
**SENATE COMMITTEE ON
BANKING AND FINANCIAL INSTITUTIONS**
Senator Steven Bradford, Chair
2019 - 2020 Regular

Bill No: AB 979 **Hearing Date:** August 13, 2020
Author: Holden
Version: July 28, 2020 Amended
Urgency: No **Fiscal:** Yes
Consultant: Eileen Newhall

Subject: Corporations: boards of directors: underrepresented communities

SUMMARY This bill requires publicly held corporations to fill their board seats with a minimum number of directors from underrepresented communities, as specified.

EXISTING LAW

- 1) Provides, for purposes of the requirements below, that “female” means an individual who self-identifies her gender as a woman, without regard to the individual’s designated sex at birth, and that “publicly held corporation” means a corporation with outstanding shares listed on a major United States stock exchange (Corporations Code Section 301.3).
- 2) Requires, no later than the close of the 2019 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to have a minimum of one female director on its board and clarifies that a corporation may increase the number of directors on its board to comply with this requirement (Corporations Code Section 301.3).
- 3) Requires, no later than the close of the 2021 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to comply with the following (Corporations Code Section 301.3):
 - a) If its number of directors is six or more, the corporation is required to have a minimum of three female directors.
 - b) If its number of directors is five, the corporation is required to have a minimum of two female directors.
 - c) If its number of directors is four or fewer, the corporation is required to have a minimum of one female director.
- 4) Requires the Secretary of State (SOS) to publish a report on its website by March 1, 2020, and annually thereafter, regarding all of the following, at a minimum (Corporations Code Section 301.3):
 - a) The number of corporations subject to the aforementioned rules that were in compliance with the requirements of the rules during at least one point during the

preceding calendar year.

- b) The number of publicly held corporations that moved their United States headquarters to California from another state or out of California into another state during the preceding calendar year.
 - c) The number of publicly held corporations that were subject to the aforementioned rules during the preceding year, but are no longer publicly traded.
- 5) Authorizes the SOS to impose fines on corporations that violate the aforementioned provisions, as specified, and provides that, for purposes of determining whether a violation has occurred, each director seat that required to be held by a female, which is not held by a female during at least a portion of a calendar year, counts as a violation (Corporations Code Section 301.3).
- 6) Applies the aforementioned rules in Corporations Code Section 301.3 to foreign corporations that are publicly held corporations to the exclusion of the laws of the jurisdictions in which those foreign corporations are incorporated (Corporations Code Section 2115.5). Defines a publicly held corporation for purposes of this provision as a foreign corporation with outstanding shares listed on a major United States stock exchange.

THIS BILL

- 1) Adds two new sections to the Corporations Code that are virtually identical to Corporations Code Sections 301.3 and 2115.5 and applies these sections to directors from underrepresented communities. Defines a director from an underrepresented community as an individual who self-identifies as Black, African-American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native. Specifically,
- a) Contains findings and declarations regarding the low percentage of African American/Black, Hispanic/Latino(a), and Asian/Pacific Islanders that hold Fortune 500 board seats, the high percentage of chief executives who are white, the low percentage of African-American and Latino computer science and engineering graduates hired by the high-tech sector, and the value of racial and ethnic diversity to corporate earnings.
 - b) Requires, no later than the close of the 2021 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to have a minimum of one director from an underrepresented community on its board and clarifies that a corporation may increase the number of directors on its board to comply with this requirement.
 - c) Requires, no later than the close of the 2022 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to comply with the following:

