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## Crashing the Boards: A Comparative Analysis of the Boxing Out of Women On Boards in the United States and Canada

Diana C. Nicholls Mutter

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# CRASHING THE BOARDS: A COMPARATIVE ANALYSIS OF THE BOXING OUT OF WOMEN ON BOARDS IN THE UNITED STATES AND CANADA

Diana C. Nicholls Mutter\*

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## INTRODUCTION

Boards of publicly traded corporations in the United States and in Canada play a crucial role in the functioning of capital markets. Directors act as advisors as well as monitors of management. They provide access to resources and external networking opportunities, allowing firms to grow and prosper.<sup>1</sup> Perhaps most importantly, the board is responsible for making decisions regarding mergers and acquisitions. Thus, the composition of these boards is a critically important question to the area of corporate governance.

In the United States women make up 17.7% of board members of Russell 3000 companies.<sup>2</sup> In Canada women comprise 15% of board seats for reporting issuers.<sup>3</sup> The U.S. Securities and Exchange Commission in 2009<sup>4</sup> and the Canadian securities regulators in 2014<sup>5</sup> introduced disclosure based models to address this issue. In the fall of 2018 California implemented Senate Bill 826<sup>6</sup> mandating that corporations with principal executive offices located in California, including corporations incorporated in jurisdictions other than California, add a certain number of women to their boards depending on the size of board.

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<sup>1</sup> AARON A. DHIR, CHALLENGING BOARDROOM HOMOGENEITY: CORPORATE LAW, GOVERNANCE, AND DIVERSITY 26–27 (2015).

<sup>2</sup> 2018 Gender Diversity Index Key Findings: 2018 Progress of Women Corporate Directors by Company Size, State and Industry Sector, 2020 WOMEN ON BOARDS (Nov. 7, 2018), <https://www.2020wob.com/companies/2020-gender-diversity-index>. Larger companies tend to have proportionally more women on their boards than smaller corporations. *Id.*

<sup>3</sup> Multilateral Staff Notice 58-310: *Report on Fourth Staff Review of Disclosure regarding Women on Boards and in Executive Officer Positions*, ONT. SEC. COMM'N (Sep. 27, 2018) at 1. This review also notes that as the market capitalization increases, so too does the percentage of female directors. *Id.* There is also great disparity across different industries. *Id.*

<sup>4</sup> 17 C.F.R. § 229.407(c) (2010); SEC, Proxy Disclosure Enhancements; 74 Fed. Reg. 68, 334 (Dec. 23, 2009) [hereinafter Final Rule].

<sup>5</sup> National Instrument 58-101F1: *Disclosure of Corporate Governance Practices* [hereinafter NI-58-101F1].

<sup>6</sup> SB 826, Section 2, adding §301.3(f)(2) to the Corporations Code [hereinafter Bill 826].

This paper will first provide a critical, comparative look at the Canadian and the federal American responses to the under-representation of women on boards of large, publicly traded corporations. There will be a discussion about the competing conceptions which emerge in addressing the regulation of women on boards in the United States and Canada and why each jurisdiction implemented its policy when it did. The conceptions arising out of questions about under-representation of women on boards tend to fall within two categories: business case rationales and normative rationales. Given the competing conceptions of this issue, this paper will attempt to demonstrate how the regulatory regimes fit within these conceptions and the solutions which follow each conception. An argument will be advanced that not only does each disclosure regime<sup>7</sup> fail to provide a solution to the underlying issue it is attempting to regulate, but also neither regime even advances the goal the regulators purport to be advancing. Finally, a closer look at the polarizing reactions to Bill 826 provides a hint as to the future direction of the American and Canadian debates. This paper will be one of the first to discuss Bill 826 and what it may mean for the U.S. and Canada.

## I. WHY THE REGULATORS DID WHAT THEY DID WHEN THEY DID

### A. *The US's Reactive Approach to Corporate Governance Issues*

Corporate and securities law reforms in the US are often reactionary, following either financial crises or market failures and scandals. In 1934 the Securities and Exchange Commission (SEC) was established as part of a series of reforms responding to the 1929 stock market crash. Its mandate was to protect investors, sustain fair, orderly and efficient capital markets and facilitate capital formation,<sup>8</sup> which is still the SEC's role today.<sup>9</sup> Following the various scandals of the early 2000s, in 2002, Congress enacted the Sarbanes-Oxley Act which is an example of what Professor Anand defines as a mandatory corporate governance

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<sup>7</sup> The disclosure regimes being referred to are the American federal board diversity regime and the Canadian board diversity regime.

<sup>8</sup> Angela Foster, *A Quest to Increase Women in Corporate Board Leadership: Comparing the Law in Norway and the U.S.*, 26 WASH. INT'L L.J., 381, 397 (2017).

<sup>9</sup> *The Role of the SEC*, INVESTOR.GOV, <https://www.investor.gov/introduction-investing/basics/role-sec> (last visited Feb. 17, 2019).

regime.<sup>10</sup> Sarbanes-Oxley requires enhanced financial reporting among other things. It is rigid, rather than enabling in its requirements.<sup>11</sup> After the financial crisis of 2008, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in 2010 as a reaction to this massive market collapse.<sup>12</sup> At the same time as Dodd-Frank was implemented (with its objective being to protect the public from future financial failings and abusive financial practices),<sup>13</sup> the SEC amended the Proxy Disclosure Requirements ostensibly to protect investors. These amendments included a diversity disclosure requirement.<sup>14</sup>

*The Diversity Policy and Why It Was Implemented*

Item 407(c) of Regulation S-K<sup>15</sup> requires that publicly traded companies in their Proxy Statements disclose whether the nominating committee “considers diversity in identifying nominees for director. If the nominating committee (or the board) has a policy with regard to the consideration of diversity in identifying director nominees,” they must “describe how this policy is implemented, as well as how the nominating committee (or the board) assesses the effectiveness of its policy.”<sup>16</sup> The SEC in its publication of this rule, stated that diversity disclosure is important for investors and that they had received many comments to this effect.<sup>17</sup> The policy, they elaborate, although not intended to “steer behavior” may lead to benefits such as increased board independence and

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<sup>10</sup> Anita Indira Anand, *An Analysis of Enabling vs. Mandatory Corporate Governance Structures Post-Sarbanes-Oxley*, 31 DEL. J. CORP. L. 229, 230 (2006).

<sup>11</sup> *Id.*

<sup>12</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 972, 124 Stat. 1376 (2010). Its objection is stated as “An Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail,’ to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.” *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> Luis Aguilar, *SEC Speech: Board Diversity: Why It Matters and How to Improve It*, SEC. & EXCHANGE COMMISSION (Nov. 4, 2010), <https://www.sec.gov/news/speech/2010/spch110410laa.htm>.

<sup>15</sup> Final Rule, *supra* note 4.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 68343.

access to a wider talent pool of candidates.<sup>18</sup> Their belief was that investors would directly benefit from these disclosures.<sup>19</sup> The SEC intentionally declined to define diversity, leaving the definition up to reporting corporations.<sup>20</sup>

However, scholars dispute whether it was truly not the SEC's intention to steer behavior with these new requirements. Professor Dhir, for instance, reviews several criticisms of the amendments and how they seem to amount to public shaming on the part of the SEC.<sup>21</sup> Luis Aguilar, an SEC Commissioner, made a speech in November of 2010<sup>22</sup> where he revealed a number of important points regarding the intention of the board diversity disclosure requirements. He discusses what should be done in the future about lack of board diversity, even encouraging companies to "prioritize and implement practices to increase board diversity."<sup>23</sup> This suggests that the diversity policy was very much intended to steer behavior in the direction of increasing board diversity. The intentions of the diversity policy will be discussed at greater length below.

### *B. Canada's Delayed Reaction Regime*

Unlike the American approach to corporate governance and securities law reforms which tend to be reactionary, and some may argue disproportionate or unrelated to the problems the reforms are attempting to address,<sup>24</sup> Canada tends to take a different approach. The Canadian approach to reforms in corporate governance is often in part a reaction to the United States' reactive regime.

In 2009, the Ontario Securities Commission (OSC) published its proposed National Policy 58-201 "Effective Corporate Governance," which included a concise history of the Canadian corporate governance regime's progression. It began in 1994 with the Dey Report. This report titled "Where Were the Directors?" was commissioned by the Toronto

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<sup>18</sup> *Id* at 68355.

<sup>19</sup> *Id.*

<sup>20</sup> *Id* at 68344.

<sup>21</sup> Dhir, *supra* note 1 at 48–94.

<sup>22</sup> Aguilar, *supra* note 14.

<sup>23</sup> *Id.*

<sup>24</sup> See Roberta Romano, *Quack Corporate Governance Corporate Governance*, 28 YALE J. ON REG., 36 (2005); Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV., 1779 (2010).

Stock Exchange (then the TSE, now the TSX).<sup>25</sup> It described fourteen recommendations of best practices for publicly traded companies.<sup>26</sup> These recommendations ranged from the separation of the CEO and chair of the board to the orientation for new directors.<sup>27</sup> Five years later, the TSE commissioned a follow-up report titled “Five Years to the Dey,” recognizing the importance of the original report, but also stating that “there is no ‘one size fits all’ solution, the TSE does not require compliance with the guidelines – but every year companies must disclose and explain any differences between their corporate governance practices and the guidelines.”<sup>28</sup> Following the Dey Report, in Canada, there was a set of exchange-endorsed “best practices,” combined with mandatory disclosure for non-compliance with these best practices.<sup>29</sup>

Later, in 2000, the TSE established the Joint Committee on Corporate Governance or the “Saucier Committee” designed to review the then current state of corporate governance in Canada. This was in the wake of the Bre-X<sup>30</sup> and YBM Magnex scandals at the end of the 1990s.<sup>31</sup> The Saucier Committee’s report, published in 2001, provided recommendations to the TSX that it change its corporate governance guidelines with a view to developments around the world.<sup>32</sup> In 2002, the Sarbanes-Oxley Act was implemented in the United States, as described

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<sup>25</sup> National Policy 58-201: *Proposed National Policy 58-201 Effective Corporate Governance* (2004) [“NP 58-201”].

<sup>26</sup> Ruth M. Corbin, *Five Years to the Dey*, EUR. CORP. GOVERNANCE INST. (1999), <http://www.ecgi.org/codes/documents/5years.pdf>.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> Anand, *supra* note 10, at 231.

<sup>30</sup> Bre-X is one of the most notorious Canadian corporate scandals in history. A small Alberta mining company which allegedly struck gold in Indonesia’s stock exploded in the mid-1990s. It turned out that the projections being publicly disclosed were a result of tampering with core samples. Once these fraudulent disclosures were brought to light, Bre-X’s stock plummeted. For a full description, see Christopher C. Nicholls, *The Bre-X Hoax: A South East Asian Bubble*, 32 Can. Bus. L.J. 173 (1999).

<sup>31</sup> YBM Magnex was an American “magnet” corporation, publicly traded on the Toronto Stock Exchange. It was in fact being used to launder money and once this was brought to the public’s attention, like Bre-X, the corporation went into receivership in 1999. For a full description see Stephen Schneider, *Money Laundering through Securities an Analysis of Canadian Police Cases*, 4 ASPER REV. INT’L BUS. & TRADE L. 169 (2004).

<sup>32</sup> NP 58-201, *supra* note 25.

above. This had an important impact on the Canadian corporate governance regime as well. A few years later with specific reference to the Sarbanes-Oxley Act, the Canadian securities regulators adopted NP 58-201.<sup>33</sup> This policy includes 18 best practices which arise from both Canadian and American regulatory regimes, including recommendations that more than half of the board should be independent, and that new board members should undergo some sort of orientation.<sup>34</sup>

The regimes seem to diverge with the implementation of Sarbanes-Oxley in the United States. As Anand notes, the United States adopted a mandatory regime, where Canada issued an enabling, disclosure-based regime.<sup>35</sup> After the financial crisis of 2008, while the United States federal government was rolling out Dodd-Frank and the SEC was implementing its diversity disclosure policy, in 2009, Canadian securities regulators proposed new versions of NP 58-201 and National Instrument 58-101: Disclosure of Corporate Governance Practices.<sup>36</sup> In true Canadian fashion, the securities regulators followed the Americans a few years later with a diversity disclosure regime.

