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PRACTICE BRIEF · CORPORATE GOVERNANCE

Recent Developments in California Corporate Governance Law: 2023-2024

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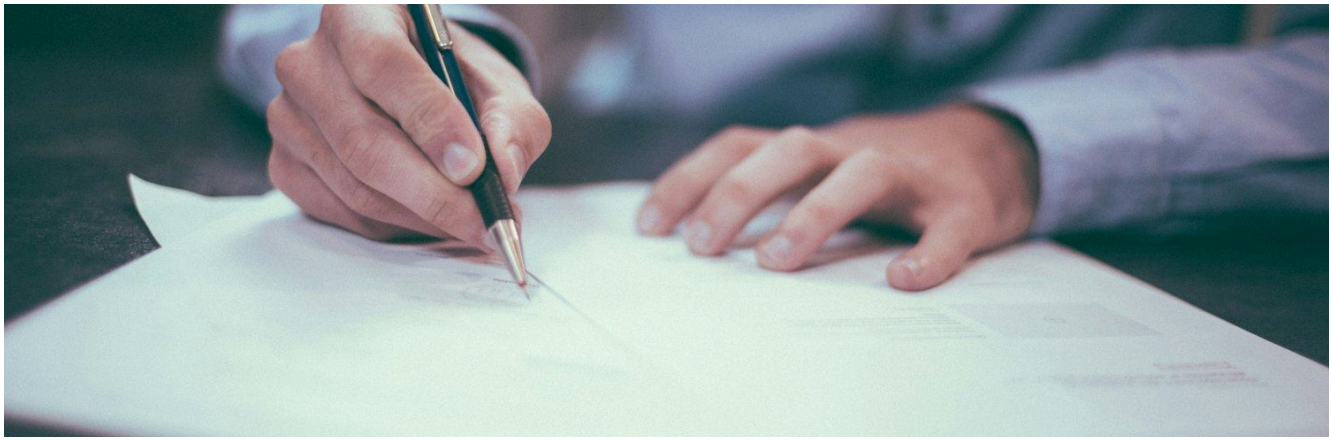

The 2023-2024 period brought a series of consequential shifts in corporate governance law affecting California businesses. Courts invalidated a signature board diversity mandate, the legislature enacted the nation's most ambitious climate disclosure regime, Congress imposed new beneficial ownership reporting on virtually every small business in the country, and LLC operating agreement disputes continued to multiply under California's Revised Uniform Limited Liability Company Act. This article surveys five developments that general counsel, corporate secretaries, and outside advisors should understand as they navigate the current regulatory environment.

Table of Contents

1. AB 979 Board Diversity Mandate Struck Down
2. SB 253: Climate Corporate Data Accountability Act
3. Delaware Fee-Shifting and Attorneys' Fees Developments
4. Corporate Transparency Act: Passage and Constitutional Challenge
5. LLC Operating Agreement Disputes Under RULLCA

I. AB 979 Board Diversity Mandate Struck Down

In April 2022, the Los Angeles County Superior Court ruled in *Crest v. Padilla* that AB 979 violated the Equal Protection Clause of the California Constitution (Art. I, § 7). AB 979, enacted in 2020, had required publicly held corporations headquartered in California to include a minimum number of directors from "underrepresented communities" on their boards — defined to include

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individuals who self-identified as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Alaska Native, gay, lesbian, bisexual, or transgender. The statute imposed escalating minimums tied to board size: at least one such director by December 31, 2021, and two or three by December 31, 2022, depending on whether the board had five to eight members or nine or more.

The trial court found that the statute employed a race-based classification subject to strict scrutiny, and that the state had failed to demonstrate that the mandate was narrowly tailored to serve a compelling governmental interest. The court noted that the legislative record relied primarily on general social science research about the benefits of board diversity rather than evidence of specific discrimination in California boardrooms that the classification was designed to remedy. The decision was affirmed on appeal in 2023, effectively ending any prospect that the mandate would be enforced.

