

**Mandating Gender Diversity in the
Corporate Boardroom:
The Inevitable
Failure of California's SB 826.**

Professor Joseph A. Grundfest

**Stanford Law School and
The Rock Center for Corporate Governance**

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Abstract: America's corporate boards are insufficiently diverse. Too few women and ethnic minorities are at the table. California's SB 826 seeks to remedy this situation by imposing penalties on publicly traded corporations with headquarters in California, regardless of where they are chartered, if their boards have fewer than a legislatively mandated number of self-identified women directors. While well intentioned, this legislation will not achieve its intended effect because it is unconstitutional as applied to the vast majority, if not all, of publicly held corporations headquartered in California. The internal affairs doctrine will limit the law's application to only 72 corporations headquartered and chartered in California, or 1.59 percent of all publicly traded corporations. The bill will increase the number of board seats occupied by women by trivial amounts, if at all. These trivial changes will, however, come at great risk to the evolution of affirmative action jurisprudence. California's own legislative analysis concludes that "the use of a quota-like system, as proposed by this bill ... may be difficult to defend." A successful equal rights challenge means that SB 826 will have no effect at all. The legislation thus offers a poor bargain for diversity advocates: gain a trivial number of board seats, if any, but increase the risk of judicial rulings inimical to broader affirmative action initiatives.

There is a better way. California can use its significant capital market influence to induce major institutional investors to mount more aggressive activist campaigns that can rapidly and materially increase boardroom diversity. These campaigns have a demonstrated history of success. They will not generate years of litigation, will not be limited to California-chartered corporations, and will pose no risk to affirmative action jurisprudence. Properly structured shareholder activism is the better, smarter way to proceed.

Keywords: boards, boardroom, directors, corporations, gender, diversity, affirmative action, equal protection, quota, SB 826, internal affairs, unconstitutional, shareholder activism, institutional investors, headquarters, state of incorporation

JEL Categories. G3, H2, H7, J7, K2.

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I. Introduction

There are too few women at the table in America's corporate boardrooms. There are also too few ethnic minorities.

SB 826, now awaiting the California Governor's signature, is a well-intentioned effort to address that challenge. The bill would impose financial penalties on publicly held corporations headquartered in California that fail to have at least one self-identified woman director by the end of 2019. By December 31, 2021, corporations with five directors must have at least two women directors, and those with six or more directors must have at least three women directors. "Publicly held corporations" are defined as corporations "with outstanding shares listed on a major United States stock exchange."¹ The legislation does not address under-representation of ethnic minorities.

A cure can be worse than the disease, and SB 826 is, unfortunately, a case in point. Because of the internal affairs doctrine,² SB 826 is unconstitutional as applied to all but 72 publicly traded corporations headquartered in California.³ Those corporations constitute a mere 1.59 percent of all publicly traded corporations in the United States. A more detailed examination of the effects of SB 826 indicates that it would, at most, increase the number of women directors at the Fortune 500 by a grand total of one. That's about 18 one hundredths of one percent of all director positions at the Fortune 500.

Considering the 117 corporations in the Russell 3000 that are headquartered in California and that have no women directors, the internal affairs doctrine would cause SB 826 to likely apply to only about 12 of those corporations. If SB 826 increases woman directorships by a total of 24 at those corporations, it will increase the number of women directors in the United States by approximately nine one-hundredths of one percent.

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¹ SB 826, Section 2, adding §301.3(f)(2) to the Corporations Code. The legislation does not identify exchanges that would be considered "major" or describe criteria for making that determination.

² Section II, below, explains the internal affairs doctrine.

³ The data and calculations supporting these empirical findings are described in Section III, below.

Most aggressively, assuming that SB 826 causes every California chartered and headquartered corporation to add the maximum number of directors commanded by the statute by 2021, the net result would be the addition of, at most, another 208 women directors over three years. This is an increase of 82 hundredths of one percent, which annualizes to a rate of change of 27 hundredths of one percent per year over three years. This is the maximum possible effect of SB 826 given the constraints imposed by the internal affairs doctrine, and there is substantial cause to conclude that this estimate is significantly overstated.

SB 826's trivial gains would, however, come at significant nationwide risk to the evolution of all gender-based and race-based affirmative action programs. The State's own legislative analysis concludes that "SB 862 would likely be challenged on equal protection grounds and the means that the bill uses, which is essentially a quota, could be difficult to defend."⁴ This equal protection litigation would almost certainly delay the bill's implementation for many years. It will also incentivize the bill's opponents to generate a parade of horrors describing other forms of quotas or quota-like governmental intrusions into the private sector that would arguably become permissible if SB 862 is held constitutional. If equal protection challenges to SB 826 succeed, then it will have no effect at all.

In stark contrast, shareholder activism, stimulated by California's influence in the nation's capital markets, can generate far greater diversity at a much more rapid pace at a much broader range of corporations. It can achieve these superior outcomes with absolutely no risk to the evolution of affirmative action jurisprudence.

SB 826 is therefore not an appealing bargain for the cause of boardroom diversity.

II. SB 826 is Unconstitutional as Applied to Corporations Not Chartered in California.

SB 826 violates the United States Constitution's Commerce Clause because it purports to apply to corporations headquartered in California that are chartered outside of California. As the United States Supreme Court has explained, a corporation's internal affairs, such as rules regulating the composition of its board of directors and shareholder elections, are governed by the corporation's state of incorporation, and not by the state in which it is headquartered.

In *Edgar v. Mite Corp.*⁵ the Supreme Court explained that "[t]he internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors and shareholders – because otherwise a corporation could be faced with conflicting demands."⁶ The composition a corporation's board of directors is a prototypical example of a matter "among or between the corporation and its

⁴ Assembly Committee on Judiciary, Staff Report on SB 826, Hearing of June 26, 2018 (Prepared by Thomas Clark and Sandra Nakagawa) (hereafter cited as "Assembly Judiciary Committee Staff Report"), attached as Appendix A, at p. 6.

⁵ *Edgar v. Mite Corp.*, 457 U.S. 624 (1982).

⁶ *Id.* at 645 (1982), citing Restatement (Second) of Conflict of Laws §302 cmt. b, pp. 307-308 (1971).

current ... directors" that must be governed by a single jurisdiction "lest a corporation be faced with conflicting demands."⁷

The Supreme Court reiterated that point in *CTS Corp. v. Dynamics Corp. of America*,⁸ again explaining that the Commerce Clause requires that corporate internal affairs be governed by "one uniform system, or plan of regulation."⁹ "So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State."¹⁰ Accordingly, "the law of the incorporating State generally should "determine the right of a shareholder to participate in the administration of the affairs of the corporation"."¹¹

A board's gender diversity is a matter of internal corporate governance, as is shareholder voting, and SB 826 interferes with both. SB 826 would establish the first and only demographic test for board membership. It thereby constrains a board's ability to designate directors in the event of a vacancy and interferes with the shareholder franchise by imposing a financial penalty if shareholders refuse to elect the minimum number of women directors mandated by SB 826.

California therefore cannot require that corporations headquartered in California but chartered in Delaware have a minimum number of women directors while Delaware simultaneously permits its chartered corporations to have any number of women directors that is consistent with the board's business judgment, subject to shareholder approval and constraints imposed by the corporation's charter and bylaws. The conflict between California law and Delaware law is apparent. Indeed, because SB 826 would be the first and only mandatory board diversity requirement in the United States, the bill creates a conflict between California and the chartering laws of every other state in the nation.

The law is clear as to how this conflict will be resolved. Both *Edgar v. Mite* and *CTS Corp. v. Dynamics Corp. of America* explain that in a contest between California with a statute asserting that Delaware chartered corporations with headquarters in California must pay penalties unless they have a minimum number of women directors, and Delaware (or any other state in the nation) with a statute permitting any number of women directors consistent with the board's business judgment, corporate charter, bylaws, and shareholder vote, Delaware wins. California loses. End of story.

