

Mandating Board Diversity

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ABSTRACT

California’s Assembly Bill 979 (AB-979) requires companies that are based in California to have a specified minimum number of directors from underrepresented communities. A “director from an underrepresented community” is 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. AB-979 received much attention for being the first law to mandate greater diversity on corporate boards in terms of race and sexual orientation. Senate Bill 826 (SB-826), which was introduced two years prior, was the first U.S. legislative effort to mandate greater gender diversity on corporate boards. AB-979 and SB-826 have received both intense praise and vehement criticism. The debate over the California board diversity bills raises fundamental questions about the proper role of the state in using its power to regulate corporations to advance public values. In this Article, I summarize and respond to the various legal challenges that have been raised against California’s board diversity bills and argue that the precedent-setting efforts of the California legislature are consistent with the original design of corporate law in the United States, which is built on a model of federalism and state competition.

INTRODUCTION

On September 30, 2020, California Governor Gavin Newsom signed into law Assembly Bill 979 (AB-979), which requires publicly held¹ domestic and foreign corporations headquartered in California² to appoint at least one director from an underrepresented community on their boards by the close of the 2021 calendar year.³ Under AB-979, a “director from an underrepresented community” is defined as an individual who self-identifies as Black, African American, Hispanic, Latino, Asian,

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1. Under AB-979, “publicly held corporation” means “a corporation with outstanding shares listed on a major United States stock exchange.” CAL. CORP. CODE § 301.4(e)(2).

2. The location of a corporation’s headquarters will be determined according to its Form 10-K. *Id.* § 301.4(a)–(b). Domestic and foreign corporations that are publicly held and headquartered in California will be referred to herein as “California-based corporations.”

3. By the end of the 2022 calendar year, California-based corporations with more than four but fewer than nine directors will be required to have at least two directors from an underrepresented community on their boards, and those with nine or more directors will be required to have at least three such directors. *Id.* § 301.4(b)(1)–(2).

Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender.⁴

Two years prior to the signing of AB-979, Senate Bill 826 (SB-826), which requires California-based corporations to have a specified minimum number of female⁵ directors on their boards within prescribed time periods,⁶ was signed into law. Both AB-979 and SB-826 (collectively referred to herein as the “California Board Diversity Bills”) have received both intense praise and criticism.⁷

Even critics of the California Board Diversity Bills agree that demographic disparities exist in corporate boardrooms.⁸ However, critics view these bills as arbitrarily privileging females over males and arbitrarily privileging transgender females and females of color over other females.⁹ Supporters view these bills as an

4. *Id.* § 301.4(e)(1).

5. Under SB-826, “female” means “an individual who self-identifies her gender as a woman, without regard to the individual’s designated sex at birth.” *Id.* § 301.3(f)(1).

6. *Id.* § 301.3(a)–(b).

7. Compare California Chamber of Commerce, et al., Letter of Opposition, *SB 826 (Jackson) Corporations: Board of Directors Oppose – As Amended May 25, 2018* 2–3 (2018) (claiming SB-826 would violate state and federal constitutions and conflict with existing civil rights laws) with Sheri Byrne-Haber, *California Law AB 979 Promoting Board Diversity Does Not Go Far Enough*, MEDIUM (Jan. 22, 2021), <https://sheribyrehaber.medium.com/california-law-ab-979-promoting-board-diversity-does-not-go-far-enough-a85c5a8b7188> (referring to AB-979 and SB-826 as “cutting edge diversity . . . protection laws” and urging even greater reform).

8. See, e.g., Chase DiFelicianantonio, *Bill Requiring Diverse Boards in California Could Have Broader Impact*, S.F. CHRONICLE (Sept. 6, 2020, 4:00 AM), <https://www.sfchronicle.com/business/article/Bill-requiring-diverse-boards-in-California-could-15544746.php> (quoting a spokeswoman for the Pacific Legal Foundation, which has brought legal challenges against the California Board Diversity Bills, as saying, “The purpose of the ongoing lawsuit is not to deny discrimination or disparities exist”); Joseph A. Grundfest, *Mandating Gender Diversity in the Corporate Boardroom: The Inevitable Failure of California’s SB 826* 1 (Stanford L. Sch. & The Rock Ctr. for Corp. Governance, Working Paper No. 232, 2018) (“There are too few women at the table in America’s corporate boardrooms. There are also too few ethnic minorities.”).

