the company and shareholders regarding the annual shareholders meeting.105 This includes regulation of the proxy statement under Section 14(a) of the Securities and Exchange Act of 1934.106 A proxy statement is a document provided by a company’s board of directors to its shareholders ahead of an annual or a special shareholder meeting for the purpose of helping shareholders make informed decisions about matters arising during a shareholder meeting.107 Distributing a proxy statement is effectively a requirement for public companies,108 and its contents are regulated specifically by the SEC via Schedule 14a-9.

101. Id. at 241, 248.
103. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 344–47 (2005) (holding that plaintiff’s must plead loss causation, i.e., that a defendant’s misrepresentations were the proximate cause of the plaintiff’s loss).
105. COOK, supra note 104, at 3.
106. 15 U.S.C. § 78n (2021) (granting the SEC the authority to prescribe rules to govern the solicitation of proxies).
107. Tuovila, supra note 12, at 5.
108. The SEC requires that shareholders of a company whose securities are registered under Section 12 of the Securities Exchange Act of 1934 receive a proxy statement prior to a shareholder meeting, whether an annual or special meeting. 17 CFR § 240.14a-3.
In addition, the SEC established Rule 14a-9 to enforce fraudulent statements or omissions in proxy statements. According to Rule 14a-9, “no solicitation . . . shall be made by means of any proxy statement . . . containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact . . ..” Like Rule 10b-5, the Supreme Court has determined that Rule 14a-9 includes an implied private right of action, meaning private plaintiffs can sue companies that make false or misleading statements in their proxy statements. Aside from this, the elements of a Rule 14a-9 claim are quite different from the elements of Rule 10b-5.

Plaintiffs under Rule 14a-9 must plead only a material misstatement and loss causation. Notably, in relation to Rule 10b-5, reliance and scienter are left out of Rule 14a-9. In regards to the standard of materiality in Rule 14a-9, the Supreme Court held in TSC Industries v. Northway Inc that a fact is material “if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.” Furthermore, the Supreme Court stated that proving materiality does not require “proof of a substantial likelihood” that

110. 17 CFR § 240.14a-9 (2021). Compare to Rule 10b-5 which is applied to “all statements made by issuers that provide information that is reasonably expected to reach investors in the trading markets.” SEC Antifraud Provisions, supra note 11.
114. Rather than a scienter requirement, the federal courts are in general agreement that negligence is the proper standard. Compare Gerste v. Gamble-Skogmo, Inc., 472d 1281, 1299 (2d Cir. 1973) and Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 777 (3d Cir. 1976) with Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 429 (6th Cir. 1980) (holding that accountant are subject to a scienter standard of liability under Rule 14a-9 for misstatements in the proxy statement). See also Negligence vs. Scienter: The Proper Standard of Liability for Violations of the Antifraud Provisions Regulating Tender Offers and Proxy Solicitations Under the Securities Exchange Act of 1934, 41 Wash. & Lee L. Rev. 1045, 1051 – 56 (1984) (discussing the approach among Circuit Courts to the standard of liability under Rule 14a-9). The Supreme Court has not determined the proper standard of liability for Rule 14a-9, which left the lower courts to adopt lower standards. See Virginia Bankshares, Inc., 501 U.S. at 1090 n.5 (reserving the question of whether scienter is necessary for liability under § 14(a)). A wave of new suits under Rule 14a-9 could cause the Supreme Court to visit this question. In regards to reliance, the Supreme Court held in Mills v. Electric Auto-Lite Co. that “[w]ere the misstatement or omission in a proxy statement has been shown to be “material,” . . . that determination itself indubitably embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable investor who was in the process of deciding how to vote . . . .” 396 U.S. 375, 384 (1970). This view refuted the Court of Appeals, which supplemented this requirement with a requirement of proof of whether the defect actually had a decisive effect on the voting. See id. at 382 n.5; William H. Painter, Civil Liability Under the Federal Proxy Rules, 64 Wash. U. L. Q. 425, 430–31 (1986).
accurate disclosure would have caused the “reasonable investor” to alter his vote; rather, it requires showing a “substantial likelihood” that accurate disclosure would have “assumed actual significance in the reasonable shareholder’s deliberations.” Therefore, like the standard in Rule 10b-5, the TSC Industries Court established an objective standard of materiality focused on the “reasonable investor.” In fact, it was the TSC Industries standard of materiality for Rule 14a-9 that the Supreme Court expressly adopted for Rule 10b-5 in Basic, Inc. v. Levinson. Thus, it appears that the materiality standards under these separate anti-fraud provisions are the exact same; but, as will be argued in Part II, this is not actually the case, as there is a slight difference which has considerable implications for diversity disclosures, in particular.

In regards to loss causation, plaintiffs have two options. First, they may prove that solicitation of proxies was an “essential link” in accomplishing the defendant’s objective for which the proxies were solicited. For the sake of illustration, consider the merger context, which is the most common situation giving rise Rule 14a-9 liability. After the board of directors approves a merger, proxy statements are distributed to shareholders to inform them of the terms and purported benefits of the merger. If the proxy statement contains false or misleading information, plaintiffs can sue under 14a-9 to enjoin the merger. In Virginia Bankshares, Inc. v. Sandberg, the question arose as to how such a plaintiff can prove loss causation. In the case, the Supreme Court held that causation is established where the proxy statement is an “essential link” in completing the transaction for which defendants sought approval, which, in the case of a merger, is the merger itself. Crucially, a plaintiff need not show directly that there were monetary losses as a result of the misstatement, as in Rule 10b-5; instead, a plaintiff need only show injury to his or her voting rights. A second option for plaintiffs to prove loss causation is to show loss of a state law remedy, such as appraisal rights. While the Supreme Court in Virginia Bankshares did not decide the question of whether Rule 14a-9 provides a cause

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116. Id.

117. Basic, Inc. v. Levinson, 485 U.S. 224, 224 (1988) (holding that “the standard set forth in [TSC], whereby an omitted fact is material if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor, is expressly adopted for the § 10(b) and Rule 10b-5 context”).


119. Id.

120. “Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction.” Id. at 1111 (quoting Mills v. Elec. Auto–Lite Co., 396 U.S. 375, 384–85 (1970)).

121. Appraisal rights are a statutory right under state corporate law to have a judicial proceeding determine a fair stock price to be paid as merger consideration and oblige the acquiring corporation to purchase shares at that price. James Chen, Appraisal Right, INVESTOPEDIA (Jun. 24, 2020), https://www.investopedia.com/terms/a/appraisalright.asp.
of action for state remedies lost as a result of false or misleading proxy solicitation, lower courts have generally held that it does. 122

By limiting the elements of Rule 14a-9 to causation and materiality and by interpreting these elements in the aforementioned manner, the Supreme Court sought to avoid the impracticalities of determining how many votes among thousands of shareholders were affected by the alleged misstatements. 123 Furthermore, the Supreme Court recognized that making the elements of Rule 14a-9 more favorable to the plaintiff will effectuate the congressional policy of ensuring that shareholders are able to make informed decisions regarding fundamental matters of corporate governance. 124 As a result, the Supreme Court established a weaker barrier, relative to Rule 10b-5, for private plaintiffs pursuing fraud claims related to proxy statements.

II. COMPARING MATERIALITY STANDARDS IN RULES 10B-5 AND 14A-9

Materiality has traditionally been the biggest hurdle for plaintiffs making securities fraud claims related to ESG statements, with courts considering such statements mere declarations of corporate optimism on which no reasonable investor would rely. 125 However, given the recent widespread efforts among investors to increase and standardize ESG disclosures and the growing body of evidence of the financial materiality of ESG factors, the materiality standard is now less of an obstacle. 126 This is particularly true for securities fraud claims against companies for allegedly false or misleading diversity plans.

