

GOVERNING THE CORPORATION

MGT 598

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Fall Semester 2007

Monday & Wednesday, 1:00-2:20pm

Room A30

Description of Class Sessions

Wednesday, September 5: Introduction and Scene-Setting

Introductions – Who we (students and instructors) are, what we expect from the course.

Overview of the course – key ideas include:

- Understanding the structure and governance of the corporation – its history (beginning in the 1800s); legal, economic, “best practices,” and justifiable constituent expectation constraints which impact governance.
- The sources of ethics, values, and integrity in business (why they matter to governance: applications).
- Case studies highlighting actual issues and “solutions.”
- Corporate governance and its impact on value-creation and value-destruction.

Team allocations for class activities.

Monday, September 10 & Wednesday, September 12: Lecture - Inventing the Corporation

Corporations 101 – what defines a corporation as opposed to other forms of enterprise (limited liability, continuity, etc.) and social contract theory.

We will generally describe the corporate form of enterprise. The corporation is treated as a functional construct for an organization that works better in some

cases than alternative means of organizing economic activity. We explore how the business corporation evolved to enable many investors to share the risks of very large scale business ventures. We will also consider how the separation of ownership and control led to the rise of the professional manager, which led to systemic divergence of interests between managers and shareholders.

Assigned Reading:

1. Sample Corporate Charter and By-Law Materials (General Motors)
2. R. Kraakman et al, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1-19 (2005). (Please pay particular attention to pp. 18-19.)
3. A. Berle & G. Means, *Property in Transition and The Divergence of Interest Between Ownership and Control*, Book I, Chs. I & VI 1-9 & 119-125; *Evolution of the Modern Corporate Structure*, Book II, Ch. I 127-152; *The Traditional Logic of Property, The Traditional Logic of Profits, The Inadequacy of Traditional Theory, & The New Concept of the Corporation* Book IV, Chs. I-IV 333-357; in THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

Recommended Reading: *

1. Bishop C. Hunt, Ph. D., THE DEVELOPMENT OF THE BUSINESS CORPORATION IN ENGLAND 1800-1867 116-144 (1936).
2. C. Dixon et al, *Corporate Law*, in CORPORATE COUNSELOR'S DESKBOOK 1-17 (M. Epstein, ed., forthcoming 2007).
3. J. Bower, *The Managerial Estate*, in THE U.S. CORPORATION: AN INSTITUTION IN TRANSITION 149-167 (J. Meyer & J. Gustafson, eds., 1988).

Monday, September 17: Lecture - Objectives of the Company and Economic Theory of the Firm (Aligning all the Interests)

Here we explore the objectives of the corporation and who – among management, the board, and shareholders – defines them. We will discuss the tensions between the objectives of these players, and those of other key constituencies (e.g., economic goals, value creation, growth, the cities and communities in which the corporation operates, employment, education, housing, health care, racial justice and the environment, to name just a few).

Can the “market” function effectively to align shareholder, firm and wider stakeholder interests? And when does it function least effectively? (Consider the

* Recommended readings will be made available.

context of the “market,” e.g., around questions of time horizon; conditions of incomplete or asymmetrical information; market externalities; managerial indifference or malfeasance; the failure of market intermediaries; etc.)

Assigned Reading:

1. American Law Institute, *The Objective and Conduct of the Business Corporation*, 2.01 55-76 in Volume 1, PRINCIPLES OF CORPORATE GOVERNANCE (1994) (Note: ignore “illustration” sections).
2. P. Gourevitch & J. Shinn, POLITICAL POWER AND CORPORATE CONTROL 1-26, 277-295 (2005).
3. J. Micklethwait & A. Wooldridge, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA xiv-xv, xx-xxi, 190-191 (2003).

Recommended Reading:

1. J. Meyer and J. Gustafson, *For Whom Does the Corporation Toil? in THE U.S. CORPORATION: AN INSTITUTION IN TRANSITION* 211-234 (1988).
2. M. Blair, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 94-121 (1995).
3. J. Charkham & A. Simpson, FAIR SHARES: THE FUTURE OF SHAREHOLDER POWER AND RESPONSIBILITY 1-26 (1999).

Wednesday September 19: Lecture – The Role of Integrity in Corporate Performance

Guest Lecturers: Michael C. Jensen, Jesse Isidor Straus Professor of Business Administration, *Emeritus*, Harvard Business School and Werner Erhard, Independent.

