How Long Is Too Long? Activists Continue To Target Director Tenure

- Proxy advisory firms and institutional investors increasingly view tenures over nine years as too long, questioning the independence of directors who have served longer than that.
- Board refreshment is a frequent demand of activists, so companies may find themselves vulnerable to activist campaigns if they have very long-serving directors.
- As boards review their own composition for skills and other attributes, they should explain to investors the value that long-serving directors bring to the board.
- While few U.S. companies have formal tenure limits, age limits are more common but less favored by proxy advisory firms.

U.S. activism remained elevated through the third quarter of 2024, with board refreshment a consistent demand by activists year after year. Central to the activists' demands for board refreshment is director tenure.

Historically, the proxy advisory firms and institutional investors have acknowledged the value long-term experience can bring to a board and have not pushed for director term limits, opting instead to evaluate director tenure on a case-by-case basis. However, leading proxy advisory firms and many institutional investors are increasingly going public with their views that tenures beyond nine years are generally too long.

This has provided ammunition for activists, who have questioned the value of long-tenured directors: 67% of activist campaigns since 2021 have targeted companies with three or more directors who have served 10 years or more, according to Evercore's Third Quarter 2024 Quarterly Review. Thus, companies with one or more directors with tenures perceived to be overlong are at an increased risk of falling into the cross hairs of an activist investor, notwithstanding the insight that long-serving directors can contribute.

Long-Tenured Directors: The Rule of 10

Pressure to cap the time directors can serve comes from several sources.

Proxy advisers. The leading proxy advisory firms appear to have begun questioning an individual director's independence on a board at 10 years of service. For example, Institutional Shareholder Services has stated that "a tenure of more than nine years is considered to potentially compromise a director's independence" and Glass Lewis similarly has stated that it "[identifies] a potential concern [in] instances where the average tenure of non-executive directors is 10 years or more and no new independent directors have joined the board in the past five years."

Institutional investors. In addition, some large institutional investors, such as BlackRock, have stated they may vote against directors who fail to promote adequate board succession. State Street Global Advisors and J.P. Morgan Asset Management have also publicly disclosed their views that directors who serve more than nine years may lose their independence. Barrow Hanley Global Investors has similarly stated "directors serving on a board for 10 years or more are not considered to be independent."

Foreign markets. Some foreign markets also appear to be moving toward this 10-year standard. For example, the U.K. Corporate Governance Code states that the independence of a director that has served for more than nine years may be impaired. The Hong Kong Exchanges and Clearing Limited (HKEX) has similarly proposed an exchange-wide rule that, among other things, limits the duration of a director's tenure to a maximum of nine years. However, HKEX-listed companies have argued against this proposed rule, claiming, among other things, that "[t]he longer the director sits on the board, the more the director understands about the business, [which can lead to] better advice," and "[t]here is no evidence of the purported benefit to listed companies. It will only limit the choice of [independent directors] and prevent companies from appointing the talent they think fit." It remains to be seen if the proposal will pass and if other markets will continue to follow this trend.

Unsurprisingly, activists are using such statements when they press to add or replace board members.

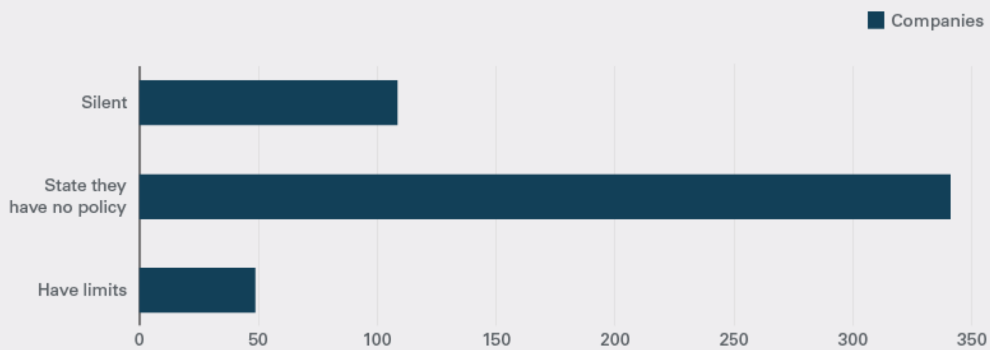
Notwithstanding global and current U.S. interest in lowering director terms, American companies appear to be reluctant to adopt formal tenure policy limits. According to Deal Point Data, only 10% of S&P 500 companies and 12% of S&P 100 companies provide for term limits, with 15 years the most common — substantially longer than the 10 years being widely considered as over tenured.

It remains to be seen whether current U.S. market pressure will influence companies to adopt tenure policies or reduce terms in existing policies.

Age Limits: An Alternative to Tenure Policy Limits

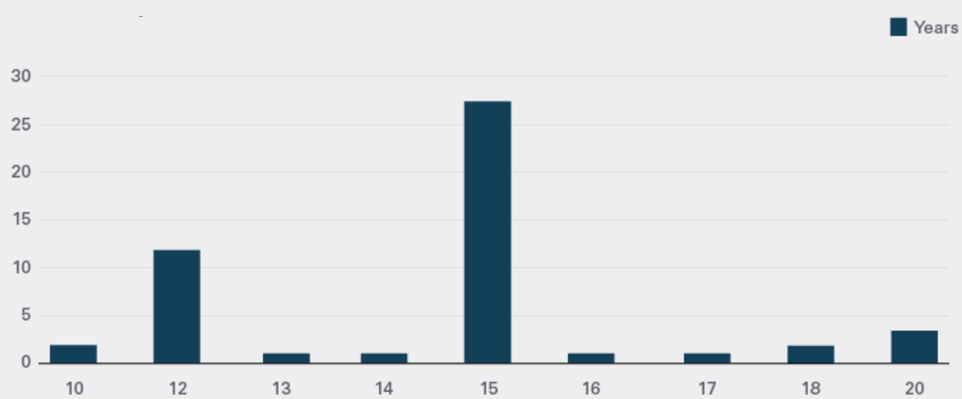
Despite the low number of public companies adopting a formal tenure policy, public companies appear more open to adopting age limits to address board refreshment. According to Deal Point Data, approximately 62% of S&P 500 companies and nearly 75% of S&P 100 companies maintain mandatory retirement policies, with 75 the most common age cap. Most,

S&P 500 Companies: Director Term Limit Policies



Source: Deal Point Data. S&P 500 as of 9/15/2024.

