

Rulings in 2022 could bring clarity on California and Nasdaq board diversity mandates

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Takeaways

- A bench trial challenging California's gender mandate for boards on state constitutional grounds is underway, and a similar challenge to the requirement to appoint directors from other underrepresented communities is scheduled for trial in March.
- Suits have been brought in federal court by a shareholder, as well as an association of shareholders and would-be directors, arguing that mandates violate the federal Equal Protection Clause and anti-discrimination laws.
- The SEC's approval of Nasdaq's board diversity rules is at issue in another federal case.

Two suits claiming the California laws violate the Equal Protection Clause of the U.S. Constitution and federal anti-discrimination statutes are pending in the Eastern District of California.

Over the last several years, investors, state legislatures and self-regulatory organizations have taken steps to increase diversity on public company boards. Many of these have been challenged in court. Companies may gain a clearer understanding of their obligations as a number of those cases are resolved in 2022.

Legislative and regulatory actions

In September 2018, California became the first state to mandate gender diversity for public companies, requiring those headquartered in California to have at least one woman on their board by 2019 and, depending on the company's size, two or three women by the end of 2021 (Senate Bill or SB 826).

That was followed in September 2020 by a similar measure requiring California-based public companies to have at least one director from an "underrepresented community" — defined as "an individual who self-identifies as Black, African American, Hispanic,

Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender" — by the end of 2021 and, depending on size, up to three by the end of 2022 (Assembly Bill or AB 979).

Other states, including Maryland, Illinois and New York, have sought to increase diversity not by mandating that companies add women or diverse directors, but by requiring companies to disclose board demographics.

At the national level, in August 2021 the Securities and Exchange Commission approved a new Nasdaq listing rule requiring companies to (1) disclose board-level diversity statistics using a standardized matrix by August 2022 or their next proxy filing and (2) have one "diverse" director by 2023 and two by 2025, or explain why they do not, with "diverse" defined as (1) a director who self-identifies as female; (2) a director who self-identifies with certain underrepresented racial or ethnic minorities; or (3) LGBTQ+.¹

Legal challenges

Predictably, there have been a number of legal challenges to these provisions. In 2022, we expect the courts to resolve some of them, giving companies greater clarity about their legal obligations to establish more diverse boards.

State court challenges to California laws

On December 1, 2021, a bench trial started in *Crest v. Padilla*, a suit in Los Angeles County Superior Court alleging that SB 826 violates the equal protection clause of California's constitution. We expect a decision in early 2022.

A companion suit challenging AB 979, also captioned *Crest v. Padilla*, is set for trial on March 28, 2022, before a different judge of the same court. Although the losing party is likely to appeal, these will likely be the first decisions to address the constitutional merits of the diversity provisions and may provide some guidance to companies subject to the laws.

Federal court challenges to California laws

Meanwhile, two suits claiming the California laws violate the Equal Protection Clause of the U.S. Constitution and federal

anti-discrimination statutes are pending in the Eastern District of California.

In *Meland v. Weber*, an action challenging SB 826, the court initially dismissed the complaint, concluding that the plaintiff, a shareholder of a company subject to the law, lacked standing to sue because SB 826 caused him no injury.

In June 2021, the U.S. Court of Appeals for the Ninth Circuit reversed that decision, reasoning that the plaintiff alleged he was coerced to vote for a woman candidate in board elections and therefore engage in sex discrimination. The circuit court held that was a sufficient allegation for the complaint to proceed.

Nasdaq-listed companies may have to comply at least with the board statistics disclosure requirement before the court rules.

Back in the district court, the plaintiff recently moved for a preliminary injunction to stop enforcement of the law. In opposition, the defendant (California Secretary of State Shirley Weber) maintained the constitutionality of SB 826 and reasserted her challenge to the plaintiff's standing.

She pointed out that the plaintiff owned a tiny amount of stock in the company at issue — too little to affect the outcome of any director election — and had voted *against* the woman candidate for the past two years, belying his claim that he was coerced to vote *for* a woman candidate.

The court's ruling on the preliminary injunction, which we expect soon, may signal how the court will ultimately decide in the case. But if the court again finds that the plaintiff lacks standing, it will not necessarily address the merits.

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Another action, *Alliance for Fair Board Recruitment v. Weber*, is pending before the same judge as the *Meland* matter. The plaintiff — a Texas-based nonprofit with anonymous members who claim to be aspiring directors or shareholders of companies subject to SB 826 and AB 979 — challenges both laws.

The parties there have fully briefed a motion to dismiss, and the court has scheduled a hearing for January 11, 2022. Again, California Secretary of State Weber has defended the constitutionality of the laws and challenged the standing of the organization that brought the suit, so, it is not clear if a ruling will address the merits.

Federal court challenge to Nasdaq rule

Finally, in *Alliance for Fair Board Recruitment v. SEC*, the same Texas-based organization that brought the challenge to SB 826 and AB 979, brought a suit directly in the U.S. Court of Appeals for the Fifth Circuit, arguing that the SEC's approval of Nasdaq's rule violated the Equal Protection Clause of the U.S. Constitution and federal anti-discrimination laws. The petitioner in that matter has filed its opening brief, and we expect further briefing and argument to be complete in the next year.

A decision from the Fifth Circuit is possible in 2022, but the timing is difficult to predict. Nasdaq-listed companies may have to comply at least with the board statistics disclosure requirement before the court rules.

Conclusion

To date, companies have had to consider how to address diversity on their boards without a clear answer as to whether the applicable legal requirements will stay in place or be struck down. As courts make decisions in these areas, companies can look forward to greater clarity on that question.

Notes

¹ <https://bit.ly/3IKM9Y7>