If Nasdaq’s comply-or-explain board diversity proposal were to be approved, or if the SEC were to make similar disclosure requirements in the future, proxy statements would likely contain more detailed information regarding board diversity goals and objectives, exposing companies to a potential source of securities fraud liability. In these circumstances, Rule 10b-5, as the catch-all provision for securities fraud, and Rule 14a-9, which deals specifically with fraudulent statements in proxy statements, would be potentially applicable. And, given the fact that the Supreme Court expressly adopted the materiality standard of Rule 14a-9 for Rule 10b-5 as well, the materiality test under each of these rules should be theoretically identical and lead to the same outcome. This may have

122. CHOI & PRITCHARD, supra note 88, at 831; see, e.g., Wilson v. Great Am. Indus., 979 F.2d 924, 930 (2d Cir. 1992) (holding that plaintiff established causation under Rule 14a-9 based upon plaintiff’s loss of its state law appraisal remedy).


124. Id.


126. See Saad & Strauss, supra note 29, at 418 (stating, in the context of ESG, “If, as the securities doctrine maintains, material information is that which is important to a reasonable investor, then the observed trends, which depart from shareholder demographics and behavior of the past decades, suggest a corresponding need to change the scope of disclosures considered legally material.”). See also United States v. Litvak, 889 F.3d 56, 64-65 (2d Cir. 2018) (“The standard of a ‘reasonable investor’ like the negligence standard of a ‘reasonable man,’ is an objective one. The standard may vary, therefore, with the nature of the traders involved in the particular market.”).
been true at one time, but the rise of passive management has called this assumption into question. For Rule 10b-5, an allegedly false or misleading statement is material if there is a substantial likelihood that a reasonable investor would consider it important to his or her trading decision (i.e., to purchase or sell). But, for Rule 14a-9, an allegedly false or misleading statement is material if there is substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. While these standards may be sufficiently analogous in enough situations to consider them the same standard, the difference in decision type (trading decision versus voting decision) has considerable implications for a securities fraud claim related to diversity plans in proxy statements. The following section evaluates the materiality of board diversity, first under Rule 10b-5 and then under Rule 14a-9.

A. The Reasonable Investor

Despite slight yet meaningful differences with respect to the materiality element, Rules 10b-5 and 14a-9 both agree that materiality is evaluated with respect to the “reasonable investor.” Therefore, it is necessary to first consider what a “reasonable investor” is. However, the meaning of “reasonable investor” is not entirely clear; regulators, scholars, and courts have not universally agreed upon a definition. Nevertheless, there seems to be a general consensus that the “reasonable investor” is an idealized, economically rational retail investor that invests for the long term. But, given the rise of passive investing and the drastic increase in institutional ownership, it may be time to reassess this definition.

127. See Basic, Inc. v. Levinson, 485 U.S. 224, 224, 235 (1988). Rule 10b-5, though considered a catch-all provision, is restricted to fraud “in connection with the purchase or sale of any security.” 17 C.F.R. § 240.10b-5 (2020). Furthermore, it only applies to shareholders that purchased or sold a company’s securities during the class period, i.e., dates during which the fraud purportedly occurred. See generally Elizabeth L. Yingling, U.S. Securities Class Actions – An Overview, Baker McKenzie, https://www.bakermckenzie.com/-/media/files/locations/india/overview_of_a_securities_class_action_suit.pdf?la=en.


129. See Amanda M. Rose, The Reasonable Investor of Federal Securities Law: Insights from Tort Law’s Reasonable Person & Suggested Reforms, 43 J. CORP. L. 77, 78-79 (2017) (describing the debate surrounding “reasonable investor” and noting Supreme Court precedent that materiality determinations via the reasonable investor test are highly fact-intensive); Stephen J. Choi & A.C. Pritchard, Behavioral Economics and the SEC, 56 STAN. L. REV. 1, 70 (2003) (describing the difficulties of defining “reasonable investor” since many investors suffer from behavioral biases and are easily led astray by overoptimism); Stefan J. Padfield, Is Puffery Material to Investors? Maybe We Should Ask Them, 10 U. PA. J. BUS. & EMP. L. 339, 340-41 (2008) (explaining survey results in which judges concluded no reasonable investor could find particular statements material while between 33% and 84% of the investors studied considered the statements material).

130. See Tom C.W. Lin, Reasonable Investor(s), 95 B.U. L. REV. 461, 466-68 (2015); Saad & Strauss, supra note 29, at 400 (describing the “reasonable investor” as an “economically rational actor who relies solely on financial disclosures in making decisions about the purchase and sale of securities”).
Investors in the U.S. stock market can generally be separated into two categories: retail investors, which includes everyday, individual, non-professional investors; and institutional investors, which include professional investors such as mutual funds, pensions, and insurance companies. Currently, institutional investors own about 75 to 80% of the market value of publicly traded companies in the United States. Compare this to 1950, when retail investors owned over 90% of the stock of U.S. corporations. As a result of this trend, approximately three-quarters of the shares in U.S. public companies are not owned directly by the constituency that apparently represents the “reasonable investor” in the market for public company stock.

Coinciding with this trend of increased institutional investor ownership has been a dramatic shift toward passive investing. Passive investing can be contrasted with active investing, which is a “hands-on” approach of picking individual stocks in order to beat the stock market’s average returns. If a retail investor wants to engage in an active strategy, they either pick individual stocks on their own or hire a portfolio manager to do it for them. Passive investing, on the other hand, generally involves investing in an index, which is essentially a portfolio of potentially thousands of stocks that mirrors performance of the market as a whole and, thus, is subject to less risk than an active portfolio. The only buying and selling that takes place from a passive investor’s perspective is the buying and selling of “shares” in the index fund. From the perspective of the asset manager that is administering the index fund, buying and selling takes place to satisfy redemptions, invest new dollars, and ensure that the underlying fund reflects the relative weights of the companies in the index. Therefore, unlike active investing, there is no evaluation of whether the companies in the index are good investments because the fund simply tracks the index; however, asset managers trade an enormous volume of shares in order to keep the index in balance.

The practicality of investing in the market portfolio, the relatively lower costs, and the evidence of underperformance of active managers have led to a massive growth of passive funds serving retail investors. In fact, passive and active funds in the U.S. reached parity in April 2019, each totaling about $4.3

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132. See 80% of Equity Market Cap Held by Institutions, supra note 21.
135. Id.
trillion in assets.\textsuperscript{138} Compare this to the end of 1998, when there were 6.5 times as many assets in actively managed U.S. stock funds as there were in index funds.\textsuperscript{139} The main beneficiaries of this trend have been the Big Three asset managers: BlackRock, State Street, and Vanguard.\textsuperscript{140} These three now own an average of 20.5\% of outstanding shares of S&P 500 companies, and, together, they are the largest shareholder in 88\% of those companies.\textsuperscript{141} Furthermore, the growth in assets under management has given these asset managers considerable influence on the proxy voting process.\textsuperscript{142} This is because investors in index funds do not own the underlying shares of the companies that are in the index; rather, the mutual fund owns the shares from which the investors in the index receive cash flows. Asset managers exercise voting rights on the fund’s behalf.\textsuperscript{143}

These significant changes in the ownership of public company stock require a reconsideration of the “reasonable investor” test. Asset managers vote the overwhelming majority of shares in the stock market and account for the most trading volume. Consequently, it is asset managers, and, in particular, the Big Three, who determine whether most proxy proposals succeed or fail.\textsuperscript{144} Reflecting the objective nature of the “reasonable investor” test, the Second Circuit held that the “reasonable investor” may vary “with the nature of the traders involved in the particular market;”\textsuperscript{145} therefore, the “reasonable investor” test in the market for public company stock should at least consider the perspective and actions of institutional investors. In light of the drastic changes in public stock ownership, to do otherwise (i.e., to treat today’s “reasonable investor” as only an unsophisticated retail investor) would make the test glaringly incomplete. The following analysis of materiality under Rules 10b-5 and 14a-9 operates under the assumption that institutional investor behavior is relevant to an assessment of the “reasonable investor.”

