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Public Company Update

Corporate America Beware: Labor Unions, Social Activists and Universal Proxy Cards

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On November 21, 2023, a coalition of labor unions led by the Service Employees International Union (SEIU), announced that it has nominated three director candidates for election to the Board of Directors of Starbucks at the 2024 annual meeting of shareholders. The coalition, which beneficially owns less than 0.00002% of the company's outstanding shares, is effectively using the campaign as a means to ratchet up its efforts to unionize Starbucks' workforce. The campaign is the logical consequence of the universal proxy rules implemented by the U.S. Securities and Exchange Commission (SEC) last year. As expected, such rules have opened the gates for social activists like labor unions to hijack the annual shareholder meeting process as a very public platform to pressure corporate management and advance their agendas.

Last year saw the implementation of the so-called universal proxy rules by the SEC. The rules require proxy cards distributed by public companies and activist shareholders in a contested director election to include both sides' director nominees, so that shareholders can "mix and match" nominees from the company's and dissident's slates. In simple terms, pre-universal proxy SEIU would have had to incur significant costs in mailing and distributing multiple sets of proxy materials if they were to mount a credible election campaign; the old regime would not have compelled Starbucks to include SEIU's nominees on any proxy card distributed by the company. Post-universal proxy such effort would take a fraction of the cost, as the names of SEIU's nominees would have to be included in every proxy card distributed by Starbucks' management. In addition to lowering the campaign cost for a dissident group, the inclusion of the dissident's nominees on the management proxy card is likely to increase the chances that shareholders elect at least one of the three SEIU nominees.

Some corporate observers recognized the possibility that universal proxy would enable and encourage labor unions and other single-agenda activists to hijack the director election process as a means to advance their agenda and extract management concessions. SEC representatives, universal proxy supporters and some corporate advisors dismissed the idea as fear mongering, and were quick to seize on the lack of comparable campaigns during the 2023 proxy season as clear and irrefutable evidence that such fears were unwarranted. The SEIU campaign at Starbucks does not make a trend, but does show that some single-agenda activists will recognize the benefits of the universal proxy regime and exploit it in ways the SEC, in our view, may not have fully appreciated when implementing the rule. While the SEC in its adopting

release did discuss so-called nominal contests recognizing that “[d]issidents may nevertheless choose to initiate nominal contests to pursue goals other than changes in board composition, such as to publicize a particular issue or to encourage management to engage with the dissident”, they also noted that “nominal contests are very rare, and the staff is unaware of any nominal contest that has resulted in the dissident gaining seats for its nominee”.

The fact is that these nominal contests by single-agenda activists can be conducted inexpensively with the activist mostly freeriding on the company’s proxy solicitation efforts. The universal proxy rules require that a dissident solicit shareholders representing at least 67% of the voting power of shares entitled to vote on the election of directors. While the SEC Staff has made clear through interpretive guidance that merely filing a proxy statement on EDGAR is not sufficient to meet the 67% solicitation requirement, according to the SEC’s adopting release, these solicitation costs even at a mega-cap company would be less than \$10,000. Further, based on publicly available data from FactSet, we estimate that the SEIU would have to mail proxy materials or provide electronic access through e-proxy procedures to less than 300 Starbucks shareholders to meet the 67% solicitation requirement. The ultimate cost of this proxy contest to the SEIU remains to be seen as it would also need to cover the cost of preparing its advance notice of nomination and its proxy statement, but we have seen a proxy contest conducted in the universal proxy era where the dissident disclosed in its proxy statement that it spent a total of \$50,000 on the proxy contest.

