

Is The Harvard Shareholder Rights Program Breaking The Law?

ValueWalk

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The Harvard Shareholder Rights Program (HSRP) has spent the last few years pushing back against board staggering, where directors are given multi-year terms so that they don't all go up for re-election at the same time (the Senate, for example, follows a similar system). The 'Harvard Proposal,' developed by the project, has been used in more than 100 campaigns against large US companies by shareholders trying to force boards to de-stagger, and the HSRP is credited with pushing the public debate steadily against staggered (or classified) boards.

But according to Stanford professor of law and business Joseph Grundfest and SEC commissioner [Daniel Gallagher](#), the 'Harvard Proposal' is illegal because it misleads shareholders.

"The Harvard Proposal's failure accurately to describe the current state of the academic literature can be characterized as a material omission that violates Rule 14a-9," they write in [Did Harvard Violate Federal Securities Law? The Campaign Against Classified Boards of Directors](#).

"Companies should therefore be able to exclude the Harvard Proposal from the corporate proxy either by seeking no-action relief or through motions for declaratory judgment [...] The SEC could bring enforcement proceedings against Harvard University alleging violations of Rule 14a-9. Private party plaintiffs should also be able to prevail in 14a-9 actions against Harvard."

Five studies that Harvard Shareholder Rights Program isn't talking about

Since [staggered boards](#) are mostly a tool used to ward off hostile takeovers (if only a third of the board is up for election each year, the hostile takeover would take two years to complete, making it far more costly), the arguments for and against them are the same ones you hear in most discussions of shareholder activism or poison pills. But Grundfest and Gallagher aren't saying that HSRP's stance on staggered boards is wrong, but that the HSRP is mischaracterizing the existing literature.

The 'Harvard Proposal' used to initiate a shareholder vote on de-staggering cites research showing that staggered boards are associated with lower firm valuations, lower gains to shareholders, more value destroying acquisitions, and more issues with executive compensation. They mention one study that shows a correlation between staggered boards and higher takeover premiums, but it also found a correlation with lower firm valuation.

Grundfest and Gallagher point to five contrarian studies that they call "unambiguously forceful in their challenge."

Older studies that find staggered boards correlate to lower firm valuations compare cross-sections of companies, but the first three studies that Grundfest and Gallagher mention look at

time-series instead. Put another way, they don't compare two different companies with different board structures, they compare the same company before and after changing its board structure, and all three find that staggered boards actually boost firm valuation. These papers argue that firms with low valuations are more likely to have staggered boards because they are more likely to take defensive measures against hostile takeovers, but once in place those defensive measures allow the board to take a longer view and build value.

The other two studies found that under some conditions staggered boards were correlated with higher firm values. One found that companies with lower visibility tended to benefit from classified boards, while the performance of high visibility firms (like those that trade on the S&P 500) were hurt. The other study found that companies with relational capital, such as a vital trade relationship with a single large client, benefited from staggered boards because it offered more stability to these important outside stakeholders.

Gallagher not speaking for the SEC

Harvard Shareholder Rights Program could probably update the Harvard Proposal with some additional references (though it has to observe a strict 500-word limit), but that's probably not going to happen. If Grundfest and Gallagher are correct then companies facing a potential vote to de-stagger should be able to get the SEC to exclude the proposal, but that doesn't seem to be happening. They say the SEC's general approach is to let the company respond in its own proxy statement, citing whatever research it wishes.

It's strange to read an academic paper co-written by an [SEC commissioner](#) (in his personal capacity), saying that the SEC could take action against HSRP for material omissions. If anyone is in the position to take action against Harvard Shareholder Rights Program it's Gallagher, and to see his name on an academic paper instead makes you think that he has made any headway convincing his fellow commissioners to take action.

See [full PDF here](#).