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Wachtell Lipton discusses Staggered Boards, Long-Term Investments and Long-Term Firm Value

By Martin Lipton and Marshall P. Shaffer
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Recent econometric studies ("empirical evidence") definitively rebut the position taken by the Harvard Law School Shareholder Rights Project (SRP) that classified boards are associated with lower firm value and inferior outcomes for shareholders. After correcting serious statistical and econometrical flaws in the studies put forth to support declassification, these new studies conclude that staggered boards result in long-term value creation:

- A 2014 study, "*Staggered Boards and Firm Value, Revisited*" found that, when measured across the "time series," firm value *improves* after firms stagger, and *declines* after firms destagger, with the effects stronger at firms seemingly more focused on the long-term. The study reinterprets traditional attacks against staggered boards, which purport to find a negative correlation in the "cross series" between staggered boards and firm value, by suggesting the decision to stagger is largely endogenous and related to *ex ante*, rather than *ex post*, lower firm value.

- A 2014 study, "*Board Destaggering: Corporate Governance Out of Focus?*" found that activism, firm size, board size, prior performance, CEO tenure and governance arrangements influence decisions to destagger. After controlling for these endogenous factors, the study found that destaggering is associated with *declines* in long-term accounting performance and *declines* in R&D investment, "consistent with the reduced incentive horizon for directors following destaggering."

- A 2015 study, "*Commitment and Entrenchment in Corporate Governance*" found that "bilateral" protective arrangements that require shareholder approval – including staggered boards – are associated with *increased* firm value across the "time series."

- In addition, a 2015 study, "*Do Staggered Boards Harm Shareholders*?" contested the results of a 2013 study, "*How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment*" that purported to find that staggered boards harm firm value, based on stock price

reactions to court rulings. Based on the same sample and methods, the 2015 study found no statistically significant evidence that staggered boards harm firm value.

Concomitantly with the rise of the SRP, activist hedge funds have significantly grown in size and have piggybacked on the campaign against staggered boards and other governance "issues" as a lever to force firms into removing their takeover defenses, thus making them more vulnerable to short-termist pressures to deliver immediate shareholder returns. These attempts have been largely successful; over the last 10 years, the percentage of S&P 500 companies with classified boards has sharply declined from 47% to 10%, while at the same time S&P 500 companies have increased dividends and buybacks by 85% to nearly $1 trillion. This has been fueled by underinvesting in long-term growth and is in diametric opposition to the interests of institutional investors in long-term value creation, as evidenced by recent statements by Vanguard's William McNabb, BlackRock's Laurence Fink and State Street's Ronald O'Hanley.

Hopefully these new studies will serve as a further wake-up call and make it clear that the recent trend of forcing companies to adopt one-size-fits-all governance "best practices" – at the expense of long-term investments and firm value – is misguided and must end.

The preceding post comes to us from Wachtell, Lipton, Rosen & Katz. It is based on a memorandum circulated by the firm on December 3, 2015.