The bill's sponsor seeks to avoid this conclusion by observing that "[a]lthough the US Supreme Court has taken a broad view of the internal affairs doctrine ... California Corporations Code Section 2115 applies a full laundry list of California statutes to out-of-state corporations notwithstanding the law applicable in their state of incorporation."¹² The flaw in this argument is apparent. Section 2115 is a state statute. It cannot over-ride the internal affairs doctrine, which is of constitutional dimension. Therefore, to the extent that Section 2115 also interferes with the

⁷ *Id.*

⁸ *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1986).

⁹ *Id.* at 89 (quoting *Cooley v. Board of Wardens*, 12 How. 299 (1852)).

¹⁰ *Id.* at 89.

¹¹ *Id.* at 89 (quoting Restatement (Second) of Conflict of Laws §304 (1971)).

¹² Assembly Judiciary Committee Staff Report, at 7.

internal affairs of a corporation chartered outside of California, Section 2115 is also unconstitutional.

This proposition has been litigated and decided against California. Delaware's Supreme Court has ruled that Section 2115 violates "Delaware's well-established choice of law rules and the federal constitution."¹³ A California Court of Appeals recognizes in *dicta* that matters of internal governance are governed by the laws of the state of incorporation, and not by California law, notwithstanding Section 2115.¹⁴ Litigation over SB 826 will therefore also cause material portions of Section 2115 to be invalidated as applied to corporations chartered outside of California.

There is no escape from the internal affairs doctrine or from the fact that SB 826, if it has any effect at all, will be limited to corporations chartered and headquartered in California.

The effect of this limitation on SB 826 is profound.

III. The Internal Affairs Doctrine Guarantees that SB 826's Impact Will be Trivial.

The internal affairs doctrine limits the application of SB 826 to only 1.59% of all publicly traded corporations.¹⁵ The math in support of this conclusion is straightforward. According to Compustat data, there are 4,540 publicly traded operating companies in the United States as of December 13, 2017.¹⁶ Of those, 721 (15.88%) have California headquarters, but only 79 (1.74%) are chartered in California.¹⁷ The very large majority of corporations with headquarters in California are chartered in Delaware, Nevada, or outside the United States. And, of the corporations chartered in California, only 72 (1.59%) also have their headquarters in California.¹⁸

Given the constraints imposed by the internal affairs doctrine, SB 826 would implicate board composition at only 72 publicly traded corporations. But even this modest estimate exaggerates the bill's potential impact because many California chartered corporations already comply with the bill's mandates.

Board composition among the Fortune 500 proves the point. Fifty of the Fortune 500 are publicly traded corporations with California headquarters.¹⁹ Of those 50, only three are chartered in California. And, of those three, only one, Apple, is not already fully compliant with SB 826's

¹³ VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1116 (Del. S. Ct. 2005).

¹⁴ Lidow v. Superior Court, 141 Cal. Rptr. 3d 729 (Cal. Ct. App. 2012).

¹⁵ These percentages are calculated on a national basis, relative to the Russell 3000, rather than relative to a base of California corporations because: (a) the adverse collateral consequences to affirmative action are potentially national in scope, and (b) the comparable effects of shareholder activism are also national in scope. Measuring the effects of SB 826 on a national scale therefore provides a more accurate basis for comparison.

¹⁶ Compustat data, calculations performed as of September 7, 2018. The data exclude mutual funds, exchange traded funds, and similar passive investment vehicles. Data on file with author.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Makeda Easter, *The New Fortune 500 List is Out. These California Companies Made the Cut*, L.A. Times (June 7, 2017).

requirements for December 31, 2021. Apple will come into compliance with the addition of a single woman director by that date. The bill will therefore, at most, cause the addition of a single woman director at the Fortune 500.²⁰

By how much does the addition of this single director move the representation needle at the Fortune 500? Large US corporations have an average of about 11 directors each.²¹ These 50 California headquartered corporations thus have an estimated total of about 550 director slots. If the net effect of SB 826 at the Fortune 500 is to cause a single corporation to add a single woman director, then the law will cause the population of woman directors at the Fortune 500 to increase by about 0.0018, or 18 one-hundredths of one percent (1/550).²²

Looking beyond the Fortune 500, the legislation asserts that 117 California-headquartered publicly traded corporations included in the Russell 3000 index have no women on their boards. The data indicate that approximately ten percent of California-headquartered corporations are likely to have California charters.²³ Therefore, only about 12 of these 117 corporations would likely be subject to SB 826. Assuming, on average, that each of these 12 corporations will add two women to their boards to comply with SB 826, the law will cause the addition of 24 women directors to corporate boards.

How meaningful is that? There are approximately 25,499 directorships at the Russell 3000.²⁴ Increasing the number of women directors by 24 increases the percentage of directorships occupied by women by approximately 0.00094, or about nine one-hundredths of one percent (24/25,499). This is not even a drop in the bucket.

And, even if one makes the most generous assumptions possible, the effect on boardroom diversity remains trivial. As already demonstrated, three of the 72 publicly traded corporations that are chartered and headquartered in California, and that are also in the Fortune 500, will generate, at most, one additional woman director. Assuming that each of the remaining 69 firms has no women directors, and that each will add three women directors to comply with SB 826 by the end of 2021, the net result would be an increase of 208 women directors over three years ((69 x 3) + 1). This constitutes an increase of 0.0082, or 82 one-hundredths of one percent over three

²⁰ The calculations in this section assume a static supply of board seats, *i.e.*, corporations do not expand board size to accommodate additional woman directors.

²¹ SPENCER STUART, SPENCER STUART U.S. BOARD INDEX 2017, at 8, 16 (2017) (noting that average board size of S&P 500 companies is 10.8 directors), https://www.spencerstuart.com/-/media/ssbi2017/ssbi_2017_final.pdf.

²² This observation is consistent with another fact regarding boardroom diversity at publicly held corporations that diminishes the significance of SB 826. Boards at larger publicly held corporations are more diverse than boards at smaller enterprises. SB 826's effect will therefore be felt largely at smaller corporations with smaller market capitalizations whose influence on the economy is also not as significant. According to Equilar, 22.5 percent of directors in Fortune 500 companies are women, compared with 16.5 percent for the full Russell 3000, and 14.1 percent for companies in the Russell 3000 but outside of the Fortune 1000. EQUILAR, GENDER DIVERSITY INDEX, Q4 2017, at 1 (2017). If the statistics cited in this article were weighted by market capitalization the effects of SB 826 would be even more trivial than indicated in the accompanying text.

²³ As noted above, 721 publicly traded corporations are headquartered in California and 72, approximately ten percent of those 721, are also chartered in California.

²⁴ E-mail from Mr. Courtney Yu, Director of Research, Equilar, Inc. (Sept. 7, 2018) (on file with author).

years (208/25,499). Annualized on a linear basis, the change amounts to 0.0027, or 27 one-hundredths of one percent per year.²⁵

But, even these estimates may be too generous. Each estimate assumes that SB 826 withstands an equal protection challenge under the United States and California Constitutions. California's own legislative analysis raises doubt that SB 826 can survive such challenge. If equal protection challenges succeed, then SB 826 is invalid as to all corporations, without regard to chartering domicile, and will have no effect at all on boardroom diversity. These estimates also assume that no entity reincorporates outside of California. In the extreme, if all California-chartered corporations otherwise subject to SB 826 penalties reincorporate outside of California, then SB 826 will again have no effect at all on the number of women in America's boardrooms simply because of the operation of the internal affairs doctrine.

SB 826 will therefore fail to achieve its desired objective. It will, at best, cause trivial changes in boardroom diversity in corporate America, assuming that it has any effect at all.

