



Client Alert: New California Law to Increase Public Company Board Diversity



By: [Michael Huseby](#) and [Calvin Cheng](#)

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Corporate diversity continues to take center stage as California Governor Gavin Newsom signed [AB-979](#) on September 30, 2020. The new law requires public companies headquartered in California to include minimum numbers of board members from underrepresented communities.

AB-979 comes as institutional investors, activists and proxy advisors have called for increased diversity and just two years after California passed [SB-826](#), which requires public companies headquartered in California to increase women's participation on their boards of directors. Both statutes face pending legal challenges.

In recent months, institutional investors, activists, and proxy advisors have called for increased diversity and related disclosure in public companies' filings.

California AB-979: Increasing Board Representation from Underrepresented Communities

Under AB-979 (which amends Corporations Code Section 301.3 and adds Section 301.4 and 2115.6), boards of publicly held corporations headquartered in California must now meet certain diversity requirements. Even if the corporation is incorporated out-of-state, if its principal executive offices (as stated on the company's Annual Report on Form 10-K filed with the SEC) are in California, it must comply with the new mandate.

By the end of 2021, California-based corporations must have at least one director who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender.



By the end of 2022, such corporations must meet the following minimum diversity requirements:

Total Board Size	Directors from Underrepresented Communities
4 or fewer corporate directors	At least 1 director from an underrepresented community
5-8 corporate directors	At least 2 directors from an underrepresented community
9+ corporate directors	At least 3 directors from an underrepresented community

Penalties for failure to comply are \$100,000 for the first violation and \$300,000 for each subsequent violation. Each board seat not properly filled by an individual from an underrepresented group is a separate violation.

Corporations may add additional board seats to help them meet AB-979's requirements. However, corporations should be aware that adding more board seats may in turn require more directors from underrepresented communities. For example, adding a ninth director increases the requirement from two to three directors from underrepresented communities.

AB-979 was passed in response to research highlighting the lack of diversity on corporate boards. The bill mentions a report by Deloitte that found the percentages of Fortune 500 company board seats held by people identified as African American/Black, Hispanic/Latino(a), and Asian/Pacific Islander to be just 8.6 percent, 3.8 percent, and 3.7 percent, respectively – numbers that are significantly lower than U.S. demographics as a whole.

California SB-826: Increasing Women's Representation on Public Company Boards

California-based publicly held corporations must also comply with SB-826, which was signed into law on September 30, 2018 and codified in [Section 301.3](#) of the California Corporations Code, SB-826, is similar to AB-979, but mandates increased women's participation on boards.

Currently, California-headquartered publicly held corporations are required to have at least one female director.



By the end of 2021, such corporations must meet the following minimum requirements:

Total Board Size	Women Directors
4 or fewer corporate directors	At least 1 woman director
5 corporate directors	At least 2 women directors
6+ corporate directors	At least 3 women directors

Penalties are the same as those for violations of AB-979 — \$100,000 for the first violation and \$300,000 for each additional violation.

Notably, boards of directors can satisfy the requirements of both SB-826 and AB-979 with the same individual. For example, if a company adds a woman from an underrepresented community to its current board of three men who are not from underrepresented communities, the corporation would comply with both California laws.

In March of 2020, the California Secretary of State issued a [“Women on Boards” report](#), which highlights the impact of SB-826 and identifies California-headquartered publicly held corporations with at least one woman board member.

Not Out of the Woods Yet: Legal Challenges to New Diversity Legislation

California’s new laws have come under fire from several conservative groups that question the constitutionality of both SB-826 and AB-979. In *Meland v. Padilla*, a disgruntled shareholder claimed SB-826 violated the Equal Protection Clause of the 14th Amendment. However, a federal judge dismissed the case for lack of standing earlier this year. In 2019, the plaintiffs in *Crest v. Padilla* argued that SB-826 violates the California constitution, a case that currently continues. Last week, the same plaintiffs filed a second lawsuit, now targeting AB-979 as unconstitutional. Corporations should actively monitor the status of both SB-826 and AB-979 as their constitutionality is challenged. But unless and until a court issues an injunction, these laws are in effect.

Disclosing and Reporting the Diversity of Public Company Boards

Investors and other stakeholders care about diversity, too. See, for example, State Street Global Advisors’ [letter to the companies in which it invests](#), in which it calls on such companies to disclose more details regarding the diversity of their boards and workforce. Additionally, Institutional Shareholder Services (ISS) — a prominent proxy advisory firm— recently sent

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[letters to public companies](#) asking them to voluntarily provide ISS with the self-identified race/ethnicity of each of the company's directors and named executive officers and stating:

"We intend to use this information within our product sets to provide our clients with a more holistic picture of board and leadership diversity across their investment portfolios and, more broadly, to help ensure that all stakeholders have accurate and complete information as they consider the wider debate concerning the state of corporate diversity beyond gender."

While not required by the Securities and Exchange Commission (SEC) to do so, some public companies do make voluntary disclosures regarding the diversity of their boards of directors. Examples include:

- Orbital Energy Group, Inc. (Nasdaq – [OEG](#)) — [Proxy Statement](#) filed on October 5, 2020 (see page 29)
- The Estée Lauder Companies Inc. (NYSE – [EL](#)) — [Proxy Statement](#) filed on September 24, 2020 (see page 10)
- Spectrum Brands Holdings, Inc. (NYSE – [SPB](#)) — [Form 10-K/A](#) filed on January 28, 2020 (see page 2)

Practical Considerations for Compliance with Board Diversity Requirements

California headquartered publicly held corporations should consider the following:

- **D&O Questionnaires:** Ask for voluntary diversity information in D&O questionnaires.
- **Consent:** Obtain consent before disclosing an individual's gender, race, ethnicity or sexual orientation.
- **Disclosure/Aggregate Reporting:** Even though not currently required by SEC disclosure requirements, consider disclosing information regarding board diversity, as institutional investors, activists and proxy advisors are increasingly asking public companies to disclose such information. Consider reporting aggregate data in SEC filings instead of specifically identifying each director's individual characteristics – but even here, consent should be sought, as aggregated data for a small group such as a corporate board is not anonymous. Such disclosures may assist the California Secretary of State in checking your company's compliance with AB-979, as it has with SB-826.



- **Board Diversity Policies:** The SEC requires public companies to disclose whether and how their boards or nominating committees consider diversity in identifying nominees for director. The SEC further require boards or nominating committees that do have a diversity policy to describe the implementation and effectiveness of its policy. In light of SB-826 and AB-979, public companies may consider adopting a board diversity policy.

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