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PERSPECTIVE

California aims to lead the way again in diversity on boards

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In 2018, California took the bold step to require a minimum number of women directors on the boards of California-based public companies. Now the Legislature is considering whether also to require those companies to have a minimum number of directors from underrepresented communities, defined as African-American, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native. Assembly Bill 979, introduced by Chris Holden, Cristina Garcia, and Eloise Reyes, proposes amendments to the Corporations Code (Sections 301, 2115) to require publicly traded companies headquartered in California to have at least one director from an underrepresented community by 2021. By 2022, the requirement increases to two such directors for companies with at least five directors, and three such directors for companies with at least nine directors. The bill is currently before the Senate Committee on Banking and Financial Institutions.

AB 979 builds on the 2018 gender diversity legislation, SB 826. Passage of SB 826 prompted significant voluntary compliance and the percentage of female directors per company rose from 15.1% to 18.5%. However, while SB 826 increased gender diversity, 35% of companies subject to the law still have all white boards. As of 2019, the U.S. Bureau of Labor reported that nationally 90% of chief executives are white. In California, 75% of publicly traded companies headquartered in the state have no African American executives, and 80% have no Latino executives.

AB 979 takes aim at technology companies. It cites a 2016 study by the Dalberg Trust and Intel, which observes that “African American and Latino computer science and computer engineering majors graduate at twice the rate that leading technology companies hire them.” The study noted that Black/African-Americans

make up roughly 2% to 3% of leadership at U.S. tech companies, and Hispanic/Latinos comprise 3% to 4%. Among new tech companies Black/African-American and Hispanic/Latino executives make up less than 1% of venture-backed tech company leaders.

Even companies that previously improved their diversity may have lost ground. McKinsey’s 2020 study classified some companies as “Resting on Laurels” and noted that, while in 2014 these companies made significant advances in diversity, by 2019 they had become less diverse. The pipeline for promotion is also in jeopardy. Ascend found that between 2007 and 2015 the number of Black/African-American executives increased 43% but the number of Black/African-American managers declined by 18%.

The push for board diversity is coming through litigation as well. Three major technology companies based in California — Oracle, Facebook and Qualcomm — have recently been sued by shareholders for failing to include Black/African-American directors on their boards, despite having publicly stated a commitment to diversity. The suits claim breach of fiduciary duty, abuse of control, and unjust enrichment arising from the alleged failure of the boards to deliver on stated diversity goals. The shareholders also allege violations of Section 14(a) of the 1934 Securities and Exchange Act, asserting that “platitudes” about diversity in proxy statements falsely present the companies’ commitments to diversity and mislead investors. The plaintiffs concede that they have not made a demand on the companies, alleging that demand is futile as the board members themselves are complicit in and could face penalties for their companies’ alleged failures to diversify. It is premature to predict the outcome of these suits. Plaintiffs have advanced novel theories and will need to meet the demanding *Caremark* standard to prevail on their duty of care claims. Nonetheless, it is interesting that this litigation aims to ensure greater diversity whereas the

lawsuits challenging SB 826 aim to dismantle California’s gender diversity legislation.

AB 979 presents a means to bring demographic diversity to California boards and to address underrepresentation in management. The bill emphasizes the perceived financial benefits of diversification, citing studies showing a correlation between increased racial and ethnic diversity and superior corporate performance. McKinsey’s 2020 study confirms these findings, recording that in 2019 the most racially and ethnically diverse executive teams were 36% more likely to outperform their peers on profitability.

While California’s gender diversity legislation, SB 826, met with considerable skepticism, AB 979, although vulnerable to the same constitutional challenges, has confronted less criticism. This may be due to the recent focus on questions of systemic racism sparked by the Black Lives Matter movement. It could also be due to the fact that SB 826 seems to have prompted voluntary compliance and has not been challenged to the same degree as was initially predicted. Only two lawsuits have been filed against SB 826, and they were filed by tax-

payers and shareholders rather than by companies subject to the law.

A deeper question is whether AB 979 will lead to broader diversity throughout California corporations. Studies have shown that racial and ethnic diversity at the top does not spread to other levels at a company or translate into a more inclusive culture, absent executive engagement and accountability. The Dalberg-Intel study analyzed data from 708 companies over 31 years found that “the key ingredient for successful diversity initiatives [is] accountability.” AB 979 does not address executive engagement but, as evidenced by the recitals, operates on the belief that greater racial and ethnic diversity at the board will not only improve the bottom line but also foster inclusion of other racially and ethnically diverse employees.

It remains to be seen whether AB 979 will effect the broader change that the Legislature wants to see, and how shareholder suits against Facebook, Oracle and Qualcomm will be decided. However, if AB 979 is enacted into law and follows the path of SB 826, it will bring a lot more directors from underrepresented communities into boardrooms, fulfilling its principal goal. ■

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