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Black & Decker—Death by Poor Governance

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[This is the third commentary based on public filings concerning the proposed merger of The Stanley Works and Black & Decker Corporation as well as other publicly available information on the two companies. The first two companion commentaries were published by Citybizlist on December 4, 2009 and December 18, 2009.]

When I first learned of the sale of **Black & Decker Corporation** (NYSE: BDK) to **The Stanley Works** (NYSE:SWK) in November of 2009, I was immediately suspicious and wondered how much money Black & Decker executives would be making by selling their own company. For decades now, it has been a growing and, in my opinion, destructive trend in U.S. acquisitions for the buyer to offer large monetary incentives to management of the seller to "influence" a favorable outcome. In an acquisition such as this one that totals over **$8 billion of market capitalization** for the combined companies, the payments to selling management, even when measured in tens of millions of dollars, can be a small fraction of the transaction value at stake.

An early attempt by Black & Decker to paint this acquisition as an almost 'merger of equals' suggested a fairly straight-up transaction. But it soon became clear that Stanley was driving the bus. Stanley would control the new board, Stanley management would run the company, and Stanley stockholders would own a slight majority of the total shares. An initial favorable article by a *New York Times* online reporter also threw me off track. He praised Black & Decker Chairman and Chief Executive Officer (CEO) **Nolan D. Archibald** for foregoing immediate vesting of stock and options plus other benefits worth over $20 million upon the sale of the company. This standalone fact was corroborated in a Black & Decker filing. Mr. Archibald was apparently in the forefront of reforming Wall Street's takeover tactics.

Then I read closely the U.S. Securities and Exchange Commission (SEC) filings of both companies. Only by reading both sets of filings was the full picture revealed. The *New York Times* reporter had failed to see that Mr. Archibald, designated to become the first **"Stanley Black & Decker"** Executive Chairman, was simply keeping all of his stock and options and converting them into Stanley stock and options---he wasn't giving up a penny. He was merely changing horses.

But the real shocker was tucked away in a Stanley filing describing Mr. Archibald's new Stanley contract. In addition to the continuance of his over $10 million per year pay package for each of the next three years and a guarantee of the same for 2009, regardless of the company's poor performance, Mr. Archibald, and Mr. Archibald alone among Black & Decker executives, was being awarded a **"cost synergy bonus"** of up to $45 million for cutting costs and eliminating jobs in the new combined company. And there was more. In addition to his current holdings of Black & Decker, which I estimated to be worth over $110 million, Mr. Archibald would also receive one million options in the new Stanley Black & Decker at the price of the stock when the transaction is closed. My estimate is that Mr. Archibald can increase his personal wealth by $70 million or more in the coming years, not including his

$10 million plus annual salary and benefits, based on the achievement of the $350 million of cost synergies and a reasonable yearly rise in the value of the new Stanley Black & Decker stock.

You might wonder how hard Mr. Archibald will be working to earn this cost synergy bonus---a bonus based on consolidating plants and operations and eliminating jobs in the middle of the worst U.S. employment crisis in decades. Subsequent filings have shown that Mr. Archibald is the only Black & Decker member on a six person **Integration Steering Committee** that has begun overseeing the consolidation planning prior to closing the transaction. Stanley management, as might be expected of the acquirer, is already hard at work on consolidation and cost-cutting. In my opinion, and it is not much of an intellectual leap to get there, this "cost synergy bonus" conceit was created by Stanley and its advisors to make a major influencing payment to Mr. Archibald more palatable and less overt. No matter how you dress it up, the payment's purpose seems quite obvious and simply falls in line with established corporate takeover practice. A U.S. CEO is enriched as he supervises the sale of his company. Just another dog bites man story on Wall Street.

After the first commentary that reported the above payments, I had no intention of writing a second one. But on December 4, 2009, Stanley filed its **Form S-4** (subsequently amended), a joint proxy statement/prospectus describing all the details of the proposed transaction and its history. This is the document upon which investors and shareholders rely to make an informed decision about whether to support or reject the transaction. It contained one of the most remarkable narratives I had ever read in a public filing. Page after page describing how Mr. Archibald led Black & Decker's negotiations, how the emphasis shifted from a wishful-thinking Black & Decker acquisition to a Stanley one, how the "cost synergy bonus" was devised, how the discussions began to include an emphasis on satisfying Mr. Archibald's contracts with both companies, how in meeting after meeting the boards of both companies addressed both the transaction and Mr. Archibald's contracts, and how, in a final board meeting, with his unique and rich new contract in the offing, Mr. Archibald was "very supportive" of the transaction before excusing himself from the final vote due to the obvious conflict of interest.

