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Long-Term Investors Have a Duty to Bring Back the Staggered Board (and Proxy Advisors Should Get on Board)

By Neil Whoriskey on June 5, 2018

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Beyond the cacophonous din of voices calling for companies to serve a "social purpose," adopt a variety of governance proposals, achieve quarterly performance targets, and listen to (and indeed even "think like") activists, there is now, most promisingly, a call from genuine long term shareholders for public companies to articulate and pursue a long term strategy.[1] This latest shareholder demand directly supports the achievement of traditional corporate purposes, and seems, more than any other shareholder demand of the last decade, the most likely to increase shareholder value. Yet in current circumstances, where all corporate defenses have been stripped in the name of "good governance," boards and management have been given zero space in which to formulate and implement a long term strategy. Indeed, the very fact that shareholders must *demand* **corporations focus on long term strategy demonstrates just how effectively the governance movement has been co-opted by market forces to serve the interests of short term activists and traders to the detriment of long term investors. It is time for long term investors to recognize that aspects of the good governance movement have in fact come at significant cost to their own investors, to be perhaps a bit more wary of partnerships with activists, and to actively create the conditions that will allow boards and management to focus on the long term. Exhortations are not enough. The first step should be to bring back staggered boards.**

A. Declassification as Good Governance or a Cheap Fix? The SRP Experiment

Harvard Law School's Shareholder Rights Project (the "SRP") was a grand social experiment, and though begun with the best of intentions, like other social experiments it obeyed strictly the law of unintended consequences. The SRP was driven by academics who found staggered boards to be "associated with lower firm valuation."[2] Based on this naked correlation, and on a speculative bit of what they termed "suggestive evidence"[3] of causation, these academics organized and staffed a campaign that targeted the boards of over 120 public companies for declassification. Along the way, the SRP garnered the support of ISS and Glass Lewis, whose policies in favor of declassification very likely resulted in many additional declassifications.

In a remarkable display of lemming-like suicidal efficiency, shareholders (including presumably many long term holders following the advice of ISS and Glass Lewis) and/or boards voted to eliminate staggered boards at 102 of the targeted corporations.[4] According to a subsequent study, this initiative was associated with an astounding decline in value of *$90 to $149 billion* **at the targeted firms.[5] Clearly the SRP campaign was not simply harmless policy tinkering. While this was not the consequence intended by its principals, the SRP cost long term shareholders a lot of money.**

This happened even though, as early as December 2014, SEC Commissioner Daniel Gallagher and Stanford Law professor Joseph Grundfest[6], had written a persuasive article arguing that SRP shareholder proposals were materially misleading – sufficiently misleading that they titled their article "Did Harvard Violate Federal Securities Laws?" Gallagher and Grundfest criticized the SRP for the failure of its proposals to recognize the substantial body of academic studies contradicting the studies cited in the SRP proposals. Gallagher and Grundfest further criticized the SRP proposals' failure to acknowledge that the aggregate correlation between staggered boards and value found in the SRP-cited articles did not apply homogeneously to all companies – even if the correlation existed overall for the firms studied, it did not exist at every company. In effect, in their view, the SRP took a slanted view on the state of scholarly research and made no attempt to show that a particular staggered board at a particular targeted company had resulted in value-draining entrenchment – entrenchment being the root evil to be eradicated by declassification. Any such company-specific analysis was foregone in favor of the assertion that staggered boards were in general associated with lower valuations, which assertion was supported by a very few lines summarizing a non-representative subset of scholarly articles.

The question arises: why would shareholders make such an important decision on this basis?

An unholy unity of interests is not hard to identify. The broad strokes of heavily debated academic research were pushed forward as a uniformly applicable policy recommendation by academics advocating on one end of the debate, by proxy advisory firms looking for standard out-of-the-box recommendations that were

easy to administer, by activists, delighted to strip away – under the flag of "good governance" – the last defense capable of slowing them down in their push to extract immediate value, and in the end by long term shareholders who were perhaps too credulous and unquestioning when presented with a measure that they were told would benefit the governance and value of their portfolio companies. The cheap fix may have worked to reduce the cost of administering a portfolio, but like a lot of cheap fixes, ended up costing long term investors far more.

