

October 1, 2020

California Expands Board Diversity Requirements

New Minimum Requirements Build Upon Existing Law Mandating Female Representation

SUMMARY

On September 30, 2020, Governor Gavin Newsom of California signed into law Assembly Bill No. 979, which will require boards of directors of publicly held companies headquartered in California to include a minimum number of persons from specified historically underrepresented communities on their boards of directors. The law, to be set forth in Section 301.4 of the California Corporations Code, will become effective on January 1, 2021, and companies within its scope must meet specified diversity requirements by December 31, 2021. Section 301.4 closely follows the structure of Section 301.3, which requires the same types of companies to maintain minimum female representation on their boards of directors. Although Section 301.4 may face similar legal challenges to those pending against Section 301.3, its enactment further underscores that board diversity remains an area of focus at numerous constituencies.

DISCUSSION

AB 979 inserts a new Section 301.4 in the California Corporations Code that provides as follows:

- **Corporations Subject to the Law.** The law applies to any publicly held corporation¹ that files with the Securities and Exchange Commission an annual report on Form 10-K identifying California as the state in which its principal executive offices are located,² regardless of its state of incorporation.
- **Qualifying Directors.** The boards of directors of companies within the scope of the law are required to include a minimum number of directors from underrepresented communities. For purposes of the law, a “director from an underrepresented community” is 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.

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- **Minimum Requirements for Compliance.** Companies within the scope of the law must have at least one director from an underrepresented community no later than the end of 2021. No later than the end of 2022, such companies must have at least (i) one qualifying director if the board has four or fewer members, (ii) two qualifying directors if the board has between five and eight directors and (iii) three qualifying directors if the board has nine or more members. In order to comply with the law, the requisite number of director seats must be filled by a director from an underrepresented community for at least a portion of a given calendar year.
- **Fines for Noncompliance.** The California Secretary of State is required to assess compliance annually and is empowered to impose fines for noncompliance. Any corporation subject to Section 301.4 that fails to file on a timely basis required information about its board members with the Secretary of State may incur a \$100,000 fine. The content and timing of required filings with the Secretary of State will be established through regulations that have not yet been issued. Separately, a corporation's first failure to have the requisite number of directors from underrepresented communities may result in a \$100,000 fine and each subsequent violation may result in a \$300,000 fine.

The companies subject to Section 301.4 remain subject to Section 301.3 of the California Corporations Code, which sets minimum requirements for female representation on their boards of directors. Section 301.3's gender diversity requirements applied beginning in 2019, with each subject board of directors required to have at least one director identifying as female. By December 31, 2021, such companies must have at least (i) one female director if the board has four or fewer members, (ii) two female directors if the board has five members and (iii) three female directors if the board has six or more members. See [*California Enacts Female Gender Quotas for Public Companies Headquartered in the State, October 1, 2018*](#), for further information about the requirements of Section 301.3.

ADDITIONAL CONSIDERATIONS

- **Preparing for Compliance.** Companies subject to Section 301.4, particularly those with classified boards of directors, may wish to begin planning for compliance. Companies are permitted to satisfy the requirements of Section 301.3 and Section 301.4 by increasing the size of their boards of directors; however, companies should be mindful of the increased minimum diversity requirements to which they may become subject as the size of the board of directors increases. In addition, companies planning to increase the size of their boards should analyze whether stockholder approval is needed to make such a change, both under their jurisdiction of incorporation as well as their charter and bylaws.
- **Interaction Between the Laws.** Section 301.4 establishes compliance reporting requirements and potential fines that are similar to, but separate from, those contained in Section 301.3. As a result, companies failing to meet the diversity requirements of both Section 301.3 and Section 301.4 (i.e., if all directors identify as male and are not members of qualifying communities) may be subject to fines imposed under each section, which would amount to an aggregate of \$200,000 for the first year of violation and an aggregate of \$600,000 for each subsequent year of violation. On the other hand, the appointment of one director may satisfy the requirements of both Section 301.3 and Section 301.4 (i.e., a director identifying as female who is a member of a qualifying underrepresented community).

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- **Challenges to Validity.** As was widely anticipated, suits have been brought and remain pending challenging the constitutionality of Section 301.3. Section 301.4 may face similar constitutional and other legal challenges. Nevertheless, given the significant interest and focus on board diversity from a variety of constituencies, including institutional investors, proxy advisors and other market participants, companies and boards of directors should continue to review their board composition and determine whether changes may be desirable.

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ENDNOTES

- ¹ “Publicly held corporation” is defined as “a corporation with outstanding shares listed on a major United States stock exchange.”
- ² Determined by a company’s annual report on Form 10-K filed with the Securities and Exchange Commission.

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