
THIRD READING

Bill No: AB 979
Author: Holden (D) and Cristina Garcia (D), et al.
Amended: 8/20/20 in Senate
Vote: 21

PRIOR VOTES NOT RELEVANT

SENATE BANKING & F.I. COMMITTEE: 6-0, 8/13/20
AYES: Bradford, Chang, Caballero, Durazo, Hueso, Portantino
NO VOTE RECORDED: Dahle

SENATE APPROPRIATIONS COMMITTEE: 4-2, 8/20/20
AYES: Portantino, Bradford, Hill, Leyva
NOES: Bates, Jones
NO VOTE RECORDED: Wieckowski

SUBJECT: Corporations: boards of directors: underrepresented communities

SOURCE: Author

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

ANALYSIS:

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 or as gay, lesbian, bisexual, or transgender. Specifically,
 - a) Contains extensive findings and declarations supporting the need for the bill.
 - 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 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.
 - e) Requires the reports described in d) above to be included with the reports required by SB 826 (Jackson, Chapter 954, Statutes of 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).
 - f) 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.

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.

Comments

The provisions of this bill are based very closely on SB 826 (Jackson). That bill, 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).

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.

Potential constitutional issues posed by this bill are discussed immediately below:

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 usually must prove that the interest in question cannot be achieved through a different method that does not require drawing distinctions based on race and ethnicity to the same degree. (*Wygant v. Jackson Board of Education* (1986) 476 U.S. 267, 280 n. 6.).

Internal Affairs Doctrine analysis. This bill applies 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, 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.

Related/Prior Legislation

AB 931 (Boerner-Horvath, Chapter 813, Statutes of 2019) required, 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.

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.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

According to the Senate Appropriations Committee, this bill will result in ongoing costs in the hundreds of thousands of dollars to gather demographic information and compile a report on this data on its internet website.

SUPPORT: (Verified 8/25/20)

State Controller Betty Yee

State Treasurer Fiona Ma

ActiveSGV

American Civil Liberties Union of California

Ascend

Asian American Bar Association of the Greater Bay Area

Asian American Unity Alliance

Asian Law Alliance

Asian Pacific American Leadership Institute

Asian Pacific Islander American Public Affairs Association

Association of Asian American Attorney and CPA Firms

Bay Area Asian American General Counsels

Bloom Energy

California Asian Pacific Islander Legislative Caucus

California Black Chamber of Commerce

California Employment Lawyers Association

California Hispanic Chambers of Commerce

Chinatown Community Development Center, San Francisco, CA

Chinese for Affirmative Action

Civic Leadership USA

Consumer Attorneys of California

Equal Rights Advocates

Greater Sacramento Urban League

HP Inc.

Insurance Commissioner Ricardo Lara

Japanese American Bar Association

League of California Cities Asian Pacific Islander Caucus

Minority Corporate Counsel Association

Monte Jade West

National Asian American United

National Asian Pacific American Bar Association

New America Alliance

Philippine American Bar Association

Sacramento Latina Leaders Network

Silicon Valley Leadership Group

Vietnamese American Bar Association of Northern California

OPPOSITION: (Verified 8/25/20)

One individual

ARGUMENTS IN SUPPORT: A broad coalition of groups promoting Asian American inclusions writes, “The Harvard Business Review argues that a diverse board contributes to better decision making, improve company governance, and can respond to market shifts more effectively. These benefits are not restricted to the board of directors; the benefits of greater diversity contribute to the overall health of the company. A cultural shift in the boardroom cultivates an environment that values different perspectives and visibly signals a commitment to more equitably hire, retain, and promote women and minorities.

The California Hispanic Chambers of Commerce write, “We are pleased to support AB 979 because California company boards of directors do not reflect the diversity of our great state. A recent study by the Latino Corporate Directors Association determined that 233 of the 662 public-company boards in California have no ethnic or racial representation. Latinos, who make up 39.4% of the state of California, are severely underrepresented in the boardroom. Of the 662 public California companies, 571 corporations, or 87%, do not have a Latino on their board. These low numbers are in stark contrast to the size and economic strength of California’s Latino population. California is home to 15.5 million Latinos with \$320 billion in annual purchasing power, and 800,000 Latino business owners.”

ARGUMENTS IN OPPOSITION: 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.”

Prepared by: Eileen Newhall / B. & F.I. / and Timothy Griffiths/Judiciary
8/25/20 14:26:35

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