\textsuperscript{138} Tom Lauricella & Gabrielle DiBenedetto, A Look at the Road to Asset Parity Between Passive and Active U.S. Funds, MORNINGSTAR: BIG PICTURE (June 12, 2019), https://www.morningstar.com/insights/2019/06/12/asset-parity.

\textsuperscript{139} Id.

\textsuperscript{140} Caleb N. Griffin, Margins: Estimating the Influence of the Big Three on Shareholder Proposals, 73 SMU L. REV. 409, 414 (2020) (finding that the Big Three together hold 81\% of index fund assets, while other index fund providers struggle to compete).

\textsuperscript{141} Id. at 417, 419.

\textsuperscript{142} See id. at 442–43.


\textsuperscript{144} See Griffin, supra note 140, at 442–43.

\textsuperscript{145} United States v. Litvak, 889 F.3d 56, 64-65 (2d Cir. 2018); Saad & Strauss, supra note 29, at 418 (stating, in the context of ESG, “If, as the securities doctrine maintains, material information is that which is important to a reasonable investor, then the observed trends, which depart from shareholder demographics and behavior of the past decades, suggest a corresponding need to change the scope of disclosures considered legally material”).
B. Materiality of Diversity Disclosures under Rule 10b-5

Under Rule 10b-5, a statement is material if there is a substantial likelihood that a “reasonable investor” would consider the statement important to their decision to buy or sell the company’s securities. Therefore, a plaintiff alleging that a company made false or misleading statements in regards to its diversity plans and objectives must show that there is a substantial likelihood that a “reasonable investor” would have considered the diversity disclosures important to their decision to buy or sell the company’s securities. Despite the increased attention on diversity in the boardroom, however, there is less support for the proposition that investors consider diversity important to a decision to buy or sell a company’s stock.

1. Evidence of Rule 10b-5 Materiality from Institutional Investors

The most often-cited evidence of ESG’s materiality are the attitudes of major asset managers, especially BlackRock. BlackRock, as the largest asset manager in the world with $8.7 trillion in AUM, carries considerable weight and influence. When BlackRock makes a commitment to “making sustainability our new standard of investing,” it understandably makes headlines. However, less attention is paid to the effect of these commitments on how BlackRock buys and sells securities in its portfolios.

For example, BlackRock touts that it has achieved its goal of “having 100% of its active and advisory portfolios ESG-integrated.” BlackRock defines ESG integration as “the practice of incorporating material ESG information into investment decisions with the objective of improving the long-term financial outcomes of our clients’ portfolios, consistent with our clients’ objectives.” However, in its annually reviewed ESG Integration Statement that applies to all of BlackRock’s investment divisions and investment teams, BlackRock provides no additional explanation as to what “material ESG information” may include.

BlackRock’s client letter reveals that this definition includes some minimal level

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146. 17 C.F.R. § 240.10b-5 (2020) (stating that the rule applies to fraud in connection with the purchase or sale of any security.”); Basic, Inc. v. Levinson, 485 U.S. 224, 224 (1988).
147. See, e.g., Saad & Strauss, supra note 29, at 413–14 (citing statements by BlackRock Chairman and CEO Larry Fink as evidence that “investors are keen to incorporate ESG data to achieve accurate pricing” and that “ESG data is acquiring financial materiality for firms with a more traditional, rather than SRI directed, orientation”); Eccles & Klimenko, supra note 40 (citing BlackRock’s integration of ESG into financial analysis as evidence of ESG’s materiality).
150. Id.
151. Id.
152. Id.
of environmental screening, as it has pledged to remove companies generating more than 25% of revenues from thermal coal production from its discretionary active investment portfolios.\textsuperscript{153} But, outside of this environmental screening process, it is unclear how BlackRock is addressing the multitude of other factors that ESG entails, especially in regards to what companies’ shares it buys and sells.

In particular, there does not appear to be a screening process related to diversity.\textsuperscript{154} In fact, when BlackRock discusses diversity, it uses soft language like “diversity may be material and could affect long-term performance” and that diversity “is playing an increasingly important role . . . in our investment solutions.”\textsuperscript{155} Despite this vague language, BlackRock has made commitments to addressing diversity in its proxy voting guidelines, which state that BlackRock may vote against members of a board of directors’ nominating committee for not adequately accounting for diversity in their board composition.\textsuperscript{156} BlackRock’s proxy voting guidelines also encourage boards to disclose more diversity metrics.\textsuperscript{157} It is crucial to note, however, that these efforts are not related to buying and selling company securities, which is the focus of the materiality inquiry under Rule 10b-5. Rather, they are related to engagement efforts, specifically via proxy voting, which is separate from buying and selling decisions.

Furthermore, because the assets of asset managers who are pushing ESG integration are heavily concentrated in passive funds,\textsuperscript{158} these managers are only able to make ESG-related investment decisions with respect to a small subset of their AUM. BlackRock has already run into this issue; despite its commitment

\begin{thebibliography}{9}
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\bibitem{154} See, e.g., Larry Fink, Larry Fink’s 2021 Letter to CEOs, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter. Larry Fink’s 2021 letter to portfolio companies focused heavily on BlackRock’s commitments to environmental sustainability. Id. Diversity received little attention; when it was discussed, Fink only asked that “disclosures on talent strategy fully reflect . . . long-term plans to improve diversity, equity, and inclusion, as appropriate by region,” which will help BlackRock “better understand the deep interdependence between environmental and social issues.” Id. Compare this to the relatively explicit standards imposed on sustainability, such as the “heightened-scrutiny model in . . . active portfolios” for companies “that pose significant climate risk (including flagging holdings for potential exit).” Id.
\bibitem{156} BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: PROXY VOTING GUIDELINES FOR U.S. SECURITIES, supra note 58, at 6 (“To the extent that a company has not adequately accounted for diversity in its board composition within a reasonable timeframe, based on our assessment, we may vote against members of the nominating/governance committee for an apparent lack of commitment to board effectiveness.”).
\bibitem{157} Id.
\end{thebibliography}
to sustainability, it holds over $85 billion in coal company stock. One explanation for this is that some coal-related companies do not meet BlackRock’s 25% threshold for divestiture, but the bigger issue is that 90% of BlackRock’s assets are in passive funds, the contents of which BlackRock is unable to alter because these funds track an index which BlackRock does not control (though, it does choose which indices to track). Therefore, regardless of any commitment to ESG integration, BlackRock has to hold some coal company stock and some of every other company’s stock with which it may disagree on ESG-related matters. The hands of other managers of passive funds are similarly tied; and, given the dramatic rise in assets under passive management, this trend is likely to continue and become even more pronounced.

As a result of these limitations, BlackRock has been accused of “greenwashing,” the process of falsely making a business seem more environmentally friendly than it really is. And BlackRock, which literally can’t put its money where its mouth is with respect to 90% of its assets, is a worthy candidate of such criticism, as are other major index fund providers. Greenwashing is similar to “cheap talk,” a concept in game theory that refers to communication between players that does not directly affect the payoffs of the game, meaning that it does not affect outcomes. More specifically, cheap talk is communication in the market that is (1) costless to transmit and receive, (2) non-binding, and (3) unverifiable. In this context, a fund saying that ESG is important is costless, non-binding, and generally unverifiable communication. The motivation for saying this is clear – funds want to attract capital. Kim & Yoon provide support for this proposition. They find that active fund managers who sign on to the United Nation’s Principles for Responsible Investment (PRI),

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160. See Liam Kennedy, BlackRock: Active Transformation, IPE (Jan. 2018), https://www.ipe.com/blackrock-active-transformation/10022518.article (finding that “BlackRock’s $300bn in active equity may represent less than 10% of its overall equity AUM”).