The SRP pitch was that by allowing shareholders to "register their views" on the performance of all directors at each annual meeting – meaning, really, allowing shareholders to replace the entire board at every meeting – the directors would become more responsive to shareholders. As we will see, in that respect, the SRP campaign was wildly successful. Directors and managers have indeed become more responsive to the demands (and even anticipated demands) of activists taking advantage of declassification – with very significant unintended and unfortunate consequences.

B. Important New Governance Tools Emerge For Long Term Holders

While entrenchment is an old complaint, and no doubt a valid one at some corporations, declassification was never a particularly well targeted remedy, absent an activist campaign to replace the board. Large institutional long term holders simply have too many companies in their portfolio, and in the past were (and in many cases are still) too under-resourced internally to themselves run proxy campaigns against entrenched directors. In essence, the power of declassification turned out to be a power wielded only by activists.

As it happened, just as the SRP campaign rolled out, a corporate governance middle ground emerged between the starkly divergent roads of either accepting entrenchment or setting activists loose to remove the entire board at a stroke. A large number of more well directed tools were developed and implemented to assure and improve the quality of boards. Good governance initiatives focusing on director qualifications, board refreshment, length of tenure, retirement age, separation of CEO and board chair positions, and diversity were all more carefully calibrated to look at a particular board and determine whether that board had

become entrenched, or its thinking too stale. These tools, in addition to proxy access, majority voting on directors, withhold vote/vote "no" campaigns, and say on pay measures, not to mention a much more robust commitment to direct engagement with their portfolio companies, have given long-term investors all of the tools they need not only to evaluate whether a board needs to be shaken up, but also the tools needed to effect change at the board. These tools can all be used without activist intervention, allowing long term investors to "register their views" on director performance on an ongoing basis and better control the direction and outcome of any board intervention. To give just one example of how these tools have grown in importance in recent years, according to ISS, in 2012 (when the SRP program was getting off the ground) only 13 US public corporations discussed board refreshment in their proxy statements; in 2018, that number jumped to 591.[7] If a stale, entrenched board was the enemy, 591 US public corporations now have the enemy in their sights. They are addressing the issue directly and openly.[8]

C. The Cost of Declassification

Given these better directed, more particularized, tools to fight entrenchment and encourage an appropriate level of responsiveness, query whether declassification – which essentially provides shareholders the option to remove the board (and hence management) on a few months' notice – is worth the cost to long term investors.

There are more than a few voices in academia saying "no." Given the origins of the SRP declassification campaign, and given that the proxy advisory firms appear still to be relying on dated academic studies to justify their strong support of declassification, it may be worthwhile to note some of these studies.

Perhaps most significant are a number of studies done by Notre Dame professors K.J. Martijn Cremers, Simon M. Sepe and their colleagues, including the study noted above which calculated the cost of declassification at 93 of the SRP declassified companies as being from $90 – $149 billion[9] – a hugely significant loss of value to long term holders. Cremers and his colleagues further demonstrate, based on their extensive statistical analysis, that, contrary to the SRP cited studies, classified boards are positively related to value, and hence an independent "good governance" measure that should be adopted at least by a subset if not all

companies.[10]

The various studies undertaken by Cremers, Sepe and their colleagues are significantly more robust than the earlier studies cited in the SRP proposals, covering far lengthier periods (from 1978-2011, as opposed to the 7 year period often used in prior studies) and controlling for a greater number of significant variables across firms studied. The use of a longer frame of reference is of obvious importance – not least to long term holders – but is also important in that it permitted Cremers and Sepe to perform a time series analysis, allowing a more sophisticated look at the data than the cross-sectional analysis used in prior studies, and leading them to conclude that the interpretation of the data in those prior cross-sectional studies had cause and effect reversed – or at a minimum had their order of events reversed: the time series analysis showed that less valuable firms sought the protection of a staggered board (and subsequently saw their value increase) rather than staggered board adoption resulting in a subsequent decline in value.[11] This is critical. When you find an association between low firm value and staggered boards, whether the low value preceded the adoption of the staggered board, or the adoption of the staggered board preceded the low value, is distinction you'd want to dig into, and something that a time series analysis can show you. Timing is everything –particularly when trying to conjure causation from correlation. The time series analyses performed by Cremers and Sepe give us a much clearer picture of the relationship between firm value and classified boards, and it is completely opposed to the conclusions previously drawn from the earlier cross-sectional studies.

