California Mandates Gender Diversity on the Boards of Public Companies

Alert
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By Jack Bowling and Bryan Pitko

On September 30, 2018, California became the first state to sign into law board gender diversity standards for public companies. Under the new law, public companies headquartered in California must have at least one woman on their board of directors. Companies must comply with the law by the end of 2019 or pay a significant fine.

The recently enacted law adds Sections 301.3 and 2115.5 to California’s Corporations Code and provides the following:

- All domestic corporations and foreign corporations with a “principal executive office” in the state must:
  - By the end of 2019, have at least one female board member (corporations may increase the number of board members to comply with the requirement)
  - By the end of 2021, have at least (i) two female board members on a five member board or (ii) three female board members on a board comprised of six members or more
  - By July 1, 2019 the state must publish reports documenting compliance. (A more detailed report will be required by March 1, 2020.)
  - Corporations that fail to comply with the diversity requirements will be subject to a $100,000 fine for the first violation and a $300,000 fine for subsequent violations.

Based on current board composition, an estimated 377 California-based Russell 3000 Index companies may need to add women to their boards by the year 2021 in order to comply with California’s law, bringing the total to 684 female directors.¹
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Proponents of the legislation argue that the law is necessary to accelerate progress toward gender parity of corporate boards, which could otherwise take 40 to 50 years to achieve according to studies cited by supporters. While California adopted resolutions in 2013 urging companies to increase the number of women on their boards, studies cited in the text of the legislation indicate that “one-fourth of California’s public companies in the Russell 3000 Index” have no female board members.² While proponents argue that legislation is necessary for gender equality, groups opposed to the law, which include the California Chamber of Commerce and numerous constituent organizations, maintain that it will harm companies and negatively impact developments in boardroom diversity. Other groups opposing the legislation cite studies from European countries that have adopted board gender quotas, which suggest that gender quotas result in increased costs and constrain companies as they are at times forced to choose board members based on gender as opposed to experience or leadership skills.³ There are also concerns that the quotas could result in overboarding of women directors.

Opponents further argue that shareholders are in a better position to achieve gender diversity of corporate boards. Institutional investors and shareholder activists have been pressing for gender diversity in the boardroom. According to a study published by Institutional Shareholder Services, women held 19 percent of board seats of companies in the S&P 1500 Index in 2017, a 50 percent increase from 2008.⁴ Board gender diversity is expected to remain a top priority for investors, with shareholders continuing to press companies on this issue. BlackRock’s 2018 Proxy voting guidelines, for example, recommend having at least two women on every board, a higher standard than California’s newly enacted law.⁵ Staunch opposition to the law, as well as constitutional challenges, could delay or restrict the law’s application. The law has been criticized for potential violations of the internal affairs doctrine, the commerce clause and the equal protection clause.⁶ Until these issues are resolved other states may be hesitant to adopt similar legislation. While the likelihood of the law’s implementation remains uncertain, investors are expected to continue to advocate for gender diversity of corporate boards. As board gender diversity is expected to remain an important issue for shareholders, public companies may be best served to accelerate their efforts in this area.

For more information on standards for public companies, please contact Jack Bowling, Bryan Pitko, Diana Rosia or the Stinson Leonard Street contact with whom you regularly work.

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   SB 826, Section 1, adding §301.3 to the California Corporations Code (Sept. 30, 2018).
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