A Battle for Control of CBS, With Far-Reaching Consequences

New York Times
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May 16, 2018

It's no secret that the proposed reunion of CBS and Viacom hasn't been a Hollywood romance. But simmering tensions erupted into open warfare this week, with far more at stake than control of two legendary entertainment companies.

No matter who emerges the victor in what promises to be a prolonged series of courtroom showdowns, both companies will be profoundly affected, and the broader media landscape fundamentally transformed.

The CBS chief executive Leslie Moonves and the company's board launched the opening salvo on Monday, filing suit to prevent Shari Redstone, the controlling shareholder of both CBS and Viacom, from firing CBS directors before they could dilute her voting rights and strip her of control — a step they plan to take Thursday, provided that a judge in Delaware allows it.

Although the two sides had been negotiating over how much CBS should pay for Viacom, and who should be in charge after the merger, control is the real issue. The CBS board and management "have simply become uncomfortable with the reality that CBS has a controlling stockholder," Ms. Redstone asserted in a response to the suit.

For its part, CBS said it's simply adhering to the principle that the company "should be and would be governed for the benefit of the company and all its shareholders, not just the controlling stockholder." It is a principle CBS said had been endorsed by Sumner Redstone, Shari's 94-year-old father, who long controlled both CBS and Viacom.

The interests of CBS shareholders other than Ms. Redstone might well include considering a takeover offer, especially in light of a rapidly consolidating media and communications landscape. Since talk of reuniting Viacom and CBS first surfaced two years ago, AT&T agreed to acquire Time Warner (a deal awaiting a court ruling on an antitrust challenge), Disney has reached a deal to buy much of 21st Century Fox, and Netflix and Amazon have emerged as fully integrated distributors and content producers.

CBS executives were incensed that Ms. Redstone rebuffed an approach from Lloyd C. McAdam, chairman and chief executive of Verizon Communications, roughly a year ago, thereby "depriving CBS stockholders of a potentially value-enhancing opportunity," CBS said in its complaint.

While the exact nature of that conversation remains in dispute, the Redstone entity that controls CBS, National Amusements, has made clear its categorical opposition to any takeover. As said in a 2016 letter to the boards of both CBS and Viacom, "To avoid any doubt, National Amusements is not willing to accept or support (i) any acquisition by a third party of either company or (ii) any transaction that would result in National Amusements surrendering its controlling position in either company or not controlling the combined company."

The issue of control often looms large at companies with dual-class share systems. Controlling shareholders often want to maintain managerial control — that's often why they establish the dual-class structure in the first place — while public shareholders often hope to sell to the highest bidder.

Although dual-class share structures are controversial and have long been opposed by shareholder-rights advocates, they have been growing in popularity, especially in Silicon Valley. Entrepreneurial founders are often reluctant to cede control; Facebook, Google's parent company Alphabet and Snap are all dual-class share companies. But so are Berkshire Hathaway, Ford Motor, Comcast and The New York Times Company.

Should CBS ultimately prevail in what would be a highly unusual attempt to dilute a controlling shareholder, a bevy of dual-class companies will no doubt be scrambling to rewrite their bylaws.

The conflict is magnified in this instance because Ms. Redstone is the controlling shareholder in both parties to the proposed merger.

“I don’t think there’s any question that the Redstones have a clear conflict of interest in this situation,” said Margaret Blair, a professor and expert in corporate governance at Vanderbilt University School of Law. “The law is very clear that the authority for running the corporation lies with the board. If the board feels the controlling shareholder is interfering with the best interest of the other shareholders, courts will defer to the board, and I think they should.”

(At a hearing on Wednesday, a judge in Delaware granted CBS’s request for the temporary restraining order. The judge is expected to issue a more expansive ruling on Thursday concerning whether the result of the CBS board’s planned vote will be allowed to go into effect.)

Such cases are rare, because directors who dare to defy a controlling shareholder’s wishes, as the CBS directors have done, can simply be replaced. There was widespread amazement on Wall Street this week that Ms. Redstone hadn’t sensed the rebellion coming, and moved to replace the CBS directors or curtail their powers. Now her hands are tied, at least temporarily.

