



California mandates female board directors for publicly held companies

Corporate Governance Alert

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Governor Jerry Brown signed a bill into law on September 30, 2018 requiring publicly held companies based in California to have at least one female on their boards of directors by the end of 2019, and, depending on the size of their boards, additional females by the end of 2021. Financial penalties will apply for noncompliance.

"Given all the special privileges that corporations have enjoyed for so long, it's high time corporate boards include the people who constitute more than half the 'persons' in America," Governor Brown wrote in a signing message.

California is the first state to mandate female directors

With the enactment of this law, California becomes the first state in the United States to mandate gender diversity in the corporate boardroom. Although California, and certain other states, such as Illinois, Massachusetts, Pennsylvania, Ohio and Colorado, have issued nonbinding resolutions encouraging gender diversity on corporate boards, until now, there has been no such requirement on a state or a federal level. California follows several countries with legal mandates for female representation on boards, among them Germany, Norway, France, Spain, Iceland and the Netherlands.

Movement towards gender diversity in the boardroom

In recent years, there has been a movement towards increased female representation on public company boards. The

percentage of Russell 3000 companies with all-male boards decreased from 19.5 percent in the first quarter of 2018 to 17.1 percent in the second quarter of 2018, according to the Q2 2018 Equilar Gender Diversity Index (GDI). In the first half of 2018, females were elected to more than one-third of new directorships, according to the same study. Despite this trend, without proactive measures to increase the number of women on corporate boards, a 2015 study by the United States Government Accountability Office and the 2017 Equilar GDI estimated that it would take 40-50 years to achieve 50 percent representation of females on public company boards.

Board diversity linked to better financial performance

The law aims to facilitate improved business performance for corporations and improved economic performance for the state. California relied on numerous independent studies on public companies indicating that women bring to the boardroom experience, perspective and transparency, and that companies with women on their boards are more profitable and productive and outperform companies with all-male directors, with significant outperformance during economic recessions. Improving the gender diversity of corporate boards is an opportunity for companies to boost financial performance and increase shareholder value.

Institutional investors push for gender diversity on boards

Apart from such legislative efforts, corporations have faced market pressure to increase female representation on their boards. Institutional investors have made gender diversity on boards a high priority. Large corporate shareholders such as BlackRock and State Street Global Advisors have adopted diversity policies or guidance on board diversity. CalPERS and CalSTRS also support gender diversity on boards.

In February 2018, BlackRock added to its Proxy Voting Guidelines for US Securities its expectation that the companies in which it invests have at least two female directors. BlackRock also sent letters to the Russell 1000 companies with fewer than two women on their boards asking them how their board composition aligns with their long-term strategies and requesting a report on board diversification efforts.

State Street Global Advisors has voted against the election of directors of companies with all-male boards that failed to take corrective steps. State Street targeted approximately 700 companies for having no female directors, and more than 150 of such companies have since added a female director.

SUMMARY OF THE NEW LAW

Applicability

- The law applies to publicly held corporations that are domestic (California-incorporated) general corporations or foreign (not California-incorporated) corporations whose principal executive offices are located in California.
- A female is an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth.
- A publicly held corporation is a corporation with outstanding shares on a major United States stock exchange. The law does not define what constitutes a "major United States stock exchange," but the Senate Rules Committee Office of Senate Floor noted that the vast majority of the 761 public companies traded on NASDAQ, NYSE and NYSE American would be subject to the law.
- The law does not make exceptions for "controlled companies" or investment companies, nor does it include phase-in rules for new or small public companies.

Compliance

- By the end of 2019, each publicly held corporation must have at least one female director.
- By the end of 2021, each publicly held corporation must comply with the following:
 - If the total number of directors is 6 or more, the corporation must have at least 3 female directors.
 - If the total number of directors is 5, the corporation must have at least 2 female directors.
 - If the total number of directors is 4 or fewer, the corporation must have at least 1 female director.
- Publicly held corporations may increase the number of directors on its board to add seats for female directors, rather than displace male directors.
- The Secretary of State is required to publish various reports regarding publicly held corporations that (a) comply with the statute, (b) moved their headquarters in or out of California in the preceding year, and (c) were previously subject

to the statute and are no longer publicly traded.

Noncompliance and penalties

- A publicly held corporation violates the law if a director seat that is required to be held by a female is not held by a female during at least a portion of the applicable calendar year.
- Penalties for noncompliance:
 - First violation: \$100,000
 - Subsequent violations: \$300,000

Anticipated legal challenges and policy debate

The law may face legal challenges. Commentators argue that it violates the equal protection clauses of the United States Constitution and the California Constitution by creating an express gender classification and the Unruh Civil Rights Act by discriminating based on gender. The Senate Rules Committee noted that a quota-like system to remedy past discrimination and differences in opportunity may be difficult to defend.

Commentators also argue that the law may conflict with the internal affairs doctrine, which is the principle that only one state should have the authority to regulate a corporation's internal affairs because otherwise a corporation could be faced with conflicting demands. The internal affairs doctrine, however, is not absolute. For example, California courts may take jurisdiction over internal affairs and apply the local law in the interest of justice or where the non-California corporation makes California its principal place of business and has its records and offices there.

While California, and, in particular, Silicon Valley, often has the reputation of being progressive, the law has sparked a challenging policy debate. Is this an effective way to enable women to break the glass ceiling? Is the government overreaching by mandating diversity in private businesses? Does the law elevate gender diversity over other aspects of diversity? Despite the debate, both advocates and critics of the law agree on the importance of board diversity.

"There have been numerous objections to this bill and serious legal concerns have been raised," Governor Brown stated in his signing message. "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."

Implementation and significance

With the enactment of this law, California publicly held corporations should begin the implementation process to ensure compliance with the new law's 2019 and 2021 deadlines. Corporations will need to comply with any requirements in their charters and bylaws governing the election, removal and replacement of directors, in addition to applicable corporate laws.

Commentators believe the law is likely to put pressure on Silicon Valley startups in the pre-IPO stage to bring gender diversity to their boards and may encourage emerging growth companies to consider gender diversity in board composition.

Although the new law only applies to California publicly held corporations, the trend of diversifying boardrooms is growing across the country. Companies in other states should anticipate new legislation and continued interest by institutional investors on the issue of board diversification.

Find out more about the California legislation by contacting:

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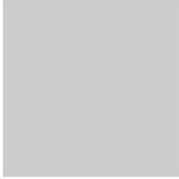
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