In addition, Gallagher and Grundfest in their 2014 article summarize the conclusions of five studies by a variety of academics that "strongly refute the categorical conclusion advocated by" SRP – namely, that staggered boards are harmful without exception.[12] These studies have found, variously, that:

- **"[D]estaggering does not appear to always lead to improved firm performance; on the contrary, destaggering could lead to managerial short-termism and less effective board monitoring"**
- **"[S]taggered boards do not appear to be harmful to shareholder interests at all firms … [and] … regulators and large investor groups should exercise**

caution concerning the single minded efforts to repeal all staggered boards"

- **"[C]lassified boards are positively associated with [value] in firms with low monitoring costs and greater advising needs"**

Another recent study has found, in re-examining the research on which the SRP campaign was based, that "the staggered board in general does not serve as an entrenching device which facilitates managerial waste."[13] Yet another study has found a significant increase in value associated with the adoption of a staggered board by "innovating firms – young firms and those that invest heavily in R&D," and also found reduced earning management and an increased return on assets at such firms.[14]

In short, it appears a number of the more recent academic studies either demonstrate that staggered boards contribute positively and significantly to the long term value of corporations, or at a minimum demonstrate that staggered boards contribute to the value of some subset of corporations. Stating the obverse, declassification is costing long term shareholders money.

As we will see, the true cost of declassification becomes even more apparent when focusing on firms that have significant long term investment budgets.

D. Are Activists and Long Term Holders Aligned on Declassification? Investment Limiting Campaigns

An important question for long term holders is whether long term funds are sufficiently aligned with activists to justify support of an anti-entrenchment remedy that (i) can only be exercised by activists, and (ii) can be exercised by activists without the support of long term holders. This question has already been answered in large measure by the long term investors themselves.

Professors Coffee and Palia have pointed out that hedge fund activism is associated with "(1) increased leverage; (2) increased shareholder payout (through either dividends or stock buybacks) and (3) reduced long-term investment in research and development."[15] They note that SRP's prime mover – Professor Bebchuk – agrees that these "investment limiting" campaigns by activists are "prevalent," but Professor Bebchuk argues that the campaigns are in fact a good development, as

they "move targets toward . . . optimal investment levels." [16] However, long term investors, to judge by their public statements, seem to have a very different view of these "investment-limiting" campaigns.

BlackRock bemoans "short-term pressures to distribute earnings, and in the process, sacrifice investments in employee development, innovation and capital expenditures that are necessary for long-term growth."[17] State Street is "wary of activist models of engagement that favor short-term gains at the expense of long-term investor interests", recognizing that some of activists' most frequent tactics – buybacks, leveraged dividends, spinoffs and M&A "could add value in the short term but may also undermine long-term value."[18] In short, long term investors have become convinced that "investment limiting" campaigns are damaging the value of their long term holdings.

These investors' concerns are well-supported, not only by their own experience, but also by detailed research, such as a broad study by McKinsey, published in the Harvard Business Review, of 615 US public companies over a 14 year period. The study showed that firms with a long term focus out-performed their peers in revenue growth (47% better than the average) and in earnings growth (36% better than the average).[19] The authors note that "if all public U.S. companies had created jobs at the scale of the long-term-focused organizations in our sample, the country would have generated at least five million more jobs from 2001 and 2015 – and an additional $1 trillion in GDP growth." The profile of these long term focused firms – presumably the very type of firms BlackRock and State Street are most interested in supporting – included increases in R&D spending at an annualized rate of 8.5%, far greater than the 3.7% rate for other companies.[20] This profile is presumably not consistent with the profile of a firm that has undergone an investment limiting campaign.

Restoring classified boards, in appropriate circumstances, would seem to be critical to protecting the value of the investments of long term holders. Once an "investment limiting" campaign has begun, long term investors are generally ill-equipped to shut it down. They lack the focus and agility of activist funds, and, though are large holders, none will be large enough to have a blocking position. This is why the defense has to be in place BEFORE the campaign starts – once the

war begins, long term holders need time to focus and organize a defense, if appropriate, of the strategy being pursued by their portfolio company. As importantly, management needs to know that what BlackRock has termed the board's "license to operate from key stakeholders"[21] is not revocable at will by activists. Without this assurance, as discussed below, boards and management will be strongly incentivized to carry out their own investment limiting campaigns, regardless of the effect on long term holders.