Professor Jensen and Mr. Erhard will define integrity and discuss their research linking integrity and personal and corporate performance. They will present a model of integrity that provides an actionable pathway to acquiring the trust of others—a very valuable asset in life. They will demonstrate that applying cost/benefit analysis to your integrity guarantees that you will be an untrustworthy person or organization and that you will be out of integrity.

Assigned Reading:

1. Sections 1 through 6, W. Erhard, M. Jensen & S. Zaffron, *Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics, and Legality*, HARVARD NOM RESEARCH PAPER NO. 06-11 AND BARBADOS GROUP WORKING PAPER NO. 06-03 (2007).

- a. Please download the most recent version of this paper from the following url:

<http://ssrn.com/abstract=920625>

Recommended Reading:

Sections 7 and 10 in the above Integrity paper.

Monday, September 24: Lecture - “Doing the Right Thing”

Ethics is not a post-Enron invention – merely a company statement required by Sarbanes-Oxley. Rather, ethics have been a fundamental dimension of human activity for thousands of years. We will explore how ethics (theories of what is right) get translated into values by religion and political systems, for example, Adam Smith’s translation of ethics and values into the realm of economics (*Theory of Moral Sentiments* to *Wealth of Nations*).

Assigned Reading:

1. J. Plender & A. Persaud, ALL YOU NEED TO KNOW ABOUT ETHICS AND FINANCE 1-36 (2007).
2. I. Millstein, *A Vision of Virtue*, HERMES 22-25 (Spring 1999).
3. J. Bogle, *Enough*, Commencement Address to MBA Graduates of the Georgetown University McDonough School of Business (May 18, 2007).
4. R. Alsop, *How Boss’s Deeds Buff a Firm’s Reputation – Gates’s Philanthropy Puts Microsoft Atop Year Survey of Best, Worst Companies*, WALL ST. J., Jan. 31, 2007, at B1.

Recommended Reading:

1. R. Dawkins, THE GOD DELUSION 211-233 (2006).
2. A. Hirsi Ali, THE INFIDEL 267-274 (2007).
3. A. Ryan, *Is Capitalism Good for You?*, N.Y. BOOK REV. 70-73 (2006) (reviewing D. McCloskey, THE BOURGEOIS VIRTUES: ETHICS FOR AN AGE OF COMMERCE (2006)).

Wednesday, September 26: Class Activity – Ethics

During this class, two teams will deal with one of the following modern dilemmas:

- o CEO Compensation – personal greed vs. social opprobrium
- o Importing and outsourcing – China

Drawing upon the wisdom of some of the great ethical thinkers – e.g., Aristotle, Bentham, Kant, Rawls – each team will be allocated 30 minutes in which to make a presentation outlining the issues at stake and possible solutions based on the thinking of the chosen philosopher. Students will be expected to describe polar positions but also discuss practical ways to implement solutions.

Assigned Reading:

1. D. Robinson & C. Grant, INTRODUCING ETHICS 30-34, 39-43, 51-55, 68-71, 80-82, 115-128 (1996).
2. CEO Compensation: materials to be distributed.
3. Importing and outsourcing – China: materials to be distributed.

Recommended Reading:

1. Enron Corporation, CODE OF ETHICS 1-62 (2000).

Monday, October 1: Case – General Motors

Students will present in teams, to be assigned.

Wednesday, October 3: Class Activity – Responding to the Tensions in Aligning Interests

In the previous class sessions, we considered what conditions need to be met in order to create a market equilibrium that optimizes the long term benefit to investors, firm and wider stakeholder interests. We also identified the tensions which challenge this equilibrium and make it difficult to align the interests between various market constituencies.

In this class, students will be divided into two teams to assume the role of firm management and to tackle one of the tensions listed below. The task will be:

- To define the objectives and the concerns of each of the salient market participants (e.g., the firm, of investors of different types; of regulators; etc.);
- To identify what you (as management) expect and need from each salient market participant (regulators, institutional investors, etc.); and
- To define what they would need from you in order to meet your expectations.

The goal is to define an optimal alignment of interests that reflects the highest market functioning for the long term interests of all relevant constituencies.

Tensions for analysis (25 minutes for each team):

- Tensions between market constituencies around long-term and short-term strategies when confronted by a value investing hedge fund.
- Tensions between market constituencies around degrees of disclosure on compensation decisions.

Monday, October 8: Lecture - State and Federal Law in the U.S.