IV. SB 826 and Equal Protection Concerns

The law governing gender-based affirmative action is complex, controversial, and susceptible of a range of interpretations as applied to SB 826. A California State Legislative analysis observes that the statute "would be subjected to heightened scrutiny under the equal protection clause of the 14th Amendment of the U.S. Constitution, and Article I, Section 7 of the California Constitution."²⁶ The analysis further observes that "whether the gender classification in [SB 826] is subject to strict or intermediate scrutiny may depend on whether a challenge is filed in state or federal court."²⁷ The analysis also highlights a distinction between many traditional affirmative action programs, in which the "government impos[es] the classification on *itself* – that is, in public agencies and institutions," and SB 826 which "would create what is essentially a quota system for *private* corporate boards. Should this bill be challenged the State would confront a difficult challenge in showing a compelling *government* interest in requiring a gender-based quota system for a *private* corporation."²⁸

The State's analysis suggests that "[t]o defend the constitutionality of this bill, it would not appear to be enough to simply cite statistics showing that women are grossly underrepresented on corporate boards. The defenders of the bill would most likely need to show specific evidence of discriminatory behavior, rather than simply inferring discrimination from the disproportionate numbers."²⁹ On the other hand, the analysis observes that "because courts have held in some cases that past discrimination and differences in opportunity, when

²⁵ A more realistic estimate that these 69 companies would add two women directors each leads to the estimated addition of 139 women directors ((69x2)+1) over three years. That constitutes an aggregate increase of 0.00545, or fifty-five hundredths of one percent over three years (139/25,499). Annualized, that is a gain of 0.00182, or eighteen hundredths of one percent a year for three years.

²⁶ Assembly Judiciary Committee Staff Report, at 6.

²⁷ *Id.* at 6-7. (California courts apply "strict scrutiny" to classifications based on gender, whereas federal courts apply a "heightened scrutiny" test that appears to require an "exceedingly persuasive justification" for a gender-based classification to survive.)

²⁸ *Id.* at 7.

²⁹ *Id.*

demonstrated with specificity, can justify gender classification, this may be a potentially promising strategy for supporters of the measure,”³⁰ assuming they can marshal the necessary evidence with the requisite “specificity.”

Courts also consider whether the means used to achieve the State’s interest are “narrowly tailored, meaning that they must be the “least restrictive” or “least discriminatory” means of achieving the State’s interest.”³¹ The analysis concludes that “SB 826 would likely be challenged on equal protection grounds and the means that the bill uses, which is essentially a quota, could be difficult to defend.”³²

If SB 826 fails on equal protection grounds, under either the United States or California constitutions, then no corporation will be required to add any women directors. Moreover, the legislation’s opponents will likely seek a stay of SB 826’s effective date pending resolution of its constitutionality. That litigation will take years. No one should therefore be confident that the legislation will take effect according to its contemplated timetable.

The State analyst’s cautionary language should also be appreciated in a larger political and social context. Affirmative action is a divisive issue. Pending cases raise important challenges to existing affirmative action doctrine. These cases include litigation challenging Harvard University’s admission policies.³³ It is significant to note in this context that the federal government has made an appearance favoring the position expressed by plaintiffs opposing Harvard’s policies.³⁴

Opponents of all forms of affirmative action will likely characterize SB 826 as an example of the potential over-reach of race-based and gender-based statutory distinctions. They will likely argue that if SB 826 is allowed to stand, then the federal government, states, and local authorities will be able to mandate racial and gender quotas across a broad range of private sector activities. Affirmative action’s opponents will construct examples of a broad array of governmental intrusions into the private sector that would arguably be permissible if SB 826 is held to be constitutional. These examples will be carefully fashioned to create politically divisive fact patterns. The objective will be to create a parade of horrors designed to stimulate a broader backlash against affirmative action efforts, not just against efforts to add diversity to corporate boards.

SB 826 therefore raises collateral risk for the entire corpus of affirmative action jurisprudence. To be sure, individual legislators can form different views as to the

³⁰ *Id.*

³¹ *Id.* at 6. SB 826 will be further challenged on this ground because California has not attempted to implement the shareholder activism strategy described in Section V of this article.

³² *Id.* at 7.

³³ See, e.g., Anemona Hartocollis and Stephanie Saul, *Affirmative Action Battle Has a New Focus: Asian-Americans*, N.Y. Times, Aug. 2, 2017; Melissa Korn, *Top U.S. Universities Back Harvard in Affirmative-Action Case*, Wall St. J., July 30, 2018; Shirley Leung, *Let’s Not Kid Ourselves. Harvard Lawsuit Is About Affirmative Action, Not Asian Americans*, Boston Globe, July 17, 2018.

³⁴ See, e.g., Katie Benner, *Justice Dept. Backs Suit Accusing Harvard of Discriminating Against Asian-American Applicants*, N.Y. Times, Aug. 30, 2018; Nick Anderson, *Justice Department Criticizes Harvard Admissions in Case Alleging Bias Against Asian Americans*, Wash. Post, Aug. 30, 2018.

reasonableness of bearing these risks, but it bears emphasis that these risks appear not to have been analyzed as part of the hearings held in connection with consideration of SB 826.

V. Shareholder Activism Offers a Superior Approach

Shareholder activism by major institutional investors is far more likely than SB 826 to increase the number of women directors at publicly traded corporations. Shareholder activism can achieve this result on a national basis, and would not be limited to the very small number of corporations headquartered and chartered in California. Shareholder activism can, moreover, achieve those results quickly, with no collateral risk to the evolution of affirmative action jurisprudence, and with no litigation-induced delay.

The dramatic decline in the incidence of classified boards³⁵ at publicly traded corporations demonstrates the potential effectiveness of shareholder activism campaigns that have broad support and clearly articulated objectives. In 2005, 52% of the S&P 500 had classified boards of directors. By the end of 2013, only 11% of those boards were classified. That dramatic and rapid decline was “spearheaded by institutional investors and their proxy advisory firms.”³⁶ Similar, if not superior, results can be obtained through shareholder activism designed to increase boardroom diversity.

To implement a shareholder activism strategy that would increase the number of women and minorities on corporate boards of directors, the State of California can exercise its substantial capital market influence to insist that institutional investors, including CalPERS and CalSTRS, immediately embark on activist campaigns pursuant to which they would oppose re-election of directors of publicly held corporations that fail to achieve specified, numerical diversity objectives by specified dates. These diversity objectives can, if the State wishes, be defined with direct reference to the criteria established by SB 826.

The key step in this strategy is to insist that institutional investors impose precisely defined numerical objectives as part of their voting guidelines. The New York State Common Retirement Fund already does so. It “plans to vote against all board directors standing for re-election at companies that have no women on their boards. In situations where a company has just one woman on its board, the Fund will vote against members of the board's governance committee standing for re-election.”³⁷ Similarly, Massachusetts' Pension Reserve Investment Management has announced that it will “[v]ote [against] ... all board nominees if less than 30 percent of the board is diverse in terms of gender and race.”³⁸ Rhode Island's Treasury has also

³⁵ Typically, in a classified board, one third of the board stands for election every third year, rather than having every director stand for election every year.

³⁶ Fried Frank, A New Approach to Classified Corporate Boards, Law360 (April 14, 2014) <http://www.friedfrank.com/siteFiles/Publications/A%20New%20Approach%20To%20Classified%20Corporate%20Boards1.pdf>.

³⁷ Press Release, *Office of the New York State Comptroller, DiNapoli: State Pension Fund Will Vote Against Board Members at Corporations with no Women Directors* (Mar. 21, 2018) <https://www.osc.state.ny.us/press/releases/mar18/032118.htm>.

