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Classified Boards Once Again Prove Their Value to Shareholders in Recent Takeover Battle

Takeover protections such as classified boards continue to be under assault from academics and shareholder activists, who argue that they reduce the opportunity of shareholders to receive takeover premiums by making takeovers more difficult to complete. In response to shareholder proposals and the current governance environment, the number of companies in the S&P 500 Index with classified boards has decreased from 56% to 45% since 2004.

Academic theory, however, is often divorced from the real world of corporate takeover practice. The use of classified boards to increase shareholder value was demonstrated again in the recent takeover battle for Midwest Air. In January 2007, AirTran commenced a hostile cash and stock tender offer for Midwest Air at \$13 per share (increased to \$15 in April), and launched a proxy fight to elect its nominees at Midwest Air's annual meeting. AirTran won its proxy fight for one-third of Midwest's board in June, and a majority of Midwest Air's shares were tendered in its tender offer. However, AirTran was prevented by Midwest Air's poison pill from purchasing the tendered shares, and Midwest Air's classified board structure prevented AirTran from being able to redeem the pill following its successful proxy fight. Following the annual meeting, Midwest Air put itself up for sale, and this week accepted a \$17 per share takeover offer from TPG Capital, 13% above the price that Midwest shareholders would have received in June had Midwest Air not had a classified board and poison pill.

Target shareholders have realized substantial benefits from the negotiating leverage provided by classified boards in other takeover battles, including Weyerhaeuser's bid for Willamette Industries a few years ago. In that situation, Weyerhaeuser won its first proxy fight and had a majority of Willamette's shares tendered into its \$50 per share tender offer. However, even in the absence of any competing bid, Weyerhaeuser raised its bid by \$600 million to \$55.50 per share, rather than wait to run another proxy fight at the following annual meeting.

The academic debate on classified boards is not one-sided. A recent study found that while classified boards somewhat deter the likelihood of receiving a takeover bid, targets with a classified board are ultimately acquired at an equivalent rate as companies without classified boards. Most importantly, this study concluded that target shareholders of firms with classified boards receive a larger proportional share of the total value gains from a merger: *"Overall, the evidence is inconsistent with the view that board classification is associated with managerial entrenchment, and instead suggests that classification may improve the relative bargaining power of target managers on behalf of their constituent shareholders."*¹

Companies should carefully weigh the substantial negotiating leverage offered by classified boards in a takeover context before following the corporate governance herd.

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¹ Bates, Becher and Lemmon, *Board Classification and Managerial Entrenchment: Evidence from the Market for Corporate Control* (April 2007) at p. 3.