



States are Leading the Charge to Corporate Boards: Diversify!

Posted by Michael Hatcher and Weldon Latham, Jackson Lewis P.C., on Tuesday, May 12, 2020

Editor's note: Michael Hatcher and Weldon Latham are Principals at Jackson Lewis P.C. This post is based on their Jackson Lewis memorandum. Related research from the Program on Corporate Governance includes [Politics and Gender in the Executive Suite](#) by Alma Cohen, Moshe Hazan, and David Weiss (discussed on the Forum [here](#)).

While the federal government is considering statutes and regulations that mandate gender and racial diversity on corporate boards of directors, the states have already begun to take action. Already a dozen states have enacted or are poised to enact requirements to enhance diversity on boards. The statutes are grounded on a large body of empirical evidence that board diversity contributes significantly to “good governance” and improved financial performance. Businesses must focus on enhancing the diversity of their boards to both comply with the new statutory requirements and secure the underlying benefits to their performance.

But while states are starting to act, many corporations have not.

In September 2018, California Governor Gavin Newsom signed a Bill mandating gender diversity on the boards of directors of publicly traded corporations with their “principal executive office” in the state. According to a March 4, 2020, report from California Secretary of State Alex Padilla, only 330 of 625 covered companies filed the required reports about their boards’ diversity. Of those that filed, 37 reported having zero women on their boards as of Dec. 13, 2019 — a violation of the requirement to have at least one female director by that time.

California’s Board Diversity Mandate

California’s law amended the State Corporations Code (Chapter 954, §§ 301.3 and 2115.5) to provide that publicly traded corporations, whether domestic or foreign (that is, whether incorporated in California or not), whose “principal executive offices” according to their U.S. Securities and Exchange Commission (SEC) filings are located in California, must attain specified minimum levels of women on their boards of directors by stated deadlines. The statute requires periodic reporting to the California Secretary of State, who is required to publicly report on corporate compliance.

California, and the other states that have started to impose legislative board diversity requirements, explain the need for legislation by contrasting a large body of empirical evidence demonstrating the value of diverse boards with the demonstrated lack of board diversity. According to a study of Russell 3000 Index companies (which included 401 S&P 500 companies) by Institutional Investor Services, Inc., women hold only 19% of director seats and minorities, *combined*, have for the first time broken the 10% barrier. African Americans, at 4%,

hold the largest proportion of director seats among minority groups, as reported [on the Forum](#) last year.

By the end of 2019, each covered corporation was required to have at least one female Director, defined as based on the Director's self-identification of gender "regardless of their designated sex at birth." By the end of 2021, each company with four or fewer directors must have at least one female Director, those with five directors must have at least two females on their boards, while boards with six or more members must have at least three female directors. Each covered corporation is required to include information about the total number of directors and number of female directors in its Annual Report.

Penalties for failing to file or failing to meet the minimums are stiff: \$100,000 for not filing on time, \$100,000 for the first violation of the mandatory minimum number of female directors and \$300,000 for subsequent violations. And the statute specifies that each required but unfilled seat is a separate violation.

As of this writing, we are aware of three legal challenges to the California statute, all alleging that mandating gender diversity creates an unlawful quota that discriminates on the basis of sex.

Creighton Meland, a citizen of Illinois, and shareholder of a company covered by the statute, filed a lawsuit in federal court alleging violation of the Equal Protection Clause of the 14th Amendment and 42 U.S. Code Section 1983, which prohibits actions by states that deprive individuals of civil rights. (*Meland v. Padilla*, U.S. District Court for the Eastern District of California).

Robin Crest and Bryan Colebrook filed separate lawsuits in California Superior Courts alleging violations of the California Constitution's Equal Protection Clause (Article 1, §7) and Nondiscrimination Clause (Article 1, §31—similar to Title VII of the Civil Rights Act of 1964). Crest also asserts violation of the U.S. 14th Amendment.

The cases are in various stages. Predictably, the State has moved to dismiss the cases and plaintiffs have opposed those motions. Presently, proceedings in all three cases appear to have been delayed due to the COVID-19 health crisis.

Other States That Have Enacted or Are Considering Board Diversity Statutes

At least 11 other states have enacted or are considering board diversity legislation. None of the other existing statutes mandate minimum numbers of female directors; instead, those statutes focus on disclosures about diversity on the board of directors, and in some instances, senior management. Many of the enacted bills were originally modeled on the California gender diversity mandates, but were changed to "disclosure only" during the legislative process.

States that have enacted board diversity-related measures are, in order of enactment, Colorado, Maryland, Illinois, and New York.

In 2017, the **Colorado** legislature adopted a Joint Resolution encouraging "equitable and diverse gender representation on corporate boards" and urging that by December 2020, corporations have a minimum number of female directors depending on the size of the board (*i.e.*, if 9 or more

directors, 3 should be women; if 5–8, then 2 women; if 4 or fewer, then 2 women). This was a non-binding Resolution and did not impose disclosure requirements.

Other states have enacted *mandatory disclosure* requirements.

Effective Oct. 1, 2019, **Maryland** law requires business entities—foreign or domestic, profit or nonprofit—with *corporate headquarters* in Maryland, to disclose in their Annual Reports the total number of directors and the total number of female directors. The Maryland requirement is notable because its coverage is not restricted to publicly traded corporations; the statute specifically applies to corporations, limited liability corporations, trusts, and other entities with revenues in excess of \$5 million. Privately held family-owned businesses are exempted if certain conditions are met.