### *The Diversity Policy and Why It Was Implemented*

Canadian securities regulators amended National Instrument 58-101F1 to include a diversity policy for ostensibly different reasons from those behind the SEC's diversity disclosure policy. In 2013, the Ontario government stated in its budget that it "strongly support[ed]" board gender diversity and that it would work with the OSC in order to increase the number of women on boards.<sup>37</sup> Following this release, the OSC held a roundtable in the fall of 2013. The transcript from this roundtable reveals the intention behind the Canadian disclosure model, that is, to enhance gender diversity on Canadian public companies' boards.<sup>38</sup> This stated

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<sup>33</sup> National Policy 58-201: *Corporate Governance Guidelines* (2005).

<sup>34</sup> Carol Hansell, *Canada Sets New Policy on Corporate Governance*, 24 INT'L. FIN. L. REV. 37, 37 (2005).

<sup>35</sup> Anand, *supra* note 10, at 229.

<sup>36</sup> NI 58-101F1, *supra* note 5. See also CSA Staff Notice 58-305: *Status Report on the Proposed Changes to the Corporate Governance Regime*, ONT. SEC. COMMISSION, (Nov. 13, 2009), <http://www.osc.gov.on.ca/en/26274.htm>.

<sup>37</sup> Charles Sousa, *A Prosperous & Fair Ontario: Budget Papers : 2013 Ontario Budget* (Toronto: Ministry of Fin., 2013) at 291.

<sup>38</sup> *Roundtable Discussion Re Women on Boards and Senior Management*, ONT. SEC. COMMISSION (Oct. 16, 2013),



objective is openly an attempt to steer the behavior of reporting issuers, which marks a departure from what the United States SEC's supposed intentions were with its disclosure model.

The disclosure regime regarding women on boards at present works in the following way. Reporting issuers<sup>39</sup> must disclose whether or not they have a policy regarding the representation of women on the board. They must further describe what steps are taken to ensure the policy's effective implementation, as well as the progress in achieving its objectives. If they do not have such a policy, they must disclose the reason why.<sup>40</sup> The issuer must disclose whether, and if not why not, it considers the representation and identification of women in its director nominating process.<sup>41</sup> It must also disclose whether, and if not why not, the issuer has targets regarding the representation of women on the board, and the progress made towards reaching this target.<sup>42</sup> Finally, the issuer must disclose the number and percentage of women currently on its board.<sup>43</sup>

The OSC's Consultation Paper includes a statement made by the Minister for the Status of Women which highlights three very different reasons for promoting board diversity. "[B]oard diversity is not about quotas or tokenism. Board diversity is about better corporate decisions, better responses to market demographics, and better financial performance. It is also about the future, and having more women in key leadership positions to serve as role models for young women and girls."<sup>44</sup> Thus, within the reasons and justification which the OSC and Minister

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[http://www.osc.gov.on.ca/en/SecuritiesLaw\\_oth\\_20131016\\_58-401\\_transcript.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_oth_20131016_58-401_transcript.htm).

<sup>39</sup> An issuer is defined by the Ontario Securities Act as "a person or company who has outstanding, issues or proposes to issue, a security." A reporting issuer is, among other things, an issuer whose shares are publicly traded. For a complete definition, see Securities Act, R.S.O. 1990, c. S.5, § 1.1 (Can.), ["Ontario Securities Act"].

<sup>40</sup> NI 58-101F1, *supra* note 5, at item 11.

<sup>41</sup> *Id* at item 12.

<sup>42</sup> *Id* at item 13.

<sup>43</sup> *Id* at item 15. Described is the regime only as it relates to board nomination. There are similar provisions which relate to disclosure of the appointment of female executive officers.

<sup>44</sup> OSC Staff Consultation Paper 58-401: *Disclosure Requirements Regarding Women on Boards and in Senior Management*, ONT. SEC. COMM'N at 6 (July 30, 2013), ["Consultation Paper"].

provide for implementing regulation are better financial performance, better decision making, and a social justice or a “normative” rationale. This example typifies not only the regulator’s confusion about the conception of the problem itself, but also may explain why Canada has a policy which does not accomplish any of these goals.

## II. COMPETING CONCEPTIONS OF THE BOX OUT PROBLEM AND RESPECTIVE SOLUTIONS

“[T]he way regulation gets framed as a problem shapes the solutions that get conceived and adopted, as well as their prospects for success . . . . Advocates of new regulatory initiatives should think carefully about how to frame the problem of regulation and whether the reforms proposed are responsive to the problems identified.”<sup>45</sup> Hence, it is crucial to comprehend just how the issue of women on boards is conceived if this issue is to be regulated properly. In both the United States and in Canada, there are two competing conceptions of this problem, and so two competing conceptions of the solution to said problem.<sup>46</sup> First, there is the idea that corporations, by under-including women on their boards, are missing out on what Rosenblum calls the “instrumental” value of women or the “diversity dividend.”<sup>47</sup> The second conception of the problem is given that women represent half the population and half the labor force,<sup>48</sup> it is simply not right that they should be so poorly represented on public corporate boards. Within these conceptions are a myriad of reasons for why women may not be advancing to the upper echelons of corporate US

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<sup>45</sup> Jodi L. Short, *The Paranoid Style in Regulatory Reform*, 63 HASTINGS L.J. 633, 680–81 (2012).

<sup>46</sup> There is an assumption here that this is indeed a problem and that there should be some regulation to remedy it. Therefore not included is the third conception that lack of boardroom diversity is not an issue and therefore requires no regulation.

<sup>47</sup> Darren Rosenblum, *When Does Sex Diversity on Boards Benefit Firms?*, 20 U. PA. J. BUS. L. 429, 431 (2017).

<sup>48</sup> Dhir, *supra* note 1, at 39.

and Canada including, *inter alia*, cognitive bias,<sup>49</sup> the pool problem,<sup>50</sup> and free choice.<sup>51</sup>

The conception of the problem (that is the under-representation of women on boards) leads to two rationales for the solution to the problem: the business case rationale, and the normative rationale. Both of these justifications for addressing the under-representation of women on boards are common to the U.S. and Canada.

#### A. *The Business Case*

The business case itself has many iterations. One form it takes, which is very popular and politically attractive because it is linked to the view that a board's duty is to increase shareholder wealth, is the following: *enhanced gender diversity on corporate boards increases corporations' financial performance*.<sup>52</sup> A number of studies relating to this formulation

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<sup>49</sup> See Deborah L. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make*, 39 DEL. J. CORP. L. 377, 404–408 (2014) (noting cognitive bias, or "in group" bias, is present in the corporate management pipeline that feeds new additions to the corporate boards, and that individuals feel for those who are like them in race, gender, and ethnicity); Dhir, *supra* note 1, at 47–54.

<sup>50</sup> See Geneva R. Fountain, *The Case for the Business Case Rationale*, 15 FLA. ST. U. BUS. REV. 81, 90–91 (2016) (noting that the hiring pool is often limited to those with board experience, often drawing from older or retired members 'the pool' which few women are a part of); Dhir, *supra* note 1, at 38–47.

<sup>51</sup> Richard A. Epstein, *Is Women's Empowerment a Bureaucratic Imperative?*, HOOVER INST. (Mar. 3, 2012), <https://www.hoover.org/research/womens-empowerment-bureaucratic-imperative>.

<sup>52</sup> Aaron A. Dhir, *Towards a Race and Gender-Conscious Conception of the Firm: Canadian Corporate Governance, Law and Diversity*, 35 QUEEN'S L.J. 569, 574 (2010); Rhode & Packel, *supra* note 49; *Quick Take: Why Diversity and Inclusion Matter: Financial Performance*, CATALYST (Aug. 1, 2018), <https://www.catalyst.org/knowledge/why-diversity-and-inclusion-matter-financial-performance>; see Fawn Lee, *Show Me the Money: Using the Business Case Rationale to Justify Gender Targets in the EU European Union Law*, 36 FORDHAM INT'L L.J. 1471 (2013); see also Lisa M. Fairfax, *Board Diversity Revisited: New Rationale, Same Old Story Board Diversity and Corporate Performance: Filling in the Gaps*, 89 N.C. L. REV. 855 (2010); David Carter et al, *The Diversity of Corporate Board Committees and Firm Financial Performance*,

of the business case have been performed. These studies use a variety of financial performance metrics. I will call these the “metrics studies.”

### *I. The Metrics Studies*

Using various financial metrics, a substantial amount of empirical data has shown a positive relationship between increased gender diversity on corporate boards and better financial performance in North America and internationally. Studies have shown a positive relationship between increased gender diversity on boards and Tobin’s Q,<sup>53</sup> Return on Assets (ROA),<sup>54</sup> Return on Sales (ROS),<sup>55</sup> Return on Equity (ROE),<sup>56</sup> and Return on Investment (ROI).<sup>57</sup> For example, using a statistical analysis of data gathered from 641 Fortune 500 firms over about 25,000 firm years from 1998-2002,<sup>58</sup> one study found a significant and positive, causal relationship between the percentage of female directors and firm performance as measured by Tobin’s Q.<sup>59</sup> Conyon and He, in a study of over 3,000 public American firms between 2007-2014, found that there

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SSRN Scholarly Paper ID 972763 (Rochester, NY: Social Science Research Network, 2007); Fountain, *supra* note 50.

<sup>53</sup> Tobin’s Q is defined as the ratio comparing a firm’s value with the cost of replacing its assets. CHRISTOPHER C. NICHOLLS, CORPORATE FINANCE AND CANADIAN LAW 2E144 (2013).

<sup>54</sup> Return on Assets is an accounting measure which reveals how much revenue can be generated from assets. It is calculated by dividing total earnings by total assets. Fountain, *supra* note 50, at 86.

<sup>55</sup> Return on Sales is an accounting measure determined by dividing the pre-tax profit divided by revenue. Nancy M. Carter et al, *The Bottom Line: Corporate Performance and Women’s Representation on Boards (2004-2008)* n.4, CATALYST (2011)

[https://www.catalyst.org/system/files/the\\_bottom\\_line\\_corporate\\_performance\\_and\\_women%27s\\_representation\\_on\\_boards\\_%282004-2008%29.pdf](https://www.catalyst.org/system/files/the_bottom_line_corporate_performance_and_women%27s_representation_on_boards_%282004-2008%29.pdf).

<sup>56</sup> Return on equity is an accounting measure determined by dividing total income by equity, or shares. *See* Fountain, *supra* note 50, at 86.

<sup>57</sup> Return on Investment is another measure of firm performance calculated by dividing after tax net operating profit by invested capital. Carter et al, *supra* note 55, at n.5.