Guest Lecturer: Judge E. Norman Veasey, Former Chief Justice of Delaware; Partner, Weil Gotshal & Manges, LLP

We will outline the expectations that are placed on the board and the pressure for greater accountability emanating from shareholders, regulators, courts, stakeholders, proxy advisory firms and corporate governance rating agencies. We will discuss the role and responsibilities of the board, focusing on fiduciary duties of care and loyalty under state law and the business judgment rule. The impact of federal securities laws and stock exchange listing standards on the board and its structure will be considered, including director independence and committee requirements. We will also discuss director liability and ways to reduce exposure.

We will discuss the international impact of litigation.

Assigned Reading:

1. E. Veasey, S. Pompian & C. Di Guglielmo, *Federalism v. Federalization: Preserving the Division of Responsibility in Corporation Law*, in 2 THE PRAC. GUIDE TO THE SARBANES-OXLEY ACT V-5-1 (J. Huber et al. eds., 2006).
2. E. Veasey, *History Informs Corporate Law Which Must Maintain Its Delicate Balance in the Federal "Ecosystem"* 201 VA. L. & BUS. REV. 202-206 (2006).

Wednesday, October 10: Lecture - Overview of Litigation and Governmental Constraints on Management and Directors

Guest Lecturers: Greg Danilow, Partner, and Irwin Warren, Partner, Weil Gotshal & Manges LLP

How does the threat of litigation affect management and board action? We will explore the extent to which certain governmental constraints and incentives – as diverse as tax policy, antitrust regulation and securities law are effective in directing management of the modern corporation towards achieving its investors' objectives. In light of changes in enforcement policy and the economic climate, how effective is regulation in constraining management?

Assigned Reading:

1. Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Markets Regulation* (“*Scott Committee Report*”) ix-xiii, 1-7, 71-92 (Nov. 30, 2006).
2. L. Thomsen, Remarks at the 2007 Corporate Counsel Institute (Mar. 8, 2007).
3. I. Warren, *Significant Considerations in Understanding Standards of Professional Conduct for Attorneys Under Sarbanes-Oxley* Presentation at The Canadian Institute 5th Annual Advanced Forum on Securities Litigation (Nov. 2005).
4. J. Allerhand & B. Aronstam, *New Wave of M&A Litigation Attacks Private Equity Deals* N.Y.L.J. (Jul. 9, 2007).
5. S. Radin & J. Margolin, *Outside Director Liability Under Federal Law: An Update 18 Months Following Enron and WorldCom Settlements* WEIL, GOTSHAL & MANGES BUSINESS & SECURITIES LITIGATOR (Jul./Aug. 2006).

Monday, October 15: Class Activity - The Impact of Regulation and Litigation

Teams present on the history of one of the following two topics (30 minutes each):

- The indictment of Milberg Weiss
- The “Scott Committee” Report

Assigned Readings:

1. Milberg Weiss: materials to be distributed.
2. Scott Committee Report: Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Markets Regulation*, 11-14, 18 (2006).

Wednesday, October 17: Class Activity - Director Liability

Teams present the one of the following two cases (30 minutes):

- Team 1: Disney (Court of Chancery and Supreme Court)
- Team 2: WorldCom

Each team is to conduct its own research on the assigned topic.

ASSIGNED READING:

1. Team 1: *In re Walt Disney Company Derivative Litig.*, Not Reported in A.2d, 2005 WL 20566651 (Del. Ch. Aug. 9, 2005) (“*Disney I*”); *In re Walt Disney*

Company Derivative Litig., Not reported in A.2d, 2006 WL 1562466 (Del. Supr. Jun. 8, 2006) (“*Disney II*”); Weil, Gotshal & Manges LLP, *Delaware Supreme Court Affirms Chancellor’s Judgment of No Liability for Directors in Ovitz Case* (Jun. 16, 2006); and Weil, Gotshal & Manges LLP, *Disney Decision Refuses to Address Director Liability and Provides Important Guidance to Directors* (Aug. 12, 2005).

2. Team 2: *In re WorldCom, Inc. Securities Litigation*, 2005 WL 638268 (S.D.N.Y. 2005); *In re WorldCom, Inc. Securities Litigation*, 346 F.Supp.2d 628 (S.D.N.Y. 2004); I. Millstein & E. Veasey, *Some Thoughts on Director Protection in Light of the WorldCom and Enron Settlements: Suggestions for Directors*, Metropolitan Counsel (Jun. 2005); and S. Radin & J. Margolin, *Outside Director Liability Under Federal Law: An Update 18 Months Following Enron and WorldCom Settlements*, Weil, Gotshal & Manges LLP, BUSINESS & SECURITIES LITIGATOR (Jul.-Aug. 2006).

