

New California Law Requires Public Companies in California to Increase Board Diversity

Insights

October 2, 2018

With the passage of Senate Bill 826 at the end of September, California has become the first state in the U.S. to require public companies incorporated in California or other public companies with their principal executive offices in California (according to their Annual Report on Form 10-K) to have specified numbers of women serving on their Boards of Directors.

The timeline for compliance is:

- By the end of the 2019 calendar year, all public companies must have one woman serving on the Board
- By the end of the 2021 calendar year, all public companies must have the number of women serving as directors, based on the size of the Board:
 - If the Board of Directors has six or more members, three women
 - If the Board has five members, two women
 - If the board has four or fewer members, one woman

Companies that do not comply with this law, will face an initial fine of \$100,000, and \$300,000 for each violation thereafter. A violation will be determined on a per seat basis, so for example, if a company has a Board of five members and no women on

its Board after 2021, the total fine would be \$600,000 if the it had previously violated this law (or \$400,000 if this was the first violation).

Does SB 826 apply to companies incorporated outside of California?

Yes, it applies to any “publicly-held corporation,” which means any corporation with outstanding shares listed on a major U.S. stock exchange. SB 826 would then apply to a corporation incorporated in Delaware, if its principal executive offices were located in California.

It is not clear if this law would apply to a foreign corporation with principal executive offices in California who does not list its shares on a major U.S. stock exchange, but rather lists American Depositary Receipts (or ADRs).

It is also not clear if this law would apply to other types of entities, such as limited partnerships or limited liability companies.

What should public companies do now?

Given the number of public companies based in California and the time it takes to recruit qualified directors in general, companies should begin the process of recruiting additional qualified candidates.

Is there a grace period for newly-public companies?

No, the first deadline for compliance is the end of the 2019 calendar year.

However, the law specifically refers to a company’s Annual Report on Form 10-K as the basis for determining the principal place of business.

If a calendar year company were to go public in 2019, with audited 2018 financial statements in its Registration Statement on Form S-1, it would not need to file a Form 10-K until the end of March 2020. So there is some degree of uncertainty if such a company would need to comply with the one female director requirement as of December 31, 2019, since no Form 10-K will yet have been filed.

On the other hand, if a calendar year company were to go public in late 2018, or prior to February 14, 2019 without audited 2018 financial statements in the IPO registration statement, a Form 10-K would need to be filed in 2019. This would mean that newly public companies in this situation would need to make sure they were able to comply with this new law.

Will this law be overturned?

Governor Brown acknowledged that the law is vulnerable to challenge, particularly from corporations incorporated outside of California. However we cannot predict with certainty the timing or outcome of any such challenge. Therefore, we believe it prudent to begin the process of identifying and recruiting additional qualified board members.

We also note that regardless of whether this law is upheld, many large and influential institutional investors are strongly encouraging companies to increase the diversity of their boards of directors, including direct outreach campaigns.

Are there any additional reporting obligations?

No specific reporting obligations are contained within the law as adopted. However, the California Secretary of State is authorized to adopt regulations to implement this law. Therefore, it is possible that additional filing obligations with the State of California will be required in the future.

Here is a link to the full text of SB 826:

https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB826

If you have any questions regarding SB 826, please do not hesitate to reach out to a member of your Gunderson Dettmer team.

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Jeffrey R. Vetter

PARTNER

P +1 650 321 2400

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