³⁸ *Pension Reserves Investment Management Board, Proxy Voting Guidelines – 2018*, at 19-20 (Feb. 15, 2018), http://www.mapension.com/files/9915/2113/4347/ISS_-_MA_PRIM_Custom_Proxy_Voting_Guidelines_Approved_by_Board_02152018.pdf.

stated that “[a]ny time a company nominates a slate of directors that would cause fewer than 30 percent of its directors to be women or racial minorities, the State of Rhode Island will vote no.”³⁹

In contrast, the largest institutional investors follow more amorphous guidelines that never commit them to vote on director elections as a function of any numerical diversity standard. Neither CalPERS⁴⁰ nor CalSTRS⁴¹ has a formal policy that would withhold support for the re-election of directors at corporations with an insufficient number of women or minority directors.

This is not to suggest that CalPERS or CalSTRS have been passive in the diversity debate. For example, in November, 2017, CalSTRS amended its Corporate Governance Principles to state that it will “vote against Nominating and Corporate Governance Committee members, and if necessary the entire board, if after engagement around the lack of board diversity at a company, CalSTRS felt that sufficient progress had not been made.”⁴² Pursuant to this new policy, CalSTRS engaged with a total of 281 companies as part of its 2017-2018 diversity initiative, and withheld votes for the re-election of 291 directors, including 144 members of nominating and governance committees.⁴³ At least 50 of the companies with whom CalSTRS engaged have appointed a woman to their boards since the initial engagement.⁴⁴ It is

³⁹ Press Release, *Treasurer Magaziner Announces Proxy Voting Initiative to Hold Corporate America Responsible for Increasing Board Diversity* (April 20, 2016) <https://www.ri.gov/press/view/27340>.

⁴⁰ “Board diversity should be thought of in terms of skill sets, gender, age, nationality, race, sexual orientation, gender identity, and historically under-represented groups. Consideration should go beyond the traditional notion of diversity to include a more broad range of experience, thoughts, perspectives, and competencies to help enable effective board leadership. A robust process for how diversity is considered when assessing board talent and diversity should be adequately disclosed....” *CalPERS, Governance and Sustainability Principles*, at 16 (June 18, 2018), <https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf>. “Over the coming months CalPERS will closely monitor the companies’ progress on the matter and enter into confidential engagements when necessary. In instances where companies fail to respond appropriately, CalPERS will consider withholding votes from directors at future annual general meetings.” Press Release, *CalPERS Expands Engagement for Greater Diversity on Corporate Boards to More than 500 U.S. Companies*, (Aug. 22, 2017), <https://www.calpers.ca.gov/page/newsroom/calpers-news/2017/engagement-corporate-board-diversity>.

⁴¹ “Board diversity should be considered by the board or the nominating committee. The director nomination process and policy should consider a diverse mix of skills, background, experience, age, gender, sexual orientation and identification, cultural and ethnic composition that are most appropriate to the company’s long-term business needs. The board should disclose the policies or procedures used to ensure board diversity. Diversity goals should include cultural diversity in addition to gender and/or race diversity. CalSTRS will hold members of the board’s nominating and governance committee and if necessary the entire board accountable if, after engagement about the lack of board diversity, sufficient progress has not been made in this regard.” *CalSTRS Corporate Governance Principles*, p. 6, updated Nov. 1, 2017. “For 2018, we will continue pursuing our initiatives on diversity by engaging companies with no women on their boards. In accordance with our Corporate Governance Principles, which were revised in November 2017, we will be taking a strong stance in our proxy vote at companies with boards that lack gender, ethnic or racial diversity. Specifically, we will withhold our support of a company’s entire nominating and governance committee, if after engaging with a company, it lacks sufficient progress in its director nomination process and policy efforts to include board diversity as outlined in our principles.” *CalSTRS, CalSTRS’ Corporate Governance Annual Report 2017*, at 8 (Interview with Anne Sheehan). (https://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_annual_report_2017.pdf).

⁴² *CalSTRS, Corporate Governance Principles*, at 6.

⁴³ Memorandum from Teachers’ Retirement Board, Investment Committee on Corporate Governance “30 and 30” Proposal, Date of Meeting July 20, 2018, Item 11, Presenter Aeisha Mastagni, at 1.

⁴⁴ *Id.* at 2.

valuable to observe that this level of engagement, even though not as aggressive as possible, has a far greater reach than could ever be achieved through SB 826 because CalSTRS's efforts are not limited to corporations chartered or headquartered in California. Moreover, these results were achieved quickly and with no litigation risk.

The largest institutional investors in the land, BlackRock,⁴⁵ State Street,⁴⁶ and Vanguard, also have no quantitatively-driven diversity programs enforced by voting policies.⁴⁷ The largest

⁴⁵ "To the extent that we believe that a company has not adequately accounted for diversity in its board composition, we may vote against the nominating/ governance committee members." *BlackRock, Proxy Voting Guidelines for U.S. Securities*, at 5 (Feb. 2018), <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf>. "BlackRock may vote against nominating/governance committee members of companies lacking board diversity. In addition to boards being comprised of a "diverse selection of individuals ... [with] competing views and opinions," BlackRock "would normally expect to see at least two women directors on every board." *Id.* at 4. Michelle Edkins, Managing Director and Global Head of BlackRock's Investment Stewardship Team, recently stated that with respect to companies that have not made much progress on board diversity, particularly gender diversity, if "we have engaged in prior years, we will be voting against the reelection of members of the governance committee unless there's a very credible explanation for lack of progress." Ellen Odoner and Aabha Sharma, Weil Gotshal, Updated BlackRock Proxy Voting Guidelines, The Harvard Forum on Corporate Governance and Financial Regulation (Feb. 9, 2018).

⁴⁶ "Our preferred approach is to drive greater board diversity through an active dialogue and engagement with company and board leadership. In the event that companies fail to take action to increase the number of women on their boards, despite our best efforts to actively engage with them, we will use our proxy voting power to effect change — voting against the Chair of the board's nominating and/or governance committee or the board leader in the absence of a nominating and/or governance committee, if necessary." *State Street Global Advisors, Guidance on Enhancing Gender Diversity on Boards*, at 2 (2018). "In March 2017, in conjunction with the installation of its 'Fearless Girl' statue on Wall Street, State Street Global Advisors sent letters to 600 companies in the United States, United Kingdom and Australia informing them that it would vote against the chair of their nominating committees if there were no female directors or candidates. Of those companies, State Street Global Advisors ultimately voted against 400 that had not initiated any efforts to increase board diversity since receiving the letter." Press Release, *State Street Global Advisor Expands Board Diversity Guidance to Companies in Japan and Canada* (Nov. 14, 2017) <https://newsroom.statestreet.com/press-release/corporate/state-street-global-advisors-expands-board-diversity-guidance-companies-japa>.

⁴⁷ "Board Composition: Good governance begins with a great board of directors. Our primary interest is to ensure that the individuals who represent the interests of all shareholders are independent, capable, and appropriately experienced. We also believe that diversity of thought, background, and experience, as well as of personal characteristics (such as gender, race, and age), meaningfully contributes to a board's ability to serve as effective, engaged stewards of shareholders' interests. If a company has a well-composed, high-functioning board, good results are more likely to follow." *Vanguard, 2018 Investment Stewardship Annual Report*, at 5 (2018), https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2018_investment_stewardship_annual_report.pdf. "Gender diversity is one element of board composition that we will continue to focus on over the coming years. We expect boards to focus on it as well, and their demonstration of meaningful progress over time will inform our engagement and voting going forward. There is a compelling evidence that boards with a critical mass of women have outperformed those that are less diverse. Diverse boards also more effectively demonstrate governance best practices that we believe lead to long-term shareholder value. Our stance on this issue is therefore an economic imperative, not an ideological choice. ..." Letter from Vanguard CEO Bill McNabb to Directors of Public Companies Worldwide, at 2, (Aug. 31, 2017), <https://about.vanguard.com/investment-stewardship/governance-letter-to-companies.pdf>.

proxy advisers, ISS⁴⁸ and Glass Lewis,⁴⁹ also have no quantitative policy calling for votes to be withheld for the re-election of any directors if a board is insufficiently diverse.