E. Where to Start? Protecting R&D

(i) Undervaluing Long Term Investment

The most natural place to start bringing back staggered boards would seem to be that subset of firms, such as tech companies, with relatively high R&D or other long term capital budgets. These are the firms most susceptible to "investment-limiting" campaigns.

Markets tend to severely undervalue long term investment projects. The Conference Board reports that "public company management prefers [short term investment projects] . . . in the belief that investors fail to properly value long-term projects" and that "McKinsey calculates that investors penalize long-term corporate investments by using discount rates that are 5 percent to 10 percent higher than risk and actual returns justify."[22] To illustrate just how impactful this overdiscounting is, consider the Conference Board's example of the discounted payback period for a hypothetical riskless investment of $60 that pays out $10 per year. If one uses a discount rate that is 5% higher than the baseline, the discounted payback period increases from 9 years to 15 years. Using a discount rate that is 10% higher than the baseline, <u>payback would never occur</u>.

The phenomena of undervaluation of long term investments is particularly acute when the firms have a high level of short term ownership (such as firms under pressure from activists). Professor Bushee of the University of Pennsylvania has found that such firms "are associated with overweighting of the near-term earnings component of value and underweighting the long-term earnings component," leading to "significant misvaluations" of those firms.[23] Similarly, Professors Asker, Farre-Mensa and Ljungqvist find that, as compared to private

firms, "short-term pressures increase the hurdle rate that public firm managers use to evaluate investment projects, resulting in lower investment levels." **[24]** **If boards adopt the overdiscounted view of long term investments held by the market, underinvestment is inevitable. And underinvestment can only pay off for so long before competitors with a longer term view gain an insuperable lead – particularly in the technology field. These studies prompt the question as to why long term investors would not demand more insulation from short term pressures at their portfolio companies.**

There are of course a number of possible explanations for market mispricing. As Professors Cremers and Sepe explain, market mispricing could be due to "information asymmetry" (i.e., the board and management having better information than the market), the Keynesian "herding effect" (the idea that shareholders trade not just on their own understanding of fundamental value, but on their understanding the average shareholder's expectation of value)[25] **and/or the fact that any information disclosed about a long term capital investment and its expected returns is "soft" information that may be given less weight in the market than the more obvious "hard" information that the investment is limiting current earnings.**[26]

However, regardless of why it happens, the mispricing creates the arbitrage opportunity activists have been exploiting in their "investment limiting" campaigns. At companies with long term capital projects, if those projects are not sufficiently valued by the market, the door is open to activists to extract value by either cutting long term spending and distributing the savings to shareholders.[27] **or by generating a sale of all or part of the firm – possibly at a premium, but only at a premium to then discounted market price. Either result is likely to be sub-optimal for long term investors who would otherwise have realized the full value of the long term investment.**

(ii) Declassification's Irremediable Moral Hazard

Even more fundamental for our purposes, is the governance dynamic established as a result of declassification – perceptively identified by Professors Cremer and Sepe. Boards and management understand perfectly well that a long term capital commitment will likely not be given full value by the market, and further

understand that – given the susceptibility of a declassified board to short term shareholder pressure – they may be fired before a long term investment can prove its worth. This will cause them to prefer investments that they can see through to completion. Similarly, management will see its performance-based pay decline with the market's unenthusiastic reception of their long term investment plans, and will know that they may not be in office long enough to see their long term bet pay off for the company or themselves. These incentives will cause the board and management to prefer short term investments or simply lower than optimal levels of R&D.[28]

This governance dynamic creates a far more powerful and intractable moral hazard than entrenchment could. There is no self-correcting systemic remedy – the board is completely aligned with its most vocal shareholders. Management is just doing what shareholders are telling them to do. Shareholders will not discipline the board, even though the board is not acting in the long term interests of shareholders, or even in furtherance of traditional corporate objectives.[29] This new moral hazard, an unintended consequence of the last decade's tidal wave of declassification, is pernicious.

