Washington Federal Court Dismisses Derivative Challenge to Starbucks' DEI Initiatives

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A federal District Court in Washington recently dismissed a shareholder derivative action by a conservative advocacy group challenging Starbucks' initiatives relating to diversity, equity, and inclusion ("DEI"). The decision in *National Center for Public Policy Research v. Schultz* held that the plaintiff did not fairly and adequately represent the interests of Starbucks and its shareholders in launching the challenge and had not pled particularized facts showing that Starbucks' Board of Directors had wrongfully refused the plaintiff's demand to dismantle the company's DEI initiatives.

In an era of politicization of DEI and other ESG-related concerns, the ruling sends a signal that at least some courts will refuse to become "political attachés" in the culture wars and will not involve themselves with partisan attacks on "reasonable and legal decisions made by the board of directors of public corporations." Decisions of this type should provide some comfort to corporations and boards as they consider how to address those complicated social and workplace issues.

Background

Starbucks implements various initiatives involving DEI and hires independent consultants to advise on how the company can "better advance DEI for its employees, customers, and communities." The National Center for Public Policy Research (the "Center"), which owns 56 shares of Starbucks stock, is "an advocacy group committed to conservative causes in government and the private sector" and is "engaged in a nationwide campaign to litigate against so-called 'woke' corporate practices concerning issues of [DEI]."

The Center published a document called “Balancing the Boardroom 2022” and encouraged readers to vote against every Starbucks director up for reelection. The Center also presented several shareholder proposals, including one to require Starbucks’ Board nominees to disclose their “ideological perspectives” and another to create a Board committee to review Starbucks’ “woke business practices.” Shareholders overwhelmingly rejected the proposals, with only 1% and 3% of total possible votes cast in favor.

In March 2022, a “public-interest law firm” called the American Civil Rights Project published an open demand to Starbucks’ Board on behalf of the Center demanding that Starbucks retract its DEI initiatives. (The firm sent similar letters to many other large public companies.) When Starbucks did not accede to the demand, the Center filed a shareholder derivative action seeking declaratory and injunctive relief for violations of federal and state law, including breach of fiduciary duty.

The Court’s Decision

The court dismissed the action under Federal Rule of Civil Procedure 23.1 (which governs pleadings in federal derivative actions) and Washington law (the law of Starbucks’ state of incorporation).

The court first held that the Center did not “fairly and adequately represent the interests” of Starbucks and its shareholders because the Center had filed the suit not “to enforce the interests of Starbucks, but to advance its own political and public policy agendas.” Moreover, the Center owns only 56 shares of Starbucks stock, and its “dislike of DEI and ESG Initiatives has little support from Starbucks’ other shareholders and no support from Starbucks’ Board,” as evidenced by the votes on the Center’s shareholder proposals.

In addition, the Center had not pled facts showing that Starbucks' Board had wrongfully refused its demand for action. The Complaint did not show that the Board's investigation of the demand was "unreasonable or not undertaken in good faith," that the Board "was not sufficiently informed, or that its process was in any way inadequate." The Board had "engaged outside counsel, management, and relevant subject matter experts to assist it in evaluating the Demand's contentions." "Only after this careful deliberation did Starbucks determine that it was not in the best interests of Starbucks to retract the challenged Initiatives." The Center thus had failed to rebut the business-judgment presumption that the Board had acted "on an informed basis, in good faith, and in the honest belief that rejecting the Demand was in the best interest of Starbucks."

Implications

The Washington court's decision supports corporations' considered business decisions to implement DEI and other ESG-related programs that corporate boards and management believe are in the companies' best interests. Those programs might draw political flak from groups hostile to the programs' goals, but the programs should be defensible if they are substantively legal and are adopted for legitimate corporate purposes.

The decision also illustrates a procedurally sound way for corporations to respond to shareholder demands challenging ESG-related initiatives and any other business decisions: engage counsel and relevant subject-matter experts to assist in evaluating the demands' contentions, carefully deliberate on the outcome of that process, and then make informed decisions about whether the challenged practices are in the company's best interests.

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