

April 5, 2022

California State Court Declares AB 979 Unconstitutional

California Board Diversity Law Invalidated, but Focus on Board Diversity Remains

On April 1, 2022, in *Crest v. Padilla*, California Superior Court Judge Terry Green granted summary judgment in favor of plaintiffs who had challenged AB 979, one of California's two board diversity statutes, as violating the California Constitution. The complaint in *Crest v. Padilla* was filed in 2020 by three California taxpayers who sought to enjoin the California Secretary of State from using taxpayer funds in effectuating or ensuring compliance with AB 979. The California Secretary of State has not yet indicated whether it intends to appeal the Court's order. Regardless of the outcome of the challenge to AB 979, and a related challenge that is currently pending to SB 826, California's board gender diversity statute, board diversity remains an important area of focus for public companies today.

AB 979. AB 979, signed into law on September 30, 2020, requires publicly held California corporations and publicly held foreign corporations whose principal executive offices are located in California to have a minimum number of directors from "underrepresented communities," which includes racial minorities and members of the LGBTQ community, on their boards. By the end of 2022, the law requires affected corporations with more than four but fewer than nine directors to have a minimum of two directors from underrepresented communities and affected corporations with nine or more directors to have a minimum of three directors from underrepresented communities.¹

Basis of Constitutional Challenge. The plaintiffs argued in their motion for summary judgment that AB 979 employed suspect classifications based on race, ethnicity, sexual preference and transgender status and violated the equal protection clause, Article I, Section 7(a), of the California Constitution. In addition, the plaintiffs argued that AB 979 violated Article I, Section 31(a) of the California Constitution, which

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prohibits the State of California from discriminating against, or granting preferential treatment to, individuals or groups based on race, color, ethnicity or national origin in the operation of public contracting. The Court's order granting the plaintiffs' motion for summary judgment did not describe the Court's reasoning, but it has been reported that during the hearing on the parties' motions for summary judgment, the Court commented that the selection of groups covered by the law seemed "arbitrary," and also questioned whether the state's statistical analysis of the racial composition of corporate boards was sufficient evidence of discrimination to justify the law.

Related Challenge to SB 826. A related lawsuit, also captioned *Crest v. Padilla*, which involves the same three plaintiffs but is pending before a different judge in the California Superior Court, asserts similar constitutional challenges to SB 826. A bench trial in that case concluded in February 2022, and the case has now been submitted for decision. SB 826 requires publicly held domestic corporations and publicly held foreign corporations whose principal executive offices are located in California to have a minimum number of female directors on their boards of directors. The current requirement is a minimum of two female directors if the board has five directors, or three female directors if the board has six or more directors.²

Other Drivers for Board Diversity. Board diversity will remain an important focus regardless of the ultimate outcome of the decision invalidating AB 979 and the pending challenge to SB 826. A number of institutional investors have recognized board diversity as a priority. A recent study of S&P 500 directors illustrated that, in 2021, 47% of new independent directors were racially diverse and 43% of new independent directors were female.³ In addition, "Nasdaq's Board Diversity Rule" imposes a disclosure standard that is designed to encourage board diversity. Under the rule, all companies listed on the U.S. Nasdaq exchange must: (1) publicly disclose their board-level diversity statistics and (2) have, or explain why they do not have, at least two diverse directors. Furthermore, other states besides California, including Maryland and New York, have passed laws requiring companies to disclose board diversity statistics.

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ENDNOTES

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- ¹ For a more complete review of AB 979, see our memorandum of October 1, 2020, entitled [California Expands Board Diversity Requirements](#).
 - ² For a more complete review of SB 826, see our memorandum of October 1, 2018, entitled [California Enacts Female Gender Quotas for Public Companies Headquartered in the State](#).
 - ³ Spencer Stuart, [2021 S&P 500 Board Diversity Snapshot](#).

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