

New California law requires diversity reporting for venture capital and private equity firms

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On Oct. 8, 2023, California Governor Gavin Newsom signed into law Senate Bill 54, titled Fair Investment Practices by Investment Advisers (the “New Diversity Reporting Law”), which requires “venture capital companies” with sufficient ties to California to collect, and annually report, the demographic information of the “founding team members” at the companies they invested in during the prior year.

Given the broad scope of the New Diversity Reporting Law, it also applies to investment vehicles that are not traditionally thought of as venture capital companies, including private equity funds, co-investment vehicles, family offices, trusts, etc., in certain circumstances.

The New Diversity Reporting Law has been lauded for being a first-of-its-kind attempt to address the inequitable distribution of funding to women- and minority-owned emerging companies and, since over 5,700 venture capital firms have offices in California and venture capital investment deployed in the State far exceeds such deployment in any other State, it is expected to have sweeping consequences for the venture capital industry in the United States.

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Broad definition of “covered entities” under the New Diversity Reporting Law

The New Diversity Reporting Law requires “venture capital companies” that qualify as “covered entities” to adhere to the new reporting requirements.

- What is a “venture capital company”? An entity that meets at least one of the following three criteria, (i) on at least one

occasion during the annual period commencing with the date of its initial capitalization, and on at least one occasion during each annual period thereafter, at least 50% of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are venture capital investments, (ii) qualifies as a “venture capital fund” under the Investment Advisors Act or (iii) qualifies as a “venture capital operating company” under the Employee Retirement Income Security Act.

- What is a “venture capital investment”? An acquisition of securities in an operating company as to which the investment adviser, the entity advised by the investment adviser, or an affiliated person of either has or obtains management rights.
- When does a “venture capital company” qualify as a “covered entity”? If it has sufficient nexus to California and satisfies at least one of the following two criteria, (i) manages assets on behalf of third-party investors (including, but not limited to, investments made on behalf of a state or local retirement or pension system) or (ii) primarily engages in the business of investing in, or providing financing to, startup, early-stage, or emerging growth companies. Nexus can be established by satisfying any of the following criteria: (a) being headquartered in California; (b) having a significant presence or operational office in California; (c) making venture capital investments in businesses that are located in, or have significant operations in, California; or (d) soliciting or receiving investments from a person who is a resident of California.

Reporting requirements under the New Diversity Reporting Law

The New Diversity Reporting Law requires “covered entities” to report, on an annual basis, to the California Civil Rights Department (“CRD”), the aggregate demographic statistics for the “founding team members” at the companies they invested in during the prior year.

Such data will be collected using a standardized survey to be established by the CRD.

- What demographic information is required to be collected and reported? The demographic information to be collected

includes gender identity, race, ethnicity, disability status, sexual orientation, veteran status and whether the individual is a resident of the State of California. "Founding team members" are allowed to opt out of the survey but the refusal to participate must also be reported to the CRD on an aggregate and anonymized basis.

- Who qualifies as a "founding team member"? An individual who either (i) owned an initial interest in the business, contributed developmentally and/or conceptually to the business prior to initial shares being issued and was not a passive investor, or (ii) is an officer, manager or person of similar managerial authority in the business.
- What additional information must be reported? The New Diversity Reporting Law also requires "covered entities" to report, on an annual basis for the prior year, (i) the number of "venture capital investments" it made in businesses whose "founding team members" are comprised of primarily "diverse founding team members," as a percentage of the total number of "venture capital investments" during such period, and (ii) the total amount of money it deployed in "venture capital investments" during such period.
- Who is a "diverse founding team member"? Any "founding team member" who self-identifies as any of the following: (i) woman, (ii) nonbinary, (iii) Black, (iv) African American, (v) Hispanic, (vi) Latino/Latina, (vii) Asian, (viii) Pacific Islander, (ix) Native American, (x) Native Hawaiian, (xi) Alaskan Native, (xii) disabled, (xiii) veteran or disabled veteran, (xiv) lesbian, (xv) gay, (xvi) bisexual, (xvii) transgender or (xviii) queer.
- Is reporting publicly disclosed? Yes, the CRD is obligated to publish the reported data in a manner such that it is readily

accessible to the public on an aggregate and anonymized basis.

Implementation timeline and potential delays

Reporting obligations under the New Diversity Reporting Law are set to begin on March 1, 2025, with "covered entities" required to report information for investments made during the 2024 calendar year.

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However, the timeline for implementation is expected to be delayed. In his signing message, Governor Newsom remarked that the bill "contains problematic provisions and unrealistic timelines that could present barriers to successful implementation and enforcement" and announced that his administration would propose cleanup language as part of his 2024-25 budget, which is typically released on or around January 10 and finalized in the summer.

About the authors



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