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# Giving Shareholders a Voice

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Staggered boards have long been a key mechanism for insulating boards of publicly traded firms from shareholders. This year, several institutional investors and a program working on their behalf have used shareholder proposals to move a large number of publicly traded firms away from such structures. Despite strong and expected criticism from the usual suspects, shareholders should welcome and support this work.

The Shareholder Rights Project, a clinical program that I run at Harvard Law School, assists public pension funds and charitable organizations in improving corporate governance at publicly traded companies. During this proxy season, we represented and advised five such clients – 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 – in connection with their submission of proposals for a vote at the annual meetings of more than 80 companies on the Standard & Poor's 500-stock index.

The proposals urge companies with a staggered board, which allow shareholders to replace only a few directors each year, to place all board members up for election every year. Such a move to annual elections is viewed by investors as a best practice of corporate governance. By enabling shareholders to register their views on all directors each year, annual elections make boards more accountable to shareholders.

Staggered boards, also known as classified boards, certainly have their staunch supporters. As DealBook reported, the law firm Wachtell, Lipton, Rosen & Katz recently denounced the work undertaken on behalf of institutional investors by our program. Wachtell's sharply worded memo, titled "Harvard's Shareholder Rights Project Is Wrong," was signed by four of the firm's senior partners, including the founding partner and inventor of the poison pill, Martin Lipton.

What particularly drew Wachtell's ire were the results of the proposals, which Steven Davidoff called "stunning" in a recent Deal Professor column. Following active engagement, many of the companies receiving shareholder proposals entered into agreements to bring management declassification proposals that would require all directors to stand for election each year. As of today, 44 Standard & Poor's 500 companies – over one-third of the S.&P. 500 companies that had staggered boards at the beginning of this proxy season – have entered into such agreements, and 35 companies have already disclosed management declassification proposals made in accordance with such agreements.

Wachtell, the go-to legal counsel for incumbent directors and managers seeking to insulate themselves from removal, has been a strong advocate for rules and practices that facilitate such entrenchment. It is thus unsurprising that Wachtell and some of its clients may have a negative view of the large-scale move away from staggered boards taking place in corporate America. This change, however, serves the best interests of shareholders.

Investors' support for annual elections is consistent with a significant body of empirical evidence. A study by Alma Cohen and myself documented that staggered boards are associated with lower firm valuation, and this finding was subsequently confirmed in a study by Prof. Olubunmi Faleye of Northeastern University and another study by Michael Frakes of Cornell. Incumbents opposing declassification proposals often cite a study reporting that targets with staggered boards capture a larger slice of the surplus created by acquisitions, but even this study confirms that, over all, staggered boards are associated with lower firm value.

Furthermore, studies find that firms with staggered boards are associated with lower returns to shareholders in the event of an unsolicited offer, are more likely to make acquisitions that decrease shareholder value, tend to provide executives with pay that is less correlated with performance, and exhibit lower association between chief executive replacement and performance. Indeed, having a staggered board is a significant element of two "poor governance" indexes that have been used in hundreds of studies by financial economists: the G-Index and the E-Index.

Despite such studies, Wachtell claims that "there is no persuasive evidence" on the value of annual elections. Wachtell does not back up its claim with any empirical evidence or analysis, but merely asserts that "it is our experience that the absence of a staggered board… is harmful to companies that focus on long-term value creation." Investors, however, have formed a decidedly different view of the value of moving away from staggered boards: during the last two proxy seasons, shareholder proposals to declassify at S.&P. 500 companies received an average level of support exceeding 75 percent of votes cast.

In criticizing the Shareholder Rights Project's work, Wachtell quotes the statement of Chancellor Leo Strine of the Delaware Chancery Court that "stockholders who propose long-lasting corporate governance changes should have a substantial, long-term interest that gives them a motive to want the corporation to prosper." However, Wachtell overlooks that the five institutional investors represented by our program are exactly the type of long-term shareholders that Chancellor Strine views as desirable proponents.

Although Wachtell professes general support for a "robust debate" on staggered boards, the firm would prefer to have fewer shareholder proposals on the subject. Yet shareholder proposals are the very mechanisms that the securities laws (and, in particular, S.E.C. Rule 14a-8, known as the "town hall meeting" rule) provide for conducting debate at publicly traded firms. Both a shareholder who puts forth a proposal to eliminate a staggered board and the board members themselves make their case in the proxy materials sent to voting shareholders, who then cast votes to indicate which position they support.

In recent years, supporters of staggered boards have been on the losing side at an overwhelming majority of votes on shareholder proposals urging board declassification. Two proposals submitted by our program's clients recently passed with large majorities. Additional such proposals are expected to go to a vote this spring at more than 30 other companies, and defenders of staggered boards are expected to continue losing such votes.

Preferring therefore to discourage such proposals, Wachtell also claims that it is "inappropriate" for a law school's clinical program to assist clients that are not "impoverished or underprivileged." However, as the Columbia law professor Jeffrey Gordon explained in a response to this claim, clinics that advance the contested agendas of clients who are neither impoverished nor underprivileged are (for good educational reasons) are standard at law schools nationwide. These clinics do not represent the views of the law schools in which they operate but only those of the clients and, in some cases, of faculty and students who choose to work in a particular clinic.

Rather than seeking to discourage our program from representing institutional investors submitting shareholder proposals, Wachtell should focus on engaging in a substantive debate about the merits of staggered boards. I welcome such a debate.

In the meantime, shareholders should continue to be given the chance to vote on whether to eliminate staggered boards at companies – and boards should take those preferences into account. Doing so would serve the long-term interests of shareholders and the economy.

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