The Wall Street Journal, April 1, 2002

"Harvard Trio Says Staggered Terms For Boards Erode Shareholder Value"

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Staggered boards of directors have gained enormous popularity as a defense against hostile takeovers, but three Harvard University professors want to restrict their use -- contending they are powerful devices that erode shareholder value.

In a 173-page study to be published in an coming issue of the Stanford Law Review, the trio challenges the conventional wisdom that staggered boards enhance value by forcing hostile bidders to pay higher prices for their targets. Instead, they argue, staggered boards reduced shareholder returns by as much as 10% for companies that were takeover targets between 1996 and 2000. They also make suggestions for changing the process in which reluctant targets deal with their hostile suitors.

More than 70% of U.S. public companies stagger their boards of directors. Also known as classified boards, the technique prevents a hostile bidder from seizing control of a target's board of directors in a single shareholder election. By staggering the terms of the board members, a hostile bidder would have to win seats at a minimum of two elections before taking control of the board. But it rarely even gets to that point; in most cases, the hostile bidder either pressures its target into a friendly deal or drops the takeover attempt before the second shareholder meeting.

"Effective staggered boards are the most potent antitakeover device in the current arsenal of takeover defense weapons," write Harvard law professors Lucian Bebchuk and John Coates, and Guhan Subramanian, an assistant professor at Harvard's business school.

Although deal makers generally maintain that staggered boards boost shareholder value by forcing bidders to make attractive offers in order to woo their target, the Harvard study contends that shareholders of companies with staggered boards see lower returns on their investments. Specifically, they say, shareholders of companies with staggered boards achieved returns of 31.8% in the nine months after a hostile bid was announced, compared with 43.4% returns for investors of targets without staggered boards.

The Harvard professors suggest that courts should force takeover targets to remove barriers to a hostile bidder if that suitor wins board seats of its target. Specifically, they want targets to drop their "poison pill" plans in order to allow a bidder to proceed with the offer. A poison pill, also known as a shareholder-rights plan, prevents an unwelcome buyer from accumulating more than a certain percentage of a target's stock.

The adoption of their recommendation "might keep bidders in the game and may make incumbents less resistant because they would know they're not going to be sheltered" by the staggered board, Mr. Bebchuk says.

Not surprisingly, the study is already drawing criticism from veteran deal makers, who consider the staggered board and poison pill as fundamental defensive devices to ward off cheapskate hostile bidders.

"I don't generally view a classified board as an antitakeover device, but rather a device that's designed to allow directors to do their job," says Lyle Ganske, head of the U.S. mergers-and-acquisitions practice at law firm Jones Day in Cleveland.

Critics also note that courts in Delaware, where most of the nation's groundbreaking corporate takeover decisions are handed down, historically have allowed a board to retain a poison pill.

The Harvard proposal "is in effect telling a board to lay down its arms and allow the shareholders on their own to decide. I think there's a question as to whether, by doing that, they would be acting in a manner consistent with their fiduciary duties," says John Madden, a partner in the mergers-and-acquisitions group at law firm Shearman & Sterling in New York.

Staggered boards have been critical in some recent high-profile takeover battles, including Weyerhaeuser Co.'s recent 14-month effort to acquire rival Willamette Industries Inc. Weyerhaeuser won three seats on Willamette's board last spring, but the staggered board prevented it from taking control. Weyerhaeuser was considering nominating a slate for another three seats this year, but Willamette capitulated and the two companies struck a deal. In this case, Weyerhaeuser's inability to wrest control of Willamette's board indeed eventually forced the hostile suitor to raise its bid from an initial $48 a share to $55.50 a share, or about $6.1 billion.

TRW Inc., target of a $5.9 billion hostile takeover from Northrop Grumman Corp., is protected by a staggered board, but it doesn't have a poison pill. TRW is incorporated in Ohio, however, which has some of the toughest laws to ward off hostile suitors.

The study reinforced concerns that have long been expressed by corporate-governance advocates. "We've been concerned about the [staggered board and poison-pill] combination and have talked with a number of companies about it to no avail. This study should cause us to worry," says Ken Bertsch, director of corporate governance for TIAA-CREF, the largest U.S. pension fund.

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