<sup>58</sup> Carter et al, *supra* note 52, at 12–23. The authors, although the evidence suggested a causal relationship, were hesitant to draw conclusions about causation because of the possibility that a third variable could have increased both gender diversity and enhanced financial performance. *Id.*

<sup>59</sup> *Id.* at 21–23. The authors, although the evidence suggested a causative relationship, were hesitant to draw conclusions about causation because of the possibility that a third variable could have increased both gender diversity and enhanced financial performance.

was a positive relationship between increased gender diversity and Tobin's Q.<sup>60</sup> Erhardt, Werbel and Shrader in a study of 127 large US companies from 1993 to 1998, found that board diversity had a positive impact on organizational performance as measured by ROA and Return on Investment Capital.<sup>61</sup> Further, Schwartz-Ziv's study demonstrated that gender balance on corporate boards, specifically when a critical mass of female directors was present on a board, was positively related to net profit margins and ROE.<sup>62</sup> Eastman, Rallis, and Mazzuchelli, in a study conducted using data from 2011 to 2016 of corporations from the MSCI All Country World Index (ACWI), determined that companies with a critical mass of female directors outperformed those with no female directors as measured by ROE.<sup>63</sup> Similarly, in 2018, McKinsey in a global study of organizations found that those firms in the top quartile for diversity on boards outperformed those in the lowest quartile measured by ROE.<sup>64</sup>

However, there are also several studies which demonstrate either no relationship or a negative relationship between greater board gender diversity and firm financial performance using the same financial metrics as a measure of firm performance. For example, Carter et al in a subsequent study found there was no relationship between board diversity and financial performance using Tobin's Q as a financial performance

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<sup>60</sup> Martin J. Conyon & Lerong He, *Firm Performance and Boardroom Gender Diversity: A Quantile Regression Approach*, 79 J. BUS. RESEARCH 198, 203 (2017).

<sup>61</sup> See Nicolas L. Erhardt et al, *Board of Director Diversity and Firm Financial Performance*, CORP. GOVERNANCE: INT'L REV. (2003).

<sup>62</sup> Miriam Schwartz-Ziv, *Does the Gender of Directors Matter?*, SSRN Scholarly Paper ID 2257867 (Rochester, NY: Social Science Research Network, 2013) at 3.-22. In this study critical mass was said to have been reached when there was the presence of 3 or more of a certain gender on a board. See *infra*, Section xx (insert) for a broader discussion of 'critical mass.'

<sup>63</sup> MEGGIN T. EASTMAN ET AL, THE TIPPING POINT: WOMEN ON BOARDS AND FINANCIAL PERFORMANCE, MSCI 23, 15 (2016) <https://www.msci.com/documents/10199/fd1f8228-cc07-4789-acee-3f9ed97ee8bb>.

<sup>64</sup> Vivian Hunt et. al., *Delivering through Diversity*, MCKINSEY & COMPANY (2018), [https://www.mckinsey.com/~media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity\\_full-report.ashx](https://www.mckinsey.com/~media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity_full-report.ashx).

metric.<sup>65</sup> Adams and Ferreira, using data from 1996-2003, concluded that there was a negative relationship between enhanced gender diversity and ROA as well as Tobin's Q.<sup>66</sup> Kenneth R. Ahern & Amy K. Dittmar also conducted a study examining Norwegian firms before and after Norway implemented a mandatory quota for the proportion of women public corporations were required to have on their boards. This study showed that the quota had a negative impact on firm performance measured by Tobin's Q.<sup>67</sup> Schwartz-Ziv makes an excellent point about this study. She states that this study is looking at a case where gender diversity was increased on boards in "one fell swoop," not gradually over time and so the results do not necessarily showcase what lasting gender diversity means for corporate performance.<sup>68</sup> Some studies above found statistically negative relationships as well as positive relationships between board gender diversity and firm financial performance, depending on the metric that was used. For instance, although Conyon and He found a positive correlation between board gender diversity and Tobin's Q, they found a statistically significant negative relationship between same and ROA.<sup>69</sup>

### *The Weakness of the Financial Performance Business Case*

Studies showing no relationship or a negative relationship between increased board gender diversity and firm financial performance pose a significant problem for proponents of the financial performance business case. As Rhode and Packel point out, the empirical research "has not convincingly established that board diversity leads to improved financial performance."<sup>70</sup> Fairfax speculates that the lack of convincing

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<sup>65</sup> David A. Carter et al, *The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance: Board Diversity and Financial Performance*, 18 Corp. GOVERNANCE: INT'L REV. 396, 408 (2010).

<sup>66</sup> Renée B. Adams & Daniel Ferreira, *Women in the boardroom and Their Impact on Governance and Performance* 94 J. FIN. ECON. 291, pincite?? (2009).

<sup>67</sup> Kenneth R. Ahern & Amy K. Dittmar, *The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation* 127 Q. J. OF ECON. 137, 168 (2012).

<sup>68</sup> Schwartz-Ziv, *supra* note 62, at 8. *But see* Ahern & Dittmar, *supra* note 67 at 183. Ahern and Dittmar do recognize this and point out that the negative relationship is not necessarily because of the gender of the board, but could have been instead a result of the inexperienced directors appointed to fulfill the quota requirement. *Id.*

<sup>69</sup> Conyon & He, *supra* note 60, at 14.

<sup>70</sup> Rhode & Packel, *supra* note 49, at 393.

business case evidence is likely the reason board gender diversity has seen what she calls a “stagnation” in recent years.<sup>71</sup>

“[M]ost knowledgeable scholars, those who do business and corporate finance rather than race and gender subjects, deny . . . that any correlation exists . . . [and] empirical work on the subject conclusively finds that no correlation can be found”.<sup>72</sup> Opponents of stronger regulation often point to the weakness of the financial performance business case. One argument is that there are inherent difficulties with all of the above studies. It is extremely difficult to prove causation; at best what is normally found is correlation.<sup>73</sup> Rhode and Packel say there may be another factor which is causing both stronger financial performance and enhancing board gender diversity.<sup>74</sup> The McKinsey Report acknowledges that its work only reveals correlation and not causation and raises that it is possible that already high performing corporations are able to dedicate resources to diversity efforts, which may explain the correlation between high performing corporations and greater board diversity.<sup>75</sup> The report does assert, however, that “in practice, this seems unlikely. We have observed that most companies only embark on a major transformation when they have a burning platform to do so.”<sup>76</sup>

Both American and Canadian scholars have written on the difficulties faced by many of the studies. For example, the sample sizes in these studies are often small and the observations are often over a short time period.<sup>77</sup> There are known methodological issues with these empirical studies as well, including a lack of good quality data, and measurement difficulties.<sup>78</sup> In the above studies, for example, a number of them are only

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<sup>71</sup> Fairfax, *supra* note 52, at 869.

<sup>72</sup> Dhir, *supra* note 52, at 26, n.108 (citing DOUGLAS M. BRANSON, NO SEAT AT THE TABLE: HOW CORPORATE GOVERNANCE AND LAW KEEP WOMEN OUT OF THE BOARDROOM, CRITICAL AMERICA (2007)).

<sup>73</sup> Fairfax, *supra* note 52, at 862. Rhode & Packel, *supra* note 49, at 386. *See also* CATALYST which states plainly that the research it cites demonstrates correlation and not causation; *see Why Diversity and Inclusion Matter: Financial Performance*, CATALYST (July 31, 2018), <https://www.catalyst.org/knowledge/why-diversity-and-inclusion-matter-financial-performance>.

<sup>74</sup> Rhode and Packel, *supra* note 49, at 386.

<sup>75</sup> Hunt *et al.*, *supra* note 64, at 39.

<sup>76</sup> *Id.*

<sup>77</sup> Rhode & Packel, *supra* note 49, at 390.

<sup>78</sup> Fountain, *supra* note 50, at 87.

across periods of four or five years and some only use data from a small number of firms.<sup>79</sup> Fountain also articulates that when using financial metrics as a measure of firm performance, inconsistent findings can still be reached even when the same metrics and time periods are used to collect data.<sup>80</sup> No one has yet to perform a study which examines the long term stock performance and its relationship to increased gender diversity on the corporate board, at least not with data from the US or Canada. Long term stock performance is what Grundfest refers to as the “gold standard” of firm financial performance.<sup>81</sup>

### *Defenses to the Weaknesses*

However, even with the issue of causation and lack of proof that increased gender diversity on corporate boards is positively related to long term stock performance, the business case is not dismantled. The inherent methodological difficulties pose equal challenges for the studies showing positive, negative, and no relationship. Further, no scholar has yet to prove that board gender diversity is bad for firms or the capital markets. Thus, the firm financial performance business case may still prove useful.

What may be missing in the above studies is a regard for critical mass<sup>82</sup> and shareholder protection measures. Critical mass stems from the idea that if there is only one female within a group, the group will only consider her a “token” female, who is a representative in her capacity as a woman. On this view, it is only once a group reaches a critical mass of women that the transformation occurs.<sup>83</sup> The meaning of the critical mass threshold on a board of directors shifts among scholars. Some define it as

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<sup>79</sup> See Hunt *et al.*, *supra* note 64, at 39; Rhode and Packel, *supra* note 49, at 386.

<sup>80</sup> *Id.*

<sup>81</sup> Rhode & Packel, *supra* note 49, at 391 (citing Joseph A. Grundfest, *Diversity on Corporate Boards: When Difference Makes a Difference*, ROCK CENTER FOR CORPORATE GOVERNANCE (Sept. 10, 2009), <https://perma.cc/9K4Q-Z8MG>).

<sup>82</sup> The original theory of critical mass was expressed by Rosabeth Moss Kanter; her theory of critical mass is that women represented at token levels will either feel that they must over-achieve, or feel compelled to make themselves invisible. ROSABETH MOSS KANTER, *MEN AND WOMEN OF THE CORPORATION* 221 (1977). “The token must often choose between trying to limit visibility- and being overlooked- or taking advantage of the publicity- and being labeled a “troublemaker.” *Id.* Either way, token women will feel socially alienated and this may affect the impact of gender diversity.

<sup>83</sup> Schwart-Ziv, *supra* note 62, at 10.



twenty percent,<sup>84</sup> thirty percent,<sup>85</sup> thirty-five percent,<sup>86</sup> and still others as three women,<sup>87</sup> irrespective of the size of the board of which they are members. When scholars consider critical mass, as do Schwartz-Ziv and Bruno *et al.* in their studies, the results are striking. Schwartz-Ziv observes that most studies use data from boards with an average of ten percent female directors which may not showcase the true impact of gender that can be seen in more gender-balanced boardrooms.<sup>88</sup> The contribution that a female director can make as one of three women rather than as the sole female director may be very different.<sup>89</sup> Therefore, Schwartz-Ziv addresses the issue of critical mass for both genders in an Israeli context where there has been board gender balance for twenty years.<sup>90</sup> The results of this study reveal not only that gender-balanced boards work harder, as indicated by a content analysis of the board meeting minutes, but also this hard work, the author concludes, “trickles up” to firm financial performance because there is a parallel positive correlation between gender-balanced boards and ROE as well as net profit.<sup>91</sup> Bruno *et al.*, in their study of Italian listed corporations, subject to a quota law which took effect over the course of six years, found that when the percentage of female directors was ten percent, the impact which gender diversity had was negative on firm performance, that the impact was insignificant at twenty percent, and that the relationship was positive and significant past

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<sup>84</sup>GSF Bruno, A. Ciavarella & N. Linciano, *Boardroom Gender Diversity and Performance of Listed Companies in Italy: A Natural Experiment*, OXFORD LAW FACULTY 4 (2018), <https://www.law.ox.ac.uk/business-law-blog/blog/2018/11/boardroom-gender-diversity-and-performance-listed-companies-italy>; Fountain, *supra* note 50, at 90.

<sup>85</sup> Rosenblum, *supra* note 47, at 456

<sup>86</sup> Schwartz-Ziv, *supra* note 62, at 10.

<sup>87</sup> *Id.*; see also Rhode & Packel, *supra* note 49, at 408–410; Dhir, *supra* note 52, at 594 n. 115; Eastman, Rallis & Mazzucchelli, *supra* note 63, at 4.

<sup>88</sup> Schwartz-Ziv, *supra* note 62, at 4.

<sup>89</sup> *Id.* at 6.