9. Keith Paul Bishop, *California Legislature Passes Corporate Board Racial/Ethnic/Gender Quota Bill*, NAT’L L. REV. (Aug. 31, 2020), <https://www.natlawreview.com/article/california-legislature-passes-corporate-board-racialethnicgender-quota-bill> [hereinafter Bishop Quota Bill (2020)]; see also Patrick McGreevy, *California Corporations Would be Required to Diversify Their Boards Under Bill Sent to Newsom*, L.A. TIMES (Aug. 30, 2020), <https://www.latimes.com/california/story/2020-08-30/california-corporations-diversify-boards-directors-legislature>; Keith Paul Bishop, *California Enacts Novel Female Board Quota Legislation*, CALIF. LAWS. ASSOC. BUS. L. 10, 13–14 (2019) [hereinafter Bishop (2019)] (discussing concerns regarding the constitutionality, firm value impact, effectiveness, and potential negative impacts on minority groups of SB-826); Christina Sandefur, *Good News for Gender Equality as Court Green Lights Meland v. Padilla*, ORANGE CNTY. REG. OPINION, <https://www.oregister.com/2021/08/01/good-news-for-gender-equality/> (last updated Aug. 1, 2021) (opposing SB-826 for being “dangerous” to everyone’s best interests).

effective means of opening seats on California corporate boards, which had thus far been occupied primarily by white men, to a more diverse group of individuals.¹⁰

The data on corporate board composition in California and the rest of the country demonstrate a consistent trend of unequal results.¹¹ A recent study by the Latino Corporate Directors Association reported that 87% of California-based public companies have *no* Latinx directors on their boards despite 39.4% of California's residents identifying as Latinx.¹² According to the 2020 Deloitte and Alliance for Board Diversity nationwide study, only 8.7% of Fortune 500 company board seats were held by African Americans/Blacks, only 4.1% by Hispanics/Latinx, and only 4.6% by Asians/Pacific Islanders.¹³ Additionally, research by Out Leadership's Quorum and Ropes & Gray LLP found that approximately twenty-four of the 5670 Fortune 500 company board seats in 2020 were held by openly LGBTQ+ individuals, and only two of those individuals were also people of color.¹⁴

While the use of a quota is blunt and not without its own harmful consequences,¹⁵ its key benefit is that it is an effective means of achieving greater equality of results within prescribed time periods. Notably, since the signing of SB-826, the number of women on California-headquartered Russell 3000 boards has nearly doubled from 480 to 964.¹⁶ While it would be naïve to believe that a quota could permanently correct the problem of the lack of diversity on corporate boards, it does invite more diverse perspectives to be heard as corporations navigate and implement more long-term and sustainable solutions.

In this Article, I examine the challenges that have been raised against the California Board Diversity Bills and examine how these challenges demonstrate precisely why the bills are needed. To begin, the often-raised concern that the California Board Diversity Bills impose an excessive economic burden on

10. In introducing AB-979, California Assembly member Chris Holden stated that people of color “need to have the same access as those who have benefitted for so long, and the time is now.” Elizabeth Castillo, *Mandate Diversity? California Bill Would Ban All-White Corporate Boards*, CALMATTERS (Aug. 4, 2020).

11. Lisa M. Fairfax, *The Bottom Line on Board Diversity: A Cost-Benefit Analysis of the Business Rationales for Diversity on Corporate Boards*, 2005 WIS. L. REV. 795, 799–801 (2005) (discussing the small percentage of people of color overall serving as directors of corporations).

12. LATINO CORPORATE DIRECTORS ASSOCIATION, 233 CA-BASED PUBLIC COMPANIES WITH ALL WHITE BOARD OF DIRECTORS (database updated July 1, 2020) (on file with author).

13. DELOITTE & ALLIANCE FOR BOARD DIVERSITY, THE MISSING PIECES REPORT: THE 2020 BOARD DIVERSITY CENSUS OF WOMEN AND MINORITIES ON FORTUNE 500 BOARDS 19 (6th ed. 2021).

14. OUT LEADERSHIP, VISIBILITY COUNTS: THE LGBTQ+ BOARD LEADERSHIP OPPORTUNITY 3 (2021).

15. See, e.g., Akshaya Kamalnath, *Diversity Quotas Will Only Lead to Token Appointments, Doing More Harm Than Good*, CONVERSATION (Feb. 25, 2020, 10:12 PM), <https://theconversation.com/diversity-quotas-will-only-lead-to-token-appointments-doing-more-harm-than-good-132244> (discussing how gender quotas may lead to token appointments).

