

Shareholder board diversity: New legal and legislative challenges

Will directors and officers, as well as their insurers, be held accountable for alleged corporate failures to diversify top down?

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Amid the #MeToo and #BlackLivesMatter movements, many corporations have publicly expressed support for gender and racial diversity. However, in the wake of ten shareholder derivative lawsuit filings within the last four months, as well as two California state legislative initiatives, corporate executives at publicly held companies and their boards of directors may be under pressure to make changes ahead of directors and officers (D&O) insurance renewals.

This paper will discuss: (a) shareholder complaints alleging corporate breach of fiduciary duty for failure to diversify leadership, (b) California's legislative initiatives for gender and racial diversity on boards of "publicly held corporations," and (c) the likely effect of both litigation and legislation on future D&O underwriting decisions.

“ Amid the #MeToo and #BlackLivesMatter movements, many corporations have publicly expressed support for gender and racial diversity. ”

Ten plaintiff shareholder derivative actions have been brought in recent weeks in California and Washington, DC, federal courts alleging lack of diversity on boards of publicly traded companies. Consumer class action law firm Bottini & Bottini has filed lawsuits against Oracle, Facebook, Qualcomm, NortonLifeLock, The Gap, and Monster Beverage. Robbins Geller, the well-known securities class action law firm, has brought four lawsuits on behalf of plaintiff shareholders of Danaher, Cisco, ADM, and Adobe. Notably, the social justice pro bono law practice Renne Public Law Group, which previously partnered with vice presidential candidate Kamala Harris on various California employee equality initiatives, has signed on as co-counsel in a number of the California filings.

Each of these lawsuits follows a similar formula, alleging that despite touting their commitments to diversity, these companies have made no real effort to promote diversity on their boards or among senior executives. For example:

- The lawsuit against Oracle filed in July, *R. Andre Klein v. Ellison, et al.*, Case No. 3:20-cv-04439, N.D. Cal., alleges that Oracle's board is "one of the few remaining publicly traded companies without a single African American director."
- The lawsuit against Facebook filed the same day, *Natalie Ocegueda v. Zuckerberg, et al.*, Case No. 3:30-cv-04444, N.D. Cal., asserts that Facebook has not only "failed to achieve real diversity on the Board and among the senior executive ranks" and tolerated racially discriminatory practices both in its workforce and on its platform but also has failed to take action to address hate speech on its platform.
- Similarly, the shareholder plaintiffs' lawsuit against The Gap filed in September, *Noelle Lee v. Fisher, et al.*, Case No. 3:20-cv-06163, N.D. Cal., argues that despite the retailer's numerous public statements and branding campaigns surrounding its commitment to diversity, its board of directors contains no African-American members.
- Cisco shareholder plaintiffs in *City of Pontiac General Employees' Retirement System v. Bush, et al.*, Case No. 1:20-cv-06651, N.D. Cal., allege that corporate directors and officers "have declined to carry out the Company's policies and proclamations and have failed to increase racial diversity at Cisco." As proof in point, the shareholders reference their August 5 letter demanding that the board "immediately commence legal action against certain current and former Cisco directors and/or officers for breach of fiduciary duty and federal proxy law violations" for failing to effectively promote diversity. However, the suit continues, neither Cisco nor its board formally responded to the demand letter, and no corrective action was taken to diversify Cisco's all-white executive leadership team prior to the filing of suit.
- The City of Pontiac General Employees' Retirement System's lawsuit against Danaher, *City of Pontiac General Employees' Retirement System v. Joyce, et al.*, Case No. 1:20-cv-002445, D.D.C., alleges that while Danaher has publicly stated throughout the years that it "effectively promotes diversity throughout its ranks" and recognizes that diversity "is vital for our sustained success," the company still maintains an all-white board of directors.



- In one week, City of Pontiac General Employees' Retirement System also filed suit (*City of Pontiac Police and Fire Retirement System v. Caldwell, et al.*, Case No. 5:20-cv-06794, N.D. Cal.) and sent a demand letter as shareholders of Advanced Micro Devices, Inc. and Adobe, alleging that both of these companies and their individual directors and officers have failed to increase the numbers of women and under-represented minorities on their corporate boards, despite public representations otherwise.

