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## California Board Diversity Law Requiring Directors From “Underrepresented Communities” Is Held Unconstitutional

*The California gender board diversity law may suffer the same fate.*

On April 1, 2022, Los Angeles County Superior Court Judge Terry A. Green issued a summary judgment order finding that California Corporations Code § 301.4 (Assembly Bill 979 or AB 979), which requires publicly listed corporations headquartered in California to have board members from “underrepresented communities,” violates the Equal Protection Clause of the California Constitution.<sup>1</sup> In the case, *Crest v. Padilla II*, plaintiff Judicial Watch mounted a facial challenge to the law, seeking a declaratory judgment arguing that the law was unconstitutional because it mandated quotas and therefore violated the state’s Equal Protection Clause.

While the court lauded the goal of fostering increased diversity on corporate boards, the court concluded that mandating diversity in this manner was not consistent with the constitutional requirement that race-based remediation of past discrimination be narrowly tailored to serve a compelling government interest.<sup>2</sup> The court did not reject outright the notion that a compelling government interest could never exist, but the court concluded that the record developed by the California Legislature in passing this law was not sufficient to support that showing; it had not, for example, conducted any surveys of board diversity or demographics.<sup>3</sup> In particular, the court observed that the Legislature, having identified demographically homogeneous boards as a problem, skipped directly to mandating heterogeneous boards as a solution. The court concluded, however:

The difficulty is that the Legislature is thinking in group terms. But the California constitution protects the right of *individuals* to equal treatment. Before the Legislature may require that members of one group be given certain board seats, it must first try to create neutral conditions under which qualified individuals from *any* group may succeed. That attempt was not made in this case.<sup>4</sup>

The state has not yet indicated whether it will appeal the decision.

## Assembly Bill 979

AB 979 was signed into law in September 2020 and requires publicly listed corporations headquartered in California to have:

- At least one director from an underrepresented community on their boards of directors by December 31, 2021; and
- By December 31, 2022:
  - At least three directors from an underrepresented community if the board has nine or more members;
  - At least two directors from an underrepresented community if the board has five to eight directors; and
  - At least one director from an underrepresented community if the board has four or fewer directors.

Under the bill, a director from an underrepresented community is one 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.”

## Senate Bill 826

AB 979 was adopted on the heels of Senate Bill 826 (SB 826), which was enacted in California a few years earlier and requires California-headquartered companies to have, by December 31, 2021, at least two female directors if their board has five directors and three female directors for boards of six or more directors.

SB 826 has also faced legal challenges alleging that it violates the US Constitution, the California Constitution, and California civil rights laws based on equal protection grounds. Judicial Watch filed a complaint in the Los Angeles County Superior Court (*Crest v. Padilla I*) alleging that SB 826 is illegal under the California Constitution because “a quota system for female representation on corporate boards employs express gender classifications.” That case, assigned to a different judge, is awaiting a court decision following a bench trial. While SB 826 remains intact, it may suffer the same fate as AB 979 if the court considering that challenge applies the same reasoning to that law as Judge Green in his ruling invalidating AB 979.

Under both statutes, noncompliance could result in a fine of US\$100,000 in the first violation and US\$300,000 for each subsequent violation, with a separate US\$100,000 fine for failing to provide required information to the state. However, to date no fines have been levied and no regulations have been adopted to implement provisions for the fines. The only “enforcement” mechanism currently available is the requirement that companies complete California’s Corporate Disclosure Statement, which contains certain questions about compliance with these statutes, by 150 days after fiscal year-end. California publishes a report listing all companies that submitted the required information and the number of directors who are female or are from underrepresented communities.

## Conclusion

While the court's reasoning in *Crest v. Padilla II* suggests the ultimate invalidity of both California diversity laws, public companies will nonetheless still need to continue to be able to respond to the demands of investors and other stakeholders to increase the diversity on their boards during engagement as well as when it comes time to elect directors. A failure to show progress may be scrutinized or lead to negative votes on the election of nominating committee chairs. Indeed, Nasdaq-listed companies will be required to disclose director diversity statistics beginning in August 2022 — although many companies are including the Nasdaq director diversity disclosure matrix in their proxies that are currently being filed. Under Nasdaq's rule, companies must either have or explain why they do not have at least two directors from underrepresented communities. Given these trends, public companies are advised to consider their approach to diversity on their boards.

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### Endnotes

<sup>1</sup> *Crest v. Padilla*, No. 20-STCV-37513 (LA Super. Ct., Apr. 1, 2022).

<sup>2</sup> *Id.* at 22-23.

<sup>3</sup> *Id.* at 23.

<sup>4</sup> *Id.* at 2.