16. Matthew Listi, *Boardroom Diversity: The Impacts of Legislation in the New Decade*, EQUILAR (June 30, 2020), <https://www.equilar.com/blogs/466-boardroom-diversity-and-impacts-of-legislation.html>.

corporations highlights why board diversity is difficult to achieve by relying on market forces or self-regulation alone. Furthermore, in response to concerns about reverse discrimination, I show how AB-979 has been carefully designed to offer protections and alternatives to the groups that may be unintentionally harmed by it. Lastly, I explain how the precedent-setting efforts of the California Board Diversity Bills are consistent with the original design of corporate law in the United States, which is built on a model of federalism and state competition.

I. BACKGROUND

AB-979 requires that a specified minimum number of board seats of a California-based corporation be filled, by the close of each of the calendar years 2021 and 2022, by members who self-identify as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identify as gay, lesbian, bisexual, or transgender.¹⁷

AB-979 authorizes California's Secretary of State to impose fines for violations of AB-979's provisions in the amount of \$100,000 for first-time violations and \$300,000 for subsequent violations.¹⁸ The amounts collected as fines must be used to administer the requirements of AB-979.¹⁹ AB-979 also requires the California Secretary of State to publish reports on its website documenting (i) the number (but not the names) of corporations that are in compliance with AB-979's provisions, (ii) the number of publicly held corporations that moved their U.S. headquarters from California to another state, (iii) the number of publicly held corporations that moved their U.S. headquarters from another state to California, and (iv) the number of publicly held corporations that were subject to AB-979's provisions during the preceding year but are no longer publicly held.²⁰

SB-826 requires that a specified minimum number of board seats of a California-based corporation be filled, by the close of each of the calendar years 2019 and 2021, by female directors.²¹ SB-826 also requires California's Secretary of State to publish reports documenting the same information relating to SB-826, and failure to satisfy the provisions of SB-826 may result in fines under the same schedule as AB-979.²²

II. LEGAL CHALLENGES FACED BY THE CALIFORNIA BOARD DIVERSITY BILLS

Both AB-979 and SB-826 have faced several legal challenges in court, with more expected to follow.²³ In this Part, I summarize and respond to the legal challenges faced by the California Board Diversity Bills.

17. CAL. CORP. CODE §§ 301.4(a)–(b), (d)(2).

18. *Id.* § 301.4(d)(1).

19. *Id.* § 301.4(d)(3).

20. *Id.* § 301.4(c).

21. *Id.* § 301.3(a)–(b).

22. *Id.* § 301.3(d)–(e).

23. In *Crest I*, three California taxpayers sought to enjoin the California Secretary of State from expending taxpayer funds and resources to enforce SB-826 on the basis that the law's express gender classification is illegal under the California Constitution. Complaint for Declaratory and Injunctive Relief, *Crest v. Padilla*, No. 19STCV27561, 2019 WL 3771990

A. Internal Affairs Doctrine

One of the central doctrines of U.S. corporate law is the internal affairs doctrine, which provides that a corporation's internal affairs should be regulated by its state of incorporation.²⁴ One challenge to the California Board Diversity Bills is that they violate the internal affairs doctrine by extending their reach to foreign corporations with California headquarters.²⁵ It should be noted, however, that the internal affairs doctrine is not a constitutional principle,²⁶ and the scope of "internal affairs" is not fixed.²⁷

While acknowledging the benefits of consistency and predictability of the internal affairs doctrine, as well as the firm position that it holds in corporate law, it is important to also recognize its limits. In another article, I argued that the status and scope of internal affairs should evolve with changing circumstances.²⁸ More recently, Jill Fisch and Steven Davidoff Solomon have proposed that the scope of internal

