

Legal Alerts

Judge Strikes Down California Board of Directors Diversity Law

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This legal alert was written by Bradley Shepard, a Law Clerk based in Foster Garvey's Seattle office.

A Los Angeles Superior Court judge recently ruled that California Assembly Bill 979 violated the state's constitution.

What is California Assembly Bill 979?

The law required publicly held companies that are headquartered in California to have a specified number of people from underrepresented communities on their board of directors. The law was passed in 2020 and required qualifying companies to have at least one director from an underrepresented community on their board by the end of 2021. Depending on the size of their board, companies would have been required to increase the number of directors from underrepresented communities by the end of 2022. If the company had nine or more directors, they would have been required to have a minimum of three underrepresented directors. Companies with between four and eight directors would have been required to have two, while companies with four directors or less would only have been required to have one.

Important Definitions

For the purposes of Assembly Bill 979, a director is considered to be from an underrepresented community if they self-identify as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Native Alaskan, gay, lesbian, bisexual, or transgender.

The law defined "publicly held company" as a company that is traded on a major stock exchange in the United States. The New York Stock Exchange and NASDAQ are generally regarded as the two major stock exchanges in the United States.

The statute specified that a company was "headquartered in California" if it identified California as the location of its principal executive offices in its 10-K filing. In other words, the applicability of the law was dependent on the location of a company's top brass, not the state in which it is incorporated.

Why was Assembly Bill 979 Struck Down?

The Judge invalidated the law on the grounds that it violated the equal protection clause of California's constitution. Under that clause, in order for a law to treat "similarly situated" individuals (in this case candidates for corporate board of directors) differently based on their demographics, the law must

advance a compelling state interest and be narrowly tailored to do so. The judge ruled that neither the compelling interest nor the narrow tailoring elements were present in the statute.

What is the Practical Effect of this Decision?

First, it is important to note that this decision may not be final. The decision came from a Superior Court, which is the lowest of California's three levels of courts. It is possible that the case will be appealed and reversed. The State of California has not commented on whether it intends to appeal.

This case may provide insight into the outcome of related litigation. A few years before passing Assembly Bill 979, California passed Senate Bill 826, which requires publicly held companies to include specified numbers of women on their boards. That law is facing a constitutional challenge similar to the one brought against Assembly Bill 979. If this decision stands, Senate Bill 826 will likely be overturned as well. The judicial annulment of these two laws may cause legislators across the country who are considering similar measures to think twice.

However, this decision does not mean that there is no hope for proponents of diversity in the board room. There are other sources of regulation that are taking aim at increasing the heterogeneity of public company boards. NASDAQ recently received approval from the Securities and Exchange Commission to implement a diversity rule for all companies that are traded on its exchange. The rule requires those companies to either have two diverse directors or provide an explanation as to why they do not. Further, NASDAQ and several states require companies to disclose demographic data on their boards.

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