The *Crest* outcome tracked the parallel challenge to SB 826, California's 2018 gender-based board diversity mandate, which was similarly struck down in *Meland v. Padilla* (Los Angeles Superior Court, May 2022). In *Meland*, the court applied the same strict scrutiny framework and reached the same conclusion: the state could not satisfy its burden to show that the gender-based board quota was narrowly tailored. Together, the two decisions dismantled California's legislative experiment with mandatory board composition quotas.

The practical impact, however, has been more muted than the legal outcome might suggest. By the time the courts issued their rulings, most large public companies had already taken steps to diversify their boards. Institutional investors, proxy advisory firms such as ISS and Glass Lewis, and major stock exchanges — notably Nasdaq's Board Diversity Rule (adopted in August 2021) — had independently created market-driven incentives for board diversity. Data from the 2023 proxy season showed that Russell 3000 companies continued to appoint diverse directors at rates comparable to the pre-invalidation period. The mandates may have catalyzed a shift that has now become self-sustaining through market norms rather than statutory compulsion.

> *"The constitutional vulnerability of race-conscious board mandates was apparent from the outset. What was less obvious was that the mandates would prove unnecessary: market forces accomplished what the legislature attempted by statute."*

II. SB 253: Climate Corporate Data Accountability Act

On October 7, 2023, Governor Newsom signed SB 253, the Climate Corporate Data Accountability Act, making California the first state to enact a comprehensive mandatory greenhouse gas emissions disclosure law. The legislation had moved through the state senate and assembly with substantial support, passing the senate 27-7 and the assembly 47-18. Governor Newsom signed the bill but simultaneously issued a signing message requesting amendments to address "implementation concerns," particularly regarding the cost and feasibility of Scope 3 emissions reporting.

SB 253 applies to any "reporting entity" that (1) does business in California, as defined under the Revenue and Taxation Code, and (2) has total annual revenues exceeding $1 billion. The statute covers both public and private companies. Covered entities must publicly disclose:

- **Scope 1 emissions** (direct emissions from owned or controlled sources) beginning with the 2026 reporting year
- **Scope 2 emissions** (indirect emissions from purchased electricity, steam, heat, or cooling) beginning with the 2026 reporting year
- **Scope 3 emissions** (all other indirect emissions in the value chain, including upstream supply chain and downstream product use) beginning with the 2027 reporting year

The Scope 3 requirement is the most significant and controversial element. For many companies, Scope 3 emissions dwarf Scope 1 and 2 combined — a consumer products manufacturer, for instance, may find that Scope 3 accounts for 80% or more of its total carbon footprint. Reporting these emissions requires collecting data from suppliers, distributors, customers, and business partners, many of whom may lack the infrastructure to measure their own emissions accurately. The statute requires third-party assurance of reported data, with limited assurance initially and reasonable assurance phased in over subsequent years.

The California Air Resources Board (CARB) was designated as the administering agency with rulemaking authority over implementation details. CARB was directed to adopt implementing regulations by January 1, 2025, though the rulemaking timeline has shifted. Civil penalties for noncompliance can reach $500,000 per reporting year.

SB 253 was enacted against the backdrop of the SEC's own proposed climate disclosure rule, which at the time of the California legislation remained pending. California's decision to move ahead of the federal government — imposing broader requirements that reach private companies and mandate Scope 3 reporting, neither of which the SEC's proposal contemplated at the same threshold — created a patchwork compliance environment that continues to evolve. Companies subject to both regimes face the burden of reconciling overlapping but non-identical reporting obligations, with potential exposure if disclosures under the two systems are inconsistent.

III. Delaware Fee-Shifting and Attorneys' Fees Developments

Fee-shifting in corporate governance litigation has been a contested issue since the Delaware Supreme Court's 2014 decision in *ATP Tour, Inc. v. Deutscher Tennisbund*, which upheld the facial validity of a bylaw requiring unsuccessful stockholder plaintiffs to pay the corporation's litigation expenses. The *ATP Tour* decision created immediate concern that fee-shifting bylaws would deter meritorious stockholder suits, and the Delaware legislature responded swiftly: in 2015, it amended DGCL § 109(b) to prohibit fee-shifting bylaws for stock corporations. Non-stock corporations remain free to adopt them.