163. A study by Allianz Global Management finds that only 1% of portfolios worldwide are managed in an ESG-conscious way, suggesting that, while the narrative surrounding ESG may have shifted among institutional investors, actual integration of ESG has lagged. See ALLIANZ GLOB. INVS., SUSTAINABLE INVESTING REPORT 2019, supra note 46, at 22.

164. See Crawford & Sobel, supra note 18.

a (non-binding) initiative in which fund managers commit to incorporating ESG into their portfolio decision-making, experience large fund inflows, regardless of the funds’ prior ESG performance. However, after signing on, PRI funds do not show improvements in fund-level ESG scores and even experience a decrease in portfolio return, providing considerable support for the cheap talk hypothesis in the context of ESG.

Despite its roots in environmental sustainability, greenwashing and the similar concept of cheap talk can be extended to diversity as well. Major asset managers have been very outspoken in their support for diversity and inclusion; however, they do not appear to be as enthusiastic about implementation. First, BlackRock and other major asset managers have not made any firm commitment to orient their active portfolios according to diversity factors, and they are restricted from doing so with respect to their passive funds. Second, initiatives at BlackRock and other major asset managers that pertain specifically to diversity do not appear to extend past board engagement into the actual buying and selling of a company’s stock. Therefore, despite what these asset managers may say, citing institutional investor efforts on ESG as proof of materiality under Rule 10b-5 is not a compelling argument. In fact, their talk is cheap.

But what about the literature supporting the financial materiality of a diverse board? First, while the majority of studies support the conclusion that diversity in the boardroom increases financial performance, the literature is not

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166. *What Are the Principles for Responsible Investment?*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment (last visited Nov. 7, 2021). Institutional investor signatories to the Principles for Responsible Investment commit to six principles: (1) to incorporate ESG issues into investment analysis and decision-making processes, (2) to be active owners and incorporate ESG issues into their ownership policies and practices, (3) to seek appropriate disclosure on ESG issues by the entities in which they invest, (4) to promote acceptance and implementation of the Principles within the investment industry, (5) to work together to enhance their effectiveness in implementing the Principles, and (6) to each report on their activities and progress towards implementing the Principles. *Id.* However, the Principles are described as “voluntary and aspirational” and are not legally binding. *Id.*


168. *Id.* at 14–15, 17; *see also Gibson et al., Responsible Investing Around the World* 4–6 (Euro. Corp. Governance Inst., Fin. Working Paper No. 712/2020) (2020) (finding that US-based PRI signatory institutions that partially implement ESG strategies exhibit worse portfolio-level ESG scores than non-PRI institutions). It is important to note that inflows increased into funds that signed the PRI, suggesting that institutional investors may value ESG generally. *Id.* But, again, this proposition is related to ESG generally and not a specific ESG factor, like diversity. It also does not apply to the actual buying and selling in the securities of public companies, which the Gibson et al. study concludes is not affected by signing onto the PRI. *Id.*

169. *See CFA INST., DRIVING CHANGE: DIVERSITY & INCLUSION IN INVESTMENT MANAGEMENT* 5 (2018), https://www.cfainstitute.org/-/media/documents/survey/diversity-and-inclusion-report-full.ashx (finding that 83% of more than 800 institutional investors surveyed said gender diversity is important to them).

170. *See supra* text accompanying note 68.
conclusive.\textsuperscript{171} Second, and more importantly, these studies are not asking the right question; they ask whether companies with a diverse board experience better returns than those without a diverse board. But this is a different question than what is necessary under the materiality test in Rule 10b-5, which asks whether there is a substantial likelihood that a reasonable investor would consider the diversity of a company’s board as an important factor in deciding whether to purchase or sell the company’s shares. To provide support in this context, a study would need to show that the diversity of a prospective portfolio company’s board affects whether funds include the company in their portfolios (i.e. that board diversity matters to how institutional investors purchase and sell securities); however, to date, there has been no such evidence.\textsuperscript{172} Therefore, though favorable to the materiality of board diversity in a general financial sense, the literature and the efforts by institutional investors do not clearly support the more specific notion of materiality under Rule 10b-5.

2. Evidence of Rule 10b-5 Materiality from Retail Investors

Generalized claims about what investors want in regard to ESG are nearly always made in relation to institutional investors, reflecting a top-down approach to ESG in the investment community.\textsuperscript{173} However, this ignores what retail investors think about the issue, which is crucial to materiality under Rule 10b-5 and its analysis of the reasonable investor. While there have been a significant number of studies and surveys about what professional managers think and how they behave in relation to ESG, there has been comparably little examination of retail investors in this context. And, where there is evidence, it lacks support for the materiality of board diversity under Rule 10b-5.

Vontobel Asset Management conducted possibly the most comprehensive survey of retail investors globally concerning ESG, and its findings are instructive here. Most notably, the study finds that 76% of retail investors in the US know nothing about ESG investment.\textsuperscript{174} Furthermore, of retail investors globally who

\textsuperscript{171} Id.

\textsuperscript{172} Related studies find support for greater net inflows by into funds with high sustainability ratings; but this is applied to ESG as a whole, so its explanatory power in the context of board diversity is not as strong. See, e.g., Samuel M. Hartzmark & Abigail B. Sussman, \textit{Do} Investors \textit{Value} Sustainability? A Natural Experiment Examining Ranking and Fund Flows (Euro. Corp. Governance Inst. Finance Working Paper No. 565/2018, 2019) (finding that funds with high sustainability ratings receive greater positive fund flows than those with low sustainability ratings). Other studies on institutional investors concern ESG ratings of the funds themselves and how this affects fund performance; however, this suffers from the same problem—it does not address the question of whether board diversity is an important factor in determining whether to include a company in the fund. See, e.g., Rajna Gibson, Philipp Krueger & Shema F. Mitali, \textit{The Sustainability Footprint of Institutional Investors: ESG Driven Price Pressure and Performance} (Eur. Corp. Governance Inst., Finance Working Paper No. 571/2018, 2021) (finding that institutional investors with better sustainability footprints outperform).

\textsuperscript{173} See, e.g., Eccles & Klimenko, supra note 40, (citing interviews with professional asset managers and high net worth individuals).

\textsuperscript{174} BANK VONTobel AG, \textit{DRIVE POSITIVE CHANGE} WITH ESG 9 (2019).
had heard of ESG, 46% expressed concerns that they do not have sufficient savings and investments “to indulge in the luxury of an ESG approach,” and 23% expressed concerns that an ESG approach would compromise performance (increasing to 43% among those with over $100,000 to invest). 175 Despite these findings, a retail investor survey by Allianz shows that 75% of respondents are interested in sustainable investments; however, this does not support the specific proposition that retail investors consider board diversity an important factor when deciding whether to purchase or sell a company’s securities. 176 Surveys are not a reliable indicator of materiality, especially in the context of ESG. The literature has long understood that research participants tend to bias their responses in surveys in order to appear in a more favorable light. 177 Not surprisingly, this has been observed in the ESG context as well. 178 Furthermore, even if these surveys were taken into account, they suggest that retail investors are largely in the dark when it comes to ESG investing. And, among the retail investors that are apparently aware and interested, there is little evidence to suggest that these investors incorporate diversity, an ESG factor long considered difficult to integrate, into their investment decisions.