To be sure, many of these organizations are actively engaged in a broad range of efforts to induce greater board diversity. For example, BlackRock Inc. earlier this year “posted on its website that it wants to see at least two women directors on every board. The firm has written to 300 companies in the Russell 1000 that have fewer than two female directors and asked them to disclose their approach to boardroom and employee diversity.”⁵⁰ State Street has also “made board diversity a key focus of its corporate governance policies, to the point of voting against 511 companies that had no women on their boards and failed “to demonstrate programs on board diversity.”⁵¹ State Street explained that 152 of the companies with which they had engaged “have placed women on their boards in the last year” but observed that “there is still important work to be done.”⁵²

The impact of these institutional investor engagements far exceeds any effect that SB 826 might have. If institutional investor engagement was driven by even more aggressive quantitative guidelines, progress would be more rapid and pronounced. The gains would also accrue on a national basis without any risk to affirmative action jurisprudence, without divisive litigation, and without any of the lawsuit-related delays and expense bound to occur if SB 826 is signed into law.

There is a significant difference between exhortative engagement policies that seek to inquire and persuade, and policies that establish powerful presumptions regarding minimum levels of diversity and that would have the world’s largest institutional investors oppose the election of directors at corporations that fail to comply with those minimal standards, unless they present a credible reason supporting an exemption from the rule. While voting guidelines of this

⁴⁸ ISS will “[h]ighlight boards with no gender diversity, however no adverse vote recommendations will be made due to any lack of gender diversity... In ISS’ 2017-2018 Governance Principles Survey, 69 percent of investor respondents replied that they could consider it problematic if there were no female directors on a public company board. Many of those respondents indicated that they may consider it appropriate to engage with the company if this were the case. While the US ISS Benchmark policy will not use any lack of gender diversity as a factor in its vote recommendations on directors, ISS will identify in its reports where a board has zero female directors.” *ISS, 2018 America’s Policy Updates, Effective for Meetings on or after Feb. 1, 2018*, at 16-17 (Nov. 16, 2017).

Nov. 16, 2017, at pp. 16-17.

⁴⁹ “In 2018, we will not make voting recommendations solely on the basis of the diversity of the board. Rather, it will be one of many considerations we make when evaluating companies’ oversight structures. Beginning in 2019, however, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members. Depending on other factors, including the size of the company, the industry in which the company operates and the governance profile of the company, we may extend this recommendation to vote against other nominating committee members. When making these voting recommendations, we will carefully review a company’s disclosure of its diversity considerations and may refrain from recommending shareholders vote against directors of companies outside the Russell 3000 index, or when boards have provided a sufficient rationale for not having any female board members or have disclosed a plan to address the lack of diversity on the board.” *Glass Lewis, 2018 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice, United States*, at 22-23 (2017). http://www.glasslewis.com/wp-content/uploads/2018/01/2018_Guidelines_UNITED_STATES.pdf.

⁵⁰ John D. Stoll, *To Shatter the Glass Ceiling, Don’t Force It*, Wall St. J., Sept. 8, 2018.

⁵¹ *More Than 150 Companies Have Added Women to Their Previously All-Male Boards: State Street*, Marketwatch.com, March 8, 2018.

⁵² *Id.*

sort can be fashioned according to numerous formulae, one possible rule would have institutional investors withhold authority for the election of every director at the board of any publicly held company with a market capitalization in excess of an amount to be determined that, by December 31, 2021, fails to have three directorships, or thirty percent of its board seats (whichever is less), occupied by women or members of minority groups.⁵³

There is obviously much room for good faith negotiation and debate among institutional investors and corporations as to the appropriate level of such triggers. Credible arguments can be presented for higher thresholds. This suggestion is intended merely as an example that can serve as a starting point for conversation. From a tactical perspective, however, it is valuable that a large number of institutional investors and proxy advisers coalesce around a common benchmark that serves a shared principle guiding exercise of the shareholder franchise.

VI. Conclusion

Shareholder activism can be far more effective than SB 826. Shareholder activism is not limited to corporations chartered in California. It will not be subject to the Constitutional constraints imposed by the internal affairs doctrine. It will not be delayed by or subject to litigation alleging violations of equal protection guarantees under the United States and California Constitutions. It will not raise collateral risks for the future evolution of affirmative action jurisprudence. Shareholder activism can generate results more rapidly than any change that would result from SB 826, which will be tied up in litigation for years, no matter how those lawsuits are resolved. SB 826, for all its good intentions, is not the best path toward improved corporate boardroom diversity.

⁵³ The market capitalization test can be modified over time and is intended to focus efforts first on attaining diversity at larger enterprises.

Appendix A

Date of Hearing: June 26, 2018

ASSEMBLY COMMITTEE ON JUDICIARY
Mark Stone, Chair
SB 826 (Jackson and Atkins) – As Amended May 25, 2018

SENATE VOTE: 22-11

SUBJECT: CORPORATIONS: BOARDS OF DIRECTORS

KEY ISSUES:

- 1) SHOULD A CORPORATION HEADQUARTERED IN CALIFORNIA HAVE AT LEAST ONE WOMAN ON ITS BOARD BY DECEMBER 31, 2019, AND HAVE BETWEEN ONE AND THREE WOMEN, DEPENDING UPON THE SIZE OF THE BOARD, BY DECEMBER 31, 2021?
- 2) SHOULD THE SECRETARY OF STATE PUBLISH REPORTS DISCLOSING INFORMATION ABOUT THE NUMBER OF CORPORATIONS SUBJECT TO THE PROVISIONS OF THIS BILL AND THE EXTENT TO WHICH THEY ARE IN COMPLIANCE?

SYNOPSIS

This bill would require all corporations that have headquarters in this state to have at least one woman on their board of directors by the end of 2019, and to have between one and three women on the board, depending upon the size of the board, by the end of 2021. This bill is a follow up to the author's SCR 62 (Res. Chap. 127, Stats. 2013) which urged corporations to diversify their corporate boards by increasing the number of women over a three-year period from January 2014 to December 2016. The minimum numbers urged in SCR 62 are similar to the numbers required by this bill. The aspirational goals of SCR 62 apparently went unrealized. Therefore, this bill would require corporations to place women on their boards of directors or face fines developed and administered by the Secretary of State. The bill would also require the Secretary of State to post information on its Internet Web site disclosing the number of corporations subject to the provisions of this bill and extent to which they are in compliance. According to the author and sponsor, women remain grossly under-represented on corporate boards, even though many studies demonstrate that corporations that have a certain threshold of female board members perform better than companies with all-male boards. As noted in the analysis, this bill, while certainly laudable and well-intended, raises considerable constitutional questions as well as more practical questions of implementation. The bill is supported by a broad coalition of women's groups and is sponsored by the California Chapter of the National Association of Women Business Owners (NAWBO). The bill is opposed by several business groups, spearheaded by the California Chamber of Commerce. The bill will be heard by the Assembly Banking & Finance Committee the day before it is heard in this Committee.

