

July 2021

California Takes Aim at Increasing Diversity in the Boardroom

By Bambo Obaro and An Tran*

In This Issue

1 California Takes Aim at Increasing Diversity in the Boardroom

In recent years, issues regarding workplace diversity, equity, and inclusion have taken the spotlight. In Silicon Valley, Black and Hispanic representation in the workforce is at just 5% and 7.3% respectively. Levi Sumagaysay, [*We are learning more about diversity at tech companies, but it isn't good news*](#), MarketWatch (Jan. 18, 2021). In the corporate world specifically, the disparities are even starker. Only 28% of all board seats at Fortune 100 companies are held by women, and just 20% are held by directors from minority backgrounds. Deloitte, Missing Pieces Report: The Board Diversity Census of Women and Minorities on Fortune 500 Boards 10 (6th ed. 2021).

In California, various sources have ramped up the pressure on corporations to diversify their leadership ranks. The state legislature has made several attempts to address discriminatory hiring practices, going as far back as the California Fair Employment and Housing Act of 1959, and continuing more recently with action aimed at increasing diversity at the board of directors level. Shareholders have also begun taking action on both sides of the debate — some on behalf of the corporation challenging the constitutionality of such diversity requirements, and some against the boards and executives of their own corporations, alleging that those in control have failed to comply with anti-discrimination laws and have falsely touted their commitment to diversity in the workplace. At least a dozen such derivative suits have been filed across a wide range of industries, from technology to retail to healthcare.

This article discusses California's recent legislative activity in this area, and several pending shareholder derivative lawsuits on workplace diversity issues in the state.

California Legislative Action on Board Diversity

In the last few years, the California legislature has taken significant actions in its efforts to diversify corporations at the very highest level. The first of these was SB 826, which went into effect on January 1, 2019. SB 826, which added a new Section 301.3 into the California Corporations Code, required that by the end of 2019, all public corporations incorporated in or headquartered in California have a minimum of one female director on their boards. Cal. Corp. Code § 301.3(a). The statute also requires that by the end of 2021, California-based companies must have female representation proportional to the size of their boards, as follows:

- If the board has four or fewer members, a minimum of one female director;

* *Zhi Yang Tan, a summer associate at the Firm, assisted with the drafting of this article.*

- If the board has five members, a minimum of two female directors; and
- If the board has six or more members, a minimum of three female directors.

Id. at § 301.3(b). Importantly, SB 826 also empowered the Secretary of State with the discretion to enforce these requirements. *Id.* at § 301.3(e)(1). Failure to comply can result in hefty fines for corporations for each seat not filled by a female director: \$100,000 per seat for the first year, and \$300,000 per seat for all subsequent years. *Id.* at § 301.3(e)(1)(A)-(B).

In 2020, the legislature passed AB 979, the counterpart of SB 826 aimed at increasing racial and sexual orientation diversity on boards. AB 979 added a new Section 301.4 into the California Corporations Code, and instituted similar deadlines, requirements, and fines as SB 826 to encourage corporations to promote directors that come from an “underrepresented minority”, 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.” *Id.* at § 301.4(a), (b), (d)(1), (e)(1).

However, various shareholder groups contested SB 826 and AB 979 very shortly after their enactment. Of particular note, two of these lawsuits have raised important questions about the standing of shareholders to challenge these laws.

Meland v. Weber

Meland was filed on November 13, 2019 in the United States District Court for the Eastern District of California. *Meland v. Padilla*, No. 2:19-cv-02288-JAM-AC, 2020 U.S. Dist. LEXIS 69114, at *2 (E.D. Cal. Apr. 20, 2020). In *Meland*, a group of shareholders in OSI Systems, Inc., a corporation headquartered in California, alleged that SB 826 forced them to discriminate in their election of a female director to the corporation’s board. *Id.* at *2-3. The threat of penalty, they argued, meant that they were essentially pressured by the state to vote a woman onto the board, lest the company be in violation of the law. *Id.* at *8-9. California argued that the shareholders lacked standing to sue on behalf of the corporation or board members, and that the

case was not ripe because there had been no enforcement of penalties against OSI. *Id.* at *3.

The District Court ruled in favor of the state, finding that because SB 826 only placed requirements on corporations, there was no personal injury to any shareholder. *Id.* at *10. And without any enforcement against OSI (because it was in compliance with the Corporations Code at the time of the suit), there was no case or controversy to be adjudicated. *Id.* at *11. The court also invoked the shareholder standing doctrine, which generally prohibits shareholders from suing on behalf of a corporation to enforce the rights of the corporation, unless management has refused to pursue the same action for reasons other than good faith business judgment. *Id.* at *13.

However, on appeal, the Ninth Circuit reversed the District Court’s ruling. *Meland v. Weber*, No. 20-15762, 2021 U.S. App. LEXIS 18378, at *3 (9th Cir. Jun. 21, 2021). The Ninth Circuit determined that the plaintiffs had standing to sue, because they were the ones at the corporation responsible for electing members to the board of directors. *Id.* at *12. Citing prior cases where parties alleged that they were forced to discriminate because of some government rule or regulation, the court found that plaintiffs were, in fact, personally injured and had standing to challenge the validity of that government requirement, because they were pressured to make a choice: either vote to elect a woman to the board, or face the threat of penalties against the company in which they owned shares. *Id.* at *8-10. The Ninth Circuit also ruled in plaintiffs’ favor on the issue of ripeness (which the District Court did not rule on), holding that even though OSI had yet to be penalized, the existence of SB 826 meant that the shareholders were pressured to elect female directors over other qualified candidates on account of gender. *Id.* at *19-20.