Nevertheless, the literature provides some support for the notion that retail investors care about ESG. For example, Martin & Moser find that potential retail investors in an experimental market setting respond more positively to voluntary disclosure of green investment than to no report. 179 Likewise, in an experimental market setting, Cheng, Green & Ko find that investors perceive ESG indicators to be more important than indicators unrelated to ESG and that investors are more willing to invest in a company whose ESG indicators have high strategic relevance. 180 However, these are laboratory tests; therefore, their explanatory value in the actual securities markets is limited. 181 More specifically, retail investors’ allocation in a hypothetical portfolio of hypothetical money is not strong evidence of materiality under Rule 10b-5—if institutional investors need to put their money where their mouth is in regards to their support for ESG and

175. Id. at 19.
176. ALLIANZ GLOB. INV., SUSTAINABLE INVESTING REPORT 2019, supra note 46, at 22.
181. Response bias is observed in experiments, as well. See Crowne & Marlowe supra note 177; Vesely & Klöckner, supra note 177; Kormos & Gifford, supra note 178.
diversity before the Rule 10b-5 materiality analysis changes, the same should be expected from retail investors.

In fact, the literature also provides support for the proposition that retail investors do not care about ESG. For example, Moss et al. examine the link between company-level ESG factors and retail investors’ buying and selling behaviors, not in a laboratory, but in the actual markets. In a first-of-its-kind study, Moss et al. use data from Robinhood Markets Inc. to provide direct evidence on retail investor portfolio decisions. Focusing on press releases rather than surveys or studies of ESG performance, they conduct an event study that compares outcome variables across event and non-event days (i.e. days with an ESG-related press release and days without an ESG-related press release) and find that the retail investor response to ESG-related press releases is indistinguishable from days without ESG-related press releases. As a result, they conclude that ESG disclosure is irrelevant to retail investors’ portfolio reallocation decisions.

These research findings, in coordination with retail investor surveys regarding ESG, describe a retail investor community that does not make investment decisions according to ESG factors. Instead, it appears as though most retail investors do not even know about ESG; and, of the ones that do, ESG is not an important factor in their decision to buy or sell a company’s securities. Yet, many retail investors say they are interested in ESG; suggesting that the greenwashing/cheap talk hypothesis may aptly apply to individual investors as well. Furthermore, while these studies and surveys of retail investors focus on ESG generally, such a conclusion may also be consistent with retail investor

183. Id. Robinhood is a discount brokerage that offers commission-free trading through its website and mobile app. The service has more than 13 million users, and is seen as a proxy for retail trading activity. Matthew Johnston, How Robinhood Makes Money, INVESTOPEDIA (Mar. 14, 2021), https://www.investopedia.com/articles/active-trading/020515/how-robinhood-makes-money.asp; see generally Maggie Fitzgerald, Retail Investors Continue to Jump into the Stock Market after GameStop Mania, CNBC (Mar. 10, 2021), https://www.cnbc.com/2021/03/10/retail-investor-ranks-in-the-stock-market-continue-to-surge.html (describing Robinhood’s popularity and the increasing presence of retail investment).
184. See Moss, Naughton & Wang, supra note 182, at 20–21.
185. Id.
186. See BANK VONTOBEL AG supra note 175 and accompanying text. Therefore, to suggest that ESG is a mainstream investment strategy would be factually inaccurate. See, e.g., The Readback, Sustainable Investing Hits a Tipping Point, Barron’s, at 0:25 (Jan. 22, 2020, 5:26:37 PM), https://www.barrons.com/podcasts/the-readback/65-sustainable-investing-hits-a-tipping-point/88551690-206a-45e9-9132-a702d40ce31b?page=1 (stating that ESG is “blazing a new path into the mainstream”).
187. See ALLIANZ GLOB. INVS., SUSTAINABLE INVESTING REPORT 2019, supra note 46, at 22.
188. See supra notes 164–65 and accompanying text; see also Lorianne Mitchell & Wesley Ramey, Look How Green I Am! An Individual-level Explanation for Greenwashing, 12 J. OF APPLIED BUS. & ECON. 40, 42–43 (explaining that motivations for greenwashing extend apply not only to companies but also to individuals, who selfishly contend to be perceived as altruistic because it elevates one’s status).
attitudes towards board diversity. Consequently, the current behavior of retail investors provides little support for the materiality of board diversity under Rule 10b-5.

In summary, despite claims from investors that ESG is “important” and that they plan to take action to increase board diversity, the buying and selling habits of institutional and retail investors suggest that board diversity is not an important factor when determining whether to invest in a company. Rather, in the context of actual buying and selling decisions, statements from investors regarding board diversity are mostly cheap talk—costless, nonbinding, and unverifiable. As a result of these characteristics, plaintiffs in a securities fraud suit alleging false or misleading statements related to board diversity would likely face challenges in pleading materiality under Rule 10b-5.

C. Materiality of Diversity Disclosures under Rule 14a-9

Under Rule 14a-9, which applies to proxy statements specifically, a statement is material if correct disclosure of the statement would have assumed actual significance in a reasonable shareholder’s deliberations regarding how to vote at a special or annual shareholders meeting. There are many different issues that are voted upon at a shareholders meeting; therefore, it is important to identify the particular voting decision to which a misstatement under Rule 14a-9 is relevant. In relation to allegedly false or misleading statements regarding board diversity, the relevant voting decision would be the election of directors and/or members of the nominating committee. Consequently, the argument in favor of Rule 14a-9 materiality in this context would be that correct disclosure about a company’s board diversity would have assumed actual significance in a reasonable shareholder’s deliberations with respect to director elections. While the materiality argument under Rule 10b-5 fell flat because of its focus on buying and selling decisions, there is a growing body of evidence that board diversity is an important factor in how investors cast votes for directors, making a strong case for materiality under Rule 14a-9.

1. Evidence of Rule 14a-9 Materiality from Institutional Investors

Institutional investors have massive influence over shareholder voting. Institutional ownership in publicly traded companies in the US is around 80%. While institutional ownership as a category comprises a vast, heterogeneous group of funds, concentration of ownership among the largest institutional shareholders is nevertheless striking. For example, among the twenty biggest US corporations, the largest five institutional shareholders control a median of

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189. See supra Section I.B.
190. See Crawford & Sobel, supra note 18; see Farrell, supra note 165.
approximately 20% of outstanding stock. The largest twenty institutional shareholders control a median of approximately 33% of stock; and the largest fifty control a median of approximately 44% of stock. And these numbers are expected to steadily grow.

Fund managers generally have the right and, typically, the obligation to vote the shares they own on behalf of fund investors. While clients with equity separate accounts (i.e., an investment portfolio owned by an individual investor and managed by a professional asset manager, as opposed to an index fund which has many individual investors) may choose not to delegate voting responsibility to the asset manager, this rarely occurs. For example, BlackRock estimates that, across its equity holdings, only about 8% of AUM are outsourced to an independent fiduciary to vote—BlackRock votes the rest. If voting is delegated to the asset manager, regulations and stewardship codes often require asset managers to vote proxies on companies in which they invest on behalf of clients to the extent their clients have delegated voting authority to the asset manager. For instance, both the SEC and the Department of Labor have issued guidance stating that, as fiduciaries, asset managers must vote proxies when doing so is in the best interest of their clients. This results in high turnout rates among professionally managed shares. According to the Government Accountability Office’s assessment of the 2016 proxy season, 91% of institutional investors voted their shares, compared to 28% of retail investors. This means that approximately 90% of votes cast in the average shareholder election are cast by institutional investors, translating to substantial power at annual shareholders meetings.

