Controlled Companies' Overtenured Directors Avoid Activists, M&A

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Many overtenured directors reside at companies with dual-class shares, giving insiders control of the vote in a clubby atmosphere.

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Until recently, Saga Communications (SGA) was one of over 300 U.S. corporations with dual-class share voting structures on a Council of Institutional Investors, or CII, list of companies giving insiders, often founders, control of the vote.

In August, however, the radio broadcaster's founder and CEO, Ed Christian, passed away, triggering a conversion of his equity from supervoting shares to common stock and ending the company's insider control of the vote and, consequently, the board.

Activist investors and even a bidder were immediately drawn to the radio broadcaster. The Tisch family fund, TowerView LLC, quickly filed an activist 13D report, noting it may have talks with directors and senior management about the path ahead. In December, Dallas firm Hoak Public Equities LP reported a 6.9% position and said it could consider an "extraordinary corporate transaction" with Saga — the same month the broadcaster said it rejected an unsolicited offer from an undisclosed rival, Connoisseur Media LLC, according to one source.

Saga appears to be in an activist and M&A crosshairs now but until recently was mostly left alone because of its dual-class status. Activists typically won't target dual-class share structure companies because they know that even if a majority of shares are opposed to the CEO's strategy and the company's shares are underperforming, they still can't elect dissident directors to drive the change they seek.

Without activist pressure, many dual-class companies have directors with lengthy tenures and clubby atmospheres, with boards that are unlikely to provide effective oversight of CEO-founders. Board members that otherwise could be targeted by an activist, particularly at underperforming companies or corporations receiving acquisition interest, often remain for lengthy periods of time.

"Directors [at dual-class companies] don't have to deal with the kind of pressure a company with a single class of shares has to worry about," said Waheed Hassan, founder of ZMH Advisors, a data-driven ESG and governance adviser. "In many cases the average age of the overall board may not be that high, but several directors could have overly long tenures."

Interested investors may take interest in Saga's board, which has at least two independent directors left over from the company's dual-class insider controlled period — Clarke Brown Jr., 83, and Gary Stevens, 84, who have been directors for 19 and 28 years, respectively.

The structure at Saga and elsewhere has helped C-suites remain in place and discouraged pressure tactics intended to drive auctions or breakups. Governance experts typically suggest that corporate boards should start to replace directors after they have served 10 years, and some companies set up term limits to remove board members after a period of time, such as 12 years, for example.

And while Saga has two overtenured directors, a wide range of other dual-class companies have many long-tenured board members, some of whom might otherwise have become targets had insiders, or founders, not controlled the vote and board.

For example, dual-class 1-800-Flowers.com Inc. (FLWS), whose shares are down 19% over the past 12 months, has four outside directors with more than 11 years on the board, including James Cannavino, 79, and Leonard Elmore, 70; two directors that have held seats for 16 and 20 years, respectively; and the CEO and founder-chairman have each held board positions for about 47 years each.

Dual-class share drug company Regeneron Pharmaceuticals Inc. (REGN) has five directors who have served for between 20 and 32 years: Pindaros Vagelos, 93; Arthur F. Ryan, 80; Michael Brown, 81; Joseph L. Goldstein, 82; and George L. Sing, 74. A spokeswoman pushed back on worries about their tenure, noting that its board includes "highly qualified" respected industry experts, Nobel Laureates and members of the National Academy of Sciences. Vagelos, she noted, is the former CEO of Merck & Co. (MRK) and considered a "biopharma luminary." Nevertheless, it's unlikely an activist would target Regeneron in the near term as its shares are up 18% and 157% over the past 12 months and five years, respectively.

Four of six directors on the board of dual-class water and wastewater services company Artesian Resources Corp. (ARTNA) have held positions for 30 years or more, including three outside directors and the CEO. One other director, a senior VP of investor relations, has held his board seat for 15 years. According to CII, Artesian's Class A shares have no votes while its Class B shares have one vote per share.

On average, directors at U.S. dual-class share structure companies haven't held board positions for extensive periods of time, partly because many of these companies, particularly in the technology sector, only recently entered the public markets.

Relationship mapping service BoardEx, a sister company to The Deal, reviewed 313 dual-class companies followed by CII and found that independent directors served on average for 6.1 years, while executive directors held board positions and other occupations for 9.3 and 12 years, respectively.

