

# States Mandating Companies' Board Member Composition

## Labor & Employment Law Update

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In an effort to try and help root out discrimination, the Illinois legislature has followed California's top-down approach of regulating the boardroom to ensure that decision makers include historically disenfranchised classes.

On March 29, 2019, the Illinois House sent HB 3394 to the Senate. HB 3394 is modeled after California Corporations Code § 301.3, which requires publically held corporations (domestic and foreign corporations that list their outstanding shares on a major U.S. Stock Exchange), which state on their SEC Form 10-K that the principal executive offices are in California, to have at least one female board member by 12/31/2019 – with the number of female board members required increasing based on the board size. A corporation may also increase the number of directors on its board to comply. The Illinois bill is more expansive, as it requires at least one female director and one African American director on the board by 12/31/2020 (though the number of “designated seats” does not increase as board size increases). Much like the California law, publically held corporations whose principal executive offices are in Illinois may increase the number of directors on its board in order to comply with this proposed legislation.

### Sizeable Penalties

Illinois's (prospective) and California's laws apply to public companies whose principle executive offices are in that state, according to SEC Form 10-K. Both laws empower their respective Secretary of State (“SOS”) to adopt rules, as well as impose penalties of (i) \$100,000 for failure to fill the designated seat(s) as required, (ii) \$300,000 for a second or subsequent violation, and (iii) \$100,000 for failure to file board member information. Each designated seat must be held “during at least one point of a calendar year” to avoid a violation (e.g., it would not be a violation if a board member left mid-year and was not contemporaneously replaced). Presumably Illinois SOS's regulations will address: (a) the process for filing board composition information, and (b) whether an individual female, African American director satisfies both composition requirements (e.g., can one person fill both “designated seats”).

### Precedent for a National Movement

Equal opportunity laws – such as ban-the-box, salary history inquiry bans, and harassment training mandates – have been sweeping the nation in a patchwork, making compliance much more difficult. While **California** is currently the only state mandating board composition, **New Jersey's** AB 4726 (introduced 11/26/2018) is pending, and others states have passed non-punitive resolutions encouraging female representation on boards, including **Illinois** (HR 439) and **Massachusetts** (Res. S 1007) in 2015, and **Pennsylvania** (HR 273) in 2017. Other than Illinois HB 3394, we are unaware of any other legislation mandating composition based on race or any other protected-class.

### Will HB 3394 Become Law?

In 2018, overriding then-Governor Rauner's veto, the Illinois General Assembly amended the Illinois Equal Pay Act to add African Americans to women as protected classes, effective 1/1/2019. (Note: Governor Rauner rejected the limitation of "African Americans" and suggested expanding the protection to race, color, national origin, and ancestry.) Governor Pritzker, along with the current General Assembly, have taken steps to enact legislation that protects employees and increases expectations and obligations for employers and businesses, ranging from increased minimum wage, wage and hour penalties, attacks on unfair competition agreements, and the like. Given this backdrop, it seems likely that Illinois will pass a board composition law, with the question being whether the current proposed language will be amended or changed.

### Is Compliance Limited to Public Companies?

Like many experiments, these laws typically first apply to public corporations that are, presumably, sophisticated enough to know, understand, and comply with their legal obligations. If successfully implemented, the requirements may be expanded to cover unlisted public companies, nonprofits, and large companies or employers.

Public companies that might be subject to these laws should start planning now, including considering topics such as board succession planning to identify qualified directors, and amending governing documents to permit increasing the board size to comply. Of course, qualified counsel should be consulted to avoid unforeseen pitfalls created by these untested laws.