SUMMARY: Requires that publicly held companies have at least one woman on their board of directors by December 31, 2019 with increasing numbers required, depending upon the size of the board, by December 31, 2021. Specifically, **this bill:**

- 1) Requires that, by December 31, 2019, all publicly held domestic or foreign corporations whose principal executive offices, according to the corporation's SEC 10-K form, are located in California shall have a minimum of one female director on its board.
- 2) Requires that, by December 31, 2021, the number of female directors on the board for subject corporations shall be as follows:
 - a) If the number of directors is six or more, a minimum of three female directors.
 - b) If the number of directors is five, a minimum of two female directors.
 - c) If the number of directors is four or fewer, a minimum of one female director.
- 3) Provides that a corporation may increase the number of directors on its board in order to comply with the required number of female directors.
- 4) Mandates that, no later than July 1, 2019, the Secretary of State shall publish a report on its Internet Web site 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 female director.
- 5) Requires that no later than March 1, 2020, and annually thereafter, the Secretary of State shall publish a report on its Internet Web site regarding, at a minimum, all of the following:
 - a) The number of corporations subject to this section that were in compliance with the requirements of this section 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 this section during the preceding year, but are no longer publicly traded.
- 6) Authorizes the Secretary of State to adopt regulations to implement this section and permits specified fines for violations and provides that fines collected pursuant to this bill shall be available, upon appropriation by the Legislature, for use by the Secretary of State to offset the cost of administering this section.
- 7) Defines "female" as an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth.
- 8) Defines "publicly held corporation" to mean a corporation with outstanding shares listed on a major United States stock exchange.
- 9) Makes legislative findings and declarations related to the current state of women's representation on corporate boards of directors and the related benefits of such representation.

EXISTING LAW:

- 1) Provides that, unless otherwise specified, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board and that the board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person. (Corporations Code Section 300 (a). All further references are to the Corporations Code unless otherwise stated.)
- 2) Specifies that at the annual shareholder meeting of a corporation, directors shall be elected to hold office until the next annual meeting. (Section 301 (a).)
- 3) Provides that a corporation may adopt provisions to split its board of directors in two or three classes to serve for terms of three years respectively, or to eliminate cumulative voting, or both. (Section 301.5 (a).)
- 4) Defines a "listed corporation" as one with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market. (Section 301.5 (d).)
- 5) Allows a board to declare vacant the office of a director who has been declared of unsound mind by order of a court or who is convicted of a felony. (Section 302.)
- 6) Provides that shareholders may elect a director at any time to fill any vacancy not filled by the directors, through a majority vote of the outstanding shares entitled to vote, unless the vacancy was created by removal, then a unanimous consent vote is required. (Section 305 (b).)
- 7) Tasks the Secretary of State to develop and maintain a registry of distinguished women and minorities who are available to serve on corporate boards of directors and specifies "minority" to mean an ethnic person of color including American Indians, Asians (including, but not limited to, Chinese, Japanese, Koreans, Pacific Islanders, Samoans, and Southeast Asians), Blacks, Filipinos, and Hispanics. (Section 318 (a).)
- 8) Requires that at least once in each three-year period during which the registry is available for corporate use, the Secretary of State, in consultation with the Senate Commission on Corporate Governance, Shareholder Rights, and Securities Transactions, shall report to the Legislature on the extent to which the registry has helped women and minorities progress toward achieving parity in corporate board appointments or elections. (Section 318 (s).)
- 9) Provides, through the United States Constitution, that no State shall deny any person within its jurisdiction the equal protection of the laws. (U.S. Const., art. XIV, Section 1.)
- 10) Prohibits under the California State Constitution that a person may not be denied equal protection of the laws. (Cal. Const., art. I, Section 7 (a).)

FISCAL EFFECT: As currently in print this bill is keyed fiscal.

COMMENTS: According to the author, SB 826 will ensure "a greater role for women in corporate boardrooms and would make California the first in the nation to require the proactive change needed to fully realize gender equality throughout society."

Stunted Progress: As noted in the legislative findings and declarations for this measure, women in the U.S. are underrepresented on corporate boards of directors. The dearth of women in the board room mirrors a larger pattern of gender inequity in leadership roles across the private and public sectors. A 2017 report from the Center for American Progress notes that “the United States ranks first in women’s educational attainment on the World Economic Forum’s 2016 Global Gender Gap Index of 144 countries. But it ranks 26th in women’s economic participation and opportunity and 73rd in women’s political empowerment.” (Judith Warner and Danielle Corley, *The Women’s Leadership Gap*, Center for American Progress (May 21, 2017) (www.americanprogress.org/issues/women/reports/2017/05/21/432758/womens-leadership-gap)).

In terms of women’s lack of representation in private sector leadership roles, according to a 2015 news article, there are more men named “John” than there are women amongst CEOs of S&P 1500 companies. (Justin Wolfers, *Fewer Women Run Big Companies than Men Named John*, New York Times (March 2, 2015) (<https://www.nytimes.com/2015/03/03/upshot/fewer-women-run-big-companies-than-men-named-john.html>)). Likewise, in the political sphere women are greatly outnumbered by men – out of the 120 California State legislators who started the 2017-2018 legislative session, only 22 percent were women. (Matt Levin, *California legislators: just like you?*, CALmatters (January 6, 2017) (<https://calmatters.org/articles/new-california-legislators-just-like-you>)).

While there are many policies that could be used to advance the representation of women in leadership roles, this measure takes the approach of setting requirements for the number of women who sit on corporate boards of directors for publicly traded companies. Companies which do not comply with the requirement would be subject to a fine.

Yet another approach to promoting women’s representation in corporate boards can be seen in Section 318 of the Corporations Code. Under Section 318, the Secretary of State is tasked with maintaining a list of women and minority individuals who are available to serve on corporate boards of directors – with the logic that companies may use the registry in order to find diverse candidates for boards. While that statute mandates that a report should be issued every three years that the registry is in existence to document the extent to which the registry has led to greater representation of women and minorities on boards, no such report appears to have been issued since the statute was enacted in 1995.

To understand the specific issue of women’s representation on corporate boards in California, the National Association of Women Business Owners (NAWBO) California writes in support of the measure:

You probably will be quite surprised to know that one-fourth of California’s public companies still have NO women directors. And that California companies average only 15.5% women directors, lagging behind the national Russell 3000 at 16.5%, and significantly behind the Fortune 1000 at 19.8%.

As of June 30, 2017, California has 445 companies in the Russell 3000 with a total of 3,645 corporate directors, but only 565 of those seats are held by women, compared to 3,080 held by men. Among the counties in the state: Los Angeles, Orange County and San Diego Counties have the lowest percent of women directors (12%). Silicon Valley (Santa Clara County), which has been historically low, has 16%. And San Francisco County has the highest at 21%.

Outcomes related to more equitable gender representation on corporate boards. Numerous studies have looked at the association between women's representation on corporate boards and the performance of firms. In particular, research cited in the legislative findings and declarations for this measure has shown that companies with a greater share of women serving on the board of directors tend to have higher profits and take fewer risks. While these studies establish a relationship between the proportion of women on corporate boards and these outcomes, it is important to note that such studies are observational in nature and do not necessarily provide evidence for a causal relationship. In other words, while company profits tend to go up when women are better represented on the board, it is possible that factors other than women's representation on the board could also explain variability in corporate performance measures. For example, corporations which are likely to elect women to the board of directors may also have more effective management personnel or better customer service – both of which could plausibly explain the increased performance of these companies.

Problems of implementation and the "internal affairs" doctrine. As suggested above, there are many strong policy arguments for increasing the number of women who sit on corporate boards of directors. Given the strides that women have made in professions like medicine and law – in 2016 the *New York Times* reported that for the first time women made up over 50 percent of first year law students– they remain conspicuously and grossly underrepresented in corporate board rooms. This bill provides a seemingly straightforward solution: require by law that corporate boards have a minimum number of women. The author believes that this could be done easily and without displacing any male board members. If a company needed to, it could simply create additional seats in order to meet the minimum requirements.