Dual-class corporations in some sectors have been public much longer than others, however, and these directors are often overtenured. For example, the average number of years since IPO for dual-class telecom companies, including broadcasters, is 18, and the average number of years directors at 18 companies in the sector have held board positions is 12.4 years. Similarly, 10 dual-class food producers and processors have been public for an average of 21 years and directors there held board positions for an average of 10 years. As an example, Cal-Maine Foods Inc. (CALM), a $2.4 billion fresh egg producer, has three independent directors who held board positions for between 14 and 22 years, while the company's executive chairman, Dolph Baker, has been on the board for 26 years.

Technology companies on average have much shorter tenures, though this corresponds to their briefer time in the public markets. In recent years, dozens of tech companies have IPO'd giving insiders control of the vote, and some have been targeted.

Hassan noted that many institutional investors give companies a grace period of about seven years after their IPO before pushing them to collapse dual-class voting systems. More pressure could be on the way since, on average, insider-controlled tech companies have been public for five years. "Particularly at tech companies, once they are past their grace period, you start to see shareholder pressure," Hassan added.

Other sectors have overtenured directors as well. For example, cosmetics company Estee Lauder Cos. (EL), whose shares are down 14% over the past year, has eight directors serving for between 17 and 28 years, and three more who have held seats for 13 to 14 years.

In addition to Saga, many broadcasters have dual-class voting structures and overtenured directors: Gray Television Inc.'s (GTN) CEO, lead independent director and another independent director have served for over 30 years. Two other members have held positions for between 11 and 19 years.

First Citizens Bancshares Inc. (FCNCA) has seven directors with between 16 and 33 years on its board, and Haverty Furniture Cos. Inc. (HVT) has five that held positions for between 19 and 34 years.

First Citizens, Gray Television, Estee Lauder and other companies in this article did not respond to requests for comment.

The Sunset Debate

In some cases, companies are choosing to collapse their dual-class share structures under pressure from shareholders, while others already had set up a phased-in, so-called sunset date for a shift to one-share, one vote. For example, Twilio Inc. (TWLO), which IPO'd in 2016 and in February announced a restructuring program, is set to collapse its dual-class share structure by June, after seven years of insider control. Activist Legion Partners Asset Management LLC recently disclosed a 600,000-share stake.

ZMH Advisors' Hassan noted that some companies will shift to one-share, one-vote under influence from shareholders that have policies stating they won't support election of directors, in particular members of nomination and governance committees, at companies with dual-class shares after a post-IPO sunset period expires.

Activist Attack? Or Not.

In rare cases, activists have made headway at insider-controlled companies. Elliott Management Corp. in December gained a seat for a portfolio manager at Pinterest Inc. (PINS) even though the social media company's founders control the vote.

Auto services company Monro Inc. (MNRO) is seeking a financial adviser to evaluate options for a share recapitalization after Ides Capital Management LP launched a campaign against directors over concerns the company's structure gives director Peter Solomon control of the vote and board despite owning about 2% of shares.

Some activists won't go anywhere near a dual-class company, however. Starboard Value LP, a prolific employer of director battles, strictly keeps away. Speaking at an investment conference in March, fund founder Jeff Smith said there wasn't anything activists can do at dual-class companies, and he urged institutions to pressure companies and exchanges to stop allowing listings with the structure in place.

"If an insider controls 52% of the vote, I can yell until I am blue in the face and provide as many choices as I want, and they don't have to listen," Smith said.

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COMPANIES MENTIONED

1-800-Flowers.Com Inc. Artesian Resources Corp. Cal-Maine Foods Inc. Connoisseur Media LLC Elliott Management Corp. Estee Lauder Cos. Inc. First Citizens BancShares Inc. Gray Television Group Inc. Gray Television Inc. Ides Capital Management LP Legion Partners Asset Management LLC Merck & Co. Inc. Monro Inc. Pinterest Inc. Regeneron Pharmaceuticals Inc. Saga Communications Starboard Value LP TowerView LLC Twilio Inc. ZMH Advisors

PEOPLE MENTIONED

Arthur F. Ryan Daniel R. Tisch Dolph Baker George L. Sing Jeff Smith Joseph L. Goldstein P. Roy Vagelos Peter J. Solomon Waheed Hassan