<sup>90</sup> *Id.* at 5, 11. This study importantly is examining boardroom performance in a context which has not just recently implemented a law and undergone a major transformation, as the Ahern and Dittmar study above did. *Id.* Further, as the author notes, the corporations in this study are Government Business Companies in Israel who by law must maximize profits and whose legal requirements are almost identical to those in the United States. *Id.* Thus, the results of this study are quite relevant to the business case in the US.

<sup>91</sup> *Id.* at 19–20.

twenty percent.<sup>92</sup> They used ROA, ROE, ROIC and ROS as measurements of firm performance.<sup>93</sup>

In addition to critical mass, the issue of endogeneity and reverse causality is dealt with in the Schwartz-Ziv, Bruno et al, and in the Conyon and He studies.<sup>94</sup> Skeptics of the financial performance business case often lean on problems of endogeneity and reverse causality to support arguments against stronger regulation. It is unclear, many say, whether or not there is some other variable which enhances both financial performance and board gender diversity, or alternatively, whether better financial performance leads to better gender representation on boards.<sup>95</sup> However, in Schwartz-Ziv's study, she asserts that it is unlikely that there could be a problem of endogeneity or reverse causality because she looked at both "below the surface" board work (the work of the board extrapolated from meeting minutes) and observed a positive relationship with this and output (financial performance). Thus, it would seem that the work of the board, which is positively related to a critical mass of female representation, has a positive relationship with ROE and net profits.<sup>96</sup> Conyon and He also accounted for endogeneity and reverse causality in their quantile regression study and concluded that lower performing firms are less likely to make the most of female directors' value because of their perception of threats which arise out of their declining performance.<sup>97</sup>

As theorized by Fountain, studies often do not take into account shareholder rights and this could account for the inconsistent findings in the studies above.<sup>98</sup> In fact, Adams and Ferreira's study showed that corporations with stronger shareholder rights were much more likely to reap the positive impacts of enhanced board diversity, whereas corporations with weak shareholder rights were more likely to see a negative impact on firm financial performance when board gender diversity increased.<sup>99</sup> Thus, perhaps if shareholder rights were accounted for in the remainder of the above studies, we would see more consistent results.

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<sup>92</sup> *Id.*

<sup>93</sup> Bruno, Ciavarella & Linciano, *supra* note 84, at 26.

<sup>94</sup> Adams & Ferreira, *supra* note 66 also accounted for these factors, but this study was performed at a time when women represented a much smaller proportion of board seats and where most firms with any female directors only had a single female director.

<sup>95</sup> See e.g., Adams & Ferreira, *supra* note 66, at 306.

<sup>96</sup> Schwartz-Ziv, *supra* note 62, at 19–21.

<sup>97</sup> Conyon & He, *supra* note 60, at 207–209.

<sup>98</sup> Fountain, *supra* note 50, at 87–90.

<sup>99</sup> Adams & Ferreira, *supra* note 66, at 292.

As theorized by Fountain, studies also often do not take into account shareholder rights and this could account for the inconsistent findings in the studies above.<sup>100</sup> In fact, Adams and Ferreira's study showed that corporations with stronger shareholder rights were much more likely to reap the positive impacts of enhanced board diversity, whereas corporations with weak shareholder rights were more likely to see a negative impact on firm financial performance when board gender diversity increased.<sup>101</sup> Thus, perhaps if shareholder rights were accounted for in the remainder of the above studies, we would see more consistent results.<sup>102</sup>

Finally, while the empirical evidence linking director independence with enhanced firm financial performance is also mixed, corporations are still very willing to implement reforms.<sup>103</sup> The question remains as to why diversity has seen so much less traction in both the United States and Canada.<sup>104</sup> All in all, the financial performance business case may need some re-working before it is able to effect real change, but it does seem that the gap in the research may be filled with studies which account for critical mass, endogeneity, and shareholder protection measures.<sup>105</sup>

## 2. *The Governance Case*

Beyond the business rationale as calculated entirely by financial performance metrics, there is another version of the business case.<sup>106</sup> This rationale uses empirical data, qualitative data, and theoretical data to show that more women on boards have a positive relationship with enhanced corporate governance.<sup>107</sup> I will call this the "governance case." The theory behind the governance case is that gender diversity leads to better decision

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<sup>100</sup> Fountain, *supra* note 50, at 87–90.

<sup>101</sup> Adams & Ferreira, *supra* note 66, at 292.

<sup>102</sup> *Id.*

<sup>103</sup> Fairfax, *supra* note 52, at 878.

<sup>104</sup> *Id.*

<sup>105</sup> The following assumption is being made: that boards themselves have an impact on financial performance. As Ahern and Dittmar conclude: if boards were simply "window-dressing" then one should not see any relationship between increased gender diversity and firm performance. However, because we do see a relationship between these two (whether positive or negative), it is likely therefore that boards have an impact on financial performance. *See Ahern & Dittmar, supra* note 67, at 139.

<sup>106</sup> Rhode & Packel, *supra* note 49, at 393.

<sup>107</sup> *Id.*

making, corporate reputation and corporate governance generally, and thus is better for business.<sup>108</sup> This rationale is not directly linked to shareholder value as the financial performance rationale is.<sup>109</sup> Instead, by enhancing governance board gender diversity brings value to a corporation in various other ways.<sup>110</sup>

*i. Better Decisions*

As Sonnenfeld outlines, the highest performing corporations are those with “extremely contentious boards that regard dissent as an obligation . . . .”<sup>111</sup> This is consistent with many scholars’ views that groupthink is a common and problematic challenge faced by homogenous corporate boards.<sup>112</sup> Groupthink is a phenomenon where members of a group are unable to consider alternatives because they place the agreement of the group above constructive dissent.<sup>113</sup> Constructive dissent and elimination of groupthink go hand in hand.<sup>114</sup> In theory, female directors are thought to bring with them an outsider perspective and rather than agreeing with the group as a whole, they will probe more deeply and ask management more challenging questions than the typical male board member.<sup>115</sup> Empirical evidence suggests that diverse groups solve problems better than homogeneous ones.<sup>116</sup> Furthermore, female directors tend to have less attendance problems than their male counterparts.<sup>117</sup> When there are more women on a board this also reduces the male director attendance problems.<sup>118</sup> Meeting attendance is important for corporate governance as it is one of the most crucial ways directors fulfill their fiduciary duties<sup>119</sup> to the corporation and the shareholders (in the American context). Thus, with more constructive dissent and better attendance this

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<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> Dhir, *supra* note 52, at 592–96.

<sup>111</sup> Jeffrey A. Sonnenfeld, *What Makes Great Boards Great*, HARV. BUS. REV. 1, 7 (2002).

<sup>112</sup> Dhir, *supra* note 52, at 151; Fountain, *supra* note 50, at 91; Rhode & Packel, *supra* note 49, at 393–94. For original description of group think see IRVING L JANIS, GROUPTHINK: PSYCHOLOGICAL STUDIES OF POLICY DECISIONS AND FIASCOS 9 (2d ed. 1982).

<sup>113</sup> Janis, *supra* note 112, at 9.

<sup>114</sup> Carter *et al.*, *supra* note 52, at 9; Dhir, *supra* note 1, at 151.

<sup>115</sup> Dhir, *supra* note 52, at 592.

<sup>116</sup> Hunt *et al.*, *supra* note 64, at 23.

<sup>117</sup> *Id.*

<sup>118</sup> Adams & Ferreira, *supra* note 66, at 296–98.

<sup>119</sup> *Id.* at 295.

should at least better the monitoring function of the board and lead to better performance as an organization.<sup>120</sup>

ii. *Increased Independence*

By virtue of being “outsiders” with fresh perspectives, female directors are typically more independent than their male counterparts.<sup>121</sup> Increased independence has been thought to be a positive change for quite some time in the corporate governance realm.<sup>122</sup> Dating back to when Jensen and Meckling proposed the Theory of the Firm in the 1970s, board independence has in Tingle’s opinion become conflated with corporate governance.<sup>123</sup> Management, the agent of the shareholders, must be monitored by the board in order to ensure that the agents are acting within the principals’ best interests and not only their own.<sup>124</sup> Therefore it is thought that the more independent the directors are, the better monitors of management they will be. Hence, the more female directors a board has, the more independent the board will be and thus the stronger monitors of management.<sup>125</sup> Adams and Ferreira note that in their large sample of S&P corporations, 84.07% of female directors acted as independent directors.<sup>126</sup> Research also indicates that female directors tend to engage in tougher monitoring of management.<sup>127</sup> In addition, it has been empirically shown that greater female representation on boards leads to greater CEO turnover when stock performance is poor.<sup>128</sup> This relationship is not shown simply when there is a greater presence of independent directors generally, but only when these directors are female.<sup>129</sup>

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<sup>120</sup> *Id.*

<sup>121</sup> Carter, *supra*, note 52 at 8.

<sup>122</sup> *Id.*

<sup>123</sup> Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Finan. Econ. 305 (1976); Bryce C. Tingle, *What Is Corporate Governance? Can We Measure It? Can Investment Fiduciaries Rely on it?*, 43 Queen’s L. J. 223, 229 (2018).

<sup>124</sup> Dhir, *supra* note 1, at 27.

<sup>125</sup> *Id.*

<sup>126</sup> Adams & Ferreira, *supra* note 66, at 293–94. Director independence in this article is defined as the Investor Responsibility Research Center defines it. A director is independent if they do not have business relations with the firm, have no relation to management and are not and have never been an employee of the firm.

<sup>127</sup> Dhir, *supra* note 1, at 167.

<sup>128</sup> *Id.*

<sup>129</sup> Adams & Ferreira, *supra* note 66, at 301.

iii. *Corporate Reputation*

Part of the business case which does not relate directly to financial performance, but which may have an indirect effect on a corporation's share price at least, is the idea that increased board gender diversity enhances corporate reputation.<sup>130</sup> This is a very difficult portion of the business case to criticize as it seems to be supported both pragmatically and by empirical evidence.<sup>131</sup> Even serious critics of corporate governance predictors in both the United States and Canada cannot deny the fact that in this age corporate reputation is crucially important to a business' functioning and ultimately may impact upon its share price.<sup>132</sup> Last year, BlackRock's CEO Larry Fink wrote a letter to the CEOs of public companies, expressing his opinion that diversity is better for the long-term of the corporation and for its shareholders.<sup>133</sup> Thus, even if one does not accept that a corporation's reputation may suffer if it has poor board diversity, it may still be the case that the corporation becomes the target of shareholder activism.<sup>134</sup>

Further, those with better corporate reputations may have opportunities that corporations with poorer reputations do not.<sup>135</sup> For example, the Canadian Imperial Bank of Commerce (CIBC) recently launched a Women in Leadership Fund, a prospectus offering for a fund that is only available to corporations which have a minimum of 30% female executives, female board members, or who have signed the Catalyst 2022 Accord.<sup>136</sup> This fund also excludes companies who deal mainly in the business of alcohol and tobacco, among other things, and those which have been linked to major social or governance scandals.<sup>137</sup>

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<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> Larry Fink, *Larry Fink's 2019 Letter to CEOs Purpose & Profit*, BLACKROCK, <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>.

