



Client Alert: California Superior Court Finds SB 826 and AB 979 to be Unconstitutional

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Senate Bill 826

On May 13, 2022, Los Angeles Superior Court Judge Maureen Duffy-Lewis found that Senate Bill 826 (“SB 826”) violates the Equal Protection Clause of the California Constitution¹. Signed in 2018 by California Governor Jerry Brown and known as the “Woman on Boards” bill, SB 826 sought to advance equitable gender representation on California corporate boards by requiring all publicly held corporations with principal offices in California to have a least one female director on their board by December 31, 2019, and set minimum numbers to be held by female directors based on the total size of a corporation’s board of directors by December 31, 2021.

After a bench trial, the Court found that the Secretary of State of California did not meet its burden of proof that SB 826 satisfies the strict scrutiny test for classifications based on gender. The Court rejected the State’s position that SB 826 was in furtherance of a compelling state interest, and also found that the State failed to prove that the law was necessary and narrowly tailored to (1) improve opportunities for women in the workplace, (2) boost California’s economy, and (3) protect California’s taxpayers. The Court found that the express goal of the legislation was, in fact, to achieve gender equity versus the more broadly stated economic goals set forth in the State’s defense, and that even if the goal of the bill was to stimulate the California economy, it failed to prove it would be effective in doing so. The Court further said that the State failed to show that lawmakers had considered gender-neutral alternatives (or determine that gender-neutral remedies were not available) and did not show that the law’s use of gender-based classification was limited in scope and duration.

Assembly Bill 979

Assembly Bill 979 (“AB 979”), another bill that sought to mandate increased diversity on board, was also recently struck down as an unconstitutional violation of California’s Equal Protection Clause. Signed in September 2020 by California Governor Newsom, AB 979 requires publicly held companies headquartered in California to have at least one director from an underrepresented community on its board of directors by December 31, 2021. The bill also requires that by December 31, 2022, companies with larger boards must further diversify their board depending on their total number of directors. AB 979 defines a director from an

¹ See *Crest v. Padilla*, LA Super. Ct. Case No. 19STCV27561.



underrepresented community to mean an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender.

Los Angeles Superior Court Judge Terry Green found that the law violated the Equal Protection Clause of the California Constitution by treating similarly positioned individuals, meaning potential corporate board members, “differently based on their membership (or lack thereof) in certain listed racial, sexual orientation, and gender identity groups.”² The Court found that the State of California failed to provide a compelling justification for this different treatment, and that while correcting past discrimination can be a compelling reason, mandating membership of corporate board rooms was too broad of an arena to accomplish this goal. The Court further asserted that there had not been convincing evidence to prove past discrimination. The Superior Court granted the plaintiffs’ motion for summary judgment to prevent the use of taxpayer funds to implement the measure, effectively striking down AB979.

The Secretary of State has indicated that the State will appeal the ruling striking SB 826, and it is expected that the motion for summary judgment that struck down AB 979 will also be appealed.

Practical Considerations for Public Companies

Under Rule 5605(f)(2), Nasdaq requires companies listed on their U.S. Exchange, with some limited exceptions, either (1) to have at least two diverse board members, or (2) to explain the company’s reason for not meeting this diversity objective. Smaller reporting companies, foreign issuers and companies with smaller boards are subject to a variation of Rule 5605(f)(2), with more flexibility as to the number and type of diverse directors. A lawsuit in the Fifth Circuit is challenging the Rule, making similar equal protection arguments as were used in the California proceedings.

Notwithstanding the outcome of either case regarding the California legislation or the ultimate decision on Nasdaq Rule 5605 (f)(2), institutional investors have increasingly indicated that board diversity is a priority. Some have announced similar expectations to AB979 regarding diversification of company boards, as well as requesting disclosure of the racial, gender and ethnic composition of the boards.³

² See *Crest v. Padilla*, LA Super. Ct. Case No. 20STCV37513.

³ Reference Bloomberg article and Investor websites: <https://news.bloomberglaw.com/banking-law/board-diversity-is-critical-to-protect-shareholders-bottom-line>; <https://www.jdsupra.com/legalnews/state-street-calls-for-board-and-9684582/>; <https://www.goldmansachs.com/our-commitments/diversity-and-inclusion/board-diversity/>



Despite the Court's recent decisions, the interest and preference for diverse boards remains strong. California companies should keep these stated preferences and regulations in mind as they continue to make decisions regarding board appointments.

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