

Date of Hearing: April 18, 2022

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 1840 (Nazarian) – As Amended March 24, 2022

SUBJECT: Corporations: boards of directors: underrepresented communities

SUMMARY: Expands the definition of “director from an underrepresented community” as it relates to the requirement that corporate board of directors include a specified number of directors from an underrepresented community.

Specifically, **this bill:**

- 1) Modifies the definition of “director from an underrepresented community” to include someone who self-identifies as Armenian, Assyrian, Greek, Jewish, Muslim, Sikh, and an individual with a disability. This is addition to the those groups included in the definition under current law, which includes someone who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Alaska Native, or gay, lesbian, bisexual, or transgender.

EXISTING LAW:

- 1) Requires, no later than the close of the 2019 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to have a minimum of one female director on its board and clarifies that a corporation may increase the number of directors on its board to comply with this requirement (Corporations Code Section 301.3).
- 2) Requires, no later than the close of the 2021 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to comply with the following (Corporations Code Section 301.3):
 - a) If its number of directors is six or more, the corporation is required to have a minimum of three female directors.
 - b) If its number of directors is five, the corporation is required to have a minimum of two female directors.
 - c) If its number of directors is four or fewer, the corporation is required to have a minimum of one female director.
- 3) Requires, no later than the close of the 2021 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to have a minimum of one director from an underrepresented community, as defined, and clarifies that a corporation may increase the number of directors on its board to comply with this requirement (Corporations Code Section 301.3).
- 4) Requires, no later than the close of the 2022 calendar year, a publicly held domestic or foreign corporation whose principal executive offices are located in California to comply

with the following (Corporations Code Section 301.4):

- a) If its number of directors is nine or more, the corporation is required to have a minimum of three directors from underrepresented communities.
 - b) If its number of directors is more than four or fewer than nine, the corporation is required to have a minimum of two directors from underrepresented communities.
 - c) If its number of directors is four or fewer, the corporation is required to have a minimum of one director from an underrepresented community
- 5) Requires the Secretary of State (SOS) to publish a report on its website each year with specified information regarding all of the following, at a minimum (Corporations Code Section 301.3 and 301.4):

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) **Purpose.**

According to the author:

Businesses always should put their customers first and in California businesses serve the largest and most diverse customer base in the country. California has a rich and proud history of being a leader for inclusion and equity, one in which our corporate boards should reflect. AB 1840 continues California's tradition of progress towards equal and fair representation, by simply requiring more voices of underrepresented groups to be heard at the highest levels of California business organizations.

2) **Background.**

AB 979 (Holden), Chapter 316, Statutes of 2019, requires each publicly held corporation whose principal executive offices are located in California to have a minimum number of "directors from underrepresented communities," defined as individuals who self-identify as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Alaska Native, or gay, lesbian, bisexual, or transgender. Modeled after SB 826 (Jackson), Chapter 954, Statutes of 2018, which established similar requirements related to the representation of women on corporate boards, AB 979 was in response to the persistent lack of diversity among corporate leaders. The bill's findings and declarations noted that according to 2018 data from Deloitte and the Alliance for Board Diversity, the percentage of Fortune 500 company board seats held by people as African American / Black, Hispanic / Latino(a), and Asian/Pacific Islander were 8.6%, 3.8%, and 3.7%, respectively.

This relative lack of diversity may have consequences that negatively affect all stakeholders in a corporation, including workers, customers, and investors. Workers from communities that are not represented on the board may find limited opportunities for

advancement through the executive ranks, as boards hire CEOs who look like themselves and CEOs surround themselves with other executives who also look like them. With a lack of diversity throughout the board and senior management, customers or potential customers from underrepresented communities may find that products or services offered by the corporation do not consider the preferences of their communities. A failure to capitalize on a diverse range of consumer preferences harms investors who would benefit from higher returns if corporations were meeting their full potential. The lack of diversity in corporate America is not a product of happenstance; rather, it is a product of systemic discrimination and bias that affects so many facets of our society – housing, education, criminal justice, and employment.

In March 2022, the Secretary of State (SOS) issued its first annual report on corporate board diversity. The report found that, out of the 716 corporations with primary headquarters located in California, 301 complied with the Underrepresented Communities on Boards requirement and 186 complied with the Women on Boards requirement.¹

3) **Legal status.**

On April 1st, 2022, a California trial court issued a ruling granting summary judgment to a taxpayer challenging AB 979, finding that the law violated the Equal Protection Clause of the California Constitution. The ruling also concludes the state failed to show evidence of past discrimination and the Legislature failed to tailor the law to address perceived discrimination through “race-neutral” steps. The court states that “A numeric requirement is certainly the most direct path to the Legislature’s desired result. But there is precious little indication that the Legislature seriously considered or attempted other intermediate and race-neutral measures.”

The SOS has not indicated if it will appeal this ruling. Thus, this bill modifies a state law that is in legal limbo, as of the publication of this analysis.

4) **Other corporate diversity efforts.**

In recent years, investors have demanded greater transparency about the leadership of the country’s largest companies. This has led to more disclosures about hiring practices and board composition. According to JUST Capitol, as of July 2021 more than 90% of the 100-largest employers in the US report the racial and ethnic composition of their board of directors, compared to just 45% a few years before.

In addition, the Nasdaq’s “Board of Diversity Rule” requires a company listed on the Nasdaq’s US exchange to publicly disclose board-level statistics (using a provided template) and explain why, if applicable, the board does not have at least two diverse directors. Importantly, the Nasdaq rule is not a mandate. Rather it is designed to

¹ See the report here: <https://bpd.cdn.sos.ca.gov/div-on-boards/dob-report-2022.pdf>

encourage more diversity while providing outside stakeholders with consistent, comparable information concerning board composition.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

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