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PERSPECTIVE

Bill to impose gender quotas in boardrooms reflects larger trend

By Maj Vaseghi
and Sarah Ray

California Senate Bill 826 has passed the California Legislature and is headed to the desk of Gov. Jerry Brown, who will have until the end of September to approve or veto it. If enacted, SB 826 will require all companies, whether or not incorporated in California, whose shares are listed on a major United States stock exchange and whose principal executive offices are located within the state of California to have at least one female director on their boards by Dec. 31, 2019. By Dec. 31, 2021, SB 826 will require corporations with five directors to have at least two female directors, and corporations with six or more directors will be required to have at least three female directors.

SB 826 would impose a fine of $100,000 in the first year of violation and $300,000 each year thereafter until the board composition is corrected, with a separate $100,000 fine for failing to provide required information to the state.

SB 826 states that more women serving on boards of directors of publicly held corporations will boost California's economy, improve opportunities for women in the workplace, and protect California taxpayers, shareholders and retirees. The bill points to studies showing that companies with female directors on their boards report higher earnings per share, a higher average return on equity and higher stock performance. It also points out that according to a 2012 study by UC Berkeley, these companies are also more likely to "'create a sustainable future' by, among other things, instituting strong governance structures with a high level of transparency." However, despite these benefits, the bill provides that studies predict it will take 40 or 50 years to achieve gender parity, if something is not done proactively.

The bill cites statistics reflecting the lack of gender diversity on the boards of the 446 California-headquartered, publicly traded companies included in the Russell 3000 index as of June 2017, with women holding only 15.5 percent of director seats among these companies. Furthermore, more than 26 percent of these companies did not have any female directors and only 12 percent had three or more female directors on their boards.

Opponents of the bill, on the other hand, state that SB 826 violates the U.S. Constitution, the California Constitution and California civil rights laws based on equal protection grounds. They argue that if two qualified candidates, one male and one female, are considered for a director position, a board would be required to choose the female candidate based on her gender. Additionally, if a company has filled all available director positions and cannot expand the company's board, the board would be forced to displace a male director to replace him with a female candidate. Opponents of SB 826 have also stated that the bill violates the internal affairs doctrine, which provides that the laws of the state where a company is incorporated should regulate the company's internal governance. They point out that SB 826 may not be enforceable against California-headquartered companies that are incorporated in other states (such as Delaware), because the bill may be inconsistent with the laws of the jurisdiction of incorporation.

Notably, despite these potential challenges, the bill highlights an international trend toward greater diversity on public company boards. Norway has mandated that 40 percent of seats on a board of directors be held by women. Spain, Belgium, France, Italy and the Netherlands have passed similar laws. Germany, the largest economy to adopt such a requirement, set a 30 percent quota for women on boards. The UK has adopted non-binding targets, currently set at 33 percent, for women on boards of directors at FTSE 100 and FTSE 350 companies. India has also passed a requirement that public companies include at least one woman director.

Institutional investors in the U.S. have also been pushing for greater gender diversity among directors. In 2017, State Street Global Advisors identified 476 companies within the Russell 3000 Index, the U.K.'s FTSE 350, and the S&P/ASX 300 in Australia that had no female directors. State Street Global Advisors voted against nominating committee chairs at 400 of those companies because they failed to make any significant efforts to address the issue. The investment firm BlackRock has also focused on gender diversity in the boardroom, stating in its voting guidelines that they would expect to see at least two female directors on every board. Public employee retirement funds CalPERS and CalSTRS have similarly pushed for diversity, including gender diversity, on boards.

Given these trends, companies may consider taking the following steps now to address their board composition for the long term:

- Recruit director candidates using broader networks. Consider working with search agencies that cast a broad net.
- Expand board member search criteria. For example, consider individuals in management roles at private or smaller public companies and consider individuals in a variety of roles, including finance, law, marketing, product management or operations, as well as in complimentary industries.
- Rather than considering candidates for board vacancies as they arise, develop long-term plans regarding the next few vacancies that will arise and what skills the board will need in the medium to long term.
- Increase female representation not only on the board, but throughout the organization, including in senior management positions, to increase the appreciation for gender diversity at all levels of the organization.
- Communicate to investors the company's efforts to enhance diversity on its board and within its organization through publicity materials, proxy statements, websites and other media.
- Ensure that diverse candidates are fully engaged and involved in the board and committee process in order to elicit the greatest benefit from diverse views.

Regardless of whether or not SB 826 is enacted and any potential ripple effect from it, gender diversity on boards has gained momentum and companies increasing the diversity of their boards will be better prepared to respond to the demands of their investors, shareholders and constituents.

Maj Vaseghi *is a partner at Latham & Watkins LLP.* **Sarah Ray** *is a partner at Latham & Watkins LLP. She is co-chair of the firm's Women Enriching Business (WEB) Committee.*

VASEGHI

RAY