Weighing the Arguments For and Against Staggered Boards

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To have a staggered board, or not to have a staggered board? That’s the corporate governance question sparked by this week’s progress report from the Harvard Law School Shareholder Rights Project (SRP), and an ensuing sharp rejoinder penned by AmLaw 100 firm Wachtell, Lipton, Rosen & Katz.

Harvard’s SRP, a clinical program at the law school, has been assisting public pension funds to get rid of—or declassify—staggered boards of directors. When a company has a staggered board, only a minority of directors face election in a given year, so it takes longer to replace a majority of board members. The SRP cites empirical research—including studies authored by the clinic’s director, Prof. Lucian Bebchuk—that show an association between staggered boards and “lower firm valuation and/or worse corporate decision-making.” [PDF]

So far, the clinic’s results have been “stunning,” in the words of Steven Davidoff, writing for the New York Times DealBook blog. Through a combination of submitting board declassification proposals and entering into agreements with companies in the S&P 500, the project has gotten close to a third of S&P 500 companies with staggered boards to commit to bringing management proposals to eliminate them.

The tally was announced in conjunction with five institutional investors that SRP represents or advises: the Illinois State Board of Investment, the Los Angeles County Employees Retirement Association, the Nathan Cummings Foundation, the North Carolina State Treasurer, and the Ohio Public Employees Retirement System.

Wachtell—known for the “poison pill” anti-takeover mechanism fashioned by founding partner Martin Lipton—doth protest. The title of the firm’s memo is something of a giveaway: “Harvard’s Shareholder Rights Project is Wrong.”

Or, as the memo puts it: “There is no persuasive evidence that declassifying boards enhances stockholder value over the long term, and it is our experience that the absence of a staggered board makes it significantly harder for a public company to fend off an inadequate, opportunistic takeover bid and is harmful to companies that focus on long-term value creation.”

The attorneys also take issue with the fact that the declassification measures are being carried out in Harvard’s name, and charge that the clinic is a reflection of Bebchuk’s “narrow agenda.”

“The portrayal of such activity as furthering ‘good governance’ is unworthy of the robust debate one would expect from a major legal institution and its affiliated programs,” write authors Martin Lipton, Theodore Mirvis, Daniel Neff, and David Katz.

Wachtell did not respond to requests for comment.

Bebchuk begs to differ, and says the clinic’s agenda is neither narrow nor his alone. “While Wachtell does not find the evidence persuasive, a majority of investors have formed a decidedly different view,” he says in an email response to CorpCounsel.com.
Between January 1, 2010, and June 30, 2011, “the average percentage of votes cast in favor of shareholder proposals to declassify boards of S&P 500 companies has exceeded 75 percent,” according to Bebchuk. He also says that in addition to the pension funds that SRP represents, institutional investors including American Funds, BlackRock, Fidelity, Vanguard, TIAA-CREF, and CalPERS, “all have policies that support annual election of all directors.”

Davidoff, a law professor at Ohio State University, took a deep dive on staggered board trends and literature in the Times, pre-Wachtell memo blast. He encountered a puzzling pattern: on the one hand, company boards in the S&P 500 are increasingly becoming declassified, dropping from 302 staggered boards in 2002 to 126 staggered boards today. On the other hand, companies that have only recently gone public—such as LinkedIn and Angie’s List—are increasingly doing so with staggered boards in place.

“According to FactSet SharkRepellent, 86.4 percent of the companies going public this year have had a staggered board,” Davidoff reports. “This figure is up from a still high 64.5 percent in 2011.”

Davidoff offers several explanations for the divergence—including the influence of shareholder pressure on existing public companies and the influence of corporate lawyers (Wachtell, anyone?) on the newbies. “Companies are acting to adopt a staggered board before shareholder pressure comes to bear,” says Davidoff, noting a few paragraphs down that newly public companies “are probably receiving legal advice to adopt a staggered board.”

As far as the literature goes: “Academic research also lends some support to the questionable value of a staggered board,” Davidoff writes (citing papers by Bebchuk and two others). “In fairness, there is also contrary evidence, and the value of the staggered board has yet to be determined definitively.”

Prof. Charles Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware, agrees there is room for debate, and says that’s where Wachtell does have a point.

Note first that Elson cannot emphasize strongly enough his dislike of staggered boards: “I am opposed to a staggered board. Always have been,” he says. He believes the setup insulates directors from answering to shareholders every year, and that “a good director should welcome and not be fearful of an annual election.”

That said, Elson also believes there’s plenty of disagreement about staggered boards, and that offering students school credit to work on the issue “seems to cross the line from academic debate to advocacy.”

(For the record, Bebchuk says the views expressed by clinics are not those of the law school, and only are those of the clinic or clients represented by the clinic.)

So while Elson “strenuously” disagrees with Wachtell’s conclusions about the value of staggered boards, he is sympathetic on one point. “I agree that it is enough of a debate that an institution shouldn’t take a position on it,” he says. “Individuals should take positions. Institutions probably shouldn’t.”