Unfortunately, the manner in which boards are elected or appointed are determined by the laws of the state of incorporation and by corporate by-laws, which in turn must be consistent with the laws of the state of incorporation. Although the method varies according to state laws and corporate by-laws, as a general rule directors are elected to the board by shareholders. Clearly, California law cannot dictate how individual shareholders must vote. While this analysis, like those prepared for this bill by prior committees, cites provisions of California's Corporations Code governing the election, appointment, and replacement of board members, these statutes are only relevant for corporations that are *incorporated* in California. As for companies incorporated in other states – which would most likely be the vast majority of publicly-traded companies headquartered in California – the election, appointment, and replacement of board members will be governed by the laws of those states. Whatever the state of incorporation, however, the author correctly points out that, at least initially, a corporation could comply with the bill by adding another seat. However, this may require a change in the corporate by-laws, which most likely will require a vote of the shareholders. At some point – again depending on the laws in the state of incorporation and the particular provisions of the corporate by-laws – the newly-created seat will be up for re-election. In order to ensure compliance, the board would need to place only female candidates before voting shareholders, which would mean that the nominating process could only consist of female candidates. This is not to say that by-laws could not be changed and future elections could not be structured in ways that would ensure a minimum number of female board members; it is merely to suggest that compliance will not be a simple matter of adding another seat to the board.

Another question raised by opponents concerns the extent to which California can dictate the internal affairs of companies incorporated in another state. To be sure, California's police powers allow it to regulate any business that operates within its borders, regardless of where the

business is incorporated. If this were not the case, the state's labor laws, health and safety codes, business regulations, anti-discrimination laws, and more, would not apply to most of the publicly-traded companies that operate within in the state, since most are incorporated elsewhere. However, those laws regulate the activities of those corporations while operating within the state; they do not regulate what the courts refer to as the "internal affairs" of the corporation. According to the "internal affairs doctrine," those matters are regulated by the laws of the state of incorporation.

As described by the United States Supreme Court, the "internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands." (*Edgar v. MITE Corp.* (1982) 457 U.S. 624, citing *Havlicek v. Coast-to-Coast Analytical Services, Inc.* (1995) 39 Cal.App.4th 1844; see also *Atherton v. FDIC* (1997) 519 U.S. 213, 224 (holding that states normally look to the state of incorporation for the law that provides the relevant corporate governance general standard of care).) California is said to have codified this doctrine in Corporations Code Section 2116. However, this rule is apparently not absolute. For example, the *Witkin* treatise notes that the internal affairs doctrine is sometimes ignored where, despite foreign [i.e. another state] incorporation, a business's books, records and principal operations are located in California. (Witkin, *Summary of Cal. Law, Corporations*, Section 239, p. 1006; quoted in *Vaughn v. LJ Ineternat* (2009) 174 Cal.App.4th 213.) Whether or not a court would find that this bill violates the internal affairs doctrine is open to question, but it is reasonable to assume that were this bill to become law it could be challenged under that doctrine.

Constitutional questions: equal protection. Because this bill creates an express gender classification, it would be subjected to heightened scrutiny under the equal protection clause of the 14th Amendment of the U.S. Constitution and Article I, Section 7 of the California Constitution. Because all government classifications "discriminate" (that is, draw distinctions) between persons or groups of persons in some way, they create a potential equal protection problem. Government classifications, therefore, must be justified by some sufficient government interest. Most classifications, such as those based on age or type of business enterprise, are subject to a "rational basis test," meaning that the classification only needs to serve a "legitimate" government purpose and the means used to achieve that purpose must be "reasonably related" to that purpose. The rational basis test is highly deferential, and the courts will generally uphold the classification so long as it is not completely arbitrary.

However, some statutory classifications are deemed "suspect" – most notably race and gender – and are therefore subject to heightened scrutiny. Under federal law, racial classifications are subject to "strict scrutiny," meaning that the classification is only justified by a "compelling government interest" and the means used to achieve that interest must be "narrowly tailored," meaning that they must be the "least restrictive" or "least discriminatory" means of achieving the interest. Beginning in the 1970s the U.S. Supreme Court began to subject gender classifications to heightened scrutiny, though it turned out to be something less than the "strict scrutiny" applied to racial classifications. By 1976 the Court and commentators had labeled this new level "intermediate scrutiny." Under this test, the government must justify the classification by showing an "important" government interest (rather than "compelling") that is "substantially related" (rather than "narrowly tailored") to that interest. (*Craig v. Boren* (1976) 429 U.S. 190, 197.) In *United States v. Virginia* (1996) 581 U.S. 515, Justice Ginsburg seemingly raised the

test for gender discrimination by requiring an "exceedingly persuasive justification," which presumably lies somewhere between "compelling" and "important." The California courts, perhaps wisely, reject the federal race-gender distinction and apply "strict scrutiny" to classifications based on race or sex, as well as sexual orientation, on the theory that all are "immutable" characteristics that are not chosen and cannot be easily changed. (*In Re Marriage Cases* (2008) 43 Cal. 4th 757.) Therefore, whether the gender classification in this bill is subject to strict or intermediate scrutiny may depend upon whether a challenge is filed in state or federal court.

Gender classifications that benefit women. Many of the earliest equal protection cases considering gender classification involved laws that limited or restricted women's activities or, to the extent they "benefitted" women – such as protective labor laws or exemptions from civic duties like jury service – were based on stereotypes about women's "natural" domestic roles, physical weakness, or forced economic dependence upon men. (*See, e.g., Bradwell v. Illinois* (1873) 83 U.S. 130, upholding a state law that prohibited women from practicing law on the grounds that a woman's "paramount destiny" was to be a "wife and mother"; *Muller v Oregon* (1908) 208 U.S. 412, upholding a state maximum hours law for women; *Hoyt Florida* (1961) 368 U.S. 57, upholding a state law exempting women from jury service.)

In more recent decades, equal protection cases involving gender and racial classification have involved affirmative action programs that have sought to promote gender and racial diversity or remedy past discrimination. For example: Can public universities use "quotas" or race as a "factor" in the admissions process in order to diversify their student body? Can state or local governments set aside a certain number of contracts for women-owned or minority-owned businesses, or otherwise favor women or minorities in the public employment or public contracting? On the first question, the prevailing view of the courts is still the *Bakke* rule that using race as a "factor" to reap the benefits of diversity is permissible, but using a "quota," or anything like it, is not a narrowly tailored means. (*Regents of University of California v. Bakke* (1978) 438 U.S. 265; *Grutter v Bollinger* (2003) 539 U.S. 306; *Gratz v Bollinger* (2003) 539 U.S. 244.) On the second question, courts have looked askance at contractual "set asides" for women and minorities, and in California the use of race and gender as a factor in public education, public employment, and public contracting was prohibited by Proposition 209. (*City of Richmond v J.A. Croson* (1989) 488 U.S. 469.) However, this bill differs from the affirmative action decisions because those programs usually involved government imposing the classification on *itself* – that is, in public agencies or institutions. This bill, however, would create what is essentially a quota system for *private* corporate boards. Should this bill be challenged, the State would confront a difficult challenge in showing a compelling *government* interest in requiring a gender-based quota system for a *private* corporation.