- i) If its number of directors is nine or more, the corporation is required to have a minimum of three directors from underrepresented communities.
 - ii) If its number of directors is more than four but fewer than nine, the corporation is required to have a minimum of two directors from underrepresented communities.
 - iii) If its number of directors is four or fewer, the corporation is required to have a minimum of one director from an underrepresented community.
- d) Requires the SOS to publish a report on its website by July 1, 2021, documenting the number of domestic and foreign corporations whose principal executive offices, according to the corporation's SEC 10-K form, are located in California and who have at least one director from an underrepresented community.
- e) Requires the SOS to publish a report on its website by March 1, 2022, and annually thereafter, regarding all of the following, at a minimum:
- i) The number of corporations subject to the aforementioned rules that were in compliance with the requirements of the rules during at least one point during the preceding calendar year.
 - ii) The number of publicly held corporations that moved their United States headquarters to California from another state or out of California into another state during the preceding calendar year.
 - iii) The number of publicly held corporations that were subject to the aforementioned rules during the preceding year, but are no longer publicly traded.
- f) Requires the reports described in d) and e), above to be included with the reports required by SB 826 from 2018 (thus, rather than having to issue separate reports regarding women and underrepresented communities, the SOS will be able to issue a single report annually that includes data on both woman and underrepresented communities).
- g) Authorizes the SOS to impose fines on corporations that violate the aforementioned provisions, as specified, and provides that, for purposes of determining whether a violation has occurred, each director seat that required to be held by a director from an underrepresented community, which is not held by a director from an underrepresented community during at least a portion of a calendar year, counts as a violation. Further clarifies that a director from an underrepresented community who holds a seat for at least a portion of the year does not represent a violation.
- 2) Applies all of the aforementioned rules to foreign corporations that are publicly held corporations to the exclusion of the laws of the jurisdictions in which those foreign corporations are incorporated.

COMMENTS

- 1) Purpose: This bill is sponsored by the author to help address the ethnic pay gap, facilitate employment and outreach opportunities for underrepresented communities, promote board diversification, establish pipeline creation and upward mobility of diverse technical talent, and facilitate retention of that talent through company culture and development.
- 2) Background: According to the author's office, "since the beginning of recent social unrest, corporations have publicly messaged their support for diversity and Black lives. However, critics have pointed out this public support does not translate to diversity within a company and will not lead to long-term structural change. According to the USC Race and Equity Center, black employees in every industry tend to be concentrated in the lowest paying, least powerful positions... All of this strongly conveys to black professionals that their lives do not matter at work — hence their doubtful reactions to company statements about George Floyd. (<https://www.washingtonpost.com/outlook/2020/06/16/corporations-say-they-support-black-lives-matter-their-employees-doubt-them/>)"

Several reports provided by the author's office identify the relative lack of racial and ethnic diversity on corporate boards and support the value that diverse boards have to corporate performance. For example, the 2018 Board Diversity Census of Women and Minorities on Fortune 500 Boards (<https://corpgov.law.harvard.edu/2019/02/05/missing-pieces-report-the-2018-board-diversity-census-of-women-and-minorities-on-fortune-500-boards/>) found that 80% of the 1,033 available board seats in Fortune 500 companies were filled by white directors. Similarly, out of the 1,222 new board members of Fortune 100 companies, 77% were white.

A report in the Harvard Business Review (<https://hbr.org/2020/06/how-diverse-is-your-board-really>) concluded that a diverse board can contribute to better decision making, improve company governance, and can respond to market shifts more effectively. The McKinsey & Company Consulting Firm (<https://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters#>) suggests that these benefits are not restricted to the board of directors, but can benefit entire companies; for example, McKinsey found that companies in the top quartile for racial and ethnic diversity are 35% more likely to have financial returns above their respective national industry medians.

- 3) Pending Litigation: The provisions of this bill are based very closely on SB 826 (Jackson), Chapter 954, Statutes of 2018. That measure, which required publicly traded companies to place a minimum number of women on their boards of directors, has been the subject of at least two lawsuits challenging its constitutionality ("This state requires company boards to include women. A new lawsuit says that's unconstitutional," by Kayla Epstein, Washington Post, November 14, 2019 and "California sued over law requiring women on corporate boards," by Levi Sumagaysay, San Jose Mercury News, August 10, 2019).

According to the cited articles, the first lawsuit was filed in August, 2019 by Judicial Watch, a Washington-based conservative activist group, and alleges that spending

taxpayer money to enforce the law is illegal under the California Constitution. That case remains pending.

The second lawsuit, filed in November 2019 by the Pacific Legal Foundation, claimed that the state's mandate is unconstitutional and in violation of the equal protection clause of the U.S. Constitution, because it discriminates on the basis of sex. The lawsuit alleges that requiring the plaintiff (shareholder Creighton Meland) to consider gender when voting to add members to OSI System's all-male, seven member board of directors forces him to discriminate. A federal District Court dismissed this case in April, 2020, on the basis that the plaintiff lacked standing to bring the action. The court did not rule on the constitutionality of the provisions of SB 826.