The 2023-2024 period saw the Delaware Court of Chancery continue to refine its approach to attorneys' fees in derivative and class action litigation through the *Sugarland* factors — the framework established in *Sugarland Industries, Inc. v. Thomas* (1980) for evaluating fee petitions in

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common benefit proceedings. The Chancery Court has increasingly scrutinized fee petitions by examining the quality of representation, the benefit conferred on the corporation or its stockholders, the contingent nature of the representation, and whether the litigation achieved a meaningful result beyond cosmetic governance reforms.

For California-incorporated entities, the Delaware fee-shifting landscape matters because many California companies adopt governance provisions modeled on the DGCL, including forum selection clauses designating the Delaware Court of Chancery for intra-corporate disputes. California Corporations Code § 2115 — the so-called "pseudo-foreign corporation" statute — imposes certain California governance requirements on foreign corporations with significant California contacts, but it does not directly address fee-shifting. Companies incorporated in California that have adopted Delaware-style governance provisions in their articles or bylaws should review those provisions against the current state of both Delaware and California law, particularly given that California's own fee-shifting rules under Code of Civil Procedure § 1032 and the private attorney general doctrine (Code of Civil Procedure § 1021.5) operate on different principles.

The practical takeaway is that fee-shifting remains unavailable as a defensive governance tool for stock corporations under Delaware law, and its viability for California corporations is constrained by California's own procedural framework. Companies seeking to manage litigation costs in governance disputes must rely on alternative mechanisms: exclusive forum provisions, advance notice bylaws, and demand requirements under the business judgment rule.

IV. Corporate Transparency Act: Passage and Constitutional Challenge

Congress enacted the Corporate Transparency Act (CTA) as part of the Anti-Money Laundering Act of 2020, itself a component of the National Defense Authorization Act for Fiscal Year 2021. The CTA represented the most significant reform to U.S. anti-money laundering infrastructure in decades, requiring most domestic and foreign entities doing business in the United States to report their beneficial owners to the Financial Crimes Enforcement Network (FinCEN).

FinCEN issued its final implementing rule in September 2022, establishing a January 1, 2024 effective date for existing companies. Entities formed or registered before January 1, 2024 were given until January 1, 2025 to file their initial beneficial ownership information (BOI) reports. Entities formed on or after January 1, 2024 were required to file within 90 days of formation (subsequently reduced to 30 days for entities formed on or after January 1, 2025).

The CTA defines a "beneficial owner" as any individual who, directly or indirectly, either (1) exercises substantial control over the reporting company, or (2) owns or controls at least 25% of the ownership interests. The statute exempts 23 categories of entities from reporting, including publicly traded companies, banks, credit unions, insurance companies, registered investment companies, accounting firms, tax-exempt organizations, and entities with more than 20 full-time employees, more than $5 million in gross receipts or sales, and an operating presence at a physical office in the United States. The effect is that the CTA primarily targets small and closely held entities — precisely the vehicles most commonly associated with shell company abuse.

Constitutional challenges materialized quickly. In March 2024, a federal district court in the Northern District of Alabama ruled in *National Small Business United v. Yellen* that the CTA exceeded Congress's enumerated powers under the Commerce Clause and was unconstitutional as applied to the plaintiffs. The court issued a nationwide injunction, which was subsequently narrowed on appeal by the Eleventh Circuit to apply only to the named plaintiffs. Parallel challenges were filed in other circuits, creating uncertainty about the CTA's enforceability during the period covered by this survey.

Regardless of the litigation's outcome, the CTA has already imposed significant compliance burdens on small businesses and their counsel. The reporting requirements demand that covered entities identify and verify the identity of all beneficial owners — an exercise that can be surprisingly complex for multi-member LLCs, family trusts holding entity interests, and corporate structures with layered ownership. California practitioners should be attentive to CTA compliance for their entity clients, particularly given that noncompliance carries civil penalties of up to $500 per day and criminal penalties including fines of up to $10,000 and imprisonment of up to two years.