(L.A. Sup. Ct. filed Aug. 6, 2019) (*Crest I*). In *Crest II*, the same three California taxpayers sought to enjoin the California Secretary of State from enforcing AB-979 on similar grounds as *Crest I*. Reply in Support of Demurrer of Secretary of State Alex Padilla to First Amended Complaint, *Crest v. Padilla*, No. 20STCV37513, 2020 WL 8409156 (L.A. Sup. Ct. filed Sept. 30, 2020) (*Crest II*). In *Meland v. Padilla*, a shareholder of a California-headquartered corporation with an all-male board sought a declaratory judgment and injunction on the basis that the law is a sex-based classification that violates the Equal Protection Clause of the U.S. Constitution and harms shareholder voting rights. *Meland v. Padilla*, No. 2:19-CV-02288-JAM-AC, 2020 WL 1911545 (E.D. Cal. Apr. 20, 2020), *rev'd*, *Meland v. Weber*, 2 F.4th 838 (9th Cir. 2021); *see also* Complaint for Declaratory and Injunctive Relief, All. for Fair Bd. Recruitment v. Weber, No. 2:21-cv-05644-RGK-RAO (July 12, 2021) (challenging both SB-826 and AB-979); Evan Symon, *Judicial Watch Files Lawsuit to Halt California's Mandatory Board Diversity Law*, CAL. GLOBE (Oct. 6, 2020, 3:17 PM), <https://californiaglobe.com/section-2/judicial-watch-files-lawsuit-to-halt-californias-mandatory-board-diversity-law/>.

24. *See* *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 91 (1987) ("It is thus an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.")

25. Pamela S. Palmer, James H.S. Levine, Howard Privette & Samantha K. Burdick, *Legal or Not, it's Working: Mandatory Board Diversity for Publicly-Held Companies Headquartered in the Golden State*, WESTLAW TODAY (Apr. 7, 2021) (noting the internal affairs doctrine as a potentially potent defense against the California Board Diversity Bills for entities incorporated outside of California); Stephen M. Bainbridge, *Can California Require Delaware Corporations to Comply with California's New Board of Director Gender Diversity Mandate?* No., PROFESSORBAINBRIDGE.COM (Sept. 1, 2018), <https://www.professorbainbridge.com/professorbainbridgecom/2018/09/can-california-require-delaware-corporations-to-comply-with-californias-new-board-of-director-gender.html>.

26. Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 597 (2003) (describing the internal affairs doctrine as "an understanding, not a crisp constitutional rule").

27. Sung Eun ("Summer") Kim, *Corporate Long Arms*, 50 ARIZ. ST. L.J. 1067, 1077-78 (2018) (claiming that the scope of internal affairs shifts over time).

28. *Id.*

affairs be limited to rules oriented toward enhancing firm economic value, thus excluding social matters such as board diversity.²⁹

Furthermore, the internal affairs doctrine must be balanced against the general power that states have to regulate not only domestic corporations but also foreign corporations doing business within its state.³⁰ Notably, a state has the power to prevent a foreign corporation from transacting within the state's borders if the corporation fails to adhere to the laws that apply to domestic corporations.³¹ Indeed, California's corporate long arm power, from which the California Board Diversity Bills are derived, originated from California's constitution, which then provided that "[n]o corporation organized outside the limits of this State shall be allowed to transact business within this State on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State."³²

While the Full Faith and Credit Clause of the U.S. Constitution requires a state to respect the corporations statute of a corporation's home state, the same clause also requires a state to respect the corporations statute of a host state to the extent that such host state has a legitimate interest in regulating that corporation's activity.³³ The California Board Diversity Bills advance the state's interest in addressing continued patterns of disparities on the boards of companies that are headquartered in the state. Furthermore, the bills make equal demands of domestic and foreign corporations that are headquartered in California.³⁴

B. Dormant Commerce Clause

Another challenge to the California Board Diversity Bills is that they violate the Dormant Commerce Clause, which provides that states cannot exercise legislative power to discriminate against or unduly burden interstate commerce, even in the absence of federal legislation regulating the activity.³⁵

Adding an additional board member to a board can be costly and burdensome to corporations,³⁶ and recent research shows that the cost of compliance is especially

29. Jill E. Fisch & Steven Davidoff Solomon, Centros, *California's "Women on Boards" Statute and the Scope of Regulatory Competition*, 20 EUR. BUS. ORG. L. REV. 493, 495 (2019) (arguing that SB-826 falls outside the scope of the internal affairs doctrine).

30. Stanley A. Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 442 n.22 (1968) (referring to the four cardinal principles that apply to foreign corporations).

31. *Id.*

32. CAL. CONST. art. XII, § 15 (repealed 1972).

33. See G. HENDERSON, *THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTION LAW* ch. VII (1918).

34. See CAL. CORP. CODE § 301.4(a) (offering no different treatment to domestic and foreign corporations).

35. *Dormant Commerce Power: Overview*, CONSTITUTION ANNOTATED, https://constitution.congress.gov/browse/essay/artI_S8_C3_1_4_1/.