(iii) The Unintended Consequences of Declassification – By the Numbers

Lest anyone think this moral hazard is simply an abstract construct of clever professors, consider not only the rigorous studies done by those professors, but also the following studies cited by Professors Coffee and Palia:

– a 2015 study finding that firms targeted by activists (and not sold) decreased their investment in R&D by 50%.[30]

– A 2014 study finding that R&D spending drops significantly during the five year window subsequent to hedge fund activism.[31]

– A 2015 study by S&P Capital IQ for the Wall Street Journal showing that, at companies targeted by activists, capital expenditures were reduced from 42% of operating cash flow to just 29% in the five years after activists first invested, while dividends and buybacks jumped to 37% of operating cash in the first year after activists invested from 22% in the year prior.[32]

In short, Coffee and Palia conclude that "research and development expenditures decline significantly in the wake of hedge fund pressure."[33] They further point out that even firms that are not targeted by activists often "increase leverage and dividends or reduce long-term investments, in fear of the growing risk of such an activist intervention."[34] While some may argue, with Professor Bebchuk, that a 25% or 50% decrease in R&D is simply a healthy movement toward "optimal investment levels," it may be tricky to square that argument with McKinsey's finding that at the long term focused companies in their study – the ones referenced above with starkly superior earnings and revenue growth – R&D spending grew at an annualized rate of 8.5%, as compared to the 3.7% rate for other companies in the study.[35]

This drop in R&D spending itself bears out Cremers and Sepe's theory that destaggering boards creates a strong moral hazard, incentivizing directors to calculate how best to align capital allocations with the market's mispricing of long term investment plans –even if that alignment comes at a steep cost to long term holders. But Cremers and Sepe's theory is also backed up, not just by statistics showing the precipitous decline in investment by companies targeted by activists, but more directly by their own multiple studies demonstrating that declassification is correlated with a LOSS in value, and classification is correlated with an INCREASE in value – in each case, more particularly so in companies with heavy R&D spending.[36] It is worth noting again that these studies appear to be significantly more sophisticated than the earlier studies – covering a much longer time period, controlling for more firm specific variables, and using a time series analysis to avoid the "reverse causality" problem of the earlier cross-sectional analyses.

And Cremers and Sepe are hardly alone in finding staggered boards to be particularly valuable at firms with significant R&D budgets. A recent study by Stanford Law professor Robert Daines and colleagues from USC and Harvard Business School, using different methodology from Cremers and Sepe, comes to the same conclusion: that "innovating firms" – including those with a heavy R&D spend – benefit significantly from a staggered board in terms of value, increased innovation, reduced earning management and increased return on investment.[37] A study by Cornell Business School professor Bhojraj and colleagues found that at

firms with significant R&D budgets, takeover protections such as staggered boards are associated with higher value, hypothesizing that "by reducing short-term market pressures, takeover protections allow for more optimal investments."[38] The evidence all points in one direction when the focus is on firms with significant long-term investments in R&D

F. Proxy Advisors Need to Get On Board

Professors Coffee and Palia in their 2016 article note that, in thinking about resurrecting the staggered board, companies "face a difficult choice between lying low or confronting the proxy advisor." This is still true – but why?

In their article, Grundfest and Gallagher pointedly warned proxy advisors of their legal and fiduciary duties to "consider the implication of the recent empirical findings for their proxy voting policies."[39] Yet there is no publicly available evidence that either ISS or Glass Lewis has considered any study done after 2010. To the contrary, Glass Lewis, in its 2018 Guidelines, continues to cite only studies published by Professor Bebchuk and his colleagues before the end of 2010, ignoring all subsequent studies (or even prior studies from a different source).[40] ISS simply states in its 2018 QualityMetrics report that "[s]tudies have shown a negative correlation between the existence of a classified board and a firm's value," language that has shown up in identical form in similar ISS documents as far back as 2010.[41] The statement is maddening both because ISS seems to be basing its inflexible position on findings of a general correlation, and because ISS does not acknowledge that a number of other more recent and more sophisticated studies have shown, with something closer to causation, that a classified board increases firm value.

Even if the proxy advisors' view of their fiduciary duties permits them to ignore all other, contrary, studies in favor of ones done a decade ago, it seems almost perverse to be ignoring their own achievements over the past decade. The focus on what makes for a good board has grown enormously over that period, in no small part due to the proxy firms focus on improving board accountability. And, as noted above the tools for fixing a bad board have also grown. The proxy firms' governance metrics, which include evaluations of factors such as director qualifications, refreshment, tenure, diversity, retirement age, etc. pinpoint the

entrenchment and responsiveness issues that were at the heart of the SRP campaign.

