

An April Fools' Day Surprise: California Court Strikes Down Corporate Board Diversity Law As Unconstitutional Under the California Constitution

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On April 1, Judge Terry Green of the Superior Court of California, County of Los Angeles found unconstitutional a recent, much-publicized California law which had been noteworthy for being the first such law in the country to mandate diversity in terms of race, ethnicity, gender and sexual orientation on corporate boards¹.

The California law, California Corporations Code Section 301.4, required publicly held corporations with principal executive offices located in California to have a minimum of one director from an underrepresented community on their board by the end of 2021. The law defined “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 who self-identifies as gay, lesbian, bisexual or transgender. The law would have increased its requirements by the end of 2022, at that time requiring that:

- corporations with nine or more directors have a minimum of three directors from underrepresented communities,
- corporations with more than four but fewer than nine directors have a minimum of two directors from underrepresented communities, and
- corporations with four or fewer directors have a minimum of one director from underrepresented communities.

Judge Green found Section 301.4 violated the Equal Protection Clause of the California Constitution on its face. Specifically, the Court held “[t]he statute treats similarly situated individuals – qualified potential corporate board members differently based on their membership (or lack thereof) in certain listed racial, sexual orientation, and gender identity groups. It requires that a certain specific number of board seats be reserved for members of the group on the list – and necessarily excludes members of other groups from those seats.” The Court also found that the Secretary of the State of California failed to identify a compelling interest to justify the law. And even though remediation of discrimination can be a compelling interest, the state legislature did not define a specific arena in which the discrimination occurred and even assuming corporate boards were a sufficiently specific arena, the Court found the state did not produce convincing evidence of valid statistical comparisons and anecdotal testimony of discrimination in that arena.

In the 24-page order, Judge Green ultimately held that the plaintiffs were entitled to a judgment declaring the law unconstitutional and an injunction preventing the expenditure of taxpayer funds on implementing the law. At this time, the State of California has not indicated whether it will appeal the ruling or not.

Meanwhile, other law suits related to board diversity have been on the rise, including shareholder derivative lawsuits filed in 2020 against Facebook, Inc.² and NortonLifeLock Inc.³ alleging that the companies had falsely represented they had made substantial progress towards diversity and inclusion on their boards. In both cases, the US District Court for the Northern District of California dismissed the suits finding in part that the companies’ statements were non-actionable puffery or only aspirational.

The issue of board diversity has also been addressed in other arenas. Notably, in 2021 the Securities and Exchange Commission approved Nasdaq's board diversity rule which now requires companies listed on Nasdaq to:

- publicly disclose board-level diversity statistics using a standardized template; and
- have - or explain why they do not have -- at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+.

While the issue of board diversity continues to face some legal challenges, these challenges are not likely to change the direction companies are heading with a focus on increasing diversity in the workplace and in corporate leadership. There is a continuing swell of stakeholder pressure coming from consumers, employees, investors and the government to address inequality and the benefits of diversity and inclusion for creating long-term shareholder value. As Judge Green stated in his ruling, the California Legislature "spotted an issue: corporate board seats by and large belong to members of one race, sexual orientation, and gender identity", and "[i]n a society based as ours is on inclusion and equal opportunity, these observations were concerning on their own terms."

1. *Crest v. Padilla II*, Case No. 20STCV37513 (Cal. Super. Ct. Apr. 1, 2022)↔

2. *Ocegueda v. Zuckerberg*, Case No. 3:20-cv-04444-LB (N.D. Cal. July 2, 2020).↔

3. *Esa v. NortonLifeLock Incorporated*, Case No. 3:20-cv-05410-RS (N.D. Cal. Aug. 5, 2020).↔

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