

California Trial Court Strikes Down Law Requiring Members of ‘Underrepresented Communities’ on Public Company Boards

Skadden

04 / 05 / 22

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

Virginia Milstead

Partner / Los Angeles

213.687.5592

virginia.milstead@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

300 South Grand Avenue
Suite 3400
Los Angeles, CA 90071
213.687.5000

In the first test of a state’s board-diversity requirement, a Los Angeles County Superior Court judge has entered summary judgment in favor of the plaintiff in *Crest v. Padilla*, who challenged the constitutionality of California’s law requiring California-based public companies to have at least one director on their boards 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.”

In its April 1, 2022, decision, the court concluded that the law, known as Assembly Bill 979 and codified at California Corporations Code §301.4, violated the equal protection clause in California’s constitution. In particular, the court reasoned that the law utilized race, sexual orientation and gender-based classifications because “it impose[d] a duty on corporations to use such categories in the selection of their board members” and to “have a specific number of directors who are members of certain listed races, or else have certain listed sexual orientations or gender identities.” Use of these classifications required the defendant, California’s Secretary of State, to prove that the law was justified by a compelling state interest and narrowly tailored to accomplish its goal.

While remedying past discrimination in board selection could potentially constitute a compelling state interest, the court concluded that the defendant had “not properly defined a sufficiently specific arena in which discrimination is to be remediated.” Instead, the law applied across all industries in California. The defendant also failed to present sufficient evidence of past discrimination, the court said. While it presented evidence that straight, cis-gender, white males are overrepresented on public company boards relative to the population as a whole, it failed to show a “disparity between the demographic make-up of the qualified talent pool and those who hold positions in the targeted arena.” As for the argument that businesses benefit from having a diverse board, the court concluded that “this sort of generic interest in healthy business [cannot] constitute a compelling state interest.”

This court also concluded that, even if the defendant had shown that remediating past discrimination in board selection was a compelling state interest, the California legislature had failed to narrowly tailor the law to that goal. For example, instead of mandating appointment of directors from underrepresented communities, the legislature could have required companies to disclose the racial, sexual orientation and gender identity make-up of their boards, or change the assertedly “subjective, secretive, and insular” process by which they select directors. Because the legislature did not consider these less restrictive means, the court concluded that the law could not survive constitutional scrutiny.

The court’s decision is the first to address the constitutionality of board-level diversity requirements. Legal challenges are also pending against the state’s law requiring every California-based public company to have at least one woman on its board (Senate Bill 826, California Corporations Code §301.4), as well as Nasdaq’s listing rule requiring companies to disclose board-level diversity statistics and, by certain dates, to either have a “diverse” director or explain why they do not. It remains to be seen whether California’s Secretary of State will appeal the ruling or whether other courts will follow its reasoning.

Regardless of the ultimate outcome of the *Crest* case, the ruling should have little effect on those companies that already have, or were planning to add, members of underrepresented communities to their boards. As the court observed, “corporations are, and have always been, free to act themselves to increase their own diversity.” Nothing in this ruling requires them to change course.