At this point, the only purpose of declassification is not to "make the board more responsive" but to allow activists to remove the entire board in a single stroke. Query why long term focused investors would need such a tool, or – given the dynamic created by awarding such a tool to activists focused on "investment limiting" campaigns – why long term investors would permit such a dynamic to persist. Perhaps of even more direct relevance to proxy advisors, is the question of why long term investors would continue to pay for advice that rests on such outdated thinking and is so contrary to their own interests. This is a critical issue for companies, long term investors and the economy generally, so one hopes that – urged by their large long term investor customers – the proxy firms will very quickly revisit their thinking.

G. Time to Act.

Activist funds, often run by world class traders, have noses for how to make a company's stock price move. However, they are not – by profession or training – CEOs. Traders can bet on whether a long term investment strategy will work out well at a portfolio company, but it is not their role to determine and manage that strategy on behalf of all shareholders. Boards and management make the big bets, and traders make secondary bets on the success of those big bets. The system doesn't work if traders are both calling the shots on the big bets and placing secondary bets on the strategy they have dictated – the company would be run for the benefit of those traders only.

This very basic distinction in roles seems to become further obscured every day that goes by – both because activists often profess that they know best how their target companies should be run, and because boards have in some cases gone from thinking like activists to acting like activists. Occasionally, listening to discussions in some board rooms, one could be forgiven for thinking that the board's job was, like the activists, simply to make the stock price move – as if shares of stock were the products the board was most immediately interested in developing and selling.

Fortunately, far more often boards attempt to act in their traditional role, as

stewards of massive amounts of capital pooled to provide investors with a competitive rate of return over the long term, produce valuable goods and services, provide employment and training, and drive economic growth. But to be able to effectively act in this traditional role, boards need at least some insulation from the short term forces that have taken over the thinking at many companies. It is time for long term shareholders to act – by either sponsoring re-classification proposals, or at a minimum by encouraging and vocally supporting re-classification at companies where they think it makes sense.

A representative of one long term shareholder, in informal discussions, has already indicated that his institution would be supportive of re-classification for companies with good boards and a good track record of performance. This is a thoughtful approach, focused on the qualities of a specific company and its board. Given the huge amount of value at stake for long term shareholders (not to mention other stakeholders), given what we know about the moral hazard created by declassification, given the prevalence of more targeted and effective tools to counter entrenchment, and given their own fiduciary duties, all long term holders should take no less thoughtful an approach.

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[1] **See, e.g., Larry Fink,** *Annual Letter to CEOs: A Sense of Purpose* **(BlackRock, January 16, 2018), available at https://bit.ly/2p26QI3 ("Without a sense of purpose, no company, either public or private, can achieve its full potential…. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives.").**

[2] **See, e.g., Illinois State Board of Investment,** *Proposal to Repeal Classified Board* **(September 10, 2012), appended to SEC Followup Letter in Connection with No Action Request (Exhibit A) (January 15, 2013), available at https://bit.ly/2LcGxbA.**

[3] **See Lucien Bebchuk and Alma Cohen,** *The Costs of Entrenched Boards*, **78 Journal of Financial Economics 409, 409 (2005). The "suggestive evidence" in question is the "fact that, since the beginning of the 1990s, shareholders of existing**

public companies have generally been unwilling to approve charter amendments that establish a staggered board." Id at 411.

[4] **Overall, staggered boards declined precipitously from 60% of the S&P 500 in 2006 to 8% in 2016. See** *Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice (United States*) **22 (Glass Lewis, 2018), available at https://bit.ly/2KO4llU.**

[5] **See K.J. Martijn Cremers and Simone M. Sepe,** *Board Declassification Activism: Why Run From the Evidence?* **2 (SSRN, June 26, 2017), available at https://ssrn.com/abstract=2962162. "Financial value" here is measured using Tobin's Q, the ratio of a company's market value to its book value, which is the "standard proxy for the financial value of the corporation in corporate finance studies." Id at 2.**

[6] **See Daniel Gallagher and Joseph Grundfest,** *Did Harvard Violate Federal Securities Law? The Campaign Against Classified Boards of Directors* **(Rock Center for Corporate Governance at Stanford University Working Paper No. 199, December 4, 2014), available at https://bit.ly/2IE1bEu.**

[7] **Subodh Mishra,** *An Early Look at US 2018 Proxy Season Trends* **(Harvard Law School Forum on Corporate Governance and Financial Regulation, May 15, 2018), available at https://bit.ly/2GsmDGF.**