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The state of California has potentially expanded the scope of future legal challenges by passing two laws within the last two years requiring “publicly held corporations” to have a certain number of female and racially diverse board members.

SB 826, which was signed into law during the height of the #MeToo movement in September 2018, required California-based public corporations to have at least one woman on their board of directors by the end of calendar year 2019. In addition, by 2021, the number of female board members must be increased depending on board size.¹ SB 826 defines a “publicly held corporation” as a corporation with outstanding shares listed on a major US stock exchange and identifies a corporation as being headquartered in California based upon the location of its corporate principal executive offices.²

California-based public corporations that fail to comply with SB 826 are subject to a \$100,000 fine for the first violation and \$300,000 for each subsequent annual violation (e.g., failure to appoint the requisite number of female board members³). In addition, the California secretary of state also publishes on its web site a list of corporations that are compliant and noncompliant.⁴ Currently posted is the secretary of state's March 2020 report with the 2019 Women on Boards corporate data.⁵

More recently, on the heels of the #BlackLivesMatter movement, the California legislature drafted and approved AB 979, which was signed into law on September 30, 2020. AB 979 mandates that California-based public corporations appoint a certain number of individuals from underrepresented communities (self-identifying as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or as gay, lesbian, bisexual, or transgender) to its board of directors.⁶

By 2021, every California-based public corporation is required to have one board member from an underrepresented community as so defined.⁷ By 2022, the number of required underrepresented community board members increases, depending on the size of the corporate board.⁸ As with SB 826, the secretary of state will publish various reports on its web site documenting, among other things, the number of corporations in compliance with the bill's provisions. The law also potentially imposes fines for violations of the Act, as well as additional fines on an annual filing basis.⁹

To sum up, any publicly traded corporation with an all-white, all-male board is at risk for a shareholder demand or lawsuit, particularly if domiciled in California. D&O underwriters moving forward must consider the possibility that other states and even the federal government may follow California's lead in mandating diversity in both board and top leadership appointments at publicly traded corporations.

Failing to follow the law and appearing to misrepresent corporate objectives are both bases for shareholder plaintiffs to allege liability in a demand or lawsuit against the corporation's board. It is especially challenging to defend against these suits if a corporation has indicated a commitment to use diversity but has not considered or appointed a female or diverse board member. Based on these factors, it appears that moving forward, risk analysis conducted during the D&O underwriting process will need to include a review of a concise plan for identifying and appointing diverse board candidates as well as of corporate governance strategy in this area.

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To help manage the potential for this type of shareholder litigation, D&O underwriters should evaluate what steps an insured has taken to bring on board members and other executive leaders that are diverse in gender and race. If the corporation is domiciled in California, the benchmark reporting requirements of SB 826 and AB 979 must be considered. A name search of the California secretary of state web site will help underwriters determine what corporations were non-compliant at the secretary of state's latest compliance review.





Markel's professional liability D&O underwriting and claims teams are partnered in a comprehensive strategy to underwrite and manage claims for publicly traded companies facing this potential exposure moving forward. With a clear understanding of how shareholder demands and litigation can be structured and the underwriting considerations for the benchmarks set forth in SB 826 and AB 979, the industry is positioned to guide brokers to help insureds manage exposure to risks arising out of an alleged failure to achieve diversity at the executive leadership and board levels.



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¹ [fenwick.com/insights/publications/new-california-law-requires-representation-of-women-on-public-company-board](https://www.fenwick.com/insights/publications/new-california-law-requires-representation-of-women-on-public-company-board).

² Ibid.

³ Ibid.

⁴ sos.ca.gov/business-programs/women-boards.

⁵ Ibid. To date, no fines or penalties have been levied against corporations that are non-compliant and there have been at least two lawsuits filed challenging SB 826 on constitutional grounds.

⁶ lexology.com/library/detail.aspx?q=bc187f71-5635-4f73-b6d0-c4d54a22539.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid.

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