Ms. Redstone has been at the center of a drawn-out soap opera over control of the media empire forged by her father, the ailing Mr. Redstone.

After years of being estranged from her father and isolated from the family business, Ms. Redstone was thrust unexpectedly into the role of media mogul after she reconciled with her father, ousted his two girlfriends from his Beverly Hills mansion, and gained control of the family trust that controls National Amusements and, in turn, CBS and Viacom.

Ms. Redstone has gone on a crash course in media management, lunching with other media executives and showing up at the Sun Valley conference and other media watering holes. By all accounts, she’s taken on the task with a level of enthusiasm and determination that rivals her father. Still, there’s nothing in her experience that would typically qualify her to run major media companies.
Image

The Harvard Law School professor Lucian A. Bebchuk used the Redstone example in an argument that dual-share class structures typically outlive their utility, and should be phased out by a company at some point. “Concerns about the emergence of inferior leadership over time are further aggravated when the dual-class structure enables a transfer of the founder’s lock on control to an heir who might be unfit to lead the company,” he wrote last year in an article titled “The Untenable Case for Perpetual Dual-Class Stock” in Virginia Law Review. He cited a “wide range of distorted choices” that are “aimed at increasing private benefits of control at the expense of the value received by other shareholders.”

CBS hasn’t said exactly why the special committee formed to evaluate and negotiate the potential merger with Viacom finally decided this past weekend that such a deal wasn’t in the best interest of CBS shareholders other than Ms. Redstone, but it isn’t hard to see what their objections might be.

Investors other than the Redstones have long opposed the idea — every time there were reports the deal was off, including this week, CBS shares jumped. A chorus of analysts has criticized the deal. One called the merger a potential “disaster” for CBS.

People close to CBS told me this week that the company was never enthusiastic about the potential combination, and agreed to consider it largely as a courtesy to Ms. Redstone. They said CBS alone is a very attractive company, either as a takeover candidate for a large telecom company like Verizon, or as a stand-alone content creator.

Though CBS faces the same advertising challenges as the other broadcast networks, analysts have praised Mr. Moonves for positioning CBS for the digital era. He's not only kept CBS the No. 1 broadcast network in prime time for the past nine years, but also executed a successful direct-to-consumer streaming strategy.

"From CBS's perspective, you've got to be pretty happy with your business," said Doug Creutz, senior media and entertainment analyst for Cowen & Co. "Why would you want to complicate it?"

For its part, Viacom, after years of turmoil, seems to have stabilized under the leadership of its new chief executive, Robert M. Bakish, who has emerged as a favorite of Ms. Redstone's. (Ms. Redstone has pushed to have him play a meaningful role in the merged companies, either as a high-level executive or as a board member.) But so far this year, Viacom's Paramount movie studio accounted for less than 6 percent of the domestic box office. Disney, the market leader, had over 34 percent.

Still, people at CBS told me that while they wouldn't mind gaining control of the Paramount studio, they have little or no interest in Viacom's traditional cable networks, including MTV, VH1 and Comedy Central. Those are suffering acutely from the cord cutting that is afflicting the entire cable industry. (Mr. Creutz, the analyst, described Viacom's cable assets as a "melting ice cube.")

Given the level of acrimony that has erupted this week from CBS's move — National Amusements said it was "outraged" and Ms. Redstone was described as "shocked, disappointed and upset" — it's hard to imagine any amicable settlement. That leaves two potential outcomes: If Ms. Redstone prevails, Mr. Moonves and his team would be out, marking the end of an era at CBS. It would presumably fall to the relatively untested Mr. Bakish to merge the two companies and soldier on at a perilous time for cable and broadcasting operations.

If CBS wins, and Ms. Redstone's control is diluted, the Redstone era will come to an end, and with it the likelihood that either CBS or Viacom will last long as independent companies. Viacom is so small and weak that it would need a rescuer, probably at a lower price than CBS was being asked to pay. And CBS would be free to pursue a merger with someone like Verizon, or go it alone.