Monday, October 29: Lecture - Board Duties in the Takeover Context

Guest Lecturer: Rebecca C. Grapsas, Associate, Weil, Gotshal & Manges LLP

We will discuss the role of the board in mergers and acquisitions, beginning with a look at the current environment and an overview of M&A strategies, including rationales for entering into different types and structures of M&A transactions and the anatomy of a deal. Many boards adopt defensive measures to ward off would-be acquirers, and we will analyze some of the different measures that may be available (such as the “poison pill,” classified board, supermajority voting, golden parachutes, fair price provisions, etc.) and the arguments for and against each. We will also discuss the board’s fiduciary duties in the M&A context, focusing on standards of review and deal protection mechanisms.

Assigned Reading:

1. T. Mirvis, *Takeover Law and Practice*, PRACTISING LAW INSTITUTE 13-73 (Nov. 2006).
2. Weil Briefing, *Caremark and Netsmart: Ten Lessons for M&A Practitioners* (Mar. 22, 2007).
3. J. Miller et al, *Delaware Quarterly, Recent Developments in Delaware Business and Securities Law, May 2007-July 2007: Deal Protection Measures Upheld*, 39(1) BANK & CORP. GOV. L. REP. 5-8 (Sept. 2007).

Recommended Reading:

1. T. Mirvis, *Takeover Law and Practice*, PRACTISING LAW INSTITUTE 1-13 (Nov. 2006).

2. Institutional Shareholder Services, *2007 Background Report: Poison Pills* (Feb. 2007).

Wednesday, October 31: Class Activity - Private Equity

Clear Channel Communications, Inc. (NYSE: CCU), a global media and entertainment company, announced a proposed merger with a company controlled by Bain Capital Partners, LLC and Thomas H. Lee Partners, L.P. The group will acquire Clear Channel in a transaction with a total value of approximately \$26.7 billion, including the assumption of approximately \$8.0 of net debt. Under the terms of the agreement, Clear Channel shareholders will receive \$36.60 in cash for each share of common stock they hold, representing a premium of approximately 25% over Clear Channel's average closing share price of \$29.99 during the 30 trading days before the Company first acknowledged that it was evaluating strategic alternatives.

The class will be divided into teams, each of which will be assigned a role: 1) Private Equity Group; 2) Management; 3) Board of Directors; 4) Shareholder; and 5) Trade Union Representative. Each team is to present its position on the proposed merger. Consider and discuss whether to support or oppose the merger and why, and if you (in the case of the Shareholder and Trade Union Representative) oppose it, what redress is available to you before and after the completion of the transaction?

Assigned Reading:

1. Clear Channel Communications: materials to be distributed.
2. D. Walker, *Disclosure and Transparency in Private Equity Consultation Document* 1-10 (Jul. 2007).

Monday, November 5: Lecture - The History of Best Practices ("Where the Law Ends")

Guest Lecturer: Holly J. Gregory, Partner, Weil, Gotshal & Manges LLP

In this class we will examine the evolution of the corporate governance movement for "best practice."

Assigned Reading:

1. I. Millstein & P. MacAvoy, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation*, 98 COLUM. L. REV. 1283-1321 (1998).
2. Millstein Center for Corporate Governance and Performance & Standard and Poors, *Rating Corporate Governance and Performance Roundtable – Report One* (2007).

Recommended Reading:

1. H. Gregory, *Comparison of U.S. Corporate Governance Guidelines and Codes of Best Practice* (2007). *Will be handed out in class.

Wednesday, November 7 & Monday, November 12: Class Activity – Putting Principles into Practice

Students will use what they have learned about corporate governance best practices to present short “caselets” relating to real-life dilemmas directors face in the boardroom.

On each day, three teams will present their approach to the issues addressed in the “caselet”(ten minutes), followed by critique and discussion. The class will then be presented with a sample “outcome” for the class to discuss and compare to the class presentations. All students are to have read both “caselets.”

Wednesday, November 14: Lecture - Economic Constraints and Shareholder Rights

We will describe the current landscape (the chain of investment) and the corporate governance “paradigm” – that is, how the system ought to work. Shareholders as owners, directors overseeing management: the private interest harnessed to the public good.