So, what is important to the voting decisions such a significant block of the corporate electorate? Not surprisingly, ESG appears to be at the top of the list. See, e.g., Morrow Sodali, Institutional Investors Highlight the Growing Importance of ESG in Investment and Proxy Voting Decisions in a New Morrow Sodali Survey, BUS. WIRE (Mar. 10, 2020, 7:00 AM), https://www.businesswire.com/news/home/20200310005039/en/institutional-investors-highlight-growing-importance-of-esg-in-investment-and-proxy-voting-decisions-

193. Id.
195. NOVICK, ET AL., supra note 143.
196. Id.
Much of this evidence comes from surveys of institutional investors; however, unlike buying and selling decisions, proxy voting decisions provide a much clearer and reliable picture of what is important to shareholders in this context. This includes a much clearer and reliable picture of diversity commitments, which may provide considerable support for materiality under Rule 14a-9. For example, consider the commitments of State Street to address the issue of board diversity. In 2021, State Street, which manages over $3 trillion,\(^200\) pledged to vote against the Chair of the Nominating & Governance Committee at companies in the S&P 500 and FTSE 100 that do not disclose the racial and ethnic composition of their boards.\(^201\) And, in 2022, State Street pledged to vote against the Chair of the Nominating & Governance Committee at companies in the S&P 500 and FTSE 100 that do not have at least one director from an underrepresented community on their boards.\(^202\) Thus, to State Street, disclosures regarding board diversity would undoubtedly be important in determining how it will vote for directors. And, unlike buying and selling, where the preference against negative screening makes it exceedingly difficult to determine whether board diversity is important to the reasonable investor, State Street’s adherence to this commitment will be verifiable from its publicly available voting record.

State Street has made the most explicit commitment to addressing board diversity among the largest fund managers; however, other fund managers are quickly evolving on the issue as well. For instance, BlackRock’s 2021 proxy guidelines state the following: “To the extent that a company has not adequately accounted for diversity in its board composition within a reasonable timeframe, based on our assessment, we may vote against members of the nominating/governance committee for an apparent lack of commitment to board effectiveness.” Likewise, Vanguard has stated that it may vote against directors at companies “where progress on board diversity falls behind market norms and expectations,” with particular focus on companies with no gender diversity or ethnic diversity.\(^203\) Though this language is not definitive, its significance will be readily demonstrable by analyzing how major funds vote in director elections at companies without a diverse board, the outcomes of which could provide meaningful evidence of materiality for diversity statements under Rule 14a-9.

And, in fact, recent stewardship reports suggest that votes against directors for lack of board diversity have already begun.\(^204\) For example, BlackRock’s

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\(^{200}\) See Nauman, supra note 42.

\(^{201}\) See Taraporevala, supra note 23.

\(^{202}\) Id.


stewardship report states that it voted against 1,569 directors due to lack of diversity from July 2019 to June 2020.205

The recommendations of proxy advisory firms provide additional support for this argument. Proxy advisors are firms that specialize in analyzing company information and issuing voting recommendations to their clients, which include institutional investors and fund managers.206 The theory is that institutional investors are unable to effectively monitor all of the companies in their portfolios, so they delegate this responsibility to proxy advisory firms who focus exclusively on shareholder voting. ISS and Glass Lewis are the most prominent proxy advisory firms, and together they control over 90% of the proxy service market, providing recommendations to institutional investors with almost $20 trillion in AUM.207 It is well documented in the literature that negative recommendations from proxy advisors influence their customers’ votes.208 For instance, Shu finds that a negative recommendation from ISS against a particular director’s election makes ISS customers 21% more likely than other investors to vote against this director.209 Likewise, a negative recommendation from Glass Lewis makes its customers 29% more likely to vote against the director.210 Professors Alon Brav, Matthew D. Cain & Jonathon Zytnick find that this effect is more pronounced with the largest institutions, as a negative recommendation from ISS is associated

State Street voted against a director for lack of board diversity at 156 companies from March 2020 to February 2021.


207. See Shu, supra note 59 (“In 2017, ISS controlled 63 percent of the proxy service market for mutual funds in the U.S. ($13.4 trillion assets from 134 fund families), and Glass Lewis controlled 28 percent of the market ($6.0 trillion assets from 27 fund families”); Id.


210. Id.
with a 35 percentage point decrease in Big Three support. This is particularly relevant because the Big Three cast an average of about 25% of the votes at S&P 500 companies, a figure that could grow to above 40% within two decades. Given this influence, proxy advisors’ recommendations can often determine the outcome of elections. Therefore, assessing proxy advisory firms’ approach to diversity, which impacts how a large number of institutional shareholders cast their votes, can provide evidence of diversity’s materiality to a reasonable shareholder’s voting decision.

ISS’s and Glass Lewis’s 2021 recommendation policies reveal that proxy advisory firms intend to take on a more active role in board diversity. For example, in regards to gender diversity, ISS has indicated that, for companies in the Russell 3000 or S&P 1500 indices, it will generally recommend voting against or withholding votes from the chair of the nominating committee (or other directors on a case-by-case basis) at companies where there are no women on the company’s board. Furthermore, in regard to ethnic and racial diversity, effective for 2022, ISS will generally recommend voting against or withholding from the chair of the nominating committee (or other directors on a case-by-case basis) where the board has no apparent racially or ethnically diverse members. Likewise, beginning in 2022, Glass Lewis will generally recommend voting against the nominating committee chair of a board (and possibly additional members of the nominating committee) that has fewer than two female directors. If these recommendations by ISS and Glass Lewis proliferate, institutional investors with over $30 trillion in AUM will be advised to vote against members of the board or nominating committee due to the fact that the board does not meet a minimum level of diversity. Given the evidence that negative recommendations have a sizable impact on director elections, the policies of ISS and Glass Lewis add more strength to the argument that board diversity is an important factor in determining how institutional investors vote.

These activities reflect a preference among institutional investors for addressing board diversity, and ESG in general, via engagement and the proxy process rather than by selling their shares. BlackRock has acknowledged this

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213. Tuch, supra note 208, at 1466 n. 20 (“ISS advice has been cited as a decisive factor in a number of major corporate events . . . .”).
214. INST’L S’HOLDER SERV., supra note 25, at 11–12.
215. Id.
216. See GLASS LEWIS, supra note 25, at 1.
217. See Patrick Temple-West, The ESG Investor’s Dilemma: To Engage or Divest?, FIN. TIMES (Jan. 27, 2021), https://www.ft.com/content/814cbd2c-00db-41b7-91af-28435301a8a2 (describing the costs and benefits of divestiture versus engagement); see also Eleonora Broccardo, Oliver Hart & Luigi Zingales, Exist vs. Voice (Eur. Corp. Governance Inst. Finance Working Paper
preference, citing its large stakes and long investment horizon as motivating factors. However, the main reason is that engagement is the only option for passive fund managers who cannot sell underperforming companies, a fact BlackRock acknowledges. There is also support for this proposition in the literature, as Amel-Zadeh and Serafeim show that, among investment professionals, negative screening (i.e., excluding companies from a portfolio based upon ESG factors) is perceived as the least beneficial ESG investment style. This may be because asset managers favor “constructive dialogue.” The more plausible explanation, however, is that investors don’t want to lose out on “juicy” returns in legal, though controversial, companies. Whatever the reason, the commitments among institutional investors and proxy advisory firms show that board diversity is clearly developing into a relevant issue in director elections. And, as a result, disclosures regarding board diversity are becoming increasingly important to the reasonable shareholders’ deliberations concerning how to vote, lending credible support to materiality under Rule 14a-9.

