

Court Rules Against California's Mandated Board Diversity for Second Time and Strikes Down Gender Diversity Law



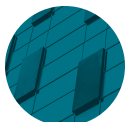
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ALERTS

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On May 13, 2022, a Los Angeles Superior Court judge struck down California's legislation requiring representation of women on the boards of publicly held companies with principal executive offices in California. The law, known as Senate Bill (SB) 826 and set forth in California Corporations Code §301.3, required public companies in California to have at least one female director by the end of 2019 and up to three female directors by the end of 2021, depending on the size of the board. The judge held that the legislation violated the equal protection clause of the California Constitution on its face, entitling plaintiffs to an injunction preventing the use of taxpayer funds to implement the measure.

The ruling follows the April 1, 2022, decision of the same court invalidating Assembly Bill (AB) 979, which required the representation of underrepresented communities on the boards of publicly held companies based in California.

California's Board Diversity Laws

On September 30, 2018, former California Governor Jerry Brown signed into law SB 826, as further discussed in this [client alert](#). The legislation required publicly held companies with their principal executive offices in California to have at least one female director on their board by December 31, 2019, and additional female directors by December 31, 2021, as follows: at least three female directors on boards with six or more directors; at least two female directors on boards with five directors; and at least one female director on boards with four or fewer directors.

In 2020, California followed up its board gender diversity initiative with the passage of AB 979, which mandated board representation of underrepresented communities, as further discussed in our [prior alert](#). The law defined "underrepresented communities" as certain racial, ethnic, or LGBT (lesbian, gay, bisexual, or transgender) groups. AB 979 was struck down by Los Angeles Superior Court Judge Terry Green on April 1, 2022, as further discussed in this [client alert](#).

Challenge to SB 826

In 2019, conservative legal advocacy group Judicial Watch filed a lawsuit in the Superior Court of the State of California for the County of Los Angeles on behalf of taxpayers challenging SB 826.¹

The complaint argued that the law established a "quota system for female representation on corporate boards" and thereby violated the state's constitutional equal protection clause by making distinctions based on gender without a compelling state interest and without being "necessary" and "narrowly tailored" to serve that interest. The complaint also alleged that SB 826 violated the prohibition in the California Constitution against "discrimination based on sex in public employment, education or

contracting." The lawsuit sought to permanently enjoin the California Secretary of State from using taxpayer-financed resources to enforce the law.

In defending SB 826, California argued that it had a compelling interest in eliminating and remedying discrimination in the director selection process, which historically has resulted in corporate boards comprised primarily of white men. The state also contended that the measure benefited the public and state economy and protected California taxpayers, public employees, and retirees.

Trial and Ruling on SB 826

The lawsuit on SB 826 went to trial in Los Angeles Superior Court on December 1, 2021 (unlike AB 979, which was decided on summary judgment). On May 13, Judge Maureen Duffy-Lewis ruled that SB 826 violated the equal protection clause of the state's constitution and granted the plaintiff's request for an injunction.

In the ruling, Judge Duffy-Lewis first rejected California's argument that the lawsuit was not ripe because no penalties had yet been paid under the statute.

The court then held that SB 826 violated the equal protection clause of the California Constitution on its face, in that it treats similarly situated individuals such as potential corporate board members "in an unequal manner" based on the "suspect" classification of gender. The court further found that the state did not have a compelling justification for the different treatment.

According to the ruling, SB 826 was intended to "achieve gender equality or parity" and "to get more women on boards." However, the court noted that under California law, "there is no compelling governmental interest in remedying societal discrimination ... [or] generalized, non-specific allegations of discrimination" and "discrimination cannot merely be conceded."

The court also found that SB 826 was not necessary or narrowly tailored to "boost California's economy, improve opportunities for women in the workplace, and protect California taxpayers, public employees, pensions and retirees." Citing various pieces of evidence, the court stated that the studies were "inconclusive" as to whether more women on boards improved corporate governance or corporate performance, and that there were other ways to boost California's economy. In the ruling, Judge Duffy-Lewis noted that despite California's claims, SB 826 was not intended at the time of its passage to benefit California's economy or its citizens, or to improve opportunities for women in the workplace.

Stay Tuned

The court's ruling on SB 826, on the heels of its ruling on AB 979, is certainly notable. However, it is still not clear how the State of California will respond to the superior court's rulings. An appeal of the cases or subsequent legislative efforts are both possible. As such, we recommend that companies based in California continue to monitor developments in these cases.

The annual board diversity reports required by AB 979 and SB 826 are available [here](#).

Nasdaq Reminder

Despite the superior court's rulings on SB 826 and AB 979, companies listed on the Nasdaq Stock Market (Nasdaq) will be required under new Nasdaq Rule 5606 to annually disclose, as early as this year, aggregated statistical information about the board's self-identified gender and racial characteristics and LGBTQ+ status and, subject to transition periods and certain exceptions, to have (or explain why they do not have) at least two diverse directors. A number of Nasdaq-listed companies have already made, or are intending to make, the required disclosures in their proxy statements for their current year annual meetings. Unlike SB 826 and AB 979, Nasdaq Rule 5606 does not require any minimum number of diverse directors and mandates disclosure only, as further discussed in [this client alert](#).

However, it should be noted that the Alliance for Fair Board Recruitment (Alliance) is seeking review of the Securities and Exchange Commission (SEC) approval of Nasdaq's board diversity listing rules. The petition has been tentatively calendared for argument in early August in the U.S. Court of Appeals for the Fifth Circuit. Alliance argues that the SEC's order and Nasdaq's rule violate the equal protection principles of the Fifth Amendment of the U.S. Constitution and the First Amendment's free speech clause, and that the SEC exceeded its statutory authority. It requests that the court vacate the SEC order and Nasdaq rule. Companies should also monitor developments in this case as they consider their board composition and disclosure requirements.

For more information on the California diversity provisions, the Nasdaq diversity rule, or any related matter, please contact any member of Wilson Sonsini's [public company representation](#) or [corporate governance litigation](#) practices.

[1] See *Crest et. al. v. Padilla*, LA Super. Ct. Case No. 19STCV27561 (2019).