36. Alisha Haridasani Gupta, *California Companies Are Rushing to Find Female Board Members*, N.Y. TIMES (Jan. 14, 2020), <https://www.nytimes.com/2019/12/17/us/california-boardroom-gender-quota.html> ("For these companies [that lack female representation on their boards], adding an additional board member can be costly."); Sunwoo Hwang, Anil Shivdasani & Elena Simintzi, *Mandating Women on Boards: Evidence from the United States* 1, 5–7, 37

high for smaller companies and poorly governed firms.³⁷ Some also point to the negative market impact of the California Board Diversity Bills³⁸ as evidence of their burden on California-based corporations.

A number of studies taking a longer view highlight the economic benefits of more diverse corporate boards. A 2018 McKinsey & Company study found that companies in the top quartile for gender diversity and in the top quartile for racial and ethnic diversity were respectively 21% and 33% more likely to have higher financial returns.³⁹ A study by Dalberg Global Development Advisors found that the high-tech industry could generate up to an additional \$370 billion each year if the racial or ethnic diversity of tech companies' workforces reflected the diversity of the underlying talent pool.⁴⁰

Investors are generally looking for a financial return on their investments, in many cases on a short-term horizon,⁴¹ which is why relying on markets or self-regulation alone cannot achieve greater board diversity. This short-term perspective tends to overweigh the immediate costs of recruiting diverse members to the board, while underweighting the long-term benefits of greater diversity on corporate boards. The California Board Diversity Bills and other similar legislative and regulatory initiatives seek to correct this short-term bias by adding more weight to the long-term and social objectives of corporations.

It should also be noted that the California Board Diversity Bills have been designed to limit their disruptive impact. First, they give companies fifteen months

(Kenan Instit. of Private Enter., Research Paper No. 18-34, 2021), <https://ssrn.com/abstract=3265783> (finding that the supply-constraints of identifying new, qualified female directors from a limited labor pool can generate costly skill mismatching between firms and directors).

37. See Lisa M. Fairfax, Symposium, *All on Board? Board Diversity Trends Reflect Signs of Promise and Concern*, 87 GEO. WASH. L. REV. 1031, 1055 (2019) (“[E]mpirical evidence indicates that board diversity efforts are more difficult at smaller companies.”); Daniel Greene, Vincent J. Intintoli & Kathleen M. Kahle, *Do Board Gender Quotas Affect Firm Value? Evidence from California Senate Bill No. 826*, 60 J. CORP. FIN. 1, 2–3 (2020) (suggesting that board diversity mandates are more costly for firms where the “supply of female candidates is limited or when firm governance is weaker”).

38. The statistical findings of market returns for California-headquartered corporations following the implementation of SB-826 have varied among studies, but the currently available research generally points to a negative market impact of SB-826 in the short-term. Hwang et al., *supra* note 36, at 6, 30 (finding a return of -1.4% for firms headquartered in California upon the adoption of SB-826); Felix von Meyerinck, Alexandra Niessen-Ruenzi, Markus Schmid & Steven Davidoff Solomon, *As California Goes, So Goes the Nation? Board Gender Quotas and the Legislation of Non-Economic Values* (European Corp. Governance Inst., Working Paper No. 785, 2021), <https://ssrn.com/abstract=3303798> (finding a return of -2.6% for firms headquartered in California upon the adoption of SB-826).

39. VIVIAN HUNT, SARA PRINCE, SUNDIATU DIXON-FYLE & LAREINA YEE, MCKINSEY & CO., *DELIVERING THROUGH DIVERSITY* 8 (2018).

40. DALBERG & INTEL, *DECODING DIVERSITY: THE FINANCIAL AND ECONOMIC RETURNS TO DIVERSITY IN TECH* 14 (2016).

41. Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 267 (2012) (discussing concerns regarding short-term approaches to value creation in corporate governance).

to comply with their full provisions.⁴² Second, California-based corporations that are not currently in compliance with the statutes have a number of options, including increasing or decreasing the total number of board seats to satisfy the bills' requirements; paying a fine; or moving their U.S. headquarters outside of California, thereby removing themselves from the reach of the California Board Diversity Bills.⁴³ Third, the California Secretary of State is only required to report the *number* of corporations that are in compliance with AB-979's and SB-826's provisions and not the *names* of corporations that are or are not in compliance.⁴⁴ The particularities of the reporting requirements suggest that they are intended as an inventorying mechanism rather than as an attempt to name and shame noncompliant corporations.