2. Evidence of Rule 14a-9 Materiality from Retail Investors

Retail investors make up approximately 25% of the average public company’s shareholder base, yet, due to low turnout rates, they only account for about 10% of the votes at shareholders’ meetings, following a steady decline over the past two decades. This is hallmark substantiation of the well-documented
collective action problem in corporate governance. This theory postulates that, in a firm with widely dispersed share ownership, the cost to any one shareholder to monitor and engage with the managers of the firm exceeds the incremental benefit the shareholder would receive from improved management. So, theoretically, no one monitors or votes. While the drastic increase in institutional investor ownership may address agency issues between management and shareholders as a whole, since major institutional investors hold large enough stakes to make some monitoring and engagement worth their while, it does not address the “rational apathy” of retail investors, which still persists. Now, though share ownership is no longer widely dispersed, retail investors with comparatively little skin in the game can look to the institutional investors to handle the monitoring and engagement, including voting at shareholder meetings, instead of incurring the costs of these activities themselves. Therefore, the collective action problem continues to explain retail investors’ low turnout rates, and it is a reason why many consider retail investors a relatively unimportant constituency in corporate elections. Furthermore, in the context of the materiality analysis under Rule 14a-9, it suggests that institutional investor behavior is much more relevant to an analysis of the reasonable shareholder, as it is the institutional investors who are meaningfully taking part in the corporate governance mechanism that Rule 14a-9 is meant to protect. However, even if its relevance is diminished due to low ownership percentages and turnout rates, retail

how retail shareholders take part in the shareholder voting process, see Brav, Cain & Zytnick, supra note 211, at 7–11.

224. For the seminal work on the shareholder collective action problem, see Adolph A. Berle & Gardiner C. Means, The Modern Corporation and Private Property (1932).


226. Bebchuk, Cohen & Hirst explain that the collective action problem that Berle & Means claimed was inherent to the public corporation no longer approximates reality. See Bebchuk, Cohen & Hirst, supra note 192, at 92. Rather, given the rise in institutional ownership, it is now likely to be optimal for some institutional shareholders with large holdings to undertake the monitoring of managers, referred to as “stewardship.” Id. at 93. However, there are also agency issues associated with institutional investors as “stewards.” See, e.g., Lucian A. Bebchuk & Scott Hirst, Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy, 119 Colum. L. Rev. 2029 (2019) (demonstrating that index fund managers have strong incentives to underinvest in stewardship and defer excessively to corporate managers).

227. See Robert C. Clark, Corporate Law 390–92 (1986) (describing “rational apathy” as the indifference a shareholder feels when they make the reasonable assumption that their vote will not have any real influence on the conclusion of a corporate election); see also Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 91 (1991).

228. See Bebchuk, Cohen & Hirst, supra note 192, at 93 (“[B]ecause the benefits of each shareholder’s actions will be shared with fellow shareholders, it will still be privately optimal for each shareholder to underspend on stewardship.”).

229. See id.

investor voting behavior must still be considered in an assessment of materiality under Rule 14a-9.

Due to the perceived unimportance of retail investors in corporate elections as currently constructed and a lack of reliable data, there is comparatively little empirical analysis of retail shareholder voting. Rather, the literature focuses on how to increase participation among retail shareholders in corporate governance. However, to appropriately analyze materiality under Rule 14a-9, it is important to identify voting trends among retail shareholders, as it assists with identifying what is important to the reasonable shareholder’s voting decision. In order to address these issues, this section relies on Brav, Cain & Zytnick’s 2019 study, which provides what is perhaps the only comprehensive empirical analysis of retail shareholder voting behavior.

Brav, Cain & Zytnick reach a number of important conclusions that are relevant to materiality under Rule 14a-9. First, and as previously established, retail investors turnout at very low rates. Second, retail shareholders differ substantially from institutional investors in how they vote, exhibiting far less sensitivity to ISS recommendations and generally less support for ESG. Third, and most importantly, retail shareholders exhibit a variety of different voting behaviors based on the size their respective stakes, as large shareholder turn out at higher rates and provide stronger support for management proposals, while smaller shareholder turnout out at lower rates but tend to provide weaker support for management proposals. In addition, those with larger stakes tend to vote against ESG proposals, while those with smaller stakes provide stronger support for these proposals when they choose to engage.

As a result of this study, it is appropriate to view retail shareholders’ interests as heterogenic. While retail shareholders as a whole may exhibit less support for ESG, this is driven by retail shareholders with large stakes, as smaller shareholders provide relatively strong support for ESG proposals. Furthermore, while these large retail shareholders provide greater support for management, smaller shareholders show more willingness to vote against

231. See, e.g., Kastiel & Nili, supra note 223, at 55 (proposing a system of highly-visible voting default arrangements that would allow retail shareholders to choose from a menu of shortcuts); Fisch, supra note 230, at 38 (advocating for the use of technology to make retail shareholder more efficient and better informed); Christopher John Gulinello, The Retail Investor Vote: Mobilizing Rationally Apathetic Shareholders to Preserve or Challenge the Board’s Presumption of Authority, 2010 Utah L. Rev. 547 (2010) (advocating for the implementation of “retail investor voting instructions” to mobilize retail investors by addressing the main reason why retail investors participate in elections at such low rates – they are uninformed).

232. See Brav, Cain & Zytnick, supra note 211, at 3.

233. See id. at 21. And, in accordance with the collective action theory, retail shareholders at larger firms, where their aggregate share ownership is smaller, turnout at lower rates than shareholders at smaller firms, where their aggregate share ownership is greater. Id.

234. Id. at 22.

235. Id. at 4.

236. Id.

237. Id.
management. This heterogeneity makes it difficult to generalize what is important to a retail investor’s voting decision, and it does not suggest that retail investors consider the more specific ESG issue of board diversity important to their voting decisions. However, given the growing, tangible efforts among institutional investors and proxy advisors to address diversity by voting against directors who do not nominate a diverse board, it will be difficult for a court to determine that a reasonable shareholder does not consider diversity important when deciding whether to vote for members of the board of directors, even in light of the lack of evidence from retail investors.

In summary, materiality under Rule 14a-9, with its focus on a reasonable shareholder’s voting decision, Rule 14a-9 gives prospective plaintiffs a more viable weapon than Rule 10b-5, which, in contrast, focuses on buying and selling decisions. While investors are becoming increasingly outspoken in favor of board diversity, there is little to no evidence to suggest that this is affecting investors’ buying or selling decisions. In fact, it appears that, with respect to portfolio allocation, investors’ statements in support of board diversity are cheap talk. By contrast, there is a growing body of strong evidence that investors intend to address board diversity via shareholding voting instead. First, institutional investors, who cast about 90% of the votes in director elections, are beginning to make firm commitments to address board diversity by voting against directors on boards that do not meet certain diversity thresholds. Second, influential proxy advisors ISS and Glass Lewis are committing to make negative recommendations against directors on boards that do not meet similar thresholds. As these policies come into effect, it will be possible to monitor their impact, likely providing strong evidence of the materiality of board diversity under Rule 14a-9. Finally, while there is not enough support for the proposition that retail investors consider diversity important to voting decisions, these investors only account for about 10% of the corporate electorate; therefore, their behaviors should not override the growing body of evidence from institutional investors of the materiality of board diversity to a reasonable shareholder’s voting decision. As a result, these factors suggest that the materiality requirement will no longer be a prohibitive hurdle for plaintiffs alleging false or misleading statements related to board diversity if brought under Rule 14a-9.

III. BRINGING A RULE 14A-9 SUIT

While TSC Industries expressly adopted the materiality standard of Rule 14a-9 for Rule 10b-5, the foregoing analysis shows that there are inherent differences between the materiality evaluations under these rules that can lead to different outcomes, particularly in the context of ESG initiatives like diversity.

238. Id.
239. See supra Section II.C.1.
240. See supra Section II.B.
This matter is especially relevant as plaintiffs’ lawyers begin targeting public companies for allegedly false or misleading statements about diversity. Though materiality is the main focus of this note, this section briefly assesses other relevant differences between Rules 10b-5 and 14a-9 and considers the relief plaintiffs can seek and the fees plaintiffs’ bar can receive under Rule 14a-9, adding to the appeal of Rule 14a-9 as an option for bringing a securities fraud claim for false or misleading diversity statements.