<sup>134</sup> *Id.*

<sup>135</sup> Alexandra Posadzki, *CIBC to Launch Canada's First Women in Leadership Bond for Institutional Investors*, THE GLOBE AND MAIL (Sept. 11, 2018), <https://www.theglobeandmail.com/business/streetwise/article-cibc-to-launch-canadas-first-women-in-leadership-bond-for>; see also Catalyst, *Catalyst Accord 2022: Accelerating The Advancement of Women*, CATALYST (Nov. 8, 2012), <https://www.catalyst.org/catalyst-accord-2022>.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

iv. *The Weaknesses of the Governance Case*

The difficulties with the governance case are two-fold. First, similarly to the financial performance case, the governance case is fraught with inconsistent empirical evidence. In a review of the literature regarding the presence of greater board diversity and corporate governance, Rhode and Packel note “[o]verall, studies on the relationship between board diversity and its capacity for strategic change have reached conflicting results.”<sup>138</sup> They also outline the conflicting empirical results concerning whether diversity enhances monitoring or whether it hinders communication between the board and management.<sup>139</sup> Adams and Ferreira’s study illustrates that because female directors are typically stronger monitors than their male counterparts, greater gender diversity can lead to over-monitoring and hurt boards that already perform well. So in some contexts where a firm is already performing well, it is possible that increasing the number of female directors on a board may damage governance.<sup>140</sup>

Secondly, it is not clear that typical corporate governance predictors lead to increased firm performance in general. There is still a question of whether director independence benefits a firm financially. Practices identified by regulators and policymakers as corporate governance best practices are not always accurate indicators of how well a corporation will perform financially, whether it will be involved in a scandal or whether it will fail.<sup>141</sup>

3. *The Talent Case*

“At Catalyst, we encourage companies to go beyond the traditional business case by focusing on diversity and inclusion as talent issues, rather than as the ‘bottom line.’”<sup>142</sup> This is a third iteration of the business case and it is by no means a new one. For instance, Carter *et al.* in 2007, in describing the business case for board diversity, include the fact that increased diversity means access to a wider talent pool.<sup>143</sup> In a more recent study, Eastman *et al.* found companies with at least three

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<sup>138</sup> Rhode & Packel, *supra* note 49, at 397.

<sup>139</sup> *Id.* at 398.

<sup>140</sup> Adams & Ferreira, *supra* note 66, at 305.

<sup>141</sup> Sonnenfeld, *supra* note 111; Tingle, *supra* note 123, at 246.

<sup>142</sup> Carter & Wagner, *supra* note 53.

<sup>143</sup> Carter *et al.*, *supra* note 52, at 10.

female directors outperformed those with none<sup>144</sup>. They supported these findings with two hypotheses, one of which is that well-performing corporations with more female directors were making better use of the talent supply available to them.<sup>145</sup>

In a study of venture capitalist investment firms, Gompers and Kovali partly accounted for their finding, that diverse partnerships led to higher returns than homogenous ones, by drawing a comparison between their results and the upturn in the economy after the 1960s.<sup>146</sup> This economic boom was because the labor market began accessing both women and people of color.<sup>147</sup>

Dhir explains another facet of the talent case in the Canadian context. He describes a phenomenon where Canadian corporations were actually losing talented women to other countries more concerned with board diversity, which were better at seeking and recruiting talented women.<sup>148</sup> He thus advocated for policy intervention to catalyze the slow growth of board diversity in Canada.<sup>149</sup> Interestingly, Dhir was writing at a time when the diversity disclosure policy in Canada was very new, and yet his point that voluntary efforts in Canada to increase boardroom gender diversity had not worked is still true today.<sup>150</sup>

### *Pool Problem*

The talent case rationale runs up against one of the most common arguments used by those who oppose stronger regulation to increase the number of women on boards. This argument is the “pool problem”. Those who are convinced that there is a lack of qualified female candidates are unlikely to be persuaded that firms should simply extend their search beyond the pool which they consider “qualified”. Qualifications for board candidacy usually include executive experience with an emphasis on CEO experience.<sup>151</sup> The pool may not, in fact, be a problem. Dhir argues that the pool problem might be based on an inaccurate conception of the

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<sup>144</sup> Eastman, Rallis & Mazzucchelli, *supra* note 63, at 6–9, 11.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> Paul Gompers & Silpa Kovvali, *The Other Diversity Dividend*, HARVARD BUSINESS REVIEW (July 2018), <https://hbr.org/2018/07/the-other-diversity-dividend>.

<sup>148</sup> Dhir, *supra* note 1, at 279.

<sup>149</sup> *Id.*

<sup>150</sup> *Id.* at 280.

<sup>151</sup> *Id.* at 40; Fountain, *supra* note 50, at 90; Fairfax, *supra* note 52, at 871.



Canadian and US labor markets.<sup>152</sup> It could also be that women are held more strictly to the CEO standard than male candidates.<sup>153</sup>

It may be that successful corporations tend to have more diverse boards because they have the means to support diversity efforts.<sup>154</sup> It is possible that these are the corporations better able to recruit the most qualified diverse candidates.<sup>155</sup> It is not clear that by extending the pool of what they consider qualified candidates, lower performing corporations would realize a diversity dividend.<sup>156</sup> This line of thinking, of course, rests on the assumption that it is not diversity which creates value at high performing firms and the correlation runs the other way.<sup>157</sup> If, on the other hand, we accept that diversity brings instrumental value, then this justifies extending the pool within which director candidates are found.<sup>158</sup> Thus, the pool problem falls flat. Another interesting counter to this is the reverse pool problem.<sup>159</sup> In the Erhardt *et al.* study, the authors point to the fact that at the time of writing there was a dearth of qualified male candidates to fill board positions.<sup>160</sup> This may not still be a problem, but, if it is, then an expanded pool of candidates would be necessary to account for this pool problem.<sup>161</sup>

### *Business Case Conclusion*

“Given the competing findings and methodological limitations of these studies, the financial benefits of board diversity should not be overstated.”<sup>162</sup> The business case in its current formulation may need some reworking if it is to be compelling enough to effect real change.<sup>163</sup> However, given that there is certainly a lack of evidence which goes against the financial performance based business case, the empirical

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<sup>152</sup> Dhir, *supra* note 1, at 38–42.

<sup>153</sup> *Id.* at 41.

<sup>154</sup> *Id.*

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> Erhardt, Werbel & Shrader, *supra* note 61, at 12.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> Rhode & Packel, *supra* note 49, at 401.

<sup>163</sup> See Carter *et al.*, *supra* note 65, at 411–412.

evidence generally does not hinder the normative rationale for greater gender diversity on boards in both the United States and Canada.<sup>164</sup>

More broadly, the business case faces the challenge that is described by Rosenblum and Dhir. That is, if we justify increased gender diversity on boards by arguing that it will lead to better firm performance, this makes it seem that if women cannot show their instrumental worth, they do not deserve a seat at the table.<sup>165</sup> For proponents of gender diversity, this again does not damage the normative case.<sup>166</sup> Unless the empirical evidence definitively proves that gender diversity impairs financial performance, there is still a compelling case for increasing board gender diversity on normative grounds.<sup>167</sup>

Another reason why the business case has yet to be convincing is it is “inextricably linked with the moral or social case for board diversity because moral and social rationales are embedded in the so-called business case.”<sup>168</sup> This point will be addressed in greater detail below.

### B. *The Normative Case*

The normative case is far less complex than the business case. It has two versions. The first is that gender diversity on boards should be promoted as it is simply the right thing to do.<sup>169</sup> The second is that it is right to promote diversity on corporate boards because the diverse groups (women and ethnic minorities) are those which have been historically disadvantaged.<sup>170</sup> We should, therefore, have regulation to ameliorate this. These versions of the normative case are identically conceptualized in the United States and Canada, and can be seen above in the Canadian and American regulators’ discussions of the diversity policies.<sup>171</sup> A McKinsey report recognizes that “social justice, legal compliance, or maintaining industry-standard employee environment protocols is typically the initial

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<sup>164</sup> *Id.* They point out that even though there is no clear relationship between greater gender diversity and firm financial performance, this does not eliminate the normative case for increasing gender diversity on boards and that decisions to add more women to the board should be because of reasons beyond business case rationales. *Id.*

<sup>165</sup> Rosenblum, *supra* note 47.

<sup>166</sup> *Id.* Some call this idea the normative case, while others refer to it as a fairness, equity, or social justice rationale. *Id.* For the purposes of this paper I will use the “normative case” to mean all of these things.

<sup>167</sup> *Id.*

<sup>168</sup> Fairfax, *supra* note 52, at 879.

<sup>169</sup> *Id.* at 857.

<sup>170</sup> Rosenblum, *supra* note 47, at 439.

<sup>171</sup> Hunt *et al.*, *supra* note 64, at 1.

impetus behind these [diversity] efforts . . .”<sup>172</sup> Paul Davies and Klaus Hopt, in discussing European policy reforms related to board diversity, said: “Although both reforms are advocated on the basis that they will promote the economic success of the company, it is not clear whether this will be the case and it is even less clear whether economic success from the perspective of the shareholders is the objective of the reforms.”<sup>173</sup> Thus, the catalyzing factor behind reforming board diversity policies is usually rooted in the normative case.<sup>174</sup>

If one accepts a purely normative case, stronger regulation such as quotas seems to be the logical solution to the lack of female directors.<sup>175</sup> However, normative objectives influencing the regulation of the inner workings of corporate boards in the private sector will not be able to escape the business case in the US and Canada.<sup>176</sup> The securities regulators are charged with promoting fairness and efficiency in the capital markets.<sup>177</sup> Their mandates make it very difficult, if not impossible, to openly pursue an objective which is purely normative.<sup>178</sup>

There is though, as Rosenblum points out, a certain amount of normative “slippage” into the business case.<sup>179</sup> The regulators in the US and Canada, as described above, support their use of diversity regulation with business case and investor protection rationales.<sup>180</sup> Yet, they seem to in fact be working from a normative-based rationale.<sup>181</sup> One can see this from the fact that the Ontario and Federal governments in Canada instructed the OSC to tackle this issue in order to “facilitate an increase in the participation of women on the boards . . .”<sup>182</sup> Unlike the SEC, these government actors are transparent about the end result which the regulation is to achieve, a result that appears to be indifferent to any likely

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<sup>172</sup> *Id.*

<sup>173</sup> Paul Davies & Klaus Hopt, *Corporate Boards in Europe - Accountability and Convergence*, European Corporate Governance Institution Working Paper 61 AMJCL 301, 330 (2013).

<sup>174</sup> *Id.*

<sup>175</sup> The Role of the SEC, *supra* note 9; Ontario Securities Act *supra* note 39.

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> Rosenblum, *supra* note 47, at 440.

<sup>180</sup> The Role of the SEC, *supra* note 9; Ontario Securities Act *supra* note 39.

<sup>181</sup> *Id.*

<sup>182</sup> Consultation Paper, *supra* note 44, at 3.

effect of increased board diversity on firm performance. It is notable that, in the case of Ontario, it was the Minister Responsible for Women's Issues, in conjunction with the Minister of Finance, and not the Minister of Finance alone, who provided this instruction.

In the US, from Luis Aguilar's speech as discussed above, we see a similar normative slippage. He even suggests that a Rooney Rule may be useful in promoting board diversity. The Rooney Rule was a technique used by the NFL to encourage more diverse hiring of coaches in which at least one diverse candidate was to be interviewed in the final rounds of hiring.<sup>183</sup>

### *The Normative Case's Biggest Hurdles*

#### *i. The Board's Role is to Maximize Shareholder Wealth*

Perhaps the most powerful argument opponents of stronger regulation have in their arsenal is based on the premise that the board's role is primarily to maximize shareholder wealth. In the United States, the conception of the board's role as a shareholder wealth maximizer, especially where a change of control is inevitable, is fairly well accepted. Generally, in the US, the directors owe fiduciary duties to the corporation as a whole and the shareholders thereof.<sup>184</sup> In a takeover context, where a change of control is inevitable, the board's duty according to the *Revlon* line of cases becomes a duty to maximize shareholder wealth.<sup>185</sup> In Canada, on the other hand, in both the federal and provincial corporate statutes, the board's fiduciary duty is only owed to the corporation as a

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<sup>183</sup> Aguilar, *supra* note 14.

<sup>184</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). The Delaware Chancery court held that considering stakeholders' interests who are not stockholders is inappropriate if a change of control transaction is inevitable. Once this threshold is reached, the role of directors shifts to auctioneers and they must maximize shareholder wealth.