This class will discuss the relationship between shareholder rights and economic constraints and incentives with respect to achieving good corporate governance. We will compare shareholder rights in the U.S. with those in the U.K., including voting rights, rights relating to shareholder proposals at the annual meeting and litigation rights. We will focus on director elections and two current reform movements in the U.S. – majority voting and shareholder access to the proxy.

Assigned Reading:

1. R. Messineo, *Director Selection Developments: Majority Voting, Proxy Solicitation Reform and Other Initiatives* (2007).
2. I. Millstein & H. Goldschmid, *The SEC-Saw*, WALL ST. J., Sept. 15, 2006, at A12.
3. A. Knieriem & K. Crean, *GRIST InDepth: ‘Say On-Pay’ Policies: A Global Comparison*, Mercer Human Resource Consulting (2007).
4. Weil, Gotshal & Manges, *SEC Proposes Two Rules on Shareholder Access – One For, One Against* (2007).

Monday, November 19: Lecture - Economic constraints and shareholder rights II

Guest Lecturer: John Bogle, Founder, Vanguard

In this class we will discuss deficiencies in the current system. In particular, why shareholders do not behave as owners:

- Lack of shareholder rights
- Abuse of minority shareholders
- Investor apathy
- Conflicts of interest/agency problem

Assigned Reading:

1. J. Bogle, THE BATTLE FOR THE SOUL OF CAPITALISM 117-137 (2005).
2. J. Bogle, *Vanishing Treasures – Business Values and Investment Values*, Remarks at the Mclean House 2007 Lecture Series (Mar. 15, 2207).
3. I. Millstein, *Institutional Investors – Think for Yourself*, DIRECTORS & BOARDS E-BRIEFING (Feb. 2006).
4. I. Millstein, *Reform Thyself - “Modern Times” at ISS?*, 6(5) THE M&A JOURNAL 6-11 (Jan. 2006).
5. G. Morgenson, *How to Find a Fund’s True Colors*, N.Y.TIMES, Sept. 10, 2006, at C1.
6. K. Scannell, *Outside Influence: How Borrowed Shares Swing Company Votes – SEC and Others Fear Hedge-Fund Strategy May Subvert Elections*, WALL ST. J., Jan. 26, 2007, at A1.

Monday, November 26: Class Activity - Accountability

In this class students will be asked to consider the apparent lack of accountability throughout the investment chain and possible solutions for protecting the interests of the ultimate beneficiaries.

Two teams will present the following issues: Are “values” and “ethics” enough to overcome agency (conflict) problems? Are the intermediary institutions who “own” the shares, who “elect” the boards which “select” the managers, who operate the corporation, and who invest in other vehicles in the capital markets truly accountable to the beneficiaries? If not, what is to be done and how?

Assigned Reading:

1. International Corporate Governance Network, *Statement of Principles on Institutional Shareholder Responsibilities* (“Montagnon Report”) (July 2007).

2. *Agreement Among PWG and U.S. Agency Principals on Principles and Guidelines Regarding Private Pools of Capital* (2007).
3. L. Strine, *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Governance*, Keynote Address at The Journal of Corporation Law Spring Banquet (Mar. 1, 2007).

Recommended Reading:

1. M. O'Sullivan, *Cross Boarder Shareholder Litigation: The News Corporation Story in International Corporate Governance Network 2006 Yearbook* (2006).
2. H. Jang & J. Kim, *Nascent Stages of Corporate Governance in an Emerging Market: Regulatory Change, Shareholder Activism and Samsung Electronics* 10 CORP. GOV.: AN INT'L REV. 94-105 (2002).

Wednesday November 28: Case Study – Cadbury

Students will present in teams, to be assigned.

Monday, December 3: Case Study – Le Novo (China)

Students will present in teams, to be assigned.

Wednesday, December 5 & Monday, December 10: Lecture & Class Activity - Does Corporate Governance Matter?

We will discuss efforts to link corporate governance and performance – we know that bad governance leads to bad performance and value destruction, but what about good governance – in what ways does corporate governance add value?

Class Activity – Value Creation vs. Value Destruction

Teams present one of the following two topics (30 minutes):

- The relationship between corporate governance and value-creation.
- The relationship between corporation governance and value-destruction.

Each team is to conduct its own research on the assigned topic.

Wednesday, December 12: Course Summary

Wrap-up of where we've been and what we've learned.