By adding the provisions of this bill to two new code sections rather than amending the existing code sections added by SB 826, this bill's author may avoid legal fallout that could result from court cases filed challenging the constitutionality of SB 826. Under this logic, even if a court were to enjoin enforcement of the provisions of SB 826 or find all or a portion of it unconstitutional, the provisions of AB 979 would remain in force. This protection would not shield AB 979 from future lawsuits or from amendments to existing lawsuits, but could prevent it from being struck down by a ruling specific to the provisions of SB 826.

- 4) Input from Senate Judiciary Committee Staff: Due to the COVID-19 Pandemic and the unprecedented nature of the 2020 Legislative Session, all Senate policy committees are working under a compressed timeline. This timeline does not allow this bill to be referred to and heard by more than one committee, as a typical timeline would allow. In order to fully vet the contents of this measure for the benefit of Senators and the public, this analysis includes the following information from Senate Judiciary Committee staff:

This bill implicates the application of two constitutional principles that would ordinarily fall within the purview of the Senate Judiciary Committee: equal protection of the law and the internal affairs doctrine.

a) Equal Protection analysis

This bill requires certain corporations to appoint a certain number of directors who self-identify as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian or Alaskan Native. Both the federal constitution and the California state constitution contain Equal Protection clauses. (U.S. Const., Amend. XIV, § 1 ("No state shall ... deny to any person within its jurisdiction the equal protection of the laws."); Cal. Const., art. I, § 7 ("A person may not be... denied equal protection of the laws.") Under the current, prevailing judicial interpretation of both the federal and California constitutions' Equal Protection clauses, a statute that draws a distinction based upon race or ethnicity in this fashion – whether remedial or punitive in intent – is suspect and only passes constitutional muster if it can meet the strict scrutiny test: that the statute is narrowly drawn to meet a compelling government interest. (*Fisher v. Univ. of Tex.* (2013) 570 U.S. 297, 307-308; *Coral Construction, Inc. v. City and County of San Francisco* (2010) 50 Cal.4th 315, 337.) By contrast, this bill would not be subject to the California

constitution's absolute bar on consideration of race in public education, contracting, and employment (Cal. Const., art. I, § 31), even if California voters retain that bar this fall, because the bill only addresses private corporations, not public entities.

Strict scrutiny is a notoriously high bar to meet, but it is not insurmountable. Remedying past discrimination can be a sufficiently compelling government interest to withstand strict scrutiny. However, the existence of general societal discrimination will not ordinarily satisfy the courts. Instead, courts conducting strict scrutiny review typically require some showing of specific discrimination that the statute remedies. (See Chemerinsky, *Constitutional Law Principles and Policies* (2nd ed. 2002), pp. 709-711.) To show that a statute is sufficiently narrowly-tailored to survive strict scrutiny review, the government must prove that the interest in question cannot be achieved through less-discriminatory means. (*Wygant v. Jackson Board of Education* (1986) 476 U.S. 267, 280 n. 6.).

SB 826 (Jackson, Ch. 954, Stats. 2018), after which this bill is modelled, presented extensive findings regarding the dearth of women on corporate boards. That bill also set forth information about prior legislative attempts to address the problem of unequal access to the corporate boardroom. The court currently considering the constitutionality of SB 826 will presumably look to those findings when analyzing the bill under the strict scrutiny test. This bill also contains findings and declarations regarding the absence of racial and ethnic diversity in the corporate workforce and in corporate leadership. To further fortify the bill against an equal protection challenge, the author may wish to provide greater detail regarding the specific discrimination that has allowed white people to occupy corporate board seats in percentages that far exceed what would be expected if the opportunity to serve on corporate boards were genuinely available on an equal basis. For similar reasons, the author may wish to include additional information in the findings and declarations about why other approaches to diversifying corporate boards have not been, or would not be, sufficiently effective.

