California to Require Inclusion of Female Directors at Public Corporations Based in the State

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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California has become the first state in the nation to require that publicly held corporations headquartered within the state include female directors on their boards. The new law, signed by Gov. Jerry Brown on September 30, 2018, applies to corporations, whether organized in California or elsewhere, "with securities listed on a major United States stock exchange" and principal executive offices located in California, as disclosed on Form 10-K filed with the Securities and Exchange Commission.

Any corporation subject to the law must have at least one female director by the end of 2019. By the end of 2021, subject corporations with five board members must have at least two female directors, while those with six or more board members must have at least three female directors. A corporation may increase the size of its board in order to comply with the new requirements. The law defines "female" as an individual who self-identifies as a woman.

The California secretary of state is permitted to adopt implementing regulations and may impose fines on noncomplying corporations — $100,000 for a failure to file board member information or a first violation of the inclusion requirement, and $300,000 for each subsequent violation. It is expected that subject corporations will be required to report to the secretary of state on the gender composition of their board of directors, and that this information will likely be made public. The secretary of state's website will also publish, by July 1, 2019, a report documenting the number of corporations subject to the new provision that have at least one female director. Beginning no later than March 1, 2020, and annually thereafter, this website will include at a minimum a report of the number of corporations in compliance with the new requirements during the preceding calendar year, the number of publicly held corporations that moved their U.S. headquarters to California from another state or out of California into another state during the preceding calendar year, and the number of publicly held corporations that were subject to this section during the preceding year but are no longer publicly traded.

Also of note, the application of this new provision to corporations organized outside of California, based solely on being headquartered in California, is distinct from the test used to identify so-called "quasi-California corporations" that are subject to other provisions of the California Corporations Code. See CCC Section 2115.

A number of commentators have stated that they expect the new law will be challenged on constitutional and state law grounds. The California Senate's analysis acknowledges a significant risk of legal challenge and that the express gender classification as proposed by S.B. 826 "may be difficult to defend" under an equal protection challenge because heightened scrutiny would apply under the U.S. and California constitutions. The law, as it applies to companies incorporated outside of California, would likely be challenged further under the internal affairs doctrine, which generally requires that "only one State should have the authority to regulate a corporation's internal affairs — matters peculiar to the relationships among or between a corporation and its current officers, directors, and shareholders" in order to avoid conflicting demands. See *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982).

We will continue to monitor additional developments and will provide updates as necessary.

The full text of SB-826 is available here.

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