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California Governor Gavin Newsom signed [Senate Bill 54](#) (SB 54) into law on October 8, 2023, to take effect March 1, 2025, for all investments made during calendar year 2024.

The law will require "covered entities" to report the demographic information of "founding team members" of all companies in which the covered entity has invested. SB 54 is meant to address the lack of venture capital funding flowing to diverse founders and is the first of its kind.^[1] Proponents of the law claim that "[f]unding to startups led by women, Black founders, or Latinx founders has never risen more than 5% in any given year."^[2]

Main Takeaway

Venture capital firms and other investors should work with counsel now to determine whether they are "covered entities" under SB 54 and ensure they are prepared to comply with SB 54's reporting requirements, which will look back to the 2024 calendar year. Compliance procedures and information gathering processes should be in place for all covered entities starting January 1, 2024.

To Whom Does SB 54 Apply?

The "covered entities" under SB 54 are venture capital companies, as defined in Section 260.204.9 of Title 10 of the California Code of Regulations, that meet at least one of the following criteria:

"(A) on at least one occasion during the annual period commencing with the date of its initial capitalization, and on at least one occasion during each annual period thereafter, at least fifty percent (50%) of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are venture capital investments...or derivative investments;

(B) the entity is a "venture capital fund" as defined in rule 203(l)-1 adopted by the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended (17 C.F.R. 275.203(l)-(1)); or

(C) the entity is a "venture capital operating company" as defined in rule 2510.3-101(d) adopted by the U.S. Department of Labor under the Employee Retirement Income Security Act of 1974 (29 C.F.R. § 2510.3-101(d))."[\[3\]](#)

The criteria for a venture capital company to be a covered entity include two prongs: the first pertains to the venture capital company's activities, and the second addresses whether those activities sufficiently touch California.

For the first prong, the requirement is met if (1) the entity "primarily engages in the business of investing in, or providing financing to, startup, early-stage, or emerging growth companies"; or (2) "manages assets on behalf of third-party investors, including, but not limited to, investments made on behalf of a state or local retirement or pension system."[\[4\]](#)

To meet the second prong, the venture capital company must be headquartered in California, have "a significant presence or operational office in California," or make investments in "businesses that are located in, or have significant operations in, California."[\[5\]](#)

Notably, covered entities are defined such that they may not on their face cover the affiliates of venture capital companies, including entities under common control. As such, this reporting requirement may only cover the general partner or investment advisor. With respect to corporate venture capital funds, SB 54 may be interpreted to cover each entity that is engaging in venture capital activities. So, if the corporate venture capital has more than one entity engaging in venture capital activities, SB 54 may cover both entities and, if so, each of those entities would be subject to the requirements of SB 54.

What Information Needs To Be Reported?

Covered entities need to provide annual information on the founding teams of all businesses that it has made venture capital investments into for the prior year. A "founding team member" is defined as any person who falls into one of two categories: (1) a person who (a) owned initial shares of the company, (b) contributed to the business before the initial share issuance, and (c) was not simply a passive investor; and (2) the "chief executive officer, president, chief financial officer, or manager of a business, or who has been designated with a role with a

similar level of authority as any of those positions."^[6]

Covered entities need to provide aggregate demographic information on founding teams pertaining to race, ethnicity, gender, sexuality, veteran status, and California residency, and disclose whether any founding team members declined to provide such information. Further, covered entities must provide information on the number of investments to, and investment amounts in, portfolio companies primarily with "diverse founding team members." A diverse founding team member is defined as a founding team member who self-identifies as a woman, nonbinary, Black, African American, Hispanic, Latino-Latina, Asian, Pacific Islander, Native American, Native Hawaiian, Alaskan Native, disabled, veteran or disabled veteran, lesbian, gay, bisexual, transgender, or queer. They must also provide the total amount of all venture capital investments in the prior year, as well as the principal places of business of all portfolio companies that received such investment. The covered entity must anonymize such data.

What Is the Process for Compliance With the Reporting Obligations?

Under SB 54, the required demographic information will be collected via a survey that will be provided to founding team members after the investment agreement has been signed by the covered entity and the first transfer of funds has been completed. Such survey will contain a written disclosure stating that disclosure of demographic information is voluntary, the founder will not face adverse action for failure to participate in the survey, and that the collected data will be aggregated for each category and reported to the Civil Rights Department of California.

All covered entities must keep records relating to these reporting obligations and preserve such records for four years after providing the information to the Civil Rights Department of California. There will be fees collected by the Civil Rights Department from the covered entities for administration costs.

What Happens if You Fail To Meet the Reporting Obligations?

All reports are due by March 1 of each year. If a report is not filed by the deadline, the Civil Rights Department will provide notice, and the report must then be filed within 60 days from notification. If a covered entity fails to file the report in this window, the California Civil Rights Department may file an *ex parte* petition in superior court seeking compelled compliance, payment of a penalty, attorneys' fees, and other relief as determined by the court.

If the court finds that the petition sets forth good cause for the relief, then it will issue an order. The Civil Rights Department will then serve the petition and the order on the covered entity, which must file a response. Either party may file a request for a hearing. If the court grants the petition, the court's order will set forth the time frame and manner of compliance.

Possible Barriers and Lasting Implications

Given that SB 54 has been signed by Governor Newsom, it will go into effect on March 1, 2025. However, in his signing statement, Governor Newsom clearly stated that his administration will propose revisions to fix "problematic provisions and unrealistic timelines that could present barriers to successful implementation and enforcement."^[7] Governor Newsom further cited his belief that the Civil Rights Department "is not situated to perform this work," and "establishing this expertise, as well as any resultant work from administering the law, creates significant, ongoing General Fund cost pressures."^[8] That means the law may be subject to substantial revisions before it comes into effect, and the state's enforcement efforts may not be funded.

Also, even though it has been signed into law, SB 54 could still be challenged based on various doctrines, including the Equal Protection Clause or the Civil Rights Act. For example, Senate Bill 826 and Assembly Bill 979 to increase diversity in the boardroom were ruled unconstitutional. In any case, these bills' attempts to increase diversity could have lasting effects even though they have been struck down, and the mere introduction of SB 54 into law could establish a legacy on the landscape of venture financings going forward.

Endnotes

[1] Dominic-Madori Davis, "[California Passes Law Mandating VC Firms To Release Investments' Diversity Information](#)," *TechCrunch* (Oct. 9, 2023, 9:01 a.m.). (explaining that "[t]his is the United States' first piece of legislation that aims to increase diversity within the venture capital landscape.").

[2] *Id.*

[3] Cal. Code Regs. tit. 10, § 260.204.9.

[4] S.B. 54, 2023 S., Reg. Sess. (Cal. 2023).

[5] S.B. 54, 2023 S., Reg. Sess. (Cal. 2023).

[6] S.B. 54, 2023 S., Reg. Sess. (Cal. 2023).

[7] "[Signing Statement From Governor Gavin Newsom Regarding Senate Bill 54 to the Members of the California State Senate](#)" (October 8, 2023).

[8] *Id.*

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