

California Introduces New Diversity Disclosure Obligations for Venture Capital Companies

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On October 8, 2023, in an effort to improve the diversity of venture capital investment in the state, California Governor Gavin Newsom signed Senate Bill No. 54 (SB 54) into law. SB 54 requires venture capital companies (VCC) to collect and report information about their funding determinations, including demographic information for the founding teams of each VCC's portfolio companies, to the state's Civil Rights Department (CRD).

Who must comply?

SB 54 broadly applies to VCCs that are headquartered in California, have a significant presence or operational office in California, make investments in businesses in California, or solicit or receive investments from a person who is a resident of California.

What is required?

Reports

Each year a VCC will need to provide a report to the CRD that includes, at an aggregated level and on an anonymized basis, the following information on the founding teams of the portfolio companies in which the VCC invested during the prior calendar year, to the extent that information was provided to the VCC under a standardized survey (described in further detail below):

- the gender identity of each member of the founding team, including nonbinary and gender-fluid identities;
- the race of each member of the founding team;
- the ethnicity of each member of the founding team;
- the disability status of each member of the founding team;
- whether any member of the founding team identifies as LGBTQ+;
- whether any member of the founding team is a veteran or a disabled veteran;
- whether any member of the founding team is a resident of California; and
- whether any member of the founding team declined to provide any of the information

described in the above clauses, inclusive.

For purposes of SB 54, a founding team member means either of: (1) a person who owned initial shares or similar ownership interests of the business; who contributed to the concept of, research for, development of, or work performed by the business before initial shares were issued; and who was not a passive investor in the business or (2) a person who has been designated as the chief executive officer, president, chief financial officer, or manager of a business, or who has been designated with a role with a similar level of authority as any of those positions.

Additionally, VCCs will need to provide information on: (a) the number of investments in businesses primarily founded by diverse founding team members, (b) the total amount of investments to businesses primarily founded by diverse founding team members, (c) the total amount of money in investments the VCC invested in each business during the prior calendar year, and (d) the principal place of business of each company in which the VCC made an investment during the prior calendar year. VCCs will also need to retain records related to its compliance with the reporting obligations for at least four years after delivery of its report and the CRD is entitled to examine such records to confirm compliance with the law.

Surveys

In order to collect the information included in the reports described above, VCCs are required to provide a survey (in a form standardized by the CRD) to each of the VCC's investments founding team members, but the survey cannot be provided until after the VCC has actually invested in the portfolio company. For example, the survey cannot be included as part of the VCC's pre-investment diligence questionnaire or materials. The survey results must also be collected in a manner that does not associate the response information with an individual founding team member.

How will the information provided by VCCs be used?

The CRD is required to make the reports received from the VCCs readily accessible, easily searchable, and easily downloadable on its website.

What is the compliance timeline?

The first reports are due to the CRD on March 1, 2025. However, this initial enforcement date is likely to be extended. Governor Newsom, in his message to the California State Senate when signing the bill, noted that SB 54 contains "unrealistic timelines that could present barriers to successful implementation and enforcement" and, as a result, his "Administration will propose clean up language as part of the 2024-2025 Governor's Budget." It is also possible that SB 54 will face legal challenges from industry stakeholders who view the new law as overly burdensome that will result in implementation delays.

What happens if a VCC fails to comply?

If a VCC fails to comply with SB 54, it may be subject to a court action brought by CRD and/or financial penalties based on the size of the VCC, the number of assets under management of the VCC, or the nature of the VCC's failure to comply. Additionally, regardless of whether a VCC fails to comply with SB 54, CRD may use the information it obtains from the reports in a civil action brought by the CRD.

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