S&P 500 Companies With Director Term Limits



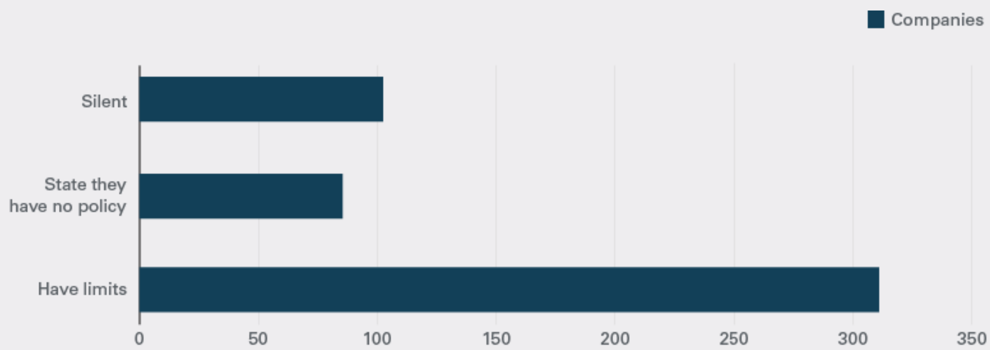
Source: Deal Point Data. 49 companies with policies. S&P 500 as of 9/15/2024. Director data as of last annual meeting.

however, allow boards to waive the policy as needed, but if waivers are granted too frequently, that may make the company vulnerable to an activist attack. For example, Cruiser Capital's campaign against American Vanguard Group criticized the board for its continual waiver of its mandatory retirement policy for two directors.

Certain proxy advisory firms and institutional investors, however, do not favor age limits. For example, Glass Lewis notes that "the long-term impact of age limits restricts experienced and potentially valuable board members from service through an arbitrary means." See "Recommended Reading: 'Multigenerational Boards'" in this issue for a study of the age range of boards.

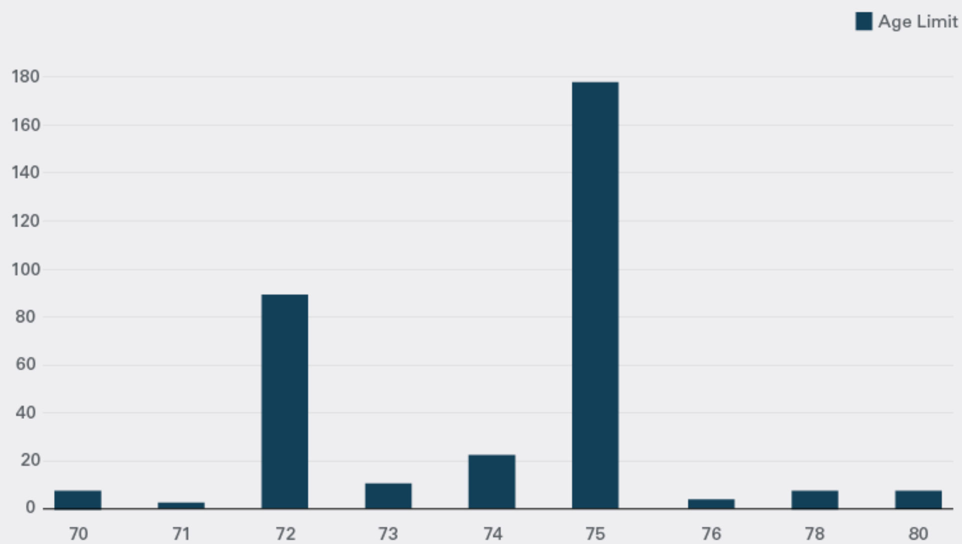
In return, activist campaigns have not included attacks on a director's age as frequently as they have targeted tenure.

S&P 500 Companies: Age Limit Policies



Source: Deal Point Data. S&P 500 as of 9/15/2024. Director data as of last annual meeting.

S&P 500 Companies: With Director Age Limits



Be Your Own Activist

The activism landscape continues to develop, and activist investors are always searching for the most effective lever to pull against companies to exert pressure in their campaigns and effect change. While no company can be fully "activist-proof," anticipating the possibility of an attack and preparing to defend against one is the best approach. While tenure and mandatory age policies can help promote regular board refreshment, they should be supplemented with other strategies. For example, boards should:

- **Regularly review board composition** to ensure it has the right mix of skills, tenure and background.
- **Anticipate potential attacks** against directors perceived to be "long-tenured," particularly if they are approaching the 10-year mark.

- **Preemptively articulate to the market** the value that long-serving directors bring to the board and company.
- **Maintain a robust pipeline of potential board candidates** that the board can quickly identify and potentially appoint if the circumstances warrant.
- **Conduct a "tabletop" exercise** with the assistance of legal and financial advisors to assess any potential attack vectors activist investors may use and responses thereto.

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This article is from *The Informed Board*, Skadden's quarterly newsletter for corporate directors.

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