"Who is this Black & Decker board?" I wondered as I penned the second commentary. After digging through public filings and the Internet, it became clear that the board lacked experience in the tool and manufacturing sectors as compared to Stanley's board, and it contained at least three out of ten "independent" members who had personal and/or professional ties to Mr. Archibald. In addition, I found that two of the board members were on an elite **Deutsche Bank Americas Advisory Board**, whose mission includes "business development." Deutsche Bank is, along with Goldman Sachs, the investment banker to The Stanley Works and appeared to be involved in first suggesting that a transaction be revived. After uncovering all of these non-obvious facts and reaching some conclusions about why this transaction was fated to happen and which company's leadership was more competent, I shut down the computer and was done with this public burial of an old U.S. corporate name. So I thought.

In the weeks that followed the publication of the second commentary, I heard from many readers. But two readers, who had been on the inside of Black & Decker, knew one fact that I did not know. One fact that seemed eminently pertinent; yet, in the wisdom of our system, this fact apparently did not require

disclosing in the transaction filings. These two readers were angry and bitter, believing strongly that their CEO had stepped over the line.

Both readers steered me to a pubic website for **"Red Ledges."** Red Ledges is a "private, four-season recreational development in the beautiful Heber Valley" in Utah. It includes a brand new Jack Nicklaus Signature Golf Course, luxury lots for sale, and many other activities (such as tennis, an equestrian center, a spa) completed or in design. Red Ledges is a short drive from Deer Valley and Park City Mountain ski resorts. Red Ledges sells lots for building upon or finished "cottages" for $1.2 million and up. A development project of this magnitude takes an enormous time and planning commitment and many millions of dollars of upfront capital to create. The grand opening for the Red Ledges golf course occurred in July of 2009, straight into the headwinds of one of the worst markets in memory for golf course expansion and luxury real estate and, coincidentally, in the middle of the negotiations between Stanley and Black & Decker.

Red Ledges is a private enterprise described as having two equal owners—Nolan Archibald, the Chairman and CEO of Black & Decker, and **Tony Burns**, the managing owner of Red Ledges. Who is Tony Burns? Tony Burns is a lifelong friend of Nolan Archibald's dating back to their college days. Tony Burns is described in the annual Black & Decker prospectus as M. Anthony Burns, Chairman Emeritus of Ryder System, Inc., a description that does not mention his managing owner role with Red Ledges. Tony Burns is a board member of Black & Decker, a board member who I included in the category of not having direct relevant experience in the tool industry but one that I missed counting as having a personal relationship with Mr. Archibald. Instead of three of ten, there were now at least four of ten to be counted as owing their board seats to a relationship with the chairman and CEO.

Missing one more friend of the chairman is not what drove this third commentary. That point regarding boardroom patronage was already made, and I had allowed that other personal connections might be discovered. What drove this writing is that Mr. Burns' name triggered a memory and a reference. I returned to the original S-4 filing and found what I thought would be there. *The Black & Decker board had chosen Mr. Burns to be one of three independent directors on the special* ***"Black & Decker Transaction Committee."*** This committee, as explained in the S-4 narrative, played a crucial role in evaluating and approving of the Stanley transaction for the entire Black & Decker board. This committee was instrumental in negotiating with Stanley and its advisors as well as in reviewing and recommending to the board Mr. Archibald's contract with Black & Decker as it related to the new, even more lucrative one with Stanley. In determining whether the 100-year-old company would live or die, Mr. Burns was given a special position of leadership.

At this point, you have to wonder whether the Black & Decker board had been vaccinated against the spread of common sense. From a regulatory standpoint, one presumes that Mr. Burns is labeled an **"independent" director** because he is not an employee of Black & Decker nor does he do business with the company. But for heaven's sakes, Mr. Burns is in a major business partnership with the chairman & CEO. This business partnership involved the sale of luxury real estate in a recession. The financial success and well-being of Mr. Burns' business partner is critical to Mr. Burns' own interests. There are tens of millions of dollars at risk. Yet, the Black & Decker board deemed Mr. Burns sufficiently

independent to place him on the three person committee that passed judgment not only on the transaction but on the appropriateness of his business partner's compensation. I am at a loss for words to describe what I believe is the bewildering conduct that infuses this transaction.