<sup>185</sup> *Id.* The *Revlon* duty was interpreted and narrowed in *Paramount Communications Inc. v Time Inc.* 571 A.2d 1140, 1150 (Del. 1989). The *Revlon* duty in *Time*, was held not to apply if a change of control transaction is inevitable, but where the control will still be widely dispersed and there will be no controlling shareholder.

whole.<sup>186</sup> Although there is reason to think that the *Revlon* duty has been applied in Canada –<sup>187</sup> since at least 2008 – the Canadian Supreme Court in its *BCE* decision,<sup>188</sup> ruled that even in a *Revlon*-type situation, the board should consider all stakeholders rather than simply the shareholders in making its decision.<sup>189</sup> So the duty of the board as a shareholder wealth maximizer in Canada is less clear. However, it is important to note that the board in *BCE*, even after considering other stakeholders, made a decision that favored the wealth maximization of its shareholders and the court was unwilling to strike this decision. Therefore, one could argue that despite the more stakeholder-centric model in Canada, a board is still at least permitted to prioritize the shareholders so long as it also fairly considers other stakeholders in its decision.

If one assumes that a board's role is to maximize shareholder wealth, one is led to the ultimate conclusion that boards should only undergo large scale transformation if this will benefit the corporation's shareholders. Under this assumption, it is difficult to justify a quota-based regulatory model unless this will also generate shareholder wealth. Even more challenging, is the evidence from Norway. When a quota was introduced for women on boards, public corporations were left scrambling to find additional women to sit on their boards, leading in some cases to the appointment of less experienced directors. This caused, it has been argued, a downturn in the market and losses for the shareholders of these companies.<sup>190</sup> Schwartz-Ziv's study of Government Business Companies in Israel, though, shows better financial performance when there was gender balance on boards for over 20 years in a context where the corporations are required by law to maximize shareholder value.<sup>191</sup> This is

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<sup>186</sup> Canada Business Corporations Act, R.S.C. 1985, c C-44, §122 (Can., 1985); Ontario Business Corporations Act, R.S.O. 1990, c B16, §134 (Can., 1990).

<sup>187</sup> CHRISTOPHER C NICHOLLS, *MERGERS, ACQUISITIONS, AND OTHER CHANGES OF CORPORATE CONTROL*, 2nd ed. ed, 229–232 (2012). See page 229–239 for detailed account of how *Revlon* has been interpreted by Canadian courts.

<sup>188</sup> *BCE Inc. v 1976 Debentureholders*, 2008 S.C.R. 69 [“*BCE*”].

<sup>189</sup> *Id.* at para. 40. This decision has since been codified into the Canada Business Corporations Act. See Canada Business Corporations Act, *supra* note 186 at §122(1.1) and *Bill C-97 An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2019 and other measures*, 1<sup>st</sup> Sess, 42<sup>nd</sup> Parliament, 2019 (assented to 21 June 2019) at s 141.

<sup>190</sup> Ahern & Dittmar, *supra* note 67 at 168.

<sup>191</sup> Schwartz-Ziv, *supra* note 62.

an excellent example of the positive effect of adequate gender representation over the course of many years in a context where shareholder wealth maximization is mandated and where gender parity increases financial performance. More generally, one could argue that so long as no damage to the capital markets can be reasonably linked to regulatory efforts to improve gender diversity on boards, such regulation in Canada and the US is justified purely on the basis that it is the right thing to do.

ii. *Command-and-Control Regulation is Inappropriate State Interference with the Private Sector*

State interference with the inner-workings of the corporate board is perceived in a negative light in both jurisdictions, but perhaps more strongly in the United States. American legal scholarship, views command-and-control measures disdainfully.<sup>192</sup> In Short's review of American legal scholarship over a 25 year period, she found that the most common criticism was that command-and-control regulation is a form of state coercion with a negative impact upon the choices of those subject to the regulation.<sup>193</sup> Opponents of command-and-control are especially critical of the SEC regulating corporate governance. The SEC, in the opinion of some, does not have the appropriate tools to deal with the issue of corporate governance. For instance, Gallagher, an SEC Commissioner, in criticizing the SEC's attempts to meddle in corporate governance, asserted: "If most corporate governance issues are a nail, the states represent a hammer, while the SEC represents, say, a wrench, or worse yet a sledge hammer! Let's not become the wrench in the works of corporate governance when we have a toolbox full of fifty hammers."<sup>194</sup> Epstein, in comparing the EU's proposed quota mandate and the US' flexible approach, asserts: "The question then arises of why it makes sense, in this time of economic malaise, to impose this costly and intrusive quota on firms that already have every incentive to pick the best board members".<sup>195</sup> His article, written in 2012, provided a hint as to what reaction a quota mandate in the US might receive. Alstott makes the point clear. She says "quotas sit uneasily with deeply-held beliefs (in the United States) about

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<sup>192</sup> Dhir, *supra* note 1 at 94.

<sup>193</sup> Short, *supra* note 45 at 662.

<sup>194</sup> Daniel M Gallagher, *The Proper Role of the Federal Government in Corporate Governance*, THE CLS BLUE SKY BLOG (Feb. 1, 2013), <http://clsbluesky.law.columbia.edu/2013/02/01/the-proper-role-of-the-federal-government-in-corporate-governance/>.

<sup>195</sup> Epstein, *supra* note 51.

the role of government and law in regulating business.”<sup>196</sup> In Canada, command-and-control is less feared and the securities regulators do not face the same challenge as the SEC because it is thought to be within the purview of Canadian securities regulators to regulate corporate governance.<sup>197</sup>

Short counters the opponents of command-and-control regulation with a persuasive argument that “tyrannophobia” when it comes to securities regulation and taxes is a misplaced fear. Tyrannophobia in this context, she advances, not only detracts from real issues of inappropriate state interference (such as torture and secret wiretapping) but it also makes it difficult for regulators to properly address issues because they constantly have to be concerned with rebutting command-and-control based arguments.<sup>198</sup> Thus, it may be that fear of command-and-control is more a distraction from the real problems in need of regulation than a constructive form of discourse in an age of complex financial institutions and capital markets capable of destroying the economy if not run properly.

### iii. *Let the Market Decide*

Richard Epstein, in comparing the American approach to gender diversity to that of the EU, provided the following critique of the European approach:

“Women are, in ever-larger numbers, graduating from universities with advanced degrees in business and

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<sup>196</sup> Anne Alstott, *Gender Quotas for Corporate Boards: Options for Legal Design in the United States* 26 Pace Int’l L. Rev. Symposium Ed., 38, 44 (2014).

<sup>197</sup> It is generally accepted in Canada that the securities regulators can regulate corporate governance. Perhaps this is because securities in Canada up until now have been provincially regulated. In the US many view corporate governance as something which should only be regulated by the states and not the federal government. For an account of the federalization of corporate governance in the US see, MARC I STEINBERG, *THE FEDERALIZATION OF CORPORATE GOVERNANCE* (2018); and for a critique of the federalization of corporate governance, see Jason Parsont, *The Proper Role of the Federal Government in Corporate Governance*, (February 1, 2013) CLS BLUE SKY BLOG, available at <http://clsbluesky.law.columbia.edu/2013/02/01/the-proper-role-of-the-federal-government-in-corporate-governance/>.

<sup>198</sup> Short, *supra* note 45 at 681–682.

management. As they move up the ranks, their presence on boards may well increase, wholly without quotas.... Firms have every incentive to pick the best board members, male or female... So what is the difference between the Wall Street Journal and the EU's approach? Simple. The former uses voluntary action and enlists high-profile leaders to make its case, while the latter uses coercion in a ham-handed effort to achieve some narrow and counterproductive initiative toward the same general end."<sup>199</sup>

This combines both fear of coercion and the supposition that if given time the markets will correct the under-representation of women on boards. The latter is a similar argument, found in Fountain's paper. She purports that the best remedy for the issue of women on boards may be time. The market will adjust to the social pressure placed on large corporations to enhance board gender diversity.<sup>200</sup> There is clearly an increasing push for diversity efforts in the market as well. As discussed above, Larry Fink's letter and the launch of CIBC's Women in Leadership Fund are just two examples of pushes from the private sector rather than government indicating that the market is moving in the direction of demanding greater gender diversity on corporate boards. One view of the regulators' initiatives is that they were responding to market developments as expressed by comments from investors who saw boardroom diversity as a laudable goal.<sup>201</sup>

However, scholars have illustrated the flaws with this market evolution argument. In the OSC's 2013 Roundtable regarding women on boards, in discussing the rate of change, a panelist, Pamela Jeffrey, remarked, "we will not be anywhere close to gender parity until 2097 at this pace of change here between half a percent and a percent a year. So 2097, we're all dead, and our children are dead, and our grandchildren. So let's get on with [it]."<sup>202</sup> Although the rate of change has improved since 2013, in Canada it will still take approximately 50 more years to reach

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<sup>199</sup> Epstein *supra* note 51.

<sup>200</sup> Fountain, *supra* note 50 at 95.

<sup>201</sup> Final Rule, *supra* note 4 at 68343; National Instrument 58-101F1: *Notice and Request for Comment in Proposed OSC Amendments to Form 58-101F1 Corporate Governance Disclosure of National Instrument 58-101 Disclosure of Corporate Governance Practices : Proposed Disclosure Requirements Regarding the Representation of Women on Boards and in Senior Management*, ONTARIO SECURITIES COMMISSION (2014).

<sup>202</sup> Roundtable Discussion *Re Women on Boards and Senior Management*, *supra* note 38.



gender parity, and this is assuming that board seats will be filled by 50% women, a higher female fill rate than there currently is.<sup>203</sup> In the US, it is predicted that it will take similarly approximately 30 years to reach gender parity.<sup>204</sup> Thus, even assuming a higher fill-rate than there is in Canada, the market likely will not correct this problem until the writer is approaching old age.

*C. How The Regulators Use the Business Case  
and the Normative Case*

The SEC and the OSC have very similar mandates. The SEC's is to protect investors, maintain fair, orderly, and efficient markets, and to facilitate capital formation.<sup>205</sup> The OSC's is to protect investors from unfair, improper or fraudulent practices, to foster fair and efficient capital markets and confidence in capital markets, and to contribute to the stability of the financial system and the reduction of systemic risk.<sup>206</sup> Thus, the policies, which each of these regulators can implement, must fit within virtually identical scopes.

Further to the discussion above, the OSC in its Request for Comment on the proposed NI 58-101F1 amendments said the following: "The Proposed Amendments are intended to encourage more effective boards and better corporate decision making by requiring greater transparency for investors and other stakeholders regarding the representation of women on boards and in senior management of TSX-listed and other non-venture issuers. This transparency is intended to assist investors when making investment and voting decisions."<sup>207</sup> Most recently at the 2017 roundtable discussing

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<sup>203</sup> *Roundtable Discussion - Third Review of Women on Boards and in Executive Officer Positions* ONT. SEC. COMMISSION (Oct. 24, 2017), [http://www.osc.gov.on.ca/documents/en/Securities-Category5/sn\\_20171103\\_transcript-wob-roundtable.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category5/sn_20171103_transcript-wob-roundtable.pdf).

<sup>204</sup> SB 826, *supra* note 6 at section 1(a).

<sup>205</sup> SEC'S Role, *supra* note 9.

<sup>206</sup> Ontario Securities Act, *supra* note 39 at section 1.1.

<sup>207</sup> National Instrument 58-101F1: *Proposed OSC Amendments to Form 58-101F1 Corporate Governance Disclosure of NI 58-101 Disclosure of Corporate Governance Practices - Proposed Disclosure Requirements Regarding the Representation of Women on Boards and in Senior Management*, ONT. SEC.COMMISSION, (Jan. 15, 2014),

women on boards, OSC Chair, Maureen Jensen, said that the Commission views this as a “governance issue”.<sup>208</sup> However, in light of both the above quote by the Minister for Women’s Issues and given that it was the Minister for the Status of Women and not just the Minister of Finance obliging the Commission to look at this issue, the true purpose of the gender diversity proposal seems clear: that is, to advance a goal rooted in fairness.