The Maryland law has a 10 year “sunset” provision, meaning the provision will expire Sept. 30, 2029, unless there is legislative action to extend it.

After considering mandatory minimums, **Illinois** enacted a board diversity disclosure law in August 2019. Like the California law, the Illinois requirement applies to publicly held, foreign and domestic, corporations with their “principal executive office” in the state. In addition to imposing minimum levels of female directors, the Illinois statute differs from the California law in two significant ways.

First, in addition to gender, the Illinois law addresses racial and ethnic diversity. We expect this trend to continue as new states enact board diversity requirements. Even if there is no statutory requirement, companies are advised to address race at the same time as gender, since actions that support only women will bring attention to underrepresentation of African Americans and other minorities.

Second, Illinois requires information about the qualifications for board and executive officer positions, the nomination and selection process, and “policies and practices for promoting diversity, equity and inclusion” among directors and executive officers.

The Illinois Secretary of State is required to report annually on the number of corporations with at least 1 female director.

The University of Illinois is required to establish a rating system for diversity on corporate boards. The rating is to incorporate compliance with demographic reporting requirements; policies and practices encouraging diversity and inclusion in recruitment, board membership and executive appointments; and demographic diversity of directors and executive officers. Beginning no later than March 1, 2021, and every March 1 thereafter, the University of Illinois is to publish a report providing aggregate data on the demographic characteristics of boards—along with an “individualized rating” for each corporation.

New York State is the latest jurisdiction to enact a board diversity requirement. The statute calls for a “study” but in order to obtain information for the study imposes reporting obligations on domestic and foreign corporations “authorized to do business in New York”—a significant expansion beyond those statutes that apply only to corporations with “principal executive offices”

in the state. Each covered corporation must identify the total number of directors and the number of female directors.

Hawaii, Massachusetts, Michigan, New Jersey, and Washington State are each considering mandatory board diversity legislation. The first two elements of these Bills mirror the California statute: (1) applicable to “publicly held, foreign or domestic, corporations” with (2) their “Principal Executive Offices” in the state. The other three key elements vary by state: (3) minimum number of female directors required, (4) deadline(s), and (5) penalties.

State	Required Minimum Number of Female Directors and Deadline(s)	Penalties
Hawaii	By 12/31/2020: 1 Female Director By 12/31/2022: a. If 6 or more directors; 3 Females b. If 5 directors; 2 Females c. If four or fewer directors; 1 Female	Failure to File: First Violation: \$100,000; Subsequent Violations within 10 years: \$500,000 Failure to Comply: TBD
Massachusetts	By 12/31/2021: 1 Female Director By 12/31/2022: a. If 6 or more directors; 3 Females b. If 5 or fewer directors; 2 Females	Violations: \$100,000
Michigan	By 12/31/2021: 1 Female Director By 12/31/2022: a. If 6 or more directors; 3 Females b. If 5 directors; 2 Females c. If 4 or fewer directors; 1 Female	First Violation: \$100,000 Subsequent Violations: \$300,000

<p>New Jersey</p>	<p>By 12/31/2019: 1 Female Director</p> <p>By 12/31/2021:</p> <ul style="list-style-type: none"> a. If 6 or more directors; 3 Females b. If 5 directors; 2 Females c. If 4 or fewer directors; 1 Female 	<p>Failure to File: \$100,000</p> <p>First Violation: \$100,000</p> <p>Subsequent Violations: \$300,000</p>
<p>Washington</p>	<p>By 12/31/2020: 1 Female Director</p> <p>By 12/31/2022:</p> <ul style="list-style-type: none"> a. If 20 or more directors; 30% Female b. If 10-19 directors; 3 Females c. If 9 or fewer directors; 1 Female 	<p>Failure to File: \$100,000</p> <p>First Violation: \$100,000</p> <p>Subsequent Violations: \$300,000</p>

(Past deadlines in draft legislation may be revised during the legislative process.)

The **Ohio** legislature is considering a Resolution to “urge” public and private companies and institutions “doing business in Ohio” to “increase gender diversity on boards and in senior management positions,” and to publish diversity goals.

Pennsylvania is considering legislation to “encourage” publicly held corporations to achieve “equitable and diverse gender representation” by 2021. Although this would not be mandatory, the proposed legislation suggests minimal levels of female board representation: if four or fewer directors, then 1 female; between 5 and 8 directors, then 2 females; and 9 or more directors, then 3 females.

In addition to these state actions, there are several Bills in the U.S Congress that would promote greater board diversity, including the “Improving Corporate Governance Through Diversity Act” (H.R. 5084, requiring disclosure of board diversity and plans to enhance board diversity) and the “Diversity in Corporate Leadership Act of 2020” (S. 3367, requiring the SEC to study and make recommendations to increase gender and racial diversity on boards).

It is clear that state legislatures will continue to seek ways to encourage greater diversity on corporate boards. Whether additional states pursue mandatory requirements in the California model most likely depends on the results of the lawsuits against the California statute and on the

success of “disclosure” requirements in driving increased representation of women and minorities on board of public companies.

The state actions described above are just the beginning of a clear trend toward legislation and regulation compelling companies to ensure their boards of directors are more reflective of their shareholders and customers.

At a minimum, companies should expect continued pressure to diversify their boards of directors and, if disclosure statutes do not result in significantly enhanced representation, then more aggressive legislation will follow.