C. Equal Protection Clause

In the eyes of many critics, the most problematic aspect of the California Board Diversity Bills is that the bills facially discriminate on the basis of race, gender identity, or sexual orientation.⁴⁵ Recently, the Ninth Circuit Court of Appeals found that a plaintiff-stockholder plausibly alleged that SB-826 required or encouraged discrimination based on sex.⁴⁶ The primary issue on remand is whether SB-826's gender-based mandate passes constitutional scrutiny.⁴⁷

One of the most vocal critics of the California Board Diversity Bills has been former California commissioner of corporations Keith Bishop.⁴⁸ Bishop has called AB-979 "divisive, arbitrary and unconstitutional."⁴⁹ At the hearing for AB-979, Bishop spoke about the adverse impact that the bill will have on male and nonbinary persons on corporate boards of directors, noting that the bill arbitrarily privileges females from underrepresented communities over males from those same communities and transgender females over other females.⁵⁰ Another vocal critic of AB-979 has been the Pacific Legal Foundation (PLF), which has argued that one's skin color, sex, or sexual orientation should not determine one's job opportunities.⁵¹

42. See CAL CORP. CODE §§ 301.3(a) (giving subject corporations until the close of the 2019 calendar year to comply), 301.4(a) (giving subject corporations until the close of the 2021 calendar year to comply).

43. Casey Leins, *Report: Some California Corporations Ignore Law Requiring Females on Boards*, U.S. NEWS (Mar. 4, 2020, 3:17 PM), <https://www.usnews.com/news/best-states/articles/2020-03-04/many-california-corporations-refuse-to-follow-gender-diversity-law-report-finds>.

44. CAL CORP. CODE §§ 301.3(d)(1), 301.4(c)(1).

45. See, e.g., Keith Paul Bishop, *Will AB 979 Expose Corporations To Section 1983 Liability?*, NAT'L L. REV. (Sept. 15, 2020), <https://www.natlawreview.com/article/will-ab-979-expose-corporations-to-section-1983-liability> [hereinafter Bishop Liability (2020)]; Symon, *supra* note 23.

46. *Meland v. Weber*, 2 F.4th 838, 846 (9th Cir. 2021).

47. *Id.*

48. *Hearing on A.B. 979 Before the Assemb. Comm. on Banking & Fin.* 3 (2020); see also Bishop (2019); Bishop Quota Bill (2020); Bishop Liability (2020).

49. McGreevy, *supra* note 9.

50. *Id.*

51. Anastasia Boden & Daniel Ortner, *Racial Quotas Have an Ugly Pedigree. California Shouldn't Try to Bring them Back*, S.F. CHRON. (Sept. 16, 2020),

The composition of corporate boards suggests, however, that one's skin color, sex, or sexual orientation has historically been a limiting factor when it comes to opportunities to serve on corporate boards.⁵² Furthermore, the California Board Diversity Bills still leave room for multiple board seats to be occupied by members of the groups that Bishop and others fear could face reverse discrimination. Ultimately, as mentioned above, corporations have the option to move their headquarters to another state or maintain a board that does not comply with the California Board Diversity Bills, bearing any economic and social consequences of that decision.⁵³

Christopher Riley has pointed out the careful design considerations of SB-826 that place it within the bounds of the California Constitution,⁵⁴ and the same reasoning can also be extended to AB-979. To briefly summarize Riley's points here—first, corporate board appointments are not under the purview of state action, and only state action is limited by prohibitions on state affirmative action plans; second, the California Board Diversity Bills apply to corporate board positions, which are not considered common occupations, and only common occupations are protected by the right to pursue employment; third, California has a compelling interest in creating a diverse workforce that is more representative of the diversity of its residents; and fourth, there is favorable California precedent that supports an antisubordination framework as establishing a compelling state interest in remedying historical underrepresentation.⁵⁵ Women and minorities have been underrepresented on corporate boards and management positions,⁵⁶ especially in the tech sector,⁵⁷ and the California Board Diversity Bills seek to remedy these gaps.

III. CORPORATE FEDERALISM

Corporate regulation in the United States is based on a federal model under which corporate law is supplied by state law, with a handful of matters reserved for federal regulation.⁵⁸ This model lends itself to greater diversity, experimentation, pluralism, and competition.⁵⁹ In this Article, I argue that the California Board Diversity Bills are prime examples of these values of federalism at work.

