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Courts Strike Down California Diversity Statutes

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In both cases, the plaintiffs, three California taxpayers, argued, *inter alia,* that the statutes in question violated the equal protection clause of California's constitution because they unlawfully rely on race- and gender-based classifications. Under applicable California law, equal protection challenges to statutes require a plaintiff to demonstrate that the state adopted a classification system that unequally affects two or more "similarly situated" groups. If a plaintiff satisfies this threshold burden, then the legal burden shifts to the state to prove that the statute in question satisfies strict scrutiny. Under this analytical framework, the state must demonstrate that the statute (a) satisfied a compelling governmental interest, (b) was necessary to satisfy that interest and (c) was narrowly tailored to meet that interest. In each of Padilla I and Padilla II, the courts found that the state failed to meet its burden, thereby rendering the statutes unlawful.

In Padilla II, the most recent of the two cases, Judge Duffy-Lewis found that California failed to meet its burden relative to any of the applicable analytical requirements and held SB 826 unconstitutional. In her ruling, the court indicated "neither the legislature nor the Defendant could identify any specific, purposeful, intentional and unlawful discrimination to be remedied." Judge Duffy-Lewis also indicated that "[l]egislative analysis of SB 826 found that connections between women on corporate boards and improved corporate performance and corporate governance are inconclusive." Legal observers have indicated that certain statements made by the statute's sponsors, as well as testimony by witnesses at trial, undermined the strength of California's legal arguments in the litigation. Moreover, the court indicated that the legislature could have taken other steps, such as amending existing

legislation, to more narrowly focus on diversifying the boardrooms of California's public companies.

In Padilla I, the legislature's attempt to foster demographic diversity in the boardroom was ruled unconstitutional on substantially similar grounds as the decision in Padilla II. The Padilla I court found that while the end goal of a diversified boardroom was laudable, the statute violated California's constitution. Employing an analysis similar to the ruling in Padilla II, Judge Green concluded that the legislature failed to develop a sufficiently strong record to support the statutory remedy in the case. Likewise, the court ruled that the legislature should have considered other tools in order to foster boardroom diversity, such as amending existing laws to address the legislature's goal more narrowly or adopting alternative tools to incent companies to diversify such as, e.g., a "diversify or explain" disclosure requirement. In the end, while the court's ruling does not foreclose the possibility that a legislative solution on boardroom diversity could survive a constitutional challenge, it does make it clear that the legislature would need to take additional actions in advance of adopting such a prescriptive solution.

Although the state of California has not stated publicly whether it will appeal these rulings, many experts expect an appeal to be taken. Recently, Gov. Gavin Newsom (D-CA), who signed AB 979 into law, said that his wife, Jennifer Siebel Newsom, told him "you'd better appeal it." It is worth noting that Ms. Siebel Newsom is a founder of the non-profit California Partners Project, which recently reported that the number of women serving on corporate boards had doubled since SB 826 was signed in 2018.

In particular, it remains to be seen whether the litigation strategy used by plaintiffs in Padilla I and Padilla II are effective in jurisdictions that have adopted similar statutes requiring boardroom diversity. That is, it remains an open question whether suits of this nature would be precluded as a threshold matter in jurisdictions that have not adopted a broadly crafted approach to taxpayer standing as is the case in California. For instance, Nasdaq's boardroom diversity rule that was approved by the U.S. Securities and Exchange Commission in August 2021, remains subject to a legal challenge before the Court of Appeals for the 5th Circuit. In that case, *Alliance for Fair Board Recruitment, et al., v. Securities and Exchange Commission*, No. 21-60626, the petitioners claim, *inter alia*, a violation of the "constitutional right to equal protection." Interested parties, including this firm on behalf of an ad hoc group of Nasdaq-listed companies,[1] have filed amicus briefs in support of the rule. The matter remains pending at this time.

Notwithstanding the rulings in Padilla I and Padilla II, public company boards of directors and executives in California (and potentially elsewhere) should remain mindful of pressures by various stakeholders, including investors and proxy advisory firms, to enhance diversity in the boardroom. We will monitor and report on subsequent developments involving these and other relevant cases.

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[1] See Brief of Ad Hoc Coalition of Nasdaq-Listed Companies as Amicus Curiae in Support of Respondent, No. 21-60626, dated February 2, 2022.

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