b) Internal Affairs Doctrine analysis

This bill would apply to corporations headquartered in California even if they are incorporated under the laws of another state (typically, though not exclusively, Delaware). Some critics of this bill, and of SB 826 (Jackson, Ch. 954, Stats. 2018) on which it is modeled, contend that such attempts by one state to impose board composition requirements on corporations incorporated in another state run afoul of the so-called "internal affairs doctrine" which emanates from the U.S. Constitution's Commerce Clause. Under that doctrine, only the state of incorporation may dictate how a corporation conducts its internal affairs. Were it otherwise, the U.S. Supreme Court has explained, corporations might be subjected to conflicting rules coming from several different states at once. (*Edgar v. MITE Corp.* (1982) 457 U.S. 624). It is likely that, if enacted, this bill would, like SB 826, face legal challenges alleging that it violates the internal affairs doctrine. Supporters of SB 826 argued that there are limits to the internal affairs doctrine. They pointed out, among other things, that existing California law, Corporations Code § 2115, already imposes certain requirements on what are arguably the internal affairs of corporations incorporated in other states. Section 2115 was upheld by the California courts against a Commerce Clause challenge (*Wilson v. Louisiana-Pacific Res.* (1982) 138 Cal.App.3d 216,

225), though it should be noted that this ruling preceded the U.S. Supreme Court decision in *Edgar v. MITE Corp.* referenced above.

5) Support:

- a) This bill's author states, "Black and Brown communities have historically faced barriers to education, have been subject to bias in hiring practices, and been excluded from access to start-up capital and small business loans (<https://www.bloomberg.com/news/articles/2018-04-23/4-ways-to-help-close-the-racial-startup-gap>) Without a diverse board it is increasingly difficult to attract diverse talent which then reinforces unconscious biases at the managerial and staff level. Even when staff from underrepresented communities are hired, the turnover rate is high due to feelings of isolation and prevalence of microaggressions. A culture shift in the boardroom cultivates an environment that values different perspectives and is more likely to hire and retain racial and gender minorities.
- b) HP writes that it "has the most diverse Board of Directors in the U.S. technology industry, with 54% minorities, 38% women, and 30% of members from underrepresented communities....While this demonstrates important progress, we also recognize that we have much more to do...At HP, we know that having a diverse board enables us to better serve our customers and position for future success. Even more broadly, fostering a culture of diversity and inclusion across our company enables us to attract, develop, and retain the talent we need to innovate."
- c) Chinese for Affirmative Action echoes the sentiments of several other supporters when it says that the "persistent lack of representation in corporate boardrooms needs continuous focus, oversight, and change. CAA believes AB 979 creates a cultural shift in California's board seats towards that end."

6) Opposition:

- a) Keith Bishop, a corporate law attorney who previously serviced as Commissioner of Corporations, is opposed to the bill on grounds that it is unconstitutional and will adversely impact the participation of male and non-binary persons on the boards of directors of publicly held corporations. Observing that the provisions of AB 979 will layer on top of the provisions of SB 826, Mr. Bishop states, "publicly held corporations will be required to comply with both sets of quotas. Therefore, individuals who self-identify as both female and as African American, Hispanic, or Native American will undoubtedly be preferred as director candidates because they will satisfy both quotas. The easily predictable result of enactment of AB 979 would be a decrease in the over-all number of directors on publicly held company boards who self-identify as male or non-binary and as being from an underrepresented community."

Mr. Bishop's letter of opposition also opines that the bill violates the Equal Protection Clauses of the California and U.S. Constitutions, the First Amendment to the U.S. Constitution, and the Commerce Clause of the U.S. Constitution.

7) Amendments: At the request of the SOS, the author plans to present amendments in committee to delete the report due by July 1, 2021, documenting the number of domestic and foreign corporations whose principal executive offices are located in California and who have at least one board director from an underrepresented community (see This Bill 1d on page 3).

8) Prior and Related Legislation:

a) SB 826 (Jackson), Chapter 954, Statutes of 2018 required domestic and foreign publicly traded corporations with their principal executive offices in California to have minimum numbers of women on their boards.

b) AB 931 (Boerner-Horvath), Chapter 813, Statutes of 2019 requires, on and after January 1, 2030, cities with populations of 50,000 or more to appoint individuals to local boards and commissions in a manner that ensures gender diversity, as specified.

LIST OF REGISTERED SUPPORT/OPPOSITION

Support

ActiveSGV
American Civil Liberties Union of California
Bloom Energy
California Employment Lawyers Association
Chinese for Affirmative Action
Consumer Attorneys of California
Equal Rights Advocates
Greater Sacramento Urban League
HP Inc.
Insurance Commissioner Ricardo Lara
League of California Cities Asian Pacific Islander Caucus
New America Alliance

Opposition

Private individual

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