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Jessica Gottsacker
Saint Louis University School of Law

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Quotas: California's Attempt to Crack Down on the Glass Ceiling

By Jessica Gottsacker*

In September, California became the first state in the United States to pass a law mandating a minimum number of women to be on the Board of Directors for publicly held corporations incorporated within the state. The mandate requires there be at least one woman on the Boards by the close of 2019.¹ By the end of the 2021 calendar year, the law increases this required minimum number to two female directors if the corporation has five directors or to three female directors if the corporation has six or more directors.² This mandate further applies to foreign companies headquartered within the state and incorporated elsewhere.³ Companies will not be forced to remove any males from their current positions but are instead invited to add a new position to the Board.⁴ However, this is not as easy as it sounds and, for many corporations, may require amendments to by-laws and shareholder approval, which can be a long and tedious process.⁵ The Secretary of State will uphold the law by imposing penalties for the corporations in violation.⁶ These penalties include a \$100,000 fine for first time offenders and a \$300,000 fine for any subsequent violation.⁷

Hannah-Beth Jackson, one of the major authors of the law, insists that the law's intent is to improve diversity among the Boards.⁸ "Gender diversity on corporate boards is associated with increased profitability, performance, governance, innovation, and opportunity," Beth-Jackson said.⁹ This argument is supported by several studies including a 2017 study by MSCI

* J.D. Candidate, 2020, Saint Louis University School of Law

¹ 2017 California Senate Bill No. 826, California 2017-2018 Regular Session.

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ Richard Vernon Smith, *California Mandates Female Representation On Public Company Boards*, FORBES, Oct. 1, 2018, at

<https://www.forbes.com/sites/allbusiness/2018/10/01/california-mandates-female-representation-public-company-boards/#4f3445cf1775>.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

which found that “United States’ companies that began the five-year period from 2011 to 2016 with three or more female directors reported earnings per share that were forty-five percent higher than those companies with no female directors at the beginning of the period.”¹⁰ The legislation itself suggests that if nothing proactive would be done to secure gender inequality within corporate America, it would take another forty to fifty years to reach the same results the new mandate aims to achieve.¹¹ Additionally, the law relies on a 2014 study by Credit Suisse which determined that “companies with at least one woman on the board had an average return on equity (ROE) of 12.2 percent, compared to 10.1 percent for companies with no female directors. Additionally, the price-to-book value of these firms was greater for those with women on their boards: 2.4 times the value in comparison to 1.8 times the value for zero-women boards.”¹²

When the law was passed, there were more than one-quarter, or 117, of the Russell 3000 companies based in California without a single woman on their Boards of Directors.¹³ Additionally, as of June 2017, of the 446 Russell 3000 companies headquartered within the state, only 566 director seats were held by women.¹⁴ This makes up only 15.5 percent of the Board of Director seats and pales in comparison to the 3,089 seats held by men within the state.¹⁵ Smaller companies are more likely than larger companies to lack women on their Board of Directors.¹⁶ Of California’s fifty lowest revenue grossing corporations, forty-eight percent do not contain a single woman on their boards.¹⁷

Some of the companies that will need to modify their Boards of Directors to include additional women include Apple, Facebook, and Google. Overall, the law would in fact establish a need for 684 women solely for the boards of the publicly traded companies that rank among the nation’s 3,000

¹⁰ 2017 California Senate Bill No. 826, California 2017-2018 Regular Session.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ 2017 California Senate Bill No. 826, California 2017-2018 Regular Session.