[8] **In discussing classified boards and corporate governance reform, it is hard to overlook the glaring difference in approach to proxy access and declassification. Long term holders are happy to have the ability to nominate 20% of the board after holding a small percentage of the company for 3 years. Yet declassification allows long term holders to replace the entire board by picking up the phone and calling an activist. Proxy access is, again, a more controlled approach to dealing with a recalcitrant board, and one that has grown exponentially since 2012 – from 2 companies with proxy access bylaws in 2012 to 63% of the S&P 500 as of early 2018.** *EY Center for Board Matters: Corporate Governance by the Numbers* **(Ernst and Young, April 30, 2018), available at https://go.ey.com/2s4VeVV. However, given the number of times a long term holder has actually exercised proxy access rights, one suspects that calling an activist is still cheaper administratively for long term**

holders than exercising proxy access rights, and that the various proxy access campaigns were nothing more than virtue-signaling distractions.

[9] **See Cremers and Sepe,** *Board Declassification Activism: Why Run Away from the Evidence?* **2 (cited in note 5).**

[10] **K.J. Martijn Cremers and Simone M. Sepe,** *Board Declassification Activism: The Financial Value of the Shareholder Rights Project* **(SSRN, June 2, 2017), available at https://ssrn.com/abstract=2962162.**

[11] **See Cremers and Sepe,** *The Shareholder Value of Empowered Boards*, **68 Stanford Law Review 67, 71-72 (2016).**

[12] **See Gallagher and Grundfest,** *Did Harvard Violate Federal Securities Law?* **at 33-41 (cited in note 6). These studies have found, variously, that:**

- **"[D]estaggering does not appear to always lead to improved firm performance; on the contrary, destaggering could lead to managerial short-termism and less effective board monitoring" (citing Weili Ge, Lloyd Tanlu, and Jenny Li Zhang,** *Board Destaggering: Corporate Governance Out of Focus?* **36 (AAA 2014 Management Accounting Section Meeting Paper, August 2016), available at https://bit.ly/2IFIsIz).**
- **"[C]lassified boards are positively associated with Tobin's Q in firms with low monitoring costs and greater advising needs" (citing Seoungpil Ahn and Keshab Shrestha,** *The Differential Effects of Classified Boards on Firm Value*, **37 Journal of Banking and Finance 3993, 3995 (2013)).**
- **"[S]taggered boards do not appear to be harmful to shareholder interests at all firms … [and] … regulators and large investor groups should exercise caution concerning the single minded efforts to repeal all staggered boards" (citing Augustine Duru, Dechun Wang, and Yijiang Zhao,** *Staggered Boards, Corporate Opacity and Firm Value*, **37 Journal of Banking and Finance 341 (2013)).**
- **"[M]any IPO firms adopt takeover defenses [including staggered boards] precisely because pre-IPO shareholders benefit from them" (citing William C. Johnson, Jonathan M. Karpoff, and Sangho Yi, The Bonding Hypothesis of**

Takeover Defenses: Evidence from IPO Firms (SSRN, February 4, 2014), available at https://bit.ly/2x7za2W).

[13] **Yakov Amihud, Markus Schmid and Steven Davidoff Solomon,** *Settling the Staggered Board Debate* **32 (SSRN, September 8, 2017), available at https://bit.ly/2LENouj.**

[14] **Robert Daines, Shelley Xin Li and Charles C.Y. Wang,** *Can Staggered Boards Improve Value? Evidence from the Massachusetts Natural Experiment* **(Harvard Business School Working Paper 16-105, May 21, 2018), available at https://bit.ly/2JzJyly.**

[15] **John C. Coffee, Jr. and Darius Palia,** *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, **41 Journal of Corporate Law 545, 550 (2016).**

[16] **See Lucian Bebchuk, Alon Brav and Wei Jiang,** *The Long-Term Effects of Hedge Fund Activism*, **115 Columbia Law Review 1085, 1137, note 103 (2015).**

[17] **See Fink,** *Annual Letter to CEOs* **(cited in note 1).**

[18] *Protecting Long-Term Shareholder Interests in Activist Engagements* **2-3 (State Street Global Advisors, October 10, 2016), available at https://bit.ly/2s2rf1H.**

