New California Law Promotes Gender Parity on Corporate Boards of Directors

On September 30, 2018, Governor Jerry Brown signed into law Senate Bill 826, which requires publicly-held corporations with their principal executive offices located in the State of California to have a specified minimum number of female members on their Board of Directors. The new law goes into effect on January 1, 2019 and requires each affected corporation to have at least one female director no later than December 31, 2019.

Background

In 2013, California became the first state to adopt a resolution urging that, by December 31, 2016, all public companies in California increase the number of women on their Boards of Directors ranging from one to three, depending upon the size of the board. Senate Bill 826, which was introduced in the State legislature in January and approved by the Senate at the end of May and the Assembly at the end of August, effectively codifies the objectives of the resolution as part of the state's General Corporation Law.

Provisions of New Law

Pursuant to new Section 301.3 of the Corporations Code, publicly-held corporations that are either incorporated in California or that are incorporated in other jurisdictions but which have their principal executive offices (as reflected in their annual report on Form 10-K) located in California and which have outstanding shares listed on a major U.S. stock exchange must:

- have a minimum of one female member of their Board of Directors by December 31, 2019; and
- no later than December 31, 2021 have a minimum of one female director if the corporation has four or fewer directors, two female directors if the corporation has five directors or three female directors if the corporation has six or more directors. (This requirement appears to be measured against the full size of the Board, and not just the independent directors.)

The new law, which provides that a female director need only hold a seat for a portion of the applicable calendar year to ensure that a company is in compliance (so even holding a seat for a single day would appear to be sufficient), defines "female" as "an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth." Privately held companies considering an initial public offering should note that there is no grace period for newly public companies. Thus, they will need to address this board composition requirement as part of their IPO process.

Failure to meet these requirements by the specified date will subject covered corporations to a monetary penalty in the amount of $100,000 (for an initial violation) and $300,000 (for a second or subsequent violation).

The California Secretary of State will be required to publish various reports on its web site documenting, among other things, the number of corporations in compliance with the new board composition requirements. While not required by the new law, the Secretary of State could potentially identify the corporations that are not in compliance with its requirements.

Validity of New Law Questioned

The new law has been the subject of significant criticism from the moment it was introduced in the California legislature. From a policy perspective, some critics derided the bill's focus on gender to the exclusion of other diversity criteria. In addition, several legal experts and other observers have questioned the constitutionality of the new law, particularly as it applies to publicly-held corporations incorporated in other states (such as Delaware). This latter issue centers largely on "equal protection" concerns as well as whether the new law violates the "internal affairs" doctrine which provides that the law of the state where an enterprise is incorporated should dictate internal corporate matters, such as any requirements for board composition.

In signing the bill into law, Governor Brown appeared to acknowledge these concerns in his message to the California State Senate:

> There have been numerous objections to this bill and serious legal concerns have been raised. I don't minimize the potential flaws that indeed may prove fatal to its

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ultimate implementation. Nevertheless, recent events in Washington D.C. – and beyond – make it crystal clear that many are not getting the message.

It is almost certain that the new law will be challenged in court on these grounds – and possibly others. Thus, the actual implementation of the new law in January is likely to be delayed or, potentially, overturned. We will be monitoring developments in this area, with an eye towards keeping clients informed as the January 1, 2019 effective date draws near.

About the Authors

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Need Assistance?

Compensia has significant experience in helping companies understand and address general corporate governance and executive compensation policies. If you have any questions on the topics covered in this Thoughtful Pay Alert or would like assistance is assessing how the new law is likely to affect your company, please feel free to contact Jason Borrevik or Mark A. Borges.■

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