Alliance for Fair Board Recruitment v. Weber

Alliance is the latest case to challenge California’s diversity-related statutes, and is the first to challenge both SB 826 *and* AB 979. Filed in the United States District Court for the Central District of California just two weeks after the Ninth Circuit’s ruling in *Meland*,

plaintiffs, a Texas-based non-profit comprised of former board candidates and current shareholders, argue that they have standing because (1) the board candidates were directly discriminated against, and (2) the shareholders' right to freely vote for the candidate of their choice was improperly impaired by the threat of fines. Complaint at ¶¶ 19-27, *Alliance for Fair Board Recruitment v. Weber*, No. 2:21-cv-05644-RGK-RAO (C.D. Cal. filed Jul. 12, 2021). California has yet to file an answer to the complaint.

Notwithstanding the plaintiffs' victory at the Ninth Circuit on the standing issue, the *Meland* and *Alliance* cases are still pending on the substantive merits, so at least for now, corporations are still beholden to the board membership requirements of SB 826 and AB 979, and must be mindful of these requirements or potentially face the financial consequences.

Shareholder Derivative Lawsuits

In addition to the risk of governmental enforcement actions, corporations are also at risk of civil actions by their own shareholders regarding diversity and discrimination issues. In particular, as the nation continues to focus acutely on the important issues of diversity, equity, and inclusion, the composition of boards of directors of public companies is also facing increased scrutiny. The allegations in such shareholder derivative suits largely have focused on these boards' alleged breach of their fiduciary duties by failing to include enough diverse directors on their boards and foster an inclusive and non-discriminatory work environment for minorities, despite repeated statements of commitment to diversity, equity, and inclusion. In one of the more recent examples of such shareholder derivative lawsuits, shareholders of Pinterest filed a derivative lawsuit on July 14, 2021, alleging that CEO Benjamin Silbermann and other company leaders fostered an environment that discriminated against minority board executives, leading to user boycotts and employee walk-outs. Complaint at ¶¶ 3, *Petretta v. Silbermann*, No. 3:31-cv-05385 (N.D. Cal.). The plaintiffs alleged that this

conduct caused hundreds of millions of dollars in reputational harm, and exposed the company to the potential of hundreds of millions of dollars in liability for state and federal law violations. *Id.* at ¶¶ 1.

That case has yet to proceed beyond the pleadings, but shareholder derivative suits alleging similar claims have thus far not been successful. For example, on July 2, 2020, shareholders of Oracle filed a derivative suit against the company for breach of fiduciary duty for allegedly failing to appoint minority board members and lying about its commitment to increasing diversity. *Klein v. Ellison*, No. 20-cv-04439-JSC, 2021 U.S. Dist. LEXIS 97965, at *5-6 (N.D. Cal. May 24, 2021). But the Northern District of California dismissed the claims in their entirety on May 24, 2021, holding (in relevant part) that the complaint failed to support an inference that Oracle's statements were false and misleading. *Id.* at *12. Other board diversity suits have similarly failed at the pleading stage. See, e.g., *Ocegueda v. Zuckerberg*, No. 20-cv-04444-LB, 2021 U.S. Dist. LEXIS 52465, at *24 (N.D. Cal. Mar. 19, 2021); *City of Pontiac Police & Fire Ret. Sys. v. Caldwell*, No. 20-cv-06794-LHK, 2021 U.S. Dist. LEXIS 123649, at *16-17 (N.D. Cal. Jul. 1, 2021); *In re Danaher Corp. S'holder Derivative Litig.*, No. 1:20-cv-02846-TNM, 2021 U.S. Dist. LEXIS 119542, at *34-35 (D.D.C. Jun. 28, 2021).

Conclusion

Despite some procedural setbacks in the courts, both the state legislature and the public at large appear committed to the goal of increasing workplace diversity (particularly at the board level) and using a variety of legal tools to drive social change. Companies should be conscious of their hiring and promotion practices, and make sure that they not only comply with anti-discrimination laws, but also take affirmative steps to foster a diverse and inclusive work environment. These efforts today could lead to major shifts in the demographics of the labor force, particularly at the executive and board levels, in the coming years.

Employer Update is published by the Employment Litigation and the Executive Compensation & Benefits practice groups of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

If you have questions concerning the contents of this issue, or would like more information about Weil's Employment Litigation and Executive Compensation & Benefits practices, please speak to your regular contact at Weil, or to the editors or practice group members listed below:

Practice Group Members:

Gary D. Friedman
Practice Group Leader
New York
+1 212 310 8963
gary.friedman@weil.com

Frankfurt
Stephan Grauke
+49 69 21659 651
stephan.grauke@weil.com

London
Ivor Gwilliams
+44 20 7903 1423
ivor.gwilliams@weil.com

Miami
Edward Soto
+1 305 577 3177
edward.soto@weil.com

New York
Sarah Downie
+1 212 310 8030
sarah.downie@weil.com
Steven M. Margolis
+1 212 310 8124
steven.margolis@weil.com

Michael Nissan
+1 212 310 8169
michael.nissan@weil.com
Nicholas J. Pappas
+1 212 310 8669
nicholas.pappas@weil.com

Amy M. Rubin
+1 212 310 8691
amy.rubin@weil.com

Paul J. Wessel
+1 212 310 8720
paul.wessel@weil.com

Silicon Valley
David Singh
+1 650 802 3010
david.singh@weil.com

© 2021 Weil, Gotshal & Manges LLP. All rights reserved. Quotation with attribution is permitted. This publication provides general information and should not be used or taken as legal advice for specific situations that depend on the evaluation of precise factual circumstances. The views expressed in these articles reflect those of the authors and not necessarily the views of Weil, Gotshal & Manges LLP. If you would like to add a colleague to our mailing list, please [click here](#). If you need to change or remove your name from our mailing list, send an email to weil.alerts@weil.com.