[19] **See Dominic Barton, James Manyika and Sarah Keohane Williamson,** *Finally, Evidence that Managing for the Long Term Pays Off* **(Harvard Business Review, February 7, 2017), available at https://bit.ly/2lnoymq.**

[20] **Id.**

[21] **See Fink,** *Annual Letter to CEOs* **(cited in note 1).**

[22] *Is Short-Term Behavior Jeopardizing the Future Prosperity of Business?* **(The Conference Board, October 2015), available at https://bit.ly/2IKYb5q.**

[23] **Brian J. Bushee,** *Do Institutional Investors Prefer Near-Term Earnings Over Long-Run Value?* **18 Contemporary Accounting Research 207, 213 (2001).**

[24] **See John Asker, Joan Farre-Mensa, Alexander Ljungqvist,** *Corporate Investment and Stock Market Listing: A Puzzle?* **28 Review of Financial Studies 342, 384 (2015).**

[25] **See Cremers and Sepe, 68 Stanford Law Review at 113 (cited in note 11) ("As explained by Keynes, through his influential metaphor of financial markets as a beauty contest, rational herding behavior may induce investors to react to aggregate market demand rather than to their own information, because 'each competitor has to pick, not those faces which he himself finds prettiest, but those which he thinks most likely to catch the fancy of the other competitors.'"). Critically, if the preponderance of active traders are short term investors (which seems necessarily to be true), short term investors will be driving the herd. This is especially true when the short term investors are activists loudly proclaiming where they think the market should go. There is no long term investor counterpart to this loud and active signaling, which will generally go quietly unchallenged by long term holders.**

[26] **Id at 114.**

[27] **See generally Coffee and Palia, 41 Journal of Corporate Law at 574-77, 580-81, 591-593 and 605 (cited in note 15).**

[28] **See generally Cremers and Sepe, 68 Stanford Law Review (cited in note 25).**

[29] **Id at 120 ("[T]he risk of short-termism is especially pronounced for corporate-production processes that involve the development of non-standardized, innovative technology and that rely more on specific human capital contributions…. firm value increasingly depends on intangible assets, such as technological know-how, patents, research and development projects, brand names and trade secrets. Along the same lines, human capital…is, today, an increasingly specialized resource. As a result…investments in long-term specific projects are no longer an exception, but arguably a defining feature of many twenty-first century corporations").**

[30] **Coffee and Palia, 41 Journal of Corporate Law at 575 (cited in note 15), citing to Yvon Allaire and Francois Dauphin,** *Hedge Fund Activism: Preliminary Results*

and Some New Empirical Evidence **(Institute for Governance of Public and Private Organizations, April 1, 2015), available at https://bit.ly/2kl3rC5.**

[31] **Id at 575, citing to Alon Brav, Wei Jiang and Xuan Tian,** *Shareholder Power and Corporation Innovation: Evidence from Hedge Fund Activism* **(Kelly School of Business Research Paper No. 2014-05, December 2014), available at https://bit.ly/2ILa5w8.**

[32] **Id at 580, citing to Vipal Monga ,** *Firms Send Record Cash Back to Shareholders***, Wall Street Journal (May 27, 2015) at A1.**

[33] **Coffee and Palia, 41 Journal of Corporate Law at 576 (cited in note 15).**

[34] **Id at 552.**

[35] **See Barton, Manyika and Williamson,** *Finally, Evidence that Managing for the Long Term Pays Off* **(cited in note 19).**

[36] **See generally Cremers and Sepe, 68 Stanford Law Review (cited in note 25); K.J. Martijn Cremers, Lubomir P. Litov and Simone M. Sepe,** *Staggered Boards and Long-Term Value, Revisited* **27 (SSRN, July 2017).**

[37] **See Daines, Li and Wang,** *Can Staggered Boards Improve Value***? 5 (cited in note 14).**

[38] **Sanjeev Bhojraj, Partha Sengupta and Suning Zhang,** *Takeover Defenses: Entrenchment* **and Efficiency, 63 Journal of Accounting and Economics 142, 160 (2017).**

[39] **Gallagher and Grundfest,** *Did Harvard Violate Federal Securities Law?* **at 65 (cited in note 6).**

[40] **See** *Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice (United States*) **22 (cited in note 4).**

[41] **See, e.g.,** *Governance Risk Indicators: A New Measure of Governance Related Risks* **79 (ISS, September 15, 2010).**

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