Likewise, in the US, SEC Commissioner Luis Aguilar’s comments show that the true intentions of item 407(c) in Regulation S-K seem to be rooted in promoting a normative goal, rather than in protecting investors.<sup>209</sup> Aguilar made the following statement in 2013: “Given the evidence of the impact diversity on boards has on the bottom line and the boardroom changes taking place with our counter- parts across the globe, gender diversity – and diversity in general – should be a priority for U.S. companies and their boards.”<sup>210</sup> Aguilar went on to claim that corporate board diversity was important to investors and board diversity disclosure will help investors make informed decisions.<sup>211</sup> Thus, the rationale behind the diversity disclosure regime was almost identical to the one provided by the Canadian securities regulators. It includes the notion that board diversity will enhance financial performance, that it will lead to improved corporate governance, and that it will better protect investors. However, Aguilar’s speech also reveals a normative rationale behind the disclosure policy.

What is striking in the US and Canada is that although they implemented different board diversity regulatory regimes at different times for allegedly different reasons, the work each disclosure model has done is similar. There has not been a dramatic change to the number and percentage of women on boards in either jurisdiction since these

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[http://www.osc.gov.on.ca/en/SecuritiesLaw\\_ni\\_20140116\\_58-101\\_pro-amd-fl.htm..](http://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20140116_58-101_pro-amd-fl.htm..)

<sup>208</sup> *Third Review of Women on Boards and in Executive Officer Positions*, *supra* note 203.

<sup>209</sup> This is not to say that the two are mutually exclusive, only that the priority seemed not to be in protecting investors, but rather in advancing a social justice goal.

<sup>210</sup> Luis Aguilar, *Merely Cracking the Glass Ceiling Is Not Enough: Corporate America Needs More than Just A Few Women in Leadership* (May 22, 2013), <https://www.sec.gov/news/speech/2013-spch052213laahtm>.

<sup>211</sup> *Id.*

reforms.<sup>212</sup> Perhaps this is because the conceptions of the problem board diversity proposals are designed to address in both the US and Canada and their respective solutions are almost identical. Moreover, perhaps corporations have remained unconvinced of the financial or other governance benefits of board diversity and believe that the securities regulators are in fact advancing a normative goal indirectly through these regimes.

As discussed above, “normative slippage” could be what has so confounded securities regulators. Both the SEC and the OSC used the business case rationale in justifying their current diversity regimes. Yet, the regulators encounter serious difficulty when they attempt to regulate what is truly a social justice or fairness issue masked in business case rationales. The result of this in both the US and Canada is weak diversity policies which have not made a noticeable difference in advancing the social justice goals which appear to be the primary motivation behind the implementation of such policies. Even if we accept that the true objectives of the policies were to increase board gender diversity to enhance firm performance, neither increases board gender diversity or enhances firm performance. Another regulatory option, of course, is a regulation which is intrusive and which faces broader administrative law challenges. The regulators cannot be seen to damage the capital markets (which is arguably what occurred in Norway, with its abrupt introduction of a mandatory quota) nor can they be seen to act beyond their mandate. What then is the answer? That is yet unclear, but perhaps with a re-statement of the business case and the lessons which the securities regulators can take from the example discussed below, regulations encouraging enhanced gender diversity which do not conflict with other laws can be implemented.

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<sup>212</sup> Before the diversity disclosure policy was implemented in the US, women represented 12% of S&P board members in 2009. *See* Fairfax, *supra* note 52 at 87. Similarly in Canada, before NI 58-101F1 was amended to include the diversity disclosure regime, women represented 11% of board seats of publicly traded corporations or directors of reporting issuers. *See* Consultation Paper, *supra* note 44 at 2. Currently, as previously mentioned, women in the US and Canada represent 17.7% and 15% of board seats of public corporations respectively, see notes 2 and 3.

## III. HANG TEN: THE CHANGING TIDE IN THE WAKE OF CALIFORNIA

## SENATE BILL 826

A. *What It Says and Why It Was Drafted*

Senate Bill No. 826 (Bill 826) was recently signed in California. This Bill adds sections 301.3 and 2115.5 to the Corporations Code. Bill 826 requires public corporations with “principal executive offices” located in California to have a minimum of one female director. This minimum number is to increase over time to at least two female directors if the board has five or more members, or 3 directors if the board has at least six members by the year 2021.<sup>213</sup> In its declaration, the legislature outlined several rationales for this highly intrusive bill. First, it states in no uncertain terms, that more female directors on public corporations’ boards will have a positive impact on California’s economy.<sup>214</sup> It then lists a number of empirical studies, the results of which indicate a positive relationship between greater gender diversity and enhanced financial performance.<sup>215</sup> Further on, it synthesizes a number of studies which attempt to show that a critical mass of women increases the board’s efficacy, including the McKinsey report as described above.<sup>216</sup> In sections 1(e)-(f), the declaration describes the particulars of under-representation of women on corporate boards in California, specifically mentioning that as of June 2017, only 15.5% of board seats in California were occupied by women. It is estimated that at the current rate it will take 40 to 50 years to reach gender parity among Russell 3000 companies across the United States.<sup>217</sup>

By March 1 2020, the Secretary of State will publish a list of those corporations who are in compliance with Bill 826, those that moved their head offices in to or out of California, and those that were subject to the law but that went private in the preceding year.<sup>218</sup> Finally, there will be fines of \$100 000 for first time violations of these amendments and \$300 000 for subsequent violations levied against firms that do not comply.<sup>219</sup>

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<sup>213</sup> Bill 826, *supra* note 6 at 94.

<sup>214</sup> *Id.* at section 1(a).

<sup>215</sup> *Id.* at section 1(c).

<sup>216</sup> *Id.* at section 1(g).

<sup>217</sup> *Id.* at subsections 1 (e)-(f).

<sup>218</sup> *Id.* at section 2(d).

<sup>219</sup> *Id.* at section 2(e).

A few important things can be gleaned from the text of the amendments themselves and from the Legislative Declaration accompanying them. First, the legislature is still attempting to justify a law with a business case rationale based on financial performance arguments while also recognizing that, notwithstanding any performance advantages, this is simply the right thing to do. Bill 826 runs into the same difficulty as the other American and Canadian regimes and the business case in general. That is, it justifies increased gender diversity on corporate boards by citing the instrumental value this will bring, implying that in the absence of such financial value it may not be worth doing. While largely focusing on the financial performance case, the very first section of the bill asserts that increasing the number of female board directors will, in turn, lead to more opportunities for women in the workplace and laments the fact that if something is not done, gender parity will not be reached for 40 to 50 years.<sup>220</sup> Thus it is likely that this bill is in fact motivated by social justice considerations and not purely, or even primarily, economic reasons.

### *B. Polarizing Reaction*

Bill 826 has already precipitated some polarized reactions in both the scholarly world and in the media. For those who support stronger regulation and are not as concerned about state interference with the private sector, this bill was more than welcome and its supporters hope that it will lead to some real change. On the other hand, for those who are less enthusiastic about state interference with the inner workings of the corporate board, and especially those who see Bill 826 as flouting the Internal Affairs Doctrine,<sup>221</sup> this bill was a clear over-reach of state power and will not have any notable positive impact.

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<sup>220</sup> *Id.* at section 1(a).

<sup>221</sup> The Internal Affairs Doctrine is defined as: “the law that governs the relations among and between the corporation, its fiduciaries, and its stockholders is the law of the subject corporation’s state of incorporation.” Steinberg, *supra* note 197 at 2; *see also* CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1986).

### I. *Those in Favor of Quotas*

While it is still early days, many applaud Bill 826 as a step in the right direction.<sup>222</sup> As Senator Hannah-Beth Jackson puts it: “This is one of the last bastions of total male domination... We know that the public and business are not being well-served by this level of discrimination.”<sup>223</sup> This comment, along with another statement she made to the press, makes it clear that this bill is rooted in social justice as well as business case rationales. In her other press statement, she said “...and I believe constitutional issues are ultimately for the courts to decide. Due to persistent inequality and discrimination at the highest levels of corporate leadership, women are being denied access and opportunity, and I believe there is an extremely compelling state interest in California moving forward to protect women and the state’s economy.”<sup>224</sup>

Still others see the new regime as a way to achieve critical masses of women directors in the boardroom.<sup>225</sup> Critical mass, as previously discussed, may be the missing link between greater board gender diversity and enhanced firm financial performance.

Before this bill, scholars in the US and Canada had suggested quotas as a solution to the under-representation of women on boards. Willey, for instance, advocates for quotas as a short term fix. They may be what is necessary to effect immediate change in the current state of gender imbalance on boards in Canada. Though she acknowledges that implementation of quotas would likely be “an uphill battle,” in the alternative, she pushes for strengthening NI 58-101F1 with stated targets

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<sup>222</sup> See Emily Stewart, *California Just Passed a Law Requiring More Women on Boards. It Matters, Even if It Fails*, VOX (Oct. 3, 2018), <https://www.vox.com/2018/10/3/17924014/california-women-corporate-boards-jerry-brown>; Mary L. Walshok, *Why It’s Time for More Women in the Boardroom*, SAN DIEGO UNION TRIBUNE (Nov. 21, 2018), <https://www.sandiegouniontribune.com/opinion/commentary/sd-utbg-women-boardroom-equity-california-20181121-story.html>.

<sup>223</sup> Sophia Bollag, *California is First State to Require Women on Corporate Boards*, THE GLOBE AND MAIL (Oct. 1, 2018), <https://www.theglobeandmail.com/world/article-california-is-first-state-to-require-women-on-corporate-boards/>.

<sup>224</sup> Jena McGregor, *Some Companies Still Don’t Have any Female Directors. California Wants to Fine Them*, WASHINGTON POST (Sept. 11, 2018), <https://www.washingtonpost.com/business/2018/09/10/there-are-companies-that-still-dont-have-any-female-directors-california-wants-fine-them/>.

<sup>225</sup> *Id.*

within the comply-or-explain regime at the very least.<sup>226</sup> She describes the current policy as an “explain-or-explain” rather than a comply-or-explain regime because the regulators have neglected to set actual targets against which company performance could be benchmarked.<sup>227</sup> NI 58-101F1, she describes, is a weak intervention and one which will not effect, and indeed has not effected, much change.<sup>228</sup>

In the US, Alstott, in 2014, also advocated for gender quotas on corporate boards in the US. She argues that the “the state makes massive expenditures to further social and economic policy under the guise of ‘tax incentives’.”<sup>229</sup> Tax law further penalizes corporations for behavior that is socially harmful, which means Alstott reasons, that legislators are already advancing “substantive” corporate governance goals.<sup>230</sup> In addition to tax law, securities regulation has engaged in substantive corporate governance since the implementation of Sarbanes-Oxley. Alstott believes that if “designed with sensitivity to exceptional U.S. institutions,”<sup>231</sup> quotas could fit very well within the US tax and securities laws. Importantly though, she notes that federal law is better suited to mandate quotas than state law.<sup>232</sup>

Since Bill 826’s introduction, there has not been very much time for academics to publish papers about its implementation. However one scholar, Joseph Grundfest, has written a piece raising serious concerns about the Bill’s potential efficacy and approach to regulating gender diversity.<sup>233</sup>

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<sup>226</sup> Kim Willey, *Bringing Canadian Women on Board: A Behavioural Economics Perspective on Whether Public Reporting of Gender Diversity Will Alter the Male-Dominated Composition of Canadian Public Company Boards and Senior Management*, 29 *Canadian Journal of Women and the Law*, 182, 208 (2017).

