

October 1, 2018

California Enacts Female Gender Quotas for Public Companies Headquartered in the State

California Becomes First State to Attempt to Require Female Representation on the Boards of Directors of Publicly Traded Companies Headquartered in the State (Even if Incorporated in Another State)

SUMMARY

On September 30, 2018, Governor Brown of California signed into law a bill, SB-826, to require female representation on the boards of directors of publicly traded companies who identify as being headquartered in the state. SB-826 makes California the first state to attempt to enact female gender quotas for boards of directors. SB-826 will become effective on January 1, 2019 and will require companies subject to the legislation to comply with the first phase of requirements (requiring boards of directors to have at least one female member) no later than December 31, 2019.

DISCUSSION

SB-826 inserts a new Section 301.3 in the California Corporations Code that provides:

- ***Corporations Subject to the Legislation.*** Section 301.3 of the California Corporations Code will apply 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, regardless of its state of incorporation.
 - ***Female Representation Requirements.*** No later than the end of 2019, the board of directors of any corporation subject to Section 301.3 of the California Corporations Code must include at least one female director. No later than the end of 2021, each corporation subject to Section 301.3 must include on its board of directors at least (i) one female director if the board has four or fewer
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members, (ii) two female directors if the board has five members and (iii) three female directors if the board has six or more members. For purposes of Section 301.3, a corporation will be in compliance if directors identifying as female, regardless of sex at birth, hold the requisite number of board seats 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 301.3 that fails to file on a timely basis 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 female directors may result in a \$100,000 fine and each subsequent violation may result in a \$300,000 fine.

IMPLICATIONS

- **Effect on Size and Composition of Boards of Directors.** Section 301.3 permits corporations to comply with the law by increasing the size of their boards of directors. However, an increase in the size of the board of directors may result in a corresponding increase in the number of female directors required. As a result, SB-826 could significantly impact the size and composition of the boards of directors subject to the legislation.
- **Preparing for Compliance.** Companies subject to Section 301.3, particularly those with classified boards of directors, may wish to begin developing a plan for compliance. Unless the certificate of incorporation of the company provides otherwise, the board of directors of a Delaware corporation is permitted to amend the bylaws of the corporation to provide for an increase in board size and fill any vacant seat by a majority vote of the directors.² On the other hand, if compliance will be achieved without increasing the size of the board of directors, a current director would either need to voluntarily resign or be removed by the requisite stockholder vote. Companies incorporated in California may find it more difficult to attain compliance with Section 301.3. A stockholder vote is required in order to change the size of the board of a California corporation to a size greater than permitted by the then-existing organizational documents, whether the number of directors is specified by the certificate of incorporation or the bylaws.³ The board of directors of a California corporation will be permitted to fill a vacant board seat following the voluntary resignation of a board member, but will not be permitted to fill a vacancy created by the removal of any director (whose removal would require a stockholder vote), unless otherwise provided in the corporation's organizational documents.⁴
- **Validity of the Legislation.** Commentators expect that there will be legal challenges to SB-826 and have questioned whether the bill complies with federal and California law, including the internal affairs doctrine and the equal protection clauses of the U.S. and California constitutions.⁵ In connection with signing the bill, Governor Brown sent a letter to the California State Senate, with a copy to the U.S. Senate Committee on the Judiciary, in which he stated, "I don't minimize the potential flaws that indeed may prove fatal to its ultimate implementation. Nevertheless, recent events in Washington, D.C. – and beyond – make it crystal clear that many are not getting the message."⁶
- **Next Steps.** Even if SB-826 is ultimately invalidated, the legislation reflects the growing sentiment in favor of diversity for boards of directors. According to Institutional Shareholder Services (ISS), more than 80% of investors and 60% of non-investors (including corporate directors and other market constituents) who participated in the ISS [2018 governance principles survey](#) believed it would be problematic if a board of directors did not include any female members.⁷ Glass, Lewis & Co. has indicated that beginning in 2019 it will generally recommend against election of the chair of the nominating committee of any Russell 3000 company having an all-male board, and ISS is reported to also be considering adopting a similar policy.⁸ Large institutional investors, including State Street Global Advisors, Inc., BlackRock, Inc. and The

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Vanguard Group, Inc., have also indicated that gender diversity on the board of directors may influence their voting decisions.⁹

Given the recent investor emphasis on the gender diversity of boards of directors, public companies have increasingly addressed in their proxy statements the principles by which the nominating or governance committee considers gender, racial and other types of diversity in choosing a slate of directors for election and the steps taken to ensure a diverse pool of potential nominees is considered. In light of SB-826 and continued interest in this topic, companies should be prepared to articulate the considerations given to gender diversity with respect to their boards of directors.

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ENDNOTES

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- 1 “Publicly held corporation” is defined as “a corporation with outstanding shares listed on a major United States stock exchange.”
- 2 Del. Code Ann. tit. 8, §§ 141(b), 141(k), 223(a).
- 3 Cal. Corp. Code § 212(a).
- 4 Cal. Corp. Code §§ 303, 305(a).
- 5 See, e.g., letter from California Chamber of Commerce, et al., to Members, California State Senate, [SB 826 \(Jackson\) Corporations: Board of Directors—Oppose](#) (May 29, 2018).
- 6 [Letter](#) from Governor Edmund G. Brown Jr. to Members, California State Senate (Sept. 30, 2018).
- 7 Currently, ISS will highlight all-male boards of directors, but will not recommend an adverse vote on the basis of gender diversity.
- 8 Glass Lewis, [2018 Proxy Paper, Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice](#); Bradley Keoun and Anders Keitz, [All-Male Boards Could Face New Pressure From Shareholder Adviser ISS](#), TheStreet (Sept. 19, 2018).
- 9 State Street Global Advisors, Inc. has indicated that it may vote against election of the chair of the board of directors’ nominating committee if the board of directors does not include at least one female director. BlackRock, Inc. has stated that it normally expects to see at least two women directors on all boards of directors of U.S. companies and that it may vote against the members of the nominating committee of a board of directors lacking diversity. The Vanguard Group, Inc. stated that demonstration of meaningful progress on gender diversity over time will inform Vanguard Group’s engagement and voting going forward. See State Street Global Advisors, [2018 Proxy Voting and Engagement Guidelines: North America \(United States & Canada\)](#) (Mar. 16, 2018); BlackRock, [Proxy voting guidelines for U.S. securities](#) (Feb. 2018); The Vanguard Group Inc.’s [open letter to directors of public companies worldwide](#).

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