Securities Regulation Daily Wrap Up, CORPORATE GOVERNANCE—ISS predicts California law will drive nationwide upswing of female board directors, (Jan. 11, 2019)

Securities Regulation Daily Wrap Up

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By Lene Powell, J.D.

A new study by ISS finds that California's new law requiring public companies to include female directors on their boards could have "significant reverberations" for the entire U.S. market, potentially increasing the number of women on U.S. boards by 22 percent. The law begins to kick in this year and ISS says that many companies have a long way to go, with 89 percent of California-based companies needing to make changes to their boards` in the next three years to meet requirements. ISS believes the law will contribute to gender diversity despite potential legal challenges that could derail implementation.

The study's findings were detailed in a post by ISS staff Mikayla Kuhns, Rudy Kwack, and Kosmas Papadopoulos.

California follows Europe. As the first legislation in the country to address gender in board composition, S.B. 826 was signed into law on September 30, 2018. The law applies to publicly held domestic general corporations or foreign corporations whose principal executive offices are located in California, as stated on the corporation's SEC 10-K form.

According to the phased-in implementation, the law will first require company boards to have at least one woman by the end of 2019. By the end of 2021, companies with boards of five directors must have at least two women on their boards, and companies with six or more directors on their boards must have at least three women directors. Penalties for violations are stiff, with fines of $100,000 for an initial violation and $300,000 for a second or subsequent violation.

The law follows the example of legislation in this area in other countries. Norway led the trend in 2007 by requiring all public company boards to have a gender balance of at least 40/60. Many European countries have followed suit, with specific requirements varying by country. The European Commission has proposed to require a minimum 40-percent gender balance for non-executive directors.

By the numbers. Applying certain filters to ISS Analytics data, the study found the following statistics:

- About one-third of California-based companies (217) lack any female director, so will need to appoint at least one female director by the end of 2019.
- Of the 689 companies with executive offices in California, only 78 companies (11 percent) fully comply with the 2021 requirements. Nearly two-thirds of the companies with market capitalization greater than $10 billion do not have enough women on their boards to meet the 2021 mandate.
- California lags in board gender diversity, particularly in the information technology and health care sectors. California ranks 37th among U.S. states in percentage of large-cap companies (market capitalization greater than $1 billion) with at least two women on the board.

ISS believes that compliance with the new law will result in women occupying 1,159 new public company board seats. This could lead to an approximately 22 percent increase of female directorships nationwide.

However, ISS's conclusions were met with skepticism by Allen Matkins partner Keith Paul Bishop, who noted that the study authors did not explain how they determined director gender or clarify whether companies excluded by the law were included in the statistics.

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Potential legal snags. The new law faces possible legal opposition. A coalition of business groups led by the California Chamber of Commerce argued three objections in a letter to the state senate prior to the bill's passage:

- Focus on gender potentially elevates it as a priority over other aspects of diversity. The group believes that a comprehensive approach covering all classifications is more productive.
- The law violates the U.S. Constitution, California Constitution, and California civil rights law. Displacing male directors would illegally discriminate against them, said the group.
- The law conflicts with the Internal Affairs Doctrine of Corporations Code Section 2116, because it applies to publicly traded corporations that have principal executive offices in California but are incorporated in another state. Under the internal affairs doctrine, the laws of the state where the company is incorporated apply, not the law of where the principal executive offices are located.

Former governor Jerry Brown noted possible legal issues upon signing the bill, saying he "did not minimize the potential flaws that indeed may prove fatal to [the law's] ultimate implementation." But whatever the outcome, ISS expects the law to enhance the existing momentum towards greater gender diversity at U.S. boards.

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