A. Other Relevant Distinctions Between Rules 10b-5 and 14a-9

Apart from materiality, two other major distinctions make Rule 14a-9 the best option for plaintiffs pursuing claims against issuers for false or misleading diversity statements. First, plaintiffs under Rule 10b-5 must plead scienter. Specifically, plaintiffs must plead that the alleged misstatement related to diversity was made with the “intent to deceive, manipulate, or defraud.” In contrast, there is no scienter requirement under Rule 14a-9. Although the Supreme Court has not weighed in on the proper standard of liability under Rule 14a-9, there is general agreement among the Circuit Courts that negligence is the proper standard. As a result, under Rule 10b-5, a plaintiff would have to plead that the issuer recklessly lied or misled investors with its statements relating to diversity; but, under Rule 14a-9, a plaintiff would need to show only that the issuer was negligent in including the false or misleading statements in its proxy statement. Therefore, in this respect, there is clearly an advantage for plaintiffs who bring such a claim under Rule 14a-9 rather than Rule 10b-5.

Second, the loss causation element is more difficult to prove under Rule 10b-5 in the context of a false or misleading diversity statement. Under Rule 10b-5, a plaintiff must plead that a company’s misrepresentation proximately caused stock price movements according to which the plaintiff incurred actual economic loss. This is especially difficult for a plaintiff under these circumstances because, as demonstrated in Section II, investors are not addressing diversity issues by divesting from companies that underperform according to diversity standards. As a result, false or misleading diversity disclosures are unlikely to affect share price upon their release. In contrast, under Rule 14a-9, plaintiffs must plead that solicitation of proxies was an essential link in accomplishing the defendant’s objective for which the proxies were solicited. Under these circumstances, Rule 14a-9 plaintiffs will have a strong argument because they

242. See supra notes 96–98 and accompanying text.
244. See supra note 114 and accompanying text.
245. See supra notes 102–03 and accompanying text.
246. This, of course, depends on degree. However, it is unlikely that the kind of misstatements considered in this note would trigger a response in share price. As an example, a company that states in its proxy statement something along the lines of “we are doing everything we can to get two diverse directors on our board” would likely not affect share price.
247. See supra notes 118–120 and accompanying text.
can show that the solicitation of proxies was clearly an essential link in accomplishing the directors’ objective of getting elected and, therefore, the inclusion of false or misleading statements regarding the company’s commitment to board diversity injured shareholders’ voting rights. These crucial distinctions indicate that, if plaintiffs can identify false or misleading statements regarding board diversity in proxy statements (which will become increasingly likely as companies are demanded and possibly mandated to provide more disclosure on this issue), then Rule 14a-9 will be a tenable option.248

B. Injunctive Relief and Mootness Fees under Rule 14a-9

Given that it is difficult to ascertain damages as a result of false or misleading diversity statements, plaintiffs pursuing a Rule 14a-9 claim may demand injunctive relief in the form of a temporary restraining order.249 Essentially, the plaintiff would assert that a company’s proxy statement contains materially false or misleading statements related to board diversity; therefore, the shareholders meeting to elect directors should be enjoined unless and until the company corrects the misstatements. This strategy is prevalent in the merger context, in which public merger announcements frequently trigger boilerplate complaints from plaintiffs making similar allegations and demands regarding false or misleading disclosures in the proxy statement.250 However, while these claims are brought with growing frequency in federal court,251 they are seldom litigated past the complaint stage. Rather, the defendant usually offers to make a corrective disclosure, which “moots” plaintiff’s claims. Then, plaintiffs’ lawyers collect mootness fees, informally known in the industry as the “merger tax,” in

248. A natural question follows: why are the elements of Rule 14a-9 more favorable to plaintiffs than the elements of Rule 10b-5? First, Rule 14a-9 protects corporate suffrage, which Congress believed should be vigorously protected; therefore, plaintiff’s burden is relatively more accommodating. See J. I. Case Co. v. Borak, 377 U.S. 426, 431 (1964) (stating that Rule14a-9 stemmed from the congressional belief that “(f)air corporate suffrage is an important right that should attach to every equity security bought on a public exchange.”). Second, given that Rule 14a-9 typically involves injunctive relief and supplemental disclosure as opposed to monetary damages like Rule 10b-5, the risk of extortionary litigation under Rule 14a-9 is less; and, therefore, stringent requirements are not as necessary.

249. See Bainbridge & Anabtawi, supra note 225, at 496 (“Probably the most common remedy in proxy litigation is some form of prospective relief, such as an ex ante injunction against the shareholder vote”). Such a claim would invoke FRCP Rule 65 and its corresponding requirements for temporary restraining orders. Fed. R. Civ. P. 65.


compensation for the supposed benefit of the corrected disclosure.\textsuperscript{252} Such a strategy has been lucrative for plaintiffs’ bar.\textsuperscript{253}

While the election of directors has different features than the approval of a merger, the same strategy may apply here. If successful, such claims would effectively result in a “tax” on publicly traded corporations that do not comply with board diversity thresholds, as these corporations would be the most vulnerable targets of these claims. The prospect of litigation, corrective disclosures, and mootness fees would add to the incentives of companies without diverse boards to comply with the diversity standards demanded by investors and potentially mandated in some form by the SEC.\textsuperscript{254}

CONCLUSION

This note assesses the implications of investors’ growing demands for diversity disclosures on the antifraud provisions of the federal securities laws. Demands among investors for more diverse boards of directors, coupled with the SEC’s reexamination of its policy towards mandatory ESG and diversity reporting, makes more comprehensive and specific diversity disclosure increasingly likely. This, in turn, makes public companies increasingly vulnerable to securities fraud claims, where Rules 10b-5 and 14a-9 are particularly relevant. As demonstrated, while the Supreme Court expressly adopted the Rule 14a-9 standard of materiality for Rule 10b-5 these standards are, in fact, not the same, and they lead to different outcomes in the context of board diversity disclosures. Compared to Rule 10b-5, Rule 14a-9, with its focus on the importance of disclosure on voting decisions, is a more favorable standard for plaintiffs making claims against public companies for false or misleading diversity statements, especially in an environment where investors appear much more willing to address diversity via shareholder elections rather than by selling their shares. This novel comparison between Rules 10b-5 and 14a-9 suggests that materiality, which has traditionally been a major hurdle for plaintiffs making ESG-related securities fraud, may not be such an impediment if brought under

\textsuperscript{252} See Cooper, Langston & McDonald, \textit{supra} note 250. For an in-depth explanation and analysis of mootness fees, see Cain, Fisch, Davidoff Solomon & Thomas, \textit{supra} note 251.

\textsuperscript{253} See Solum, \textit{supra} note 250.

\textsuperscript{254} There are a number of other relevant considerations regarding the effectiveness of the merger strategy as applied to diversity-related misstatements in director elections. For instance, differences in perceived strength between claims in the directors election context and claims in the merger context may affect defendants’ motivations to avoid litigation and make corrective disclosures. Furthermore, given that a corrective disclosure addressing diversity would essentially equate to admitting that a defendant’s diversity plans were, at best, negligently misleading and, at worst, lies, defendants may be less willing to make such corrections. But, given the general premise established by the Supreme Court that “[shareholders] who have established a violation of the security laws by their corporation and its officials should be reimbursed by corporation or its survivor for costs of establishing the violation,” plaintiffs’ bar should be confident in receiving some sort of compensation if it is determined that a company’s proxy statement is false or misleading. See Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 389–90 (1970).
Rule 14a-9. Furthermore, the additional strategic strengths associated with a Rule 14a-9 claim for false or misleading diversity statements suggest that the prospect of Rule 14a-9 litigation may incentivize companies that do not have diverse boards to meet the minimum requirements demanded by the market and, perhaps soon, by the SEC.