

Meridian Client Update

California Legislature Approves Diversity Mandate for Boards of Public Companies

On August 30, 2020, the California Assembly approved a first-in-the-nation legislation that would require public companies to include a minimum number of individuals from underrepresented communities on their boards (“Diversity Bill”). If passed into law, the Diversity Bill would apply to publicly held corporations whose principal executive offices are located in California. The Diversity Bill would expand on California’s current legal mandate on board gender diversity, which was enacted two years ago (see Meridian Client Update dated October 8, 2018).

California Governor Gavin Newsom must sign the Diversity Bill by September 30, 2020 for it to become law.

Requirements of Diversity Legislation

If enacted, the Diversity Bill’s requirements would be phased-in over a multi-year period, with compliance initially required by the close of the 2021 calendar year. A public company found to be in noncompliance with the diversity requirements may be subject to monetary fines. The specific requirements of the Diversity Bill are detailed below.

- **Subject Corporations.** The Diversity Bill would be applicable to publicly held domestic or foreign corporations with outstanding shares listed on a major U.S. stock exchange and whose principal executive offices, according to the corporation’s 10-K (annual report), are located in California. Thus, the Diversity Bill would apply to both publicly held corporations incorporated in California and those incorporated in other states or countries (i.e., foreign corporations), so long as their principal executive offices are located in California.
- **Minimum Number of Board Members from Underrepresented Communities.** The Diversity Bill would require a subject corporation’s board of directors to include a minimum number of individuals from underrepresented communities in accordance with the following schedule:
 - By the end of calendar year 2021, a subject corporation’s board of directors would be required to include at least one member from an underrepresented community.
 - By the end of calendar year 2022, a subject corporation’s board of directors would be required to include a minimum number of members from an underrepresented community based on the total number of board members, as shown in the following chart:

Total Number of Board Members	Minimum Number of Directors From an Underrepresented Community
9 or more	3 directors
More than 4 but fewer than 9	2 directors
4 or fewer	1 director

— The Diversity Bill would permit a corporation to meet the foregoing quotas by increasing the number of board members as necessary to accommodate new directors from an underrepresented community.

- **Definition of Individual From an Underrepresented Community.** The Diversity Bill defines “Director from an underrepresented community” to mean 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.
- **Fines for Noncompliance.** The Diversity Bill authorizes, but does not require, the California Secretary of State to impose a fines for a corporation’s violation of the diversity requirements (\$100,000 for a initial violation and \$300,000 for any subsequent violation).

Meridian Comment. As noted above, in 2018 California enacted a first-in-the-nation law that mandated gender diversity on public company boards. So far, no other state has followed suit. If enacted, the Diversity Bill, along with the increased focus by state governments on social justice issues and racial inequities, could serve as catalysts for other states to investigate and, perhaps ultimately pass, legislation imposing diversity quotas on corporate boards, despite the potential legal obstacles.

However, some states may prefer to move slowly on board diversity mandates prior to the outcome of the inevitable legal challenges to the Diversity Bill and the current legal challenges to California’s board gender diversity law. In August 2019, Judicial Watch filed a lawsuit claiming that the board gender diversity law is illegal under California’s Constitution. Separately, Pacific Legal Foundation filed a lawsuit in November 2019, claiming that the law violates the U.S. Constitution’s Equal Protection Clause. Although not raised in these cases, some legal experts have expressed doubt as to whether California’s board diversity requirements could be lawfully imposed on corporations that are incorporated outside of California.

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The **Client Update** is prepared by Meridian Compensation Partners’ Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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