

# California Court Rules State Board Diversity Requirement Unconstitutional — Where Do We Go From Here?

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Earlier this month, a Los Angeles County Superior Court order put the brakes on one of California's much contested board diversity requirements, a decision certain to reverberate among the business community and efforts to pass or enforce similar laws elsewhere. The April 1, 2022 ruling is the first of several long-awaited decisions in the variety of legal challenges to California's [Assembly Bill 979](#), and corresponding gender diversity requirements under [SB 826](#).

## Background

AB 979 requires boards of directors for publicly held (those traded on major U.S. stock exchanges) California-headquartered companies to include a certain number of directors from underrepresented communities. SB 826, an earlier statute, mandates a similar gender diversity requirement. Both statutes implemented staggered deadlines for applicable companies to appoint a minimum number of directors that met the laws' respective categories, with significant penalties for noncompliance.

These requirements invited a variety of legal challenges in California state and federal courts. In a pair of lawsuits, both called *Robin Crest et al. v. Alex Padilla* ("*Crest I*" and "*Crest II*") several taxpayers backed by the organization Judicial Watch sued California's Secretary of State, challenging each statute's constitutionality and the state's use of taxpayer resources to implement each law's requirements. The April 1 ruling granted those plaintiffs' motion for summary judgment in *Crest II*, enjoining the state from enforcing AB 979. The court denied California's own motion that contested the plaintiffs' legal standing to assert their lawsuit. *Crest I* remains undecided, but a similar result is probable.

## Is this the end of the road?

No. California will probably appeal. In that event, a stay will likely issue on the injunction in which case, California could continue to enforce AB 979's requirements. As such, companies subject to the statute should not ignore their 2022 reporting requirements, which, depending on those companies'

board composition, may include adding additional directors above the law's Dec. 31, 2021 single director deadline. Similarly, SB 826's gender diversity requirements remain in effect until further notice. If and when courts issue similar rulings against either law in other pending challenges, companies should expect the same sequence of events. In other words, applicable companies should continue to comply with either law until the issue is finally settled.

## Outside California

For NASDAQ listed companies, the *Crest II* decision may not even move the needle. On Aug. 6, 2021, the SEC approved what is now [NASDAQ Listing Rule 5605\(f\)](#), mandating new disclosure obligations for listed companies relating to Rule 5605's board diversity requirements. In the simplest terms, Rule 5605(f) requires most listed companies to have two or more diverse board members — at least one of whom self-identifies as female, and one of whom self-identifies as belonging to the LGBTQ+ community or to an underrepresented minority. This requirement is subject to some meaningful exemptions and exceptions.

The latest Board Diversity Matrix instructions that outline those disclosure requirements are available [here](#), and listed companies must comply by Aug. 8, 2022, unless certain proxy statement or annual reporting filings extend that deadline. NASDAQ provides [additional guidance](#), but companies subject to these rules should work with their legal advisors to ensure compliance.

## Practical, Business, and Legal Considerations

To date, the business community has generally not opposed recent board diversity requirements, and many companies have complied with alacrity. California reported minimal violations of SB 826 and AB 979 since the first reporting deadlines in 2019. The *Crest II* court even prefaced its opinion with thoughtful support for those laws' intended effects, describing the objective business advantages attendant to companies' diversification at the board level, namely the benefit of expanded perspectives and backgrounds. Companies' inclusivity efforts, whether at the board, leadership, and/or workforce level, may carry the added benefit of general goodwill among employees, consumers, and shareholders. Companies, in turn, should engage these efforts with a similar eye towards building stronger protections around governance disputes, shareholder challenges, and other labor and employment issues.

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