



COMMENTARY
OCTOBER 2018

California Mandates Female Directors for Public Corporations

IN SHORT

The Situation: California's governor recently signed into effect a new law requiring public corporations whose principal executive offices are located in California to have a certain minimum number of female directors on their boards of directors.

The Result: The new law will immediately apply to public corporations headquartered in California (regardless of place of incorporation), with the first deadline for compliance occurring at the end of 2019.

Looking Ahead: The new law is likely to face court challenges, but if it survives, corporations headquartered in California will need to ensure that they comply with the minimum requirements for female directors or pay fines starting at \$100,000.

On September 30, 2018, California Governor Jerry Brown signed California Senate Bill No. 826 ("New Law"), which amends California's General Corporation Law. The New Law became effective immediately upon signing and requires, among other things, that publicly held corporations whose principal executive offices are located in California (regardless of where the corporation is incorporated) must have a minimum of one female director on their respective boards of directors no later than the end of 2019. Such corporations may need to add additional female directors to their boards (depending on the size of the board at that time) no later than the end of 2021. The New Law also provides that the California Secretary of State may subject corporations that do not comply with these requirements to fines.

Summary of the New Law

The New Law requires that, by the end of the 2019 calendar year, a publicly held domestic (incorporated in California) or foreign (not incorporated in California) corporation whose principal executive offices are located in California must have a minimum of one female director on its board of directors.

In addition, by the end of the 2021 calendar year, any such corporation must have:

- A minimum of three female directors, if its number of directors is six or more;
- A minimum of two female directors, if its number of directors is five; or
- A minimum of one female director, if its number of directors is four or fewer.

According to the New Law: (i) a "publicly held corporation" means a corporation with outstanding shares listed on a major United States stock exchange; and (ii) "female" means an individual who self-identifies as a woman, without regard to the individual's designated sex at birth.



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The New Law also requires the California Secretary of State to publish an initial report, by July 1, 2019, documenting the number of publicly held corporations that have at least one female director, and another report by March 1, 2020, and annually thereafter, containing a description of at least the following: (i) the number of subject corporations in compliance with the requirements of the New Law; (ii) the number of publicly held corporations that moved their U.S. headquarters in or out of California in the preceding year; and (iii) the number of publicly held corporations that were subject to the New Law during the preceding year but are no longer publicly traded.

Companies may be subject to fines if they fail to timely file board member information with the Secretary of State that reflects the new requirements. The size of these fines may begin at \$100,000 for a first violation and increase to \$300,000 for a second or subsequent violation.

Legal Challenges

The New Law will undoubtedly face legal challenges on constitutional grounds and is unlikely to survive judicial scrutiny in its current form, particularly since it attempts to change the corporate governance

requirements of corporations incorporated in jurisdictions outside California.

Points to Consider

The diversification of board membership is an accelerating trend in various jurisdictions throughout the world, and it has been a recent area of focus of the U.S. Securities and Exchange Commission.

Countries such as Germany, France, Spain, Iceland, and the Netherlands have addressed the lack of gender diversity on corporate boards by instituting quotas mandating 30 percent to 40 percent of board seats to be held by female directors. Five other states in the United States (Illinois, Massachusetts, Pennsylvania, Ohio, and Colorado) have passed nonbinding resolutions urging companies in their states to add women to their boards.

Until the results of anticipated challenges to the New Law are known, publicly held companies with their principal executive offices in California should review their current board compositions to assess whether they meet the requirements under the New Law and also examine their articles of incorporation and bylaws to ensure their authorized number of directors and the mechanisms governing the election and removal of directors are sufficient to accommodate the required number of female directors. In particular, companies with classified boards may need to plan ahead, as the New Law makes no allowance for failure to comply as a result of the staggered elections of a classified board. Affected companies should also consider the impact of the New Law in their proxy disclosures regarding how diversity is assessed in choosing their directors.

Although the New Law does not apply to nonpublic companies in California, pre-IPO stage companies headquartered in California should be aware of this legislation and the broader global focus on board diversity when considering the composition of their own boards.

Conclusion

As Governor Brown essentially acknowledged when signing the bill, the New Law likely will be invalidated in litigation, at least as to companies not incorporated in California. The litigation can be expected to come from business groups that fear interference into the internal governance of companies incorporated in other states (even if they are not necessarily opposed to the underlying goals of the legislation). Even if the New Law is invalidated, however, California will have made an important statement by enacting the law.

FOUR KEY TAKEAWAYS

1. A recent amendment to California's General Corporation Law requires that a public corporation with its principal executive office located in California must have a minimum of one female director on its board of directors by the end of 2019.
2. Further requirements mandate additional female board representation, determined by the number of a directors on company's board, by the end of 2021.
3. Court challenges are expected, and the law will likely not survive in its current form.
4. Still, publicly held companies with their principal executive offices in California should review their current board compositions to determine whether they meet the new obligations.



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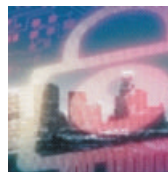
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