If you, as a shareholder, think it is important to know information such as which board members have personal connections with the chairman and CEO and which board members do business with the CEO---then don't look to the **SEC** for help. The SEC is silent on this point, choosing with unpredictability when and where it becomes an advocate for disclosure. The question is not what Black & Decker failed to do, because presumably the company has stayed within the rules as they exist today. The question becomes what Black & Decker (and other public companies) should do to be more responsible and transparent for shareholders and the market.

The concerns presented in the first days after the announcement of this proposed deal still persist. Why is Black & Decker selling itself at the beginning of a business cycle upturn (favorable to construction, housing, home improvement and 'business products' companies) and at the lower end of its trading range for four of the past ten years? Why is a stellar brand name such as Black & Decker not the consolidator and acquirer instead of the seller? Why does Black & Decker fall by the wayside while Stanley survives?

One answer to these questions is in how Black & Decker was led and governed over the last two decades. In its final chapter, Black & Decker becomes, in my opinion, a parody of **good corporate governance**. Good governance encompasses best industry practices, and Black & Decker falls short in many categories. None of these failings appear to violate any explicit rules or regulations. None of them are unique to Black & Decker; they can be found across the universe of today's major public companies. But together, they seem indicative of a tradition of misguided governance that has brought Black & Decker to its final days:

- Entrenched CEO. Black & Decker's chairman and CEO has retained his position for almost 24 years—an extraordinary record of longevity for corporate America. But in my opinion, this level of imperial leadership begets many shortcomings in a typical company. Potential rivals within the executive ranks are eliminated or marginalized. Succession planning is made irrelevant. Innovation and rejuvenation are stifled. At the end of over two decades at the helm, Nolan Archibald became synonymous with Black & Decker. As he gets elevated to his non-managerial role with Stanley, little remains of Black & Decker management. No other Black & Decker leader after Mr. Archibald is invited into the executive suite. From a governance viewpoint, it is, in my mind, no coincidence that the legacy of a 24-year CEO is no legacy.
- Chairman and executive functions in one person. A CEO who is also chairman of the board is effectively his own boss and employer. Where are the checks and balances on his tenure, compensation, board appointments and more? The SEC has only recently flagged this obvious and most common corporate conflict as one for concern and disclosure.
- Board patronage. Aside from Mr. Archibald, the Black & Decker board consists of ten "independent" members as defined by the SEC and an internal Black & Decker code. Yet,

many directors have personal connections to the chairman and CEO (at least 40%). These relationships marginalize the board's ability to question, discipline or fire its chief executive.

- Board inexperience. The majority of the Black & Decker board has little to no experience in the tool or manufacturing industries, raising into question the board's ability to challenge management on strategy and operating issues versus a more experienced competitor's board.
- Executive compensation. Per dollar of market capitalization, Mr. Archibald is one of the highest paid CEOs in the U.S. when compared to the Standard & Poor's 500 Index of companies in general and Black & Decker's peer group in particular. In 2008, his total compensation was over three times that of the CEO/chairman of his counterpart at The Stanley Works. In 2007, it was over twice that of his acquirer. In addition, Mr. Archibald's perks total over 30% more than S&P 500 companies that average twice the size of Black & Decker. Over twenty-four years, the Black & Decker board has helped Mr. Archibald amass a fortune of Black & Decker stock and stock equivalents worth, by my estimate, at least $110 million, making him the largest individual Black & Decker stockholder and an equal to the company's largest institutional shareholders.
- Conflicts of interest. It is a long list with this board. A fraternizing investor relationship between board members. Board members on an advisory board of the acquirer's investment banker. A CEO leading sale negotiations while negotiating personal contracts with both companies. The CEO's investment partner on the board committee that recommends the transaction to the full board. The word that comes to mind is sloppy. Sloppy controls and sloppy governance.

Conclusion: On March 12, 2010 at a special meeting of stockholders, Black & Decker will be consigned to the dustheap of famous U.S. corporations that have met their end through acquisition by a competitor. The 100-year-old brand name will be tucked behind the Stanley name. Good jobs will be lost in Maryland and elsewhere as Stanley takes costs out of the combined businesses to make the transaction a success. No tears will be shed for senior Black & Decker management. They are well-cared for, particularly the chairman and CEO.

Few people will remember this, but Mr. Archibald was once hailed as a young innovator, the Harvard Business School trained executive who brought in his team to save a struggling old tool maker. Twenty-four years later, he will be remembered as the last Black & Decker CEO, the man who had no successors and no surviving strategy, except to sell the company. Black & Decker has a special anniversary in 2010. In January, the company rolled out a press campaign entitled "**Black & Decker(R) Celebrates 100 Years of Innovation."** If that were true at the governance level, this story might have a different ending.

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