¹⁷ *Id.*

largest.¹⁸ This estimate does not include the state's smaller sized companies.¹⁹

The lack of women on corporation boards is not just an issue in California. The nation as a whole produces similar results.²⁰ Currently, there are twelve Fortune 500 companies without any women on their boards, and the number of Fortune 500 female CEOs dropped by twenty-five percent this year, from thirty-two to twenty-four.²¹

California, while the first state in the United States to implement a quota for women on Board of Directors, is not the first in the world. In fact, countries such as Belgium, France, Germany, Iceland, India, Israel, Italy, Norway and Spain all have legislated quotas for their publicly held corporations.²² Norway pioneered their initiative in 2006 and mandated forty percent of Board seats to belong to women.²³ In 2016, the number of women on Boards had reached forty-two percent there.²⁴ France, also after implementing their mandate, saw the number of women on their Boards surge from eight percent in 2006 to thirty-five percent in 2015.²⁵

There are some notable shortcomings with California's law, however. Specifically, the law does not provide for any transitional period for IPO companies. Companies wishing to go public in the near future will also need to abide by the new law and its deadlines. Companies are also left to manage compliance when there is future turnover and a female director

¹⁸ Emily Stewart, *California just passed a law requiring more women on boards. It matters, even if it fails.*, VOX, Oct. 3, 2018, at <https://www.vox.com/2018/10/3/17924014/california-women-corporate-boards-jerry-brown>.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² S. C., *Are Gender Quotas Good for Business?* THE ECONOMIST, Sept. 3, 2018, at <https://www.economist.com/the-economist-explains/2018/09/03/are-gender-quotas-good-for-business>.

²³ Claire Zillman, *The EU Is Taking a Drastic Step to Put More Women on Corporate Boards*, FORTUNE, Nov. 20, 2017, at <http://fortune.com/2017/11/20/women-on-boards-eu-gender-quota/>.

²⁴ *Id.*

²⁵ *Id.*

steps down or needs immediate replacement.²⁶ The law does provide that Boards must only meet the required number of women directors at one time during the calendar year in order to help deal with any issues during the transitional period.²⁷ However, companies are left on their own to develop such plans for the unexpected vacancies.²⁸

Commentators have also raised concerns regarding the constitutionality of the law itself since the law specifically creates classification based on gender and potentially violates the Unruh Civil Rights Act by discriminating based on gender.²⁹ Governor Edmund G. Brown, Jr., when signing the Bill into law stated, “I don’t minimize the potential flaws [in the new law] that indeed may prove fatal to its ultimate implementation.”³⁰ Nevertheless, Governor Brown offered his view that, despite the objections to the new law, “it’s high time corporate boards include the people who constitute more than half the ‘persons’ in America.”³¹

Some further argue that, according to Internal Affairs Doctrine, the state of the company’s incorporation is the only state that has the power to create such mandates.³² This would drastically decrease the number of companies affected, as corporations are frequently incorporated in other states such as Delaware.³³ In fact, the Delaware Supreme Court has held³⁴ a decade before that they do not need to uphold and follow California law surrounding shareholder voting rights on the basis of the Internal Affairs Doctrine.³⁵ If brought to court, the government will face a heightened scrutiny to

²⁶ Richard Vernon Smith, *California Mandates Female Representation On Public Company Boards*, FORBES, Oct. 1, 2018, at <https://www.forbes.com/sites/allbusiness/2018/10/01/california-mandates-female-representation-public-company-boards/#4f3445cf1775>.

²⁷ *Id.*

²⁸ *Id.*

²⁹ Jennifer Kristen Lee, Jennifer H. Gallo, Andrew D. Ledbetter, Rachel M. Paris, *California Mandates Female Board Directors for Publicly Held Companies*, Oct 1, 2018, at <https://www.dlapiper.com/en/us/insights/publications/2018/10/california-governor-signs-bill-mandating-female-board-directors/>.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ See *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005).

³⁵ *Id.*

establish that they not only had good reason for the law but also that there is no better way to achieve its goal except through the mandated quota system.³⁶ "It's my hope that corporations, rather than fight this, will acknowledge its value and take the lead on pulling together and bringing greater diversity into their boardrooms," Jackson said.³⁷ It is uncertain if the law will withstand challenges, but companies are now pressured to acknowledge that gender diversity may not be such a bad thing for the economy.

Edited by Carter Gage

³⁶ Laurel Wamsley, *California Becomes 1st State To Require Women On Corporate Boards*, NPR, Oct. 1, 2018, at <https://www.npr.org/2018/10/01/653318005/california-becomes-1st-state-to-require-women-on-corporate-boards>.

³⁷ *Id.*