V. LLC Operating Agreement Disputes Under RULLCA

California's Revised Uniform Limited Liability Company Act (RULLCA), codified at Corporations Code § 17701.01 et seq. and effective January 1, 2014, has now had a full decade to generate case law. The 2023-2024 period saw a notable increase in reported LLC disputes, reflecting both the proliferation of LLCs as the preferred entity form for California businesses and the complexity of the operating agreements that govern them.

A central issue in LLC litigation is the distinction between member-managed and manager-managed LLCs under Corporations Code § 17704.07. In a member-managed LLC, each member has equal rights in management and conduct of the company's activities, and matters in the ordinary course are decided by a majority of members. In a manager-managed LLC, management authority is vested in one or more designated managers, and members who are not managers have no management authority. The operating agreement typically controls which structure applies, and many disputes arise from ambiguity in the operating agreement about whether certain decisions fall within the managers' authority or require member approval.

The 2024 decision in *Huang v. Seto* illustrated the trend toward contractarian analysis. The court treated the operating agreement as the primary source of the parties' rights and obligations, applying principles of contract interpretation rather than imposing default fiduciary norms. This approach is consistent with RULLCA's design: Corporations Code § 17701.07(a) provides that the operating agreement governs the relations among members and between members and the LLC, subject to certain non-waivable provisions. Among the provisions that cannot be waived by agreement are the obligations of good faith and fair dealing (§ 17701.07(b)(5)) and the power of a court to decree judicial dissolution (§ 17701.07(b)(11)).

Judicial dissolution under § 17707.03 has emerged as a significant remedy in LLC deadlock disputes. The statute permits a member or manager to petition for dissolution when it is "not reasonably practicable to carry on the activities of the limited liability company in conformity with

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the articles of organization and any operating agreement." Courts have interpreted this standard to require more than mere disagreement among members — the petitioner must demonstrate that the company's purpose has been frustrated or that governance dysfunction has made continued operation impracticable. Unlike corporate dissolution under Corporations Code § 1800, which is available on multiple grounds including deadlock, fraud, and mismanagement, LLC dissolution under § 17707.03 turns on a single functional test.

Fiduciary duty claims in the LLC context present distinct challenges. RULLCA does not enumerate specific fiduciary duties owed by members or managers. Instead, § 17704.09 provides that a member of a member-managed LLC or a manager of a manager-managed LLC owes duties of loyalty and care to the company and its members, and further provides that these duties may be modified — but not eliminated — by the operating agreement. Courts have recognized that LLC fiduciary duties occupy a middle ground between the extensive, judicially developed fiduciary framework applicable to corporate directors and the minimal duties applicable to partners in limited partnerships. Operating agreements that attempt to eliminate fiduciary duties entirely, rather than merely restricting their scope, risk being held unenforceable under § 17701.07(b)(4)-(5).

PRACTICAL RECOMMENDATIONS

- Review board composition policies in light of *Crest v. Padilla* and *Meland v. Padilla* — voluntary diversity initiatives are legally permissible, but mandatory quotas tied to protected classifications are not
- If your company has annual revenues exceeding $1 billion and does business in California, begin building a Scope 1 and 2 emissions measurement program now; engage supply chain partners on Scope 3 data before the 2027 reporting deadline
- Audit exclusive forum provisions and fee-shifting clauses in charter documents for consistency with current Delaware and California law; provisions drafted before the 2015 DGCL amendment may be unenforceable
- Confirm CTA compliance for all entity clients, particularly closely held LLCs and multi-layered structures; calendar the applicable filing deadline and implement a process to update BOI reports within 30 days of any change in beneficial ownership
- Draft LLC operating agreements with explicit designation of member-managed or manager-managed status, a clear allocation of decision-making authority, and carefully scoped fiduciary duty modifications that comply with RULLCA's non-waivable provisions
- Include deadlock resolution mechanisms — such as mediation requirements, buy-sell provisions, or designated tie-breaking procedures — to avoid judicial dissolution as the only remedy for governance impasse

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