The universal proxy rules are here to stay and corporations need to adapt to them. In furtherance of that, we recommend the following:

- **Consider Full Implications of Universal Proxy:** Corporate management and Boards must be mindful that the universal proxy rules allow *any* shareholder to have its nominees included in management’s proxy card. There are no levels of minimum ownership. As such, a group like SEIU can have its nominees’ names included in management’s proxy card even though they own only 162 shares of Starbucks, an investment of less than \$20,000 in a company with a market cap of over \$100 billion.
- **Understand the End Game:** Unlike a traditional hedge fund activist, groups like SEIU are ultimately less interested in board representation. Although motivations may evolve over time, it is more likely that mounting a credible campaign for a director election and the attending publicity around it is aiming for a settlement in which SEIU might be able to extract management concessions that it would have otherwise been unable to obtain in a more orthodox negotiation between management and labor.
- **Coordination:** The new regime requires even further coordination among corporate divisions as it relates to matters of social, environmental, labor and corporate governance impact. It takes ownership of just one share for a negotiation with labor to turn into an election contest at the annual meeting of shareholders.
- **Organizational Documents:** Despite the robust debate around corporate advance notice bylaws responding to universal proxy rules, most of this dialogue has focused on traditional economic activists like hedge funds. Many advance notice bylaws remain inadequate at eliciting the information that would be relevant and applicable to single-agenda non-traditional activists like labor unions.
- **Institutional Investors and Proxy Advisory Firms:** It remains to be seen whether institutional investors will be willing to vote in favor of one or more directors proposed by single-agenda activists. Further, ISS’s Special Situations Research, which provides recommendations on how shareholders should vote on all proxy contests, has indicated that in ESG contests the activist will need to connect the dots between ESG issues, operational concerns, and shareholder value.

Indeed, the initial materials issued by SEIU loosely try to connect the dots by making the somewhat disingenuous argument that management's efforts to oppose unionization generates expenses and negative publicity that, in turn, is not in the best interest of stockholders. Time will tell whether ISS and large shareholders are able to distinguish empty claims that only pay lip service to ISS' guidance, as opposed to proposals that have a clear relation to shareholder value (however value may be defined for these purposes). Companies should proactively refine their messaging on E&S issues to make sure that shareholders understand how they are addressing and managing such issues in a way that creates shareholder value.

- **Monitor Stock Transfer Books:** Most advance notice bylaws require that a nominating stockholder hold shares in their record name. This means that a dissident's stock ownership must be registered directly with the corporation's transfer agent in order to make a valid director nomination; nominations by beneficial holders that own their stock in street name through their brokers is generally not permissible. Companies should therefore periodically monitor their transfer agent's records for potential indicia that a single-agenda activist is considering a campaign. By way of example, in late 2022 social activist As You Sow ostensibly prepared to nominate candidates by moving a nominal number of shares onto the registered list of several mega-cap companies in the lead-up to the 2023 proxy season.
- **Review Annual Meeting Voting Results on Shareholder Proposals:** Companies should review voting results on any shareholder proposals that were voted on at last year's annual meeting. A workers' rights shareholder proposal at Starbucks' 2023 Annual Meeting received support from a majority of shareholders. If a shareholder proposal relating to an E&S issue passes, or even if it does not pass it receives a large amount of shareholder support, it may embolden a single-agenda activist to run a proxy contest at next year's annual meeting. Companies should proactively engage with shareholders if an E&S proposal received a large amount of support at last year's meeting to make sure they are responding to the concerns that caused shareholders to vote in favor of such proposal.

The SEIU campaign should remind corporations that the full implications of the universal proxy card cannot be assessed after a single proxy season. We would expect similar campaigns organized by labor and other interest groups will occur in the coming proxy seasons. But such campaigns will likely not be waged in isolation. Labor will continue to wage comprehensive campaigns against companies by utilizing all levers of influence and power to pressure them into agreeing to union demands, with the universal proxy campaign as an added arrow in the quiver. And given the National Labor Relations Board's recent precedent-shifting decisions – including, for example, [elevating union authorization cards over secret-ballot elections to compel companies to recognize unions](#), and [adopting a stricter standard for assessing the lawfulness of workplace rules](#) – the old playbook that has been developed to deal with hedge fund activists will need to be revisited and adapted for the changing times.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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