<https://www.sfchronicle.com/opinion/openforum/article/Racial-quotas-have-an-ugly-pedigree-California-15569927.php>.

52. *See supra* notes 11–14.

53. *See supra* note 43 and accompanying text.

54. Christopher J. Riley, *An Equal Protection Defense of SB 826*, CALIF. L. REV. ONLINE (July 2020), <http://californialawreview.org/equal-protection-defense-sb826>.

55. *Id.*

56. *See supra* notes 11–14.

57. Using data collected in 2014, the EEOC's Diversity in High Tech report shows that Whites are represented at a higher rate in the executives category, and fewer than 1% of Silicon Valley executives and managers are African American. U.S. EQUAL EMP. OPPORTUNITY COMM'N, SPECIAL REPORT, DIVERSITY IN HIGH TECH (2016), <https://www.eeoc.gov/special-report/diversity-high-tech>. *See also* Jennifer S. Fan, *Innovating Inclusion: The Impact of Women on Private Company Boards*, 46 FLA. ST. U. L. REV. 345 (2019).

58. *See* D. GORDON SMITH & CYNTHIA A. WILLIAMS, BUSINESS ORGANIZATIONS 309–10 (4th ed. 2018) (discussing corporate federalism in relation to shareholder voting).

59. *See* Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for*

Most commentators, including those who oppose the California Board Diversity Bills, seem to agree that the lack of diversity on corporate boards is a problem.⁶⁰ Corporate directors exert considerable power over U.S. corporations and their stakeholders, and in turn, our society, and the data reveals that this power is concentrated in the hands of a few demographic groups.⁶¹ While there have been calls from investors, regulators, and consumers for greater diversity on boards, progress has been slow.⁶²

Through the California Board Diversity Bills, California has taken one step toward offering a solution to the problem of lack of diverse representation on corporate boards. And early indications suggest that the bills are doing their intended work. In the two years following the implementation of SB-826, the number of women on California-headquartered Russell 3000 boards nearly doubled⁶³ and has led to various efforts to widen the talent pool. In connection with the California Board Diversity Bills, the state has created a registry that collects the résumés of underrepresented candidates and has hosted several webinars for prospective women board directors.⁶⁴ Furthermore, both bills have led to more academic and professional attention being given to diversity on boards and have facilitated deeper conversations about the role and function of boards and the need for greater diversity thereon.⁶⁵

Even if the pending and potential future legal challenges to the California Board Diversity Bills are successful, the bills will still have done some of their intended work. The law firm Morrison & Foerster LLP advises its clients: “Despite potential challenges to the law, companies with their principal executive offices in California should closely monitor this law, as well as their own board compositions.”⁶⁶ The

Corporate Governance?, 21 OXFORD REV. ECON. POL'Y 212 (2005) (discussing how competitive federalism has been beneficial to U.S. corporate governance); Marcel Kahan & Edward B. Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1590 (2005) (arguing that the relationship between federal and state corporate regulation is symbiotic, with one regulator supplying laws where another regulator is more constrained).

60. See *supra* note 8 and accompanying text.

61. See *supra* notes 11–14.

62. Lisa M. Fairfax, *Board Diversity Revisited: New Rationale, Same Old Story*, 89 N.C. L. REV. 855, 866–68 (2011).

63. See *supra* note 16 and accompanying text.

64. See Press Release, Fiona Ma, California State Treasurer, Six Hundred Women Registered for August Webinar on What It Takes to Get a Corporate Board Seat in California (Aug. 18, 2020) (on file with author).

65. See, e.g., Gupta, *supra* note 36 (“Board seats are being redefined as functional roles instead of everybody being former C.E.O.s and C.F.O.s.”).

66. *New California Law to Require Representation from “Underrepresented Communities” on Boards of Public Companies Headquartered in California*, MORRISON FOERSTER CLIENT ALERT (Aug. 31, 2020), <https://www.mofo.com/resources/insights/200831-new-california-law.html>.