Classification, the meaning of "discrimination," and remedying past wrongs. Critics of the courts' treatment of laws that benefit women and minorities as forms of "discrimination" demanding heightened scrutiny persuasively argue that there is a fundamental moral and political difference between discriminatory laws that seek to exclude groups of people (such as laws prohibiting women from the legal profession or racial segregation laws) on the one hand, and, on the other hand, "benign" classifications that seek to redress past discrimination by making the centers of economic and political privilege more accessible to those who have been historically excluded. (*See, e.g.,* Richard Lempert, "The Force of Irony: On the Morality of Affirmative Action and *United Steelworks v. Weber*," 95 *Ethics* 86-89 (1984); John Hart Ely, "The Constitutionality of Reverse Racial Discrimination," 41 *U. Chi. L. Rev* 723 (1974).) In the

courts, this debate has often taken the form of whether "strict scrutiny" should apply to affirmative action programs that attempt to address historically-based inequality. For example, in *Gratz v. Bollinger* (2003) 539 U.S. 244, the U.S. Supreme Court invalidated a race-based preference at the University of Michigan graduate program. In her dissenting opinion, however, Justice Ginsburg criticized the Court's equal protection jurisprudence for failing to appreciate that the court began applying "strict scrutiny" to racial classifications not because race is an inherently "suspect" category, but because historically racial classifications were always drawn for maintaining racial inequality. Ginsburg wrote that, "Where race is considered for 'the purpose of achieving equality,' no automatic proscription is in order." (*Id.* at 301, quoting from *Norwalk C.O.R.E. v. Norwalk Redevelopment Agency* (1968) 395 F. 2d 921.) Notwithstanding Justice Ginsburg's dissent, the Court majority continues to maintain that all suspect classifications are subject to heightened scrutiny whether they are benign or not, since one person's "benign discrimination" is another person's "reverse discrimination."

Closely related to the question of the appropriate level of scrutiny for benign discrimination is the extent to which remedying past discrimination is a sufficiently compelling or important justification for affirmative action or, in the case of this bill, whether laws that benefit women can be justified as a remedy to past discrimination and differences in opportunity. While the courts have held that in certain cases remedying past discrimination may be a valid justification for both race and gender classifications, they have generally construed this very narrowly. That is, the courts have generally not accepted broad assertions of generalized discrimination that permeate society at large; rather, race- or gender-conscious preferences are only justified, if at all, where they address specific examples of discrimination in specific industries or government institutions. (See e.g. Erwin Chemerinsky, *Constitutional Law: Principles and Policies*, 3d ed., pp. 760-765.) To defend the constitutionality of this bill, it would not appear to be enough to simply cite statistics showing that women are grossly underrepresented on corporate boards. The defenders of the bill would most likely need to show specific evidence of discriminatory behavior, rather than simply inferring discrimination from the disproportionate numbers. Nonetheless, because courts have held in some cases that past discrimination and differences in opportunity, when demonstrated with specificity, can justify gender classification, this may be a potentially promising strategy for supporters of this measure.

As the discussion above suggests, SB 826 would likely be challenged on equal protection grounds and the means that the bill uses, which is essentially a quota, could be difficult to defend. But if governments refrained from enacting laws because of the possibility that such laws might be deemed unconstitutional, constitutional law would never change because there would be no laws that tested constitutional boundaries or challenged constitutional orthodoxies. Constitutional traditionalists might favor this timid approach because they believe that those boundaries were fixed in 1787 (or 1868 for the 14th Amendment) and should not be changed absent a constitutional amendment. However, the author does not appear to be a constitutional traditionalist.

ARGUMENTS IN SUPPORT: According to the author: "California women make up 52 percent of the state's population, but only about 28 percent of the directors of our public corporations. So, roughly 70 percent of the state's corporations are operating without the benefit of the experience, perspective and tools that women bring with them to the corporate setting. Research clearly shows that boards with women members perform better in the marketplace. By having such low participation rates for women in California's corporate leadership ranks, we effectively inhibit our own economic performance as a state. Other nations have previously acknowledged

the financial benefits and require a percentage of board membership to be female – thus representing the experience, expertise and wisdom of half of the population. Senate Bill 826 takes the first step towards closing this gender gap. SB 826 increases gender diversity on corporate boards by requiring each publicly-held corporation headquartered in California to have at least one woman on its board of directors by the end of 2019. Further, beginning in July 2021, the bill requires a minimum of two women directors on boards with five directors, and at least three women on boards with six or more directors."

The National Association of Women Business Owners (NAWBO) California – the sponsor of SB 826 – argues that "California is the 5th largest economy in the world and should set an example globally for enlightened business practice." Therefore, NAWBO believes, "California has a responsibility to ensure that women are included in the board discussions and decisions that affect corporate actions and profitably." NAWBO claims that "research shows that corporations with female directors outperform companies that don't have women on the boards. Yet one-fourth of California's public companies still have no women directors. "

ARGUMENTS IN OPPOSITION: The California Chamber of Commerce and several other business groups oppose this bill. They make three central arguments.

First, opponents argue that SB 826 is flawed because it considers "only one element of diversity." The opposition writes: "Gender is an important aspect of diversity, as are the other protected classifications recognized under our laws. We are concerned that the mandate under SB 826 that focuses only on gender potentially elevates it as a priority over other aspects of diversity. Many of our companies are making significant efforts to address and improve diversity in the workforce by focusing on their hiring practices, training promotion, retention, etc. Our companies are not focused on only one particular classification, but rather all classifications. We believe this comprehensive approach is more productive in addressing diversity than a mandated quota that only focuses on one aspect of diversity." [It is not clear that the opposition would support a measure that required racial and ethnic diversity, as well as gender diversity.]

Second, the opposition argues that SB 826 violates the U.S. Constitution, the California Constitution, and civil rights law by subjecting corporations to civil penalties if they fail to achieve the phased-in, but mandatory requirement to have a minimum number of female directors by the dates set forth in the bill. Opponents believe that this will require them to discriminate against males who wish to serve on corporate boards. While the author contends that corporations could meet the requirements of this bill by simply adding another seat to the board, and thereby avoiding the need to displace a male member, opponents point out that where there are two qualified candidates for an open board seat, one female and one male, if the open seat must be filled by a female to maintain the minimum number, then the company would be required to select the female candidate and reject the male candidate. Also, opponents point out that if shareholders do not approve an additional seat on the board, the company would have no choice but to replace a male board member with a female board member, or pay a fine. The opponents believe that in making these decisions, the company would be liable for violating the Unruh Civil Rights Act.

Finally, opponents argue that this bill conflicts with Corporations Code Section 2116 and the internal affairs doctrine which holds that the internal affairs of a corporation should be governed by the state law in which the company is incorporated.

REGISTERED SUPPORT / OPPOSITION:

Support

National Association of Women Business Owners – California (sponsor)
Alliance of Chief Executives
Anvaya Solutions
Barnard-Bahn Consulting & Coaching
Berkhemer Clayton, Inc.
Burleson Consulting
Chelette Enterprises
Consumer Attorneys of California
CR&A Custom
DG Consulting
DLC Consulting Services
Dr. Sandra's Sanctuary
Fraser Communications
Frieda's Specialty Produce
Garcia Realty
Hiland Consulting
Hispanas Organized For Political Equality (Hope)
Hollifield Creative
Hunter Hawk Inc.
Impact Sciences
Legislative Women's Caucus
Lentini Design & Marketing
Loza and Loza
NAWBO Los Angeles
NAWBO Ventura County
Plan the World
Posh Baban
Rose Policy Solutions
Sagent
Schaub Insurance Agency
Small Business California
Sunrun
Toni's Kitchen
Unisource
Several private individuals

Opposition

Brea Chamber of Commerce
California Ambulance Association
California Association of Winegrape Growers
California Business Properties Association
California Chamber of Commerce
California Grocers Association
California Manufacturers and Technology Association

California Restaurant Association
California Trucking Association
Camarillo Chamber of Commerce
Cerritos Chamber of Commerce
Garden Grove Chamber of Commerce
Gateway Chambers Alliance
Greater Coachella Valley Chamber of Commerce
Greater Riverside Chambers of Commerce
Murrieta Chamber of Commerce
North Orange County Chamber
Official Police Garages of Los Angeles
Personal Insurance Federation of California
Rancho Cordova Chamber of Commerce
Redondo Beach Chamber of Commerce
Santa Maria Valley Chamber of Commerce
South Bay Association of Chambers of Commerce
Wildomar Chamber of Commerce

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