<sup>227</sup> *Id.* at 193.

<sup>228</sup> *Id.* at 209.

<sup>229</sup> Alstott, *supra* note 196 at 41.

<sup>230</sup> *Id.* at 47.

<sup>231</sup> *Id.* at 40.

<sup>232</sup> *Id.* at 49.

<sup>233</sup> Joseph Grundfest, *Mandating Gender Diversity in the Corporate Boardroom: The Inevitable Failure of California’s SB 826*, SSRN Scholarly Paper ID 3248791 (2018).

## 2. *Those Opposed*

Grundfest argues that Bill 826 will come up against the Internal Affairs Doctrine, and as a result its effects will be negligible.<sup>234</sup> Because of the Internal Affairs Doctrine, the bill will only be applicable to corporations that are both incorporated under California corporate law and have their headquarters in California. Given the small number of large corporations that are both headquartered and incorporated in California, this leaves only 50 Fortune 500 corporations subject to the quota. Many of these corporations are already compliant with the bill's provisions. Grundfest concludes that only one corporation, Apple, will have to add a female director to its board. In total, therefore, Grundfest asserts that Bill 826 will result in the addition of one single female board member to the Fortune 500.<sup>235</sup> Before it can make any difference, he says it will be subject to litigation regarding equal protection.<sup>236</sup> Furthermore, he argues that this bill will set back other affirmative action causes. Opponents of affirmative action, Grundfest predicts, will use Bill 826 as the jumping off point of a slippery slope argument for what else in the private sector state and federal legislatures will be able to regulate.<sup>237</sup> Lastly, he pushes for action by institutional investors, rather than legislators, in tackling this issue, as institutional investors can produce substantial change quickly.<sup>238</sup> Stephen Bainbridge provides a critique similar to Grundfest's, adding that the application of the Internal Affairs Doctrine will be up to the US Supreme Court to decide, but given the jurisprudence, it will probably agree with the position that California cannot require corporations incorporated in other jurisdictions, such as Delaware, to add more women to their boards.<sup>239</sup>

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<sup>234</sup> *Id.* at 4–6.

<sup>235</sup> *Id.*

<sup>236</sup> U.S. CONST. amend. XIV. Grundfest speculates that Bill 826, if met with litigation, may be subject to enhanced scrutiny on equal protection grounds. Grundfest, *supra* note 233 at 6–8. For the most part, equal protection and how it relates to Bill 826 is beyond the scope of this paper. See *Id.* There has been one legal challenge launched in relation to Bill 826. Judicial Watch, a conservative activist group, has commenced a suit against California's Secretary of State, which contains allegations that the law is discriminatory on the basis of sex and so unconstitutional, see *Judicial Watch Sues California over Gender Quota Mandate for Corporate Boards*, JUDICIAL WATCH (Aug. 9, 2019) <https://www.judicialwatch.org/press-releases/judicial-watch-sues-california-over-gender-quota-mandate-for-corporate-boards/>.

<sup>237</sup> Grundfest, *supra* note 233, at 6–8.

<sup>238</sup> *Id.* at 8–12.

<sup>239</sup> Stephen Bainbridge, *Can California Require Delaware Corporations to Comply with California's New Board of Director Gender Diversity Mandate?*



Others see the debate surrounding Bill 826 as a stakeholder versus shareholder issue. SEC Commissioner Hester Peirce made her thoughts on Bill 826 clear in a speech at the Annual SEC Conference for Corporate Reporting and Governance.<sup>240</sup> She argues that proposals like those found in Bill 826 require corporations to consider not just its shareholders, but the interests of all women as stakeholders. “Opening such a wide door introduces uncertainty and political influence into corporate operations.”<sup>241</sup> Peirce goes on to cite the US corporate law as it relates to directors’ duties which she interprets to be owed principally to shareholders.<sup>242</sup> Aside from this picture of directors’ duties being up for debate, Peirce’s assertion that corporations with headquarters in California now must view all women as stakeholders is an overstatement. At most, these corporations may have to extend their searches for new directors to a wider range of candidates. At the very least, it will mean corporations will be incentivized to consider those who have appropriate experience and who are qualified female candidates more seriously when they fill their board seats.

Finally, the Californian Chamber of Commerce has come forward with criticism of the bill as well. The Chamber is for corporations autonomously deciding who should be on their boards. Furthermore, in its view, this bill will make other diversity initiatives more difficult. The vice-president for policy has been quoted as saying: “It creates a challenge for a board on achieving broader diversity goals,”<sup>243</sup> because it puts gender before other kinds of diversity, such as racial and ethnic diversity.<sup>244</sup>

One common thread throughout the criticism of Bill 826, even for those who agree with the policy goals of the bill, is that it is likely to face extreme, if not fatal, constitutional challenges.

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No, PROFESSORBAINBRIDGE.COM,  
<https://www.professorbainbridge.com/professorbainbridge.com/2018/09/can-california-require-delaware-corporations-to-comply-with-californias-new-board-of-director-gender.html>.

<sup>240</sup> Hester Peirce, *My Beef with Stakeholders: Remarks at the 17th Annual SEC Conference, Center for Corporate Reporting and Governance*, SEC (Sept. 21, 2018), <https://www.sec.gov/news/speech/speech-peirce-092118>.

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> Bollag, *supra* note 223.

<sup>244</sup> *Id.*

C. *What Bill 826 May Mean for the Future*

*in the United States and Canada*

If Bill 826 does withstand the challenges it faces, this may lead to a few outcomes. First, companies may simply ignore the quota and pay the fines. For large corporations especially, the fines may simply become a cost of doing business and certainly a few hundred thousand dollars every year will not put any issuer with a large market capitalization out of business. Bill 826 may have a greater impact on those publicly traded firms with smaller market capitalizations. A second possibility is that corporations will move their head offices out of California, which could have a negative impact on California's economy. The opposite of this is also possible. In attempting to send a message to investors and the public, corporations which see diversity as a worthwhile endeavor may intentionally move their head offices to California, or comply with the provisions of the statute while remaining in other jurisdictions.

Since Bill 826's implementation, other states have begun to implement similar legislation. A bill was signed in Illinois for instance which originally would have required Illinois corporations to have one female and one African American director.<sup>245</sup> However, before the bill was signed it was amended to require that firms only disclose the demographics of their boards.<sup>246</sup> It has not become clear yet what this bill may mean for public companies in Illinois.<sup>247</sup> More broadly in the US and

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<sup>245</sup> US, HB3394, *An Act Concerning Business*, 101st Gen Assem., Reg. Sess., II, 2019

<sup>246</sup> Emma Hinchliffe, *Illinois Almost Follows in California's Board Footsteps: The Broadsheet*, FORTUNE, <https://fortune.com/2019/06/07/illinois-almost-follows-in-californias-board-footsteps-the-broadsheet/> (last accessed Aug. 12, 2019).

<sup>247</sup> For more on the debate and legislative history of HB3394 see Bo Erickson CBS News November 15, 2018, and 6:13 Pm, "House Democrats Consider New Rules Related to Diversity, Legislative Process," accessed November 23, 2018, <https://www.cbsnews.com/news/democrats-consider-new-rules-related-to-diversity-legislative-process/>; Chuck Jordan, "Critic Has It Wrong: Legislation Seeks Greater Disclosure of Diversity on Corporate Boards," Text, TheHill, January 8, 2019, <https://thehill.com/blogs/congress-blog/politics/424432-critic-has-it-wrong-legislation-seeks-greater-disclosure-of-jaime-di-paulo>, "Corporate Board Diversity Is Good for Business. But It's Not the Norm — and That's Why a Law Is Needed. - Chicago Tribune," accessed

Canada, perhaps California's divisive bill will encourage other jurisdictions to follow suit.

And perhaps this will also prompt a conversation in Canada between the provincial regulators and soon-to-be national regulator,<sup>248</sup> investors, scholars, and those subject to securities regulation. Canada, given its pattern of observing American corporate governance regimes and frequently implementing policies to imitate and sometimes improve upon them, may see this as an opportunity to push for stronger regulation.

If indeed Bill 826 fails, then perhaps Canada and other US states can still learn from it, depending on the reason for its failure. For instance, if it is to fail because of the Internal Affairs Doctrine, then because Canada has no such doctrine, something like Bill 826 may still be successful in Canada. If it fails because corporations begin to use the fines as a license fee for doing business in California, then small companies will be much more likely to comply with the quotas than large companies. In Canada where there is a great deal of very small publicly traded corporations, the effects of a law like Bill 826 could be quite dramatic. Either way, California's Bill 826 has already begun to make waves.

#### CONCLUSION

Although the United States and Canada have substantively different board diversity policies implemented for ostensibly different purposes, the impacts of both the SEC's policy found in Regulation S-K and the Canadian policy found in NI 58-101F1 are strikingly similar. I have advanced the argument that both policies were met with very little traction because in truth both regulators implemented these policies out of a concern for what is right, rather than the reasons which the regulators openly provided. Moreover, the conceptions of the issue arising out of the under-representation of women on boards are the same in both jurisdictions. There is a slight diversion between the two in what the role of the board is and whether it is only to maximize shareholder wealth, or whether it is rather to fulfil a broader fiduciary duty to the corporation, which may involve considering non-shareholder interests.

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August 11, 2019, <https://www.chicagotribune.com/opinion/commentary/ct-perspec-diversity-corporate-boards-bill-20190503-story.html>.

<sup>248</sup> See *Reference re Pan-Canadian Securities Regulation*, 2018 SCC 48 at para. 132.

American legal scholars historically seem to view command-and-control regulation with much more passionate disdain than Canadian scholars as well. While American scholars harshly criticize command-and-control regulation, the current Canadian diversity regime has not gone without criticism. It has been referred to as an “explain-or-explain policy” and a weak intervention.<sup>249</sup> Interestingly, it was California that implemented a very stringent quota regime, not Canada. This law has so far polarized scholarly and media opinion. Perhaps other states will follow suit. Perhaps this bill will spark consideration of quotas in Canada. Or perhaps Bill 826 is destined to die at the hands of the Internal Affairs Doctrine.

What is needed now is a re-statement of the business case; a re-statement that outlines definitively why businesses and securities regulators should promote greater gender diversity on public corporate boards. This may require further research which takes into account critical mass and shareholder rights. Alternatively, regulators could be more transparent about what exactly the objectives are behind the diversity regimes they have implemented. They could justify stronger regulations with a clear assertion that they are advancing normative goals, so long as these regulations do not damage the capital markets and still fit within their mandates. If we accept Alstott’s argument that tax and securities regulators already promote social goals through substantive corporate governance regulation, then it does follow that the SEC could introduce a stronger diversity policy. What might be necessary in the scholarship is a definitive link between greater board gender diversity (outside of the traditional business case) and the regulators’ mandates.

On the other hand, perhaps a multi-actor solution is the answer.<sup>250</sup> While institutional investors may be helping with the effort to increase boardroom diversity, the jury is still out on whether shareholder activism in general creates long-term value or whether it is only useful for creating short-term value.<sup>251</sup>

There has been some small amount of progress made. If there is to be more, calls for diversity must not stop. Ultimately, in the US and Canada stronger regulation will be necessary that transparently recognizes

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<sup>249</sup> Willey, *supra* note 226 at 193.

<sup>250</sup> See Dhir, *supra* note 1 at 94–96.

<sup>251</sup> See John C. Coffee Jr. & Darius Palia, *The Impact of Hedge Fund Activists: Evidence and Implications*, ECGI Working Paper Series in Law Working Paper No 266/2014 (2014); Mark J. Roe, *Stock Market Short-Termism’s Impact*, ECGI Working Paper Series in Law Working Paper No 426/2018 (2018).

and works towards achieving what is right and what is good for business without conflating the two.