California Board Diversity Bills have also coincided with and inspired similar initiatives at the industry,⁶⁷ stock exchange,⁶⁸ and international levels.⁶⁹

Certainly, the California Board Diversity Bills have some limitations. For one, the bills apply only to publicly traded corporations that are headquartered in California.⁷⁰ Furthermore, the bills do not apply to private corporations or to corporations headquartered outside of the state of California, even if they hold significant property, employee, or revenue interests in California. While a corporation's California headquarters is one proxy of California's interest, it is incomplete. In addition, the bills also rely on self-identification by prospective board members,⁷¹ and may pressure candidates to make unwanted disclosures.⁷²

These limits leave room for other states to step in to fill these open gaps. The full impact of the California Board Diversity Bills should be measured not only by their impact on California-based corporations but also by the impact they have on other states and actors to implement more efficient and creative ways to achieve greater diversity on corporate boards. This propagating effect is a virtue of the federalist system of U.S. corporate law.

67. For example, the financial adviser Goldman Sachs has declared it would only take a firm public if the firm had at least one diverse board member. *Goldman Sachs' Commitment to Board Diversity*, GOLDMAN SACHS (Feb. 4, 2020), <https://www.goldmansachs.com/what-we-do/investing-and-lending/launch-with-gs/pages/commitment-to-diversity.html>. Another recent and widely publicized development was Reddit founder Alexis Ohanian's decision to step down from the Reddit board to make way for Michael Seibel, the CEO of the Bay Area startup incubator Y Combinator, who is Black. Seth Cohen, *By Asking to Be Replaced by a Black Person, Reddit's Alexis Ohanian Boldly Shows How to Be an Ally for Racial Inclusion*, FORBES (June 5, 2020, 5:53 PM) (on file with author).

68. The Securities and Exchange Commission recently approved the Nasdaq Stock Market LLC's (Nasdaq) Board Diversity Proposal, which requires companies listed on Nasdaq's U.S. exchange to publicly disclose board-level diversity statistics and to explain why a company's board is not diverse, where applicable. SEC. & EXCH. COMM'N, RELEASE NO. 34-92590, ORDER APPROVING PROPOSED RULE CHANGES TO ADOPT LISTING RULES RELATED TO BOARD DIVERSITY AND TO OFFER CERTAIN LISTED COMPANIES ACCESS TO A COMPLIMENTARY BOARD RECRUITING SERVICE (2021) (approving Nasdaq Rules 5606(f) and 5606(a)).

69. A revision was recently passed to add Article 165-20 to Korea's Financial Investment Services and Capital Markets Act, which prohibits corporate boards from being formed entirely of the same gender, with a grace period of two years. Enforcement Law No. 16958 [Financial Investment Services and Capital Markets Act], *adding art. 165-20*, Aug. 5, 2020 (S. Kor.).

70. CAL. CORP. CODE §§ 301.3(a)–(b), 301.4(a)–(b).

71. *Id.* §§ 301.3(f)(1), 301.4(e)(1).

72. Laura Weiss, *California Board Diversity Mandate Fuels Debate in Other States*, CONGRESS, CONG. Q. ROLL CALL, Westlaw (2019) (“Commissioner Hester M. Peirce, a Republican and often an ardent adversary of government regulation, dedicated a speech at the San Diego conference to her concerns with California's law and with requirements that companies report board diversity information, which she said could push people to publicly share personal information against their wishes.”).

IV. ALTERNATIVES AND NEXT STEPS

The present unequal composition of U.S. corporate boards has been widely acknowledged, even by the most vocal critics of the California Board Diversity Bills.⁷³ Joseph Grundfest, who has been critical of the bills, suggests that California should rather use its significant capital market influence to encourage institutional investors to effect change through shareholder activism.⁷⁴ Other alternatives have also been proposed, including a tax incentive plan to induce corporations to create more diverse boards and reformulating the bills into a sunset provision encapsulated in another law, so that they would expire within a short period without reapproval.⁷⁵

These alternative reforms are not mutually exclusive with the California Board Diversity Bills. The bills are not intended to be a cure all or an exclusive solution to the problem of lack of diversity on U.S. corporate boards. Rather, they are one in a series of many steps in the long journey toward a more equal society. The true value of the California Board Diversity Bills is to be measured by not only the changes they propel in the companies they regulate but also by the attention they have brought to the issue of lack of diversity on corporate boards and the alternative solutions they have inspired. By this measure, the California Board Diversity Bills can be said to have done more in three years than was accomplished in the preceding three decades.

73. See *supra* note 8 and accompanying text.

74. Grundfest, *supra* note 8, at 8.

75. Teal N. Trujillo, Note, *Do We Need to Secure a Place at the Table for Women? An Analysis of the Legality of California